Section 1: 10-Q (10-Q)

UNITED STATES SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-Q

☒ QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended March 31, 2020

☐ TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from__________ to___________

Commission file number 001-38884

FRANKLIN FINANCIAL SERVICES CORPORATION

(Exact name of registrant as specified in its charter)

Pennsylvania	25-1440803
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
20 South Main Street, Chambersburg, PA	17201-0819
(Address of principal executive offices)	(Zip Code)

(717) 264-6116
(Registrant's telephone number, including area code)

Not Applicable
(Former name, former address and former fiscal year, if changed since last report)

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

Title of class	Symbol	Name of exchange on which registered
Common stock	FRAF	Nasdaq Capital Market

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 every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit such files). Yes ☒ No ☐

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

Large accelerated filer ☐ Accelerated filer ☒ Non-accelerated filer ☐ Smaller reporting company ☒ Emerging growth company ☐

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act. ☐

Indicate by check mark whether the Registrant is a shell company (as defined in Rule 12b-2 of the Act) Yes ☐ No ☒

There were 4,340,837 outstanding shares of the Registrant's common stock as of April 30, 2020.

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Part I FINANCIAL INFORMATION

Item 1. Financial Statements

Consolidated Balance Sheets

(Dollars in thousands, except share and per share data) (unaudited)	**March 31, 2020**	December 31, 2019
Assets		
Cash and due from banks	**$ 12,848**	$ 15,336
Short-term interest-bearing deposits in other banks	**40,502**	68,492
Total cash and cash equivalents	**53,350**	83,828
Long-term interest-bearing deposits in other banks	**10,738**	8,746
Debt securities available for sale, at fair value	**208,040**	187,433
Equity securities	**313**	440
Restricted stock	**465**	465
Loans held for sale	**2,751**	2,040
Loans	**936,386**	934,575
Allowance for loan losses	**(14,730)**	(11,966)
Net Loans	**921,656**	922,609
Premises and equipment, net	**13,717**	13,851
Right of use asset	**5,118**	5,126
Bank owned life insurance	**20,955**	23,748
Goodwill	**9,016**	9,016
Deferred tax asset, net	**3,570**	4,003
Other assets	**12,437**	7,852
Total assets	**$ 1,262,126**	$ 1,269,157
Liabilities		
Deposits		
Noninterest-bearing checking	**$ 198,384**	$ 192,108
Money management, savings, and interest checking	**835,208**	843,936
Time	**83,841**	89,348
Total deposits	**1,117,433**	1,125,392
Lease liability	**5,159**	5,161
Other liabilities	**10,529**	11,076
Total liabilities	**1,133,121**	1,141,629
Commitments and contingent liabilities		
Shareholders' equity		
Common stock, $1 par value per share,15,000,000 shares authorized with 4,710,822 shares issued and 4,337,520 shares outstanding at March 31, 2020 and 4,709,849 shares issued and 4,352,753 shares outstanding at December 31, 2019	**4,711**	4,710
Capital stock without par value, 5,000,000 shares authorized with no shares issued and outstanding	**—**	—
Additional paid-in capital	**42,390**	42,268
Retained earnings	**95,359**	94,946
Accumulated other comprehensive loss	**(4,360)**	(5,986)
Treasury stock, 373,302 shares at March 31, 2020 and 357,096 shares at December 31, 2019, at cost	**(9,095)**	(8,410)
Total shareholders' equity	**129,005**	127,528
Total liabilities and shareholders' equity	**$ 1,262,126**	$ 1,269,157

The accompanying notes are an integral part of these unaudited financial statements.

Consolidated Statements of Income

(Dollars in thousands, except per share data) (unaudited)	For the Three Months Ended March 31, 2020	2019
Interest income		
Loans, including fees	**$ 10,168**	$ 11,009
Interest and dividends on investments:		
Taxable interest	**1,062**	540
Tax exempt interest	**171**	338
Dividend income	**6**	5
Deposits and obligations of other banks	**258**	97
Total interest income	**11,665**	11,989
Interest expense		
Deposits	**1,413**	1,624
Short-term borrowings	**—**	36
Total interest expense	**1,413**	1,660
Net interest income	**10,252**	10,329
Provision for loan losses	**3,000**	399
Net interest income after provision for loan losses	**7,252**	9,930
Noninterest income		
Investment and trust services fees	**1,445**	1,452
Loan service charges	**285**	203
Deposit service charges and fees	**565**	545
Other service charges and fees	**347**	353
Debit card income	**418**	402
Increase in cash surrender value of life insurance	**124**	127
Life insurance gain	**812**	—
Net (losses)/gains on sales of debt securities	**(10)**	24
Change in fair value of equity securities	**(127)**	3
Other	**30**	56
Total noninterest income	**3,889**	3,165
Noninterest Expense		
Salaries and employee benefits	**5,535**	5,442
Net occupancy	**830**	856
Marketing and advertising	**455**	402
Legal and professional	**395**	430
Data processing	**806**	705
Pennsylvania bank shares tax	**175**	243
FDIC Insurance	**60**	65
ATM/debit card processing	**264**	258
Telecommunications	**105**	105
Other	**903**	906
Total noninterest expense	**9,528**	9,412
Income before federal income taxes	**1,613**	3,683
Federal income tax (benefit) expense	**(106)**	446
Net income	**$ 1,719**	$ 3,237
Per share		
Basic earnings per share	**$ 0.40**	$ 0.73
Diluted earnings per share	**$ 0.39**	$ 0.73

The accompanying notes are an integral part of these unaudited financial statements.

Consolidated Statements of Comprehensive Income

(Dollars in thousands) (unaudited)	For the Three Months Ended March 31, 2020	2019
Net Income	**$ 1,719**	$ 3,237
Debt Securities:		
Unrealized gains arising during the period	**2,048**	1,414
Reclassification adjustment for losses (gains) included in net income (1) (2)	**10**	(24)
Net unrealized gains	**2,058**	1,390
Tax effect	**(432)**	(291)
Net of tax amount	**1,626**	1,099
Total other comprehensive income	**1,626**	1,099
Total Comprehensive Income	**$ 3,345**	$ 4,336

(1) Reclassified to net gains on sales of debt securities

(2) Net of the reclassification of $(2) and $5 to Federal income tax (benefit) expense

The accompanying notes are an integral part of these unaudited financial statements.

Consolidated Statements of Changes in Shareholders' Equity
For the three months ended March 31, 2020 and 2019

(Dollars in thousands, except per share data) (unaudited)	Common Stock	Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Loss	Treasury Stock	Total
Balance at January 1, 2020	**$ 4,710**	**$ 42,268**	**$ 94,946**	**$ (5,986)**	**$ (8,410)**	**$ 127,528**
Net income	**—**	**—**	**1,719**	**—**	**—**	**1,719**
Other comprehensive income	**—**	**—**	**—**	**1,626**	**—**	**1,626**
Cash dividends declared, $0.30 per share	**—**	**—**	**(1,306)**	**—**	**—**	**(1,306)**
Acquisition of 36,401 shares of treasury stock	**—**	**—**	**—**	**—**	**(1,172)**	**(1,172)**
Treasury shares issued under dividend reinvestment plan, 20,124 shares	**—**	**75**	**—**	**—**	**485**	**560**
Stock Compensation Plans:						
Treasury shares issued (71 shares)	**—**	**1**	**—**	**—**	**2**	**3**
Common shares issued (973 shares)	**1**	**15**	**—**	**—**	**—**	**16**
Compensation expense	**—**	**31**	**—**	**—**	**—**	**31**
Balance at March 31, 2020	**$ 4,711**	**$ 42,390**	**$ 95,359**	**$ (4,360)**	**$ (9,095)**	**$ 129,005**
Balance at January 1, 2019	$ 4,701	$ 41,530	$ 83,946	$ (6,380)	$ (5,401)	$ 118,396
Net income	—	—	3,237	—	—	3,237
Other comprehensive	—	—	—	1,099	—	1,099
Cash dividends declared, $0.27 per share	—	—	(1,192)	—	—	(1,192)
Acquisition of 15,163 shares of treasury stock	—	—	—	—	(560)	(560)
Treasury shares issued under dividend reinvestment plan, 10,150 shares	—	2	—	—	3	5
Stock Compensation Plans:						
Treasury shares issued (10,150 shares)	—	161	—	—	190	351
Common shares issued (6,982 shares)	7	148	—	—	—	155
Balance at March 31, 2019	$ 4,708	$ 41,841	$ 85,991	$ (5,281)	$ (5,768)	$ 121,491

The accompanying notes are an integral part of these unaudited financial statements.

Consolidated Statements of Cash Flows

(Dollars in thousands) (unaudited)	Three Months Ended March 31, 2020	2019
Cash flows from operating activities		
Net income	**$ 1,719**	$ 3,237
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	**331**	338
Net amortization of loans and investment securities	**340**	409
Provision for loan losses	**3,000**	399
Decrease (increase) in fair value of equity securities	**127**	(3)
Debt securities losses (gains), net	**10**	(24)
Loans originated for sale	**(9,223)**	(6,467)
Proceeds from sale of loans	**8,512**	6,390
Increase in cash surrender value of life insurance	**(124)**	(127)
Gains from claim on life insurance policy	**(812)**	—
Stock option compensation	**31**	—
Increase in other assets	**(1,139)**	(50)
(Decrease) increase in other liabilities	**(281)**	118
Net cash provided by operating activities	**2,491**	4,220
Cash flows from investing activities		
Net increase in long-term interest-bearing deposits in other banks	**(1,992)**	—
Proceeds from sales and calls of investment securities available for sale	**165**	3,876
Proceeds from maturities and pay-downs of securities available for sale	**10,941**	6,084
Purchase of investment securities available for sale	**(29,974)**	(5,344)
Net increase in loans	**(2,077)**	(7,245)
Capital expenditures	**(174)**	(136)
Net cash used in investing activities	**(23,111)**	(2,765)
Cash flows from financing activities		
Net decrease in demand deposits, interest-bearing checking, and savings accounts	**(2,452)**	(33,621)
Net (decrease) increase in time deposits	**(5,507)**	27,483
Dividends paid	**(1,306)**	(1,192)
Purchase of Treasury shares	**(1,172)**	(560)
Cash received from option exercises	**19**	160
Treasury shares issued under dividend reinvestment plan	**560**	351
Net cash used in financing activities	**(9,858)**	(7,379)
Decrease in cash and cash equivalents	**(30,478)**	(5,924)
Cash and cash equivalents at the beginning of the period	**83,828**	52,957
Cash and cash equivalents at the end of the period	**$ 53,350**	$ 47,033
Supplemental Disclosures of Cash Flow Information		
Cash paid during the year for:		
Interest on deposits and other borrowed funds	**$ 1,547**	$ 1,562
Noncash Activities		
Lease liabilities arising from obtaining right-of-use assets	**$ 105**	$ 22
Life insurance claim receivable	**$ 3,613**	$ —

The accompanying notes are an integral part of these unaudited financial statements.

FRANKLIN FINANCIAL SERVICES CORPORATION and SUBSIDIARIES

UNAUDITED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 1. Basis of Presentation

The consolidated financial statements include the accounts of Franklin Financial Services Corporation (the Corporation), and its wholly owned subsidiaries, Farmers and Merchants Trust Company of Chambersburg (the Bank) and Franklin Future Fund Inc. Farmers and Merchants Trust Company of Chambersburg is a commercial bank that has one wholly owned subsidiary, Franklin Financial Properties Corp. Franklin Financial Properties Corp. holds real estate assets that are leased by the Bank. Franklin Future Fund Inc. is a non-bank investment company. The activities of non-bank entities are not significant to the consolidated totals. All significant intercompany transactions and account balances have been eliminated.

In the opinion of management, all adjustments (which include only normal recurring adjustments) necessary to present fairly the consolidated financial position, results of operations, and cash flows as of March 31, 2020, and for all other periods presented have been made.

Certain information and footnote disclosures normally included in consolidated financial statements prepared in accordance with accounting principles generally accepted in the United States of America ("GAAP") have been condensed or omitted. It is suggested that these consolidated financial statements be read in conjunction with the audited consolidated financial statements and notes thereto included in the Corporation's 2019 Annual Report on Form 10-K. The consolidated results of operations for the three-month period ended March 31, 2020 are not necessarily indicative of the operating results for the full year. Management has evaluated subsequent events for potential recognition and/or disclosure through the date these consolidated financial statements were issued.

The consolidated balance sheet at December 31, 2019 has been derived from the audited consolidated financial statements at that date but does not include all of the information and footnotes required by GAAP for complete consolidated financial statements.

For purposes of reporting cash flows, cash and cash equivalents include cash and due from banks, interest-bearing deposits in other banks and cash items with original maturities less than 90 days.

Earnings per share are computed based on the weighted average number of shares outstanding during each period end. A reconciliation of the weighted average shares outstanding used to calculate basic earnings per share and diluted earnings per share follows:

	For the Three Months Ended March 31,			
(Dollars and shares in thousands, except per share data)		**2020**		2019
Weighted average shares outstanding (basic)		**4,347**		4,412
Impact of common stock equivalents		**14**		21
Weighted average shares outstanding (diluted)		**4,361**		4,433
Anti-dilutive options excluded from calculation		**50**		—
Net income	**$**	**1,719**	$	3,237
Basic earnings per share	**$**	**0.40**	$	0.73
Diluted earnings per share	**$**	**0.39**	$	0.73

Note 2. Recent Accounting Pronouncements

ASU 2017-04, Goodwill (Topic 350)		
Description		This guidance, among other things, removes step 2 of the goodwill impairment test thus eliminating the need to determine the fair value of individual assets and liabilities of the reporting unit. Upon adoption of this standard, goodwill impairment will be the amount by which a reporting unit's carrying value exceeds its fair value, not to exceed the carrying amount of goodwill. This may result in more or less impairment being recognized than under the current guidance. Early adoption is permitted for any impairment tests performed after January 1, 2017, applied prospectively.
Effective Date		January 1, 2020
Effect on the Consolidated Financial Statements		The Corporation early adopted the ASU in the fourth quarter of 2018 with the completion of the 2018 impairment analysis. The ASU did not have a material effect on the consolidated financial statements.

ASU 2018-14, Disclosure Framework (Topic 715): Changes to the Disclosure Requirements for Defined Benefit Plans		
Description		This ASU makes minor changes to the disclosure requirements for employers that sponsor defined benefit pension and/or other postretirement benefit plans. ASU 2018-14 is effective for fiscal years ending after December 15, 2020; early adoption is permitted.
Effective Date		January 1, 2020
Effect on the Consolidated Financial Statements		The Corporation adopted the provisions of the ASU on January 1, 2020. As the ASU only revised disclosure requirements, it did not have a material effect on the consolidated financial statements.

Recently issued but not yet effective accounting standards

ASU 2016-13, Financial Instruments - Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments		
Description		This standard requires credit losses on most financial assets measured at amortized cost and certain other instruments to be measured using an expected credit loss model (referred to as the current expected credit loss (CECL) model). Under this model, entities will estimate credit losses over the entire contractual term of the instrument (considering estimated prepayments, but not expected extensions or modifications unless reasonable expectation of a troubled debt restructuring exists) from the date of initial recognition of that instrument. The ASU replaces the current accounting model for purchased credit impaired loans and debt securities. The allowance for credit losses for purchased financial assets with a more-than insignificant amount of credit deterioration since origination ("PCD assets"), should be determined in a similar manner to other financial assets measured on an amortized cost basis. However, upon initial recognition, the allowance for credit losses is added to the purchase price to determine the initial amortized cost basis. The subsequent accounting for PCD financial assets is the same expected loss model described above.
Effective Date		January 1, 2023
Effect on the Consolidated Financial Statements		We have formed an implementation team led by the Corporation's Risk Management function. The team is reviewing the requirements of the ASU and evaluating methods and models for implementation. The new standard will result in earlier recognition of additions to the allowance for loan losses and possibly a larger allowance for loan loss balance with a corresponding increase in the provision for loan losses in results of operations; however, the Corporation is continuing to evaluate the impact of the pending adoption of the new standard on its consolidated financial statements. A third-party vendor has been selected to assist with the CECL calculations and the implementation process has started. The Corporation expects to be able to run the CECL model in test mode in 2020.

ASU 2019-05, Financial Instruments - Credit Losses (Topic 326):Targeted Transition Relief		
Description		This ASU allows entities to irrevocably elect, upon adoption of ASU 2016-13, the fair value option on financial instruments that (1) were previously recorded at amortized cost and (2) are within the scope of ASC 326-20 if the instruments are eligible for the fair value option under ASC 825-10. The fair value option election does not apply to held-to-maturity debt securities. Entities are required to make this election on an instrument-by-instrument basis. ASU 2019-05 has the same effective date as ASU 2016-13. On October 16,2019, FASB approved its August 2019 proposal to grant certain small public companies a delay in the effective date of ASU 2016-13. For the Corporation, the delay makes the ASU effective January 2023. Since the Corporation currently meets the SEC definition of a small reporting company, the delay will be application to the Corporation. Early adoption is permitted.
Effective Date		January 1, 2023
Effect on the Consolidated Financial Statements		The Corporation will continue to review the ASU as part of its adoption of ASU 2016-13.

Note 3. Accumulated Other Comprehensive Loss

The components of accumulated other comprehensive losses, net of income tax effects, included in shareholders' equity are as follows:

(Dollars in thousands)	Unrealized Gains and Losses on Available-for-sale Securities	Defined Benefit Pension Items	Total
March 31, 2020			
Beginning Balance	$ 185	$ (6,171)	$ (5,986)
Other comprehensive income before reclassification	1,618	—	1,618
Amounts reclassified from accumulated other comprehensive income	8	—	8
Current period other comprehensive income	1,626	—	1,626
Ending balance	$ 1,811	$ (6,171)	$ (4,360)
March 31, 2019			
Beginning Balance	$ (870)	$ (5,510)	$ (6,380)
Other comprehensive income before reclassification	1,117	—	1,117
Amounts reclassified from accumulated other comprehensive income	(18)	—	(18)
Current period other comprehensive income	1,099	—	1,099
Ending balance	$ 229	$ (5,510)	$ (5,281)

Note 4. Investments

Available for Sale (AFS) Securities

The amortized cost and estimated fair value of AFS securities as of March 31, 2020 and December 31, 2019 are as follows:

(Dollars in thousands) **March 31, 2020**	**Amortized cost**	**Gross unrealized gains**	**Gross unrealized losses**	**Fair value**
U.S. Government and Agency securities	**$ 13,602**	$ **57**	$ **(34)**	$ **13,625**
Municipal securities	**94,560**	**2,892**	**(242)**	**97,210**
Trust preferred securities	**4,102**	**—**	**(556)**	**3,546**
Agency mortgage-backed securities	**68,970**	**1,638**	**(461)**	**70,147**
Private-label mortgage-backed securities	**316**	**11**	**(4)**	**323**
Asset-backed securities	**24,197**	**28**	**(1,036)**	**23,189**
	$ 205,747	**$ 4,626**	**$ (2,333)**	**$ 208,040**

(Dollars in thousands) December 31, 2019	Amortized cost	Gross unrealized gains	Gross unrealized losses	Fair value
U.S. Government and Agency securities	$ 8,418	$ 30	$ (20)	$ 8,428
Municipal securities	90,865	1,418	(997)	91,286
Trust preferred securities	4,097	—	(130)	3,967
Agency mortgage-backed securities	58,503	435	(234)	58,704
Private-label mortgage-backed securities	398	31	—	429
Asset-backed securities	24,918	6	(305)	24,619
	$ 187,199	$ 1,920	$ (1,686)	$ 187,433

At March 31, 2020 and December 31, 2019, the fair value of AFS securities pledged to secure public funds and trust deposits totaled $98.0 million and $107.1 million, respectively.

The amortized cost and estimated fair value of debt securities at March 31, 2020, by contractual maturity are shown below. Actual maturities may differ from contractual maturities because of prepayment or call options embedded in the securities. Securities not due at a single maturity date are presented separately.

(Dollars in thousands)	**Amortized cost**	**Fair value**
Due in one year or less	$ 12,900	$ 12,978
Due after one year through five years	31,461	31,369
Due after five years through ten years	76,697	77,637
Due after ten years	15,403	15,586
	136,461	137,570
Mortgage-backed securities	69,286	70,470
	$ 205,747	$ 208,040

The composition of the net realized gains on AFS securities for the three months ended are as follows:

	For the Three Months Ended March 31,	
(Dollars in thousands)	**2020**	2019
Proceeds	**$ 165**	$ 3,876
Gross gains realized	**—**	33
Gross losses realized	**(10)**	(9)
Net gains (losses) realized	**$ (10)**	$ 24
Tax benefit (provision) on net (losses) gains realized	**$ 2**	$ (5)

Impairment:

The AFS securities portfolio contained 105 securities with $76.5 million of temporarily impaired fair value and $2.3 million in unrealized losses at March 31, 2020. The total unrealized loss position has increased $647 thousand since year-end 2019.

For securities with an unrealized loss, Management applies a systematic methodology in order to perform an assessment of the potential for other-than-temporary impairment. In the case of debt securities, investments considered for other-than-temporary impairment: (1) had a specified maturity or repricing date; (2) were generally expected to be redeemed at par, and (3) were expected to achieve a recovery in market value within a reasonable period of time. In addition, the Bank considers whether it intends to sell these securities or whether it will be forced to sell these securities before the earlier of amortized cost recovery or maturity. The impairment identified on debt securities and subject to assessment at March 31, 2020, was deemed to be temporary and required no further adjustments to the financial statements, unless otherwise noted.

The following table reflects temporary impairment in the AFS portfolio, aggregated by investment category, length of time that individual securities have been in a continuous unrealized loss position and the number of securities in each category as of March 31, 2020 and December 31, 2019:

	March 31, 2020								
	Less than 12 months			**12 months or more**			**Total**		
(Dollars in thousands)	**Fair Value**	**Unrealized Losses**	**Count**	**Fair Value**	**Unrealized Losses**	**Count**	**Fair Value**	**Unrealized Losses**	**Count**
U.S. Government and Agency securities	**$ 6,681**	**$ (27)**	**8**	**$ 1,284**	**$ (7)**	**7**	**$ 7,965**	**$ (34)**	**15**
Municipal securities	**19,666**	**(235)**	**21**	**796**	**(7)**	**1**	**20,462**	**(242)**	**22**
Trust preferred securities	**840**	**(119)**	**1**	**2,706**	**(437)**	**4**	**3,546**	**(556)**	**5**
Agency mortgage-backed securities	**22,506**	**(459)**	**35**	**312**	**(2)**	**1**	**22,818**	**(461)**	**36**
Private-label mortgage-backed securities	**123**	**(4)**	**1**	**—**	**—**	**—**	**123**	**(4)**	**1**
Asset-backed securities	**15,252**	**(554)**	**16**	**6,300**	**(482)**	**10**	**21,552**	**(1,036)**	**26**
Total temporarily impaired securities	**$ 65,068**	**$ (1,398)**	**82**	**$ 11,398**	**$ (935)**	**23**	**$ 76,466**	**$ (2,333)**	**105**

(Dollars in thousands)	December 31, 2019								
	Less than 12 months			12 months or more			Total		
	Fair Value	Unrealized Losses	Count	Fair Value	Unrealized Losses	Count	Fair Value	Unrealized Losses	Count
U.S. Government and Agency securities	$ 2,559	$ (12)	6	$ 1,335	$ (8)	7	$ 3,894	$ (20)	13
Municipal securities	38,874	(966)	40	2,655	(31)	4	41,529	(997)	44
Trust preferred securities	—	—	—	3,967	(130)	5	3,967	(130)	5
Agency mortgage-backed securities	21,185	(185)	32	6,555	(49)	22	27,740	(234)	54
Asset-backed securities	17,644	(128)	19	5,669	(177)	9	23,313	(305)	28
Total temporarily impaired securities	$ 80,262	$ (1,291)	97	$ 20,181	$ (395)	47	$ 100,443	$ (1,686)	144

The following table represents the cumulative credit losses on AFS securities recognized in earnings for:

(Dollars in thousands)	Three Months Ended March 31,	
	2020	2019
Balance of cumulative credit-related OTTI at January 1	**$ 272**	$ 272
Additions for credit-related OTTI not previously recognized	—	—
Additional increases for credit-related OTTI previously recognized when there is no intent to sell and no requirement to sell before recovery of amortized cost basis	—	—
Decreases for previously recognized credit-related OTTI because there was an intent to sell	—	—
Reduction for increases in cash flows expected to be collected	—	—
Balance of credit-related OTTI at March 31	**$ 272**	$ 272

Equity Securities at Fair Value

The Corporation owns one equity investment. At March 31, 2020 and December 31, 2019, this investment was reported at fair value of $313 thousand and $440 thousand, respectively, with changes in value reported through income.

Note 5. Loans

The Bank reports its loan portfolio based on the primary collateral of the loan. It further classifies these loans by the primary purpose, either consumer or commercial. The Bank's residential real estate loans include long-term loans to individuals and businesses secured by mortgages on the borrower's real property and include home equity loans. Construction loans are made to finance the purchase of land and the construction of residential and commercial buildings thereon and are secured by mortgages on real estate. Commercial real estate loans include construction, owner and non-owner occupied properties and farm real estate. Commercial loans are made to businesses of various sizes for a variety of purposes including property, plant and equipment, working capital and loans to government municipalities. Commercial lending is concentrated in the Bank's primary market, but also includes purchased loan participations. Consumer loans are comprised of installment loans and unsecured personal lines of credit.

Each class of loans involves a different kind of risk. However, risk factors such as changes in interest rates, general economic conditions and changes in collateral values are common across all classes. The risk of each loan class is presented below.

Residential Real Estate 1-4 family

The largest risk in residential real estate loans to retail customers is the borrower's inability to repay the loan due to the loss of the primary source of income. The Bank attempts to mitigate this risk through prudent underwriting standards including employment history, current financial condition and credit history. These loans are generally owner occupied and serve as the borrower's primary residence. Commercial purpose loans, secured by residential real estate, are usually dependent upon repayment from the rental income or other business purposes. These loans are generally non-owner occupied. In addition to the real estate collateral, these loans may have personal guarantees or UCC filings on other business assets. If a payment default occurs on a 1-4 family residential real estate loan, the collateral serves as a source of repayment, but may be subject to a change in value due to economic conditions.

Residential Real Estate Construction

This class includes loans to individuals for construction of a primary residence and to contractors and developers to improve real estate and construct residential properties. Construction loans to individuals generally bear the same risk as 1-4 family residential loans. Additional risks may include cost overruns, delays in construction or contractor problems.

Loans to contractors and developers are primarily dependent on the sale of improved lots or finished homes for repayment. Risks associated with these loans include the borrower's character and capacity to complete a development, the effect of economic conditions on the valuation of lots or homes, cost overruns, delays in construction or contractor problems. In addition to real estate collateral, these loans may have personal guarantees or UCC filings on other business assets, depending on the financial strength and experience of the developer. Real estate construction loans are monitored on a regular basis by either an independent third party or the responsible loan officer, depending on the size and complexity of the project. This monitoring process includes at a minimum, the submission of invoices or AIA documents detailing the cost incurred by the borrower, on-site inspections, and an authorizing signature for disbursement of funds.

Commercial Real Estate

Commercial real estate loans may be secured by various types of commercial property including retail space, office buildings, warehouses, hotels and motel, manufacturing facilities and, agricultural land.

Commercial real estate loans present a higher level of risk than residential real estate loans. Repayment of these loans is normally dependent on cash-flow generated by the operation of a business that utilizes the real estate. The successful operation of the business, and therefore repayment ability, may be affected by general economic conditions outside of the control of the operator. On most commercial real estate loans ongoing monitoring of cash flow and other financial performance indictors is completed annually through financial statement analysis. In addition, the value of the collateral may be negatively affected by economic conditions and may be insufficient to repay the loan in the event of default. In the event of foreclosure, commercial real estate may be more difficult to liquidate than residential real estate.

Commercial

Commercial loans are made for various business purposes to finance equipment, inventory, accounts receivables, and operating liquidity. These loans are generally secured by business assets or equipment, non-real estate collateral and/or personal guarantees.

Commercial loans present a higher level of credit risk than other loans because repayment ability is usually dependent on cash-flow from a business operation that can be affected by general economic conditions. On most Commercial loans ongoing monitoring of cash flow and other financial performance indictors at least annually through financial statement analysis. In the event of a default, collateral for these loans may be more difficult to liquidate, and the valuation of the collateral may decline more quickly than loans secured by other types of collateral.

Loans to governmental municipalities are also included in the Commercial class. These loans generally have less risk than C&I loans due to the taxing authority of the municipality and its ability to assess fees on services.

Consumer

These loans are made for a variety of reasons to consumers and include term loans and personal lines-of credit. The loans may be secured or unsecured. Repayment is primarily dependent on the income of the borrower and to a lesser extent the sale of collateral. The underwriting of these loans is based on the consumer's ability and willingness to repay and is determined by the borrower's employment history, current financial condition and credit background. Collateral for these loans, if any, usually depreciates quickly and therefore, may not be adequate to repay the loan if it is repossessed. Therefore, the overall health of the economy, including unemployment rates and wages, will have an effect on the credit quality in this loan class.

A summary of loans outstanding, by class, at the end of the reporting periods is as follows:

(Dollars in thousands)	**March 31, 2020**	December 31, 2019
Residential Real Estate 1-4 Family		
Consumer first liens	**$ 82,719**	$ 85,319
Commercial first lien	**60,587**	57,627
Total first liens	**143,306**	142,946
Consumer junior liens and lines of credit	**45,269**	42,715
Commercial junior liens and lines of credit	**5,397**	4,882
Total junior liens and lines of credit	**50,666**	47,597
Total residential real estate 1-4 family	**193,972**	190,543
Residential real estate - construction		
Consumer	**4,523**	4,107
Commercial	**10,959**	9,216
Total residential real estate construction	**15,482**	13,323
Commercial real estate	**494,143**	494,262
Commercial	**226,128**	230,007
Total commercial	**720,271**	724,269
Consumer	**6,661**	6,440
	936,386	934,575
Less: Allowance for loan losses	**(14,730)**	(11,966)
Net Loans	**$ 921,656**	$ 922,609
Included in the loan balances are the following:		
Net unamortized deferred loan (fees) costs	**$ 397**	$ 178
Loans pledged as collateral for borrowings and commitments from:		
FHLB	**$ 764,056**	$ 764,340
Federal Reserve Bank	**49,636**	32,155
	$ 813,692	$ 796,495

Note 6. Loan Quality and Allowance for Loan Losses

The following table presents, by class, the activity in the Allowance for Loan Losses (ALL) for the periods shown:

	Residential Real Estate 1-4 Family							
(Dollars in thousands)	First Liens	Junior Liens & Lines of Credit	Construction	Commercial Real Estate	Commercial	Consumer	Unallocated	Total
ALL at December 31, 2019	**$ 416**	**$ 119**	**$ 184**	**$ 6,022**	**$ 3,815**	**$ 84**	**$ 1,326**	**$ 11,966**
Charge-offs	**—**	**—**	**—**	**—**	**(220)**	**(30)**	**—**	**(250)**
Recoveries	**3**	**—**	**—**	**—**	**5**	**6**	**—**	**14**
Provision	**144**	**59**	**82**	**1,582**	**886**	**38**	**209**	**3,000**
ALL at March 31, 2020	**$ 563**	**$ 178**	**$ 266**	**$ 7,604**	**$ 4,486**	**$ 98**	**$ 1,535**	**$ 14,730**
ALL at December 31, 2018	$ 491	$ 133	$ 108	$ 5,698	$ 4,511	$ 70	$ 1,404	$ 12,415
Charge-offs	(33)	(1)	(3)	(63)	(61)	(26)	—	(187)
Recoveries	1	—	—	1	42	10	—	54
Provision	28	—	47	270	70	18	(34)	399
ALL at March 31, 2019	$ 487	$ 132	$ 152	$ 5,906	$ 4,562	$ 72	$ 1,370	$ 12,681

The following table presents, by class, loans that were evaluated for the ALL under the specific reserve (individually) and those that were evaluated under the general reserve (collectively) and the amount of the ALL established in each class as of March 31, 2020 and December 31, 2019:

	Residential Real Estate 1-4 Family							
(Dollars in thousands)	First Liens	Junior Liens & Lines of Credit	Construction	Commercial Real Estate	Commercial	Consumer	Unallocated	Total
March 31, 2020								
Loans evaluated for ALL:								
Individually	**$ 653**	**$ —**	**$ 521**	**$ 10,795**	**$ —**	**$ —**	**$ —**	**$ 11,969**
Collectively	**142,653**	**50,666**	**14,961**	**483,348**	**226,128**	**6,661**	**—**	**924,417**
Total	**$ 143,306**	**$ 50,666**	**$ 15,482**	**$ 494,143**	**$ 226,128**	**$ 6,661**	**$ —**	**$ 936,386**
ALL established for loans evaluated:								
Individually	**$ —**	**$ —**	**$ —**	**$ —**	**$ —**	**$ —**	**$ —**	**$ —**
Collectively	**563**	**178**	**266**	**7,604**	**4,486**	**98**	**1,535**	**14,730**
ALL at March 31, 2020	**$ 563**	**$ 178**	**$ 266**	**$ 7,604**	**$ 4,486**	**$ 98**	**$ 1,535**	**$ 14,730**
December 31, 2019								
Loans evaluated for ALL:								
Individually	$ 659	$ —	$ 523	$ 10,994	$ —	$ —	$ —	$ 12,176
Collectively	142,287	47,597	12,800	483,268	230,007	6,440	—	922,399
Total	$ 142,946	$ 47,597	$ 13,323	$ 494,262	$ 230,007	$ 6,440	$ —	$ 934,575
ALL established for loans evaluated:								
Individually	$ —	$ —	$ —	$ —	$ —	$ —	$ —	$ —
Collectively	416	119	184	6,022	3,815	84	1,326	11,966
ALL at December 31, 2019	$ 416	$ 119	$ 184	$ 6,022	$ 3,815	$ 84	$ 1,326	$ 11,966

The following table shows additional information about those loans considered to be impaired at March 31, 2020 and December 31, 2019:

(Dollars in thousands)	Impaired Loans				
	With No Allowance		With Allowance		
March 31, 2020	Recorded Investment	Unpaid Principal Balance	Recorded Investment	Unpaid Principal Balance	Related Allowance
Residential Real Estate 1-4 Family					
First liens	**$ 653**	**$ 653**	**$ —**	**$ —**	**$ —**
Junior liens and lines of credit	**—**	**—**	**—**	**—**	**—**
Total	**653**	**653**	**—**	**—**	**—**
Residential real estate - construction	**521**	**729**	**—**	**—**	**—**
Commercial real estate	**10,795**	**11,909**	**—**	**—**	**—**
Commercial	**—**	**—**	**—**	**—**	**—**
Total	**$ 11,969**	**$ 13,291**	**$ —**	**$ —**	**$ —**
December 31, 2019					
Residential Real Estate 1-4 Family					
First liens	$ 659	$ 659	$ —	$ —	$ —
Junior liens and lines of credit	—	—	—	—	—
Total	659	659	—	—	—
Residential real estate - construction	523	729	—	—	—
Commercial real estate	10,994	12,096	—	—	—
Commercial	—	—	—	—	—
Total	$ 12,176	$ 13,484	$ —	$ —	$ —

The following table shows the average of impaired loans and related interest income for the three months ended March 31, 2020 and 2019:

(Dollars in thousands)	Three Months Ended March 31, 2020	
	Average Recorded Investment	Interest Income Recognized
Residential Real Estate 1-4 Family		
First liens	**$ 656**	**$ 10**
Junior liens and lines of credit	**—**	**—**
Total	**656**	**10**
Residential real estate - construction	**521**	**—**
Commercial real estate	**10,899**	**94**
Commercial	**—**	**—**
Total	**$ 12,076**	**$ 104**

(Dollars in thousands)	Three Months Ended March 31, 2019	
	Average Recorded Investment	Interest Income Recognized
Residential Real Estate 1-4 Family		
First liens	$ 893	$ 11
Junior liens and lines of credit	44	—
Total	937	11
Residential real estate - construction	653	—
Commercial real estate	13,494	102
Commercial	129	—
Total	$ 15,213	$ 113

The following table presents the aging of payments of the loan portfolio:

(Dollars in thousands)		Loans Past Due and Still Accruing					Total
	Current	30-59 Days	60-89 Days	90 Days+	Total	Non-Accrual	Loans
March 31, 2020							
Residential Real Estate 1-4 Family							
First liens	**$ 142,621**	**$ 588**	**$ 55**	**$ 1**	**$ 644**	**$ 41**	**$ 143,306**
Junior liens and lines of credit	**50,581**	**40**	**—**	**31**	**71**	**14**	**50,666**
Total	**193,202**	**628**	**55**	**32**	**715**	**55**	**193,972**
Residential real estate - construction	**14,961**	**—**	**—**	**—**	**—**	**521**	**15,482**
Commercial real estate	**490,468**	**110**	**643**	**—**	**753**	**2,922**	**494,143**
Commercial	**225,310**	**288**	**355**	**—**	**643**	**175**	**226,128**
Consumer	**6,625**	**30**	**6**	**—**	**36**	**—**	**6,661**
Total	**$ 930,566**	**$ 1,056**	**$ 1,059**	**$ 32**	**$ 2,147**	**$ 3,673**	**$ 936,386**
December 31, 2019							
Residential Real Estate 1-4 Family							
First liens	$ 141,843	$ 646	$ 358	$ 31	$ 1,035	$ 68	$ 142,946
Junior liens and lines of credit	47,420	70	30	46	146	31	47,597
Total	189,263	716	388	77	1,181	99	190,543
Residential real estate - construction	12,800	—	—	—	—	523	13,323
Commercial real estate	490,114	813	326	—	1,139	3,009	494,262
Commercial	229,659	31	120	—	151	197	230,007
Consumer	6,397	25	18	—	43	—	6,440
Total	$ 928,233	$ 1,585	$ 852	$ 77	$ 2,514	$ 3,828	$ 934,575

The following table reports the risk rating for those loans in the portfolio that are assigned an individual risk rating. Consumer purpose loans are assigned a rating of either pass or substandard based on the performance status of the loans. Substandard consumer loans are comprised of loans 90 days or more past due and still accruing, and nonaccrual loans. Commercial purpose loans may be assigned any rating in accordance with the Bank's internal risk rating system.

(Dollars in thousands)	Pass (1-5)	OAEM (6)	Substandard (7)	Doubtful (8)	Total
March 31, 2020					
Residential Real Estate 1-4 Family					
First liens	**$ 143,264**	**$ —**	**$ 42**	**$ —**	**$ 143,306**
Junior liens and lines of credit	**50,621**	**—**	**45**	**—**	**50,666**
Total	**193,885**	**—**	**87**	**—**	**193,972**
Residential real estate - construction	**14,961**	**—**	**521**	**—**	**15,482**
Commercial real estate	**484,031**	**5,951**	**4,161**	**—**	**494,143**
Commercial	**225,737**	**—**	**391**	**—**	**226,128**
Consumer	**6,661**	**—**	**—**	**—**	**6,661**
Total	**$ 925,275**	**$ 5,951**	**$ 5,160**	**$ —**	**$ 936,386**
December 31, 2019					
Residential Real Estate 1-4 Family					
First liens	$ 142,847	$ —	$ 99	$ —	$ 142,946
Junior liens and lines of credit	47,520	—	77	—	47,597
Total	190,367	—	176	—	190,543
Residential real estate - construction	12,800	—	523	—	13,323
Commercial real estate	483,878	5,875	4,509	—	494,262
Commercial	229,465	4	538	—	230,007
Consumer	6,440	—	—	—	6,440
Total	$ 922,950	$ 5,879	$ 5,746	$ —	$ 934,575

The following table presents information on the Bank's Troubled Debt Restructuring (TDR) loans as of:

(Dollars in thousands)	Troubled Debt Restructurings				Troubled Debt Restructurings Within the Last 12 Months That Have Defaulted On Modified Terms	
	Number of Contracts	**Recorded Investment**	**Performing***	**Nonperforming***	**Number of Contracts**	**Recorded Investment**
March 31, 2020						
Residential real estate - construction	**1**	**443** $	**443** $	—	—$	—
Residential real estate	**4**	**652**	**652**	—	—	—
Commercial real estate	**11**	**9,220**	**8,244**	**976**	—	—
Total	**16** $	**10,315** $	**9,339** $	**976**	—$	—
December 31, 2019						
Residential real estate - construction	1 $	444 $	444 $	—	—$	—
Residential real estate	4	659	659	—	—	—
Commercial real estate	11	9,343	9,343	—	—	—
Total	16 $	10,446 $	10,446 $	—	—$	—

**The performing status is determined by the loan's compliance with the modified terms.*

There were no new TDR loans during 2020 or 2019. Loans that have been modified on a good-faith basis in response to COVID-19 to borrowers who were classified as current prior to any relief are not TDRs as outlined in the March 22, 2020 *Interagency Statement on Loan Modifications and Reporting for Financial Institutions Working with Customers Affected by the Coronavirus*. Such short-term modifications (e.g., six months) may include payment deferrals, fee waivers, extension of payment terms or other delays in payment that are insignificant. As of March 31, 2020, the Bank has granted approximately $30 million loan deferrals or modifications (approximately 3% of gross loans).

Note 7. Leases

The Corporation leases various assets in the course of its operations that are subject to recognition on the balance sheet. The Corporation considers all of its leases to be operating leases and it has no finance leases. The leased assets are comprised of equipment, and buildings and land (collectively real estate). The equipment leases are shorter-term than the real estate leases, and generally have a fixed payment over a defined term without renewal options. Certain equipment leases have purchase options and it was determined the option was not reasonably certain to be exercised. The real estate leases are longer-term and may contain renewal options after the initial term, but none of the real estate leases contain a purchase option. The renewal options on real estate leases were reviewed and if it was determined the option was reasonably certain to be renewed, the option term was considered in the determination of the lease liability. There is only one real estate lease with a variable payment based on an index included in the lease liability. None of the leases contain any restrictive covenants and there are no significant leases that have not yet commenced. The discount rate used to determine the lease liability is based on the Bank's fully secured borrowing rate from the Federal Home Loan Bank for a term similar to the lease term. Operating lease expense is included in net occupancy expense in the consolidated statements of income.

Lease costs:

The components of total lease cost were as follows:

(Dollars in thousands)	Three Months Ended March 31, 2020	Three Months Ended March 31, 2019
Operating lease cost	**$ 158**	**$ 188**
Short-term lease cost	**2**	**6**
Variable lease cost	**14**	**11**
Total lease cost	**$ 174**	**$ 205**

Supplemental Lease Information:

(Dollars in thousands)		Three Months Ended March 31, 2020	Three Months Ended March 31, 2019
Cash paid for amounts included in the measurement of lease liabilities:			
Operating cash flows from operating leases	**$**	**152**	123
Weighted-average remaining lease term (years)		**12.8**	13.7
Weighted-average discount rate		**3.53%**	3.54%

Lease Obligations:

Future undiscounted lease payments for operating leases with initial terms of one year or more as of March 31, 2020 are as follows:

(Dollars in thousands)		
2020	**$**	**577**
2021		**556**
2022		**546**
2023		**552**
2024		**508**
2025 and beyond		**3,756**
Undiscounted cash flow		**6,495**
Imputed Interest		**(1,336)**
Total lease liability	**$**	**5,159**

Note 8. Other Real Estate Owned

Changes in other real estate owned were as follows:

	Three Months Ended March 31,			
(Dollars in thousands)		**2020**		2019
Balance at beginning of the period	**$**	**—**	$	2,684
Additions		**—**		—
Proceeds from dispositions		**—**		—
Gains on sales, net		**—**		—
Valuation adjustment		**—**		—
Balance at the end of the period	**$**	**—**	$	2,684

Note 9. Derivatives

The Corporation is exposed to certain risks arising from both its business operations and economic conditions. The Corporation principally manages its exposures to a wide variety of business and operational risks through management of its core business activities. The Corporation manages economic risks, including interest rate, liquidity, and credit risk, primarily by managing the amount, sources, and duration of its assets and liabilities.

The Corporation’s existing credit derivatives result from participations in interest rate swaps provided by external lenders as part of loan participation arrangements, therefore, are not used to manage interest rate risk in the Corporation’s assets or liabilities. Derivatives not designated as hedges are not speculative and result from a service the Corporation provides to certain lenders which participate in loans.

The table below presents the fair value of the Corporation's derivative financial instruments as well as their classification on the Balance Sheet.

Fair Value of Derivative Instruments

(Dollars in thousands)	Derivative Liabilities					
	March 31, 2020			March 31, 2019		
	Notional amount	Balance Sheet Location	Fair Value	Notional amount	Balance Sheet Location	Fair Value
Derivatives not designated as hedging instruments						
Other Contracts	**6,967**	Other Liabilities	$ **55**	—	Other Liabilities	$ —
Total derivatives not designated as hedging instruments			$ **55**			$ —

The table below presents the effect of the Corporation's derivative financial instruments that are not designated as hedging instruments on the Income Statement.

Effect of Derivatives Not Designated as Hedging Instruments on the Statement of Financial Performance

Derivatives Not Designated as Hedging Instruments under Subtopic 815-20	Location of Gain or (Loss) Recognized in Income on Derivative	Amount of Gain or (Loss) Recognized in Income on Derivatives	
(Dollars in thousands)		Three Months Ended	
		March 31, 2020	March 31, 2019
Other Contracts	Other income/(expense)	$ **(36)**	$ -

As of March 31, 2020, the fair value of derivatives in a net liability position, which includes accrued interest but excludes any adjustment for nonperformance risk, related to these agreements was $55 thousand.

Note 10. Pension

The components of pension expense for the periods presented are as follows:

(Dollars in thousands)	Three Months Ended March 31, **2020**	2019
Components of net periodic cost:		
Service cost	**$ 83**	$ 80
Interest cost	**131**	158
Expected return on plan assets	**(269)**	(270)
Recognized net actuarial loss	**226**	152
Total pension expense	**$ 171**	$ 120

The Bank expects its pension expense to increase to approximately $680 thousand in 2020 compared to $421 thousand in 2019, due primarily to increases in recognized net actuarial losses. The service cost component of pension expense is in the salaries and employee benefits line on the income statement. All other cost components are in the other expense line on the income statement.

Note 11. Fair Value Measurements and Fair Values of Financial Instruments

Management uses its best judgment in estimating the fair value of the Corporation's financial instruments; however, there are inherent weaknesses in any estimation technique. Therefore, for substantially all financial instruments, the fair value estimates herein are not necessarily indicative of the amounts the Corporation could have realized in a sales transaction on the dates indicated. The estimated fair value amounts have been measured as of their respective period-ends and have not been re-evaluated or updated for purposes of these financial statements subsequent to those respective dates. As such, the estimated fair values of these financial instruments subsequent to the respective reporting dates maybe different than the amounts reported at each year-end. The Corporation uses the exit price notion to measure the fair value of financial instruments.

FASB ASC Topic 820, "Financial Instruments", requires disclosure of the fair value of financial assets and liabilities, including those financial assets and liabilities that are not measured and reported at fair value on a recurring and

nonrecurring basis. The Corporation does not report any nonfinancial assets at fair value. FASB ASC Topic 820 establishes a fair value hierarchy that prioritizes the inputs to valuation methods used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1 measurements) and the lowest priority to unobservable inputs (Level 3 measurements). The three levels of the fair value hierarchy under FASB ASC Topic 820 are as follows:

Level 1: Valuation is based on unadjusted, quoted prices in active markets that are accessible at the measurement date for identical, unrestricted assets or liabilities.

Level 2: Valuation is based upon quoted prices for similar instruments in active markets, quoted prices for identical or similar instruments in markets that are not active, and model-based valuation techniques for which all significant assumptions are observable in the market. There may be substantial differences in the assumptions used for securities within the same level. For example, prices for U.S. Agency securities have fewer assumptions and are closer to level 1 valuations than the private label mortgage backed securities that require more assumptions and are closer to level 3 valuations.

Level 3: Valuation is generated from model-based techniques that use significant assumptions not observable in the market. These unobservable assumptions reflect the Corporation's assumptions regarding what market participants would assume when pricing a financial instrument.

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

The following information regarding the fair value of the Corporation's financial instruments should not be interpreted as an estimate of the fair value of the entire Corporation since a fair value calculation is only provided for a limited portion of the Corporation's assets and liabilities. Due to a wide range of valuation techniques and the degree of subjectivity used in making the estimates, comparisons between the Corporation's disclosures and those of other companies may not be meaningful.

The following methods and assumptions were used to estimate the fair values of the Corporation's financial instruments measured at fair value on a recurring and nonrecurring basis.

Equity Securities: Equity securities are valued using quoted market prices from nationally recognized markets (Level 1). Equity securities are measured at fair value on a recurring basis.

Investment securities: Fair values of investment securities available-for-sale were primarily measured using information from a third-party pricing service. This service provides pricing information by utilizing evaluated pricing models supported with market data information. Standard inputs include benchmark yields, reported trades, broker/dealer quotes, issuer spreads, two-sided markets, benchmark securities, bids, offers, and reference data from market research publications. Level 2 investment securities are primarily comprised of debt securities issued by states and municipalities, corporations, mortgage-backed securities issued by government agencies, and government-sponsored enterprises. Fair values were estimated primarily by obtaining quoted prices for similar assets in active markets or through the use of pricing models. Investment securities are measured at fair value on a recurring basis.

Impaired Loans: The fair value of impaired loans with specific allocations of the allowance for loan losses is generally based on recent real estate appraisals conducted by an independent, licensed appraiser, less cost to sell. These appraisals may utilize a single valuation approach or a combination of approaches including comparable sales and the income approach (Level 2). If the appraiser makes an adjustment to account for differences between the comparable sales and income data available for similar loans, or if management adjusts the appraised value, then the fair value is considered Level 3. Non-real estate collateral may be valued using an appraisal, net book value per the borrower's financial statements, or aging reports, adjusted or discounted based on management's historical knowledge, changes in market conditions from the time of the valuation, and management's expertise and knowledge of the client and client's business, resulting in a Level 3 fair value classification. Impaired loans are evaluated on a quarterly basis for additional impairment and adjusted in accordance with the allowance policy. No partial charge-offs on impaired loans were taken in the first quarter of 2020. Impaired loans are measured at fair value on a nonrecurring basis.

Recurring Fair Value Measurements

For financial assets and liabilities measured at fair value on a recurring basis, the fair value measurements by level within the fair value hierarchy used at March 31, 2020 and December 31, 2019 are as follows:

(Dollars in thousands)	**Fair Value at March 31, 2020**			
Asset Description	**Level 1**	**Level 2**	**Level 3**	**Total**
Equity securities, at fair value	**$ 313**	**$ —**	**$ —**	**$ 313**
Available for sale:				
U.S. Government and Agency securities	**—**	**13,625**	**—**	**13,625**
Municipal securities	**—**	**97,210**	**—**	**97,210**
Trust preferred securities	**—**	**3,546**	**—**	**3,546**
Agency mortgage-backed securities	**—**	**70,147**	**—**	**70,147**
Private-label mortgage-backed securities	**—**	**323**	**—**	**323**
Asset-backed securities	**—**	**23,189**	**—**	**23,189**
Total assets	**$ 313**	$ **208,040**	$ **—**	$ **208,353**

(Dollars in thousands)	Fair Value at December 31, 2019			
Asset Description	Level 1	Level 2	Level 3	Total
Equity securities, at fair value	$ 440	$ —	$ —	$ 440
Available for sale:				
U.S. Government and Agency securities	—	8,428	—	8,428
Municipal securities	—	91,286	—	91,286
Trust preferred securities	—	3,967	—	3,967
Agency mortgage-backed securities	—	58,704	—	58,704
Private-label mortgage-backed securities	—	429	—	429
Asset-backed securities	—	24,619	—	24,619
Total assets	$ 440	$ 187,433	$ —	$ 187,873

Nonrecurring Fair Value Measurements

There were no assets measured at fair value on a nonrecurring basis as March 31, 2020 and the following table presents the fair value measurement by level within the fair value hierarchy used at December 31, 2019:

(Dollars in Thousands)	Fair Value at December 31, 2019			
Asset Description	Level 1	Level 2	Level 3	Total
Impaired loans (1)	$ —	$ —	$ 1,080	$ 1,080
Total assets	$ —	$ —	$ 1,080	$ 1,080

(1) *Includes assets directly charged-down to fair value during the year-to-date period.*

The Corporation did not record any liabilities at fair value for which measurement of the fair value was made on a nonrecurring basis at March 31, 2020. For financial assets and liabilities measured at fair value on a recurring basis, there were no transfers of financial assets or liabilities between Level 1 and Level 2 during the period ending March 31, 2020.

There were no assets measured at fair value on a nonrecurring basis at March 31, 2020 and the following table presents additional quantitative information about Level 3 assets measured at fair value on a nonrecurring basis at December 31, 2019:

(Dollars in thousands)

December 31, 2019	Fair Value	Valuation Technique	Unobservable Input	Weighted Average
Impaired loans	$ 1,080	Appraisal	Appraisal Adjustments	0% - 100% (48%)

(1) Includes assets directly charged-down to fair value during the year-to-date period.

The carrying amounts and estimated fair value of financial instruments not carried at fair value are as follows:

	March 31, 2020				
(Dollars in thousands)	**Carrying Amount**	**Fair Value**	**Level 1**	**Level 2**	**Level 3**
Financial assets, carried at cost:					
Cash and cash equivalents	**$ 53,350**	**$ 53,350**	**$ 53,350**	**$ —**	**$ —**
Long-term interest-bearing deposits in other banks	**10,738**	**10,738**	**10,738**	**—**	**—**
Loans held for sale	**2,751**	**2,751**	**—**	**2,751**	**—**
Net loans	**921,656**	**921,269**	**—**	**—**	**921,269**
Accrued interest receivable	**3,789**	**3,789**	**—**	**—**	**3,789**
Financial liabilities:					
Deposits	**$ 1,117,433**	**$ 1,118,307**	**$ —**	**$ 1,118,307**	**$ —**
Accrued interest payable	**302**	**302**	**—**	**302**	**—**

	December 31, 2019				
(Dollars in thousands)	Carrying Amount	Fair Value	Level 1	Level 2	Level 3
Financial assets, carried at cost:					
Cash and cash equivalents	$ 83,828	$ 83,828	$ 83,828	$ —	$ —
Long-term interest-bearing deposits in other banks	8,746	8,746	8,746	—	—
Loans held for sale	2,040	2,040	—	2,040	—
Net loans	922,609	918,640	—	—	918,640
Accrued interest receivable	3,845	3,845	—	—	3,845
Financial liabilities:					
Deposits	$ 1,125,392	$ 1,125,877	$ —	$ 1,125,877	$ —
Accrued interest payable	436	436	—	436	—

Note 12. Capital Ratios

Capital adequacy is currently defined by regulatory agencies through the use of several minimum required ratios. The capital ratios to be considered “well capitalized” are: (1) Common Equity Tier 1 (CET1) of 6.5%, (2) Tier 1 Leverage of 5%, (3) Tier 1 Risk-Based Capital of 8%, and (4) Total Risk-Based Capital of 10%. In addition, a capital conservation buffer of 2.50% is applicable to all of the capital ratios except for the Tier 1 Leverage ratio. The capital conservation buffer is equal to the lowest value of the three applicable capital ratios less the regulatory minimum for each respective capital measurement. The Bank’s capital conservation buffer at March 31, 2020 was 7.78% (total risk-based capital 15.78% less 8.00%) compared to the 2020 regulatory buffer of 2.50%. Compliance with the capital conservation buffer is required in order to avoid limitations to certain capital distributions and is in addition to the minimum required capital requirements. As of March 31, 2020, the Bank was “well capitalized”.

In 2019, the Community Bank Leverage Ratio (CBLR) was approved by federal banking agencies as an optional capital measure available to Qualifying Community Banking Organizations (QCBO). If a bank qualifies as a QCBR and maintains a CBLR of 9% or greater, the bank would be considered “well-capitalized” for regulatory capital purposes and exempt from complying with the risk-based capital rule described above. The CBLR rule took effect January 1, 2020 and banks desiring to opt-in can do so through an election in the first quarter 2020 regulatory filing. The Bank meets the criteria of a QCBR but did not opt-in to the CBLR.

The Bank is participating in the Paycheck Protection Program (PPP) and the Paycheck Protection Program Liquidity Facility (PPPLF) to fund PPP Loans. In accordance with regulatory guidance, PPP loans pledged as collateral for PPPLF, and PPPLF advances, are excluded from leverage capital ratios. PPP loans will also carry a 0% risk-weight for risk-based capital rules.

The consolidated asset limit on small bank holding companies is $3 billion and a company with assets under that limit is not subject to the consolidated capital rules but may file reports that include capital amounts and ratios. The Corporation has elected to file those reports.

The following table summarizes the regulatory capital requirements and results as of March 31, 2020 and December 31, 2019 for the Corporation and the Bank:

			Regulatory Ratios	
(Dollars in thousands)	**March 31, 2020**	December 31, 2019	**Adequately Capitalized Minimum**	**Well Capitalized Minimum**
Common Equity Tier 1 Risk-based Capital Ratio (1)				
Franklin Financial Services Corporation	**14.73%**	14.82%	N/A	N/A
Farmers & Merchants Trust Company	**14.52%**	14.62%	4.500%	6.50%
Tier 1 Risk-based Capital Ratio (2)				
Franklin Financial Services Corporation	**14.73%**	14.82%	N/A	N/A
Farmers & Merchants Trust Company	**14.52%**	14.62%	6.000%	8.00%
Total Risk-based Capital Ratio (3)				
Franklin Financial Services Corporation	**15.99%**	16.08%	N/A	N/A
Farmers & Merchants Trust Company	**15.78%**	15.87%	8.000%	10.00%
Tier 1 Leverage Ratio (4)				
Franklin Financial Services Corporation	**9.85%**	9.72%	N/A	N/A
Farmers & Merchants Trust Company	**9.71%**	9.59%	4.000%	5.00%

(1) Common equity Tier 1 capital/ total risk-weighted assets (2) Tier 1 capital / total risk-weighted assets
(3) Total risk-based capital / total risk-weighted assets, (4) Tier 1 capital / average quarterly assets

Note 13. Revenue Recognition

All of the Corporation's revenue from contracts with customers within the scope of ASC 606 is recognized in non-interest income as presented in our consolidated statements of income. Revenue generating activities that fall within the scope of ASC 606 are described as follows:

Investment and Trust Service Fees - these represent fees from wealth management (assets under management), fees from the management and settlement of estates and commissions from the sale of investment and insurance products.

Asset management fees are generally assessed based on a tiered fee schedule, based on the value of assets under management, and are recognized monthly when the service obligation is completed. Fees recognized were $1.3 million for the first quarter of 2020 and 2019.

Fees for estate management services are based on the estimated fair value of the estate. These fees are generally recognized monthly over an 18-month period that Management has determined to represent the average time to fulfill the performance obligations of the contract. Management has the discretion to adjust this time period as needed based upon the nature and complexity of an individual estate. Fees recognized were $33 thousand for the first quarter of 2020, compared to $70 thousand for the first quarter of 2019.

Commissions from the sale of investment and insurance products are recognized upon the completion of the transaction. Commissions recognized were $74 thousand for the first quarter of 2020 and $68 thousand for 2019.

Loan Service Charges – these represent fees on loans for services or charges that occur after the loan has been booked, for example, late payment fees. These also include fees for mortgages settled for third-party mortgage companies. All of these fees are transactional in nature and are recognized upon completion of the transaction which represents the performance obligation.

Deposit Service Charges and Fees – these represent fees from deposit customers for transaction based, account maintenance, and overdraft services. Transaction based fees include, but are not limited to, stop payment fees and overdraft fees. These fees are recognized at the time of the transaction when the performance obligation has been fulfilled. Account maintenance fees and account analysis fee are earned over the course of a month, representing the period of the performance obligation, and are recognized monthly.

Debit Card Income – this represents interchange fees from cardholder transactions conducted through the card payment network. Cardholders use the debit card to conduct point-of-sale transactions that produce interchange fees. The

fees are transaction based and the fee is recognized with the processing of the transaction. These fees are reported net of cardholder rewards.

Other Service Charges and Fees – these are comprised primarily of merchant card fees, credit card fees, ATM surcharges and interchange fees and wire transfer fees. Merchant card fees represent fees the Bank earns from a third party for enrolling a customer in the processor's program. Credit card fees represent a fee earned by the Bank for a successful referral to a card-issuing company. ATM surcharges and interchange fees are the result of Bank customers conducting ATM transactions that generate fee income and are processed through multiple card networks. All of these fees are transaction based and are recognized at the time of the transaction.

Gains/Losses on the Sale of Other Real Estate – these are recognized when control of the property transfers to the buyer.

Increases in the cash surrender value of life insurance and security transactions are not within the scope of ASC 606.

Contract Balances

A contract asset balance occurs when an entity performs a service for a customer before the customer pays consideration (resulting in a contract receivable) or before payment is due (resulting in a contract asset). A contract liability balance is an entity's obligation to transfer a service to a customer for which the entity has already received payment (or payment is due) from the customer. The Company's noninterest revenue streams are largely based on transactional activity, or standard month-end revenue accruals such as asset management fees based on month-end market values. Consideration is often received immediately or shortly after the Company satisfies its performance obligation and revenue is recognized. The Company does not typically enter into longer-term revenue contracts with customers, and therefore, does not experience significant contract balances.

Contract Acquisition Costs

The Corporation expenses all contract acquisition costs as costs are incurred.

Note 14. Commitments and Contingencies

In the normal course of business, the Bank is a party to financial instruments that are not reflected in the accompanying financial statements and are commonly referred to as off-balance-sheet instruments. These financial instruments are entered into primarily to meet the financing needs of the Bank's customers and include commitments to extend credit and standby letters of credit. Those instruments involve, to varying degrees, elements of credit and interest rate risk not recognized in the consolidated balance sheet.

The Corporation's exposure to credit loss in the event of nonperformance by other parties to the financial instruments for commitments to extend credit and standby letters of credit is represented by the contract or notional amount of those instruments. The Bank uses the same credit policies in making commitments and conditional obligations as they do for on-balance-sheet instruments.

The Bank had the following outstanding commitments for the periods presented:

(Dollars in thousands)	**March 31, 2020**	December 31, 2019
Financial instruments whose contract amounts represent credit risk		
Commercial commitments to extend credit	**$ 241,341**	$ 248,251
Consumer commitments to extend credit (secured)	**58,712**	56,898
Consumer commitments to extend credit (unsecured)	**5,146**	5,088
	$ 305,199	$ 310,237
Standby letters of credit	**$ 24,199**	$ 26,382

Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses with the exception of home equity lines and personal lines of credit and may require payment of a fee. Since many of the commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. The Bank evaluates each customer's creditworthiness on a case-by-case basis. The amount of collateral obtained, if deemed necessary by the Bank, is based on Management's credit evaluation of the counterparty. Collateral for most commercial commitments varies but may include accounts receivable, inventory, property, plant, and equipment, and income-producing commercial properties. Collateral for secured consumer commitments consists of liens on residential real estate.

Standby letters of credit are instruments issued by the Bank, which guarantee the beneficiary payment by the Bank in the event of default by the Bank's customer in the nonperformance of an obligation or service. Most standby letters of credit are extended for one-year periods. Generally, the credit risk involved in issuing letters of credit is essentially the same as that involved in extending loan facilities to customers. The Bank holds collateral supporting those commitments for which collateral is deemed necessary primarily in the form of certificates of deposit and liens on real estate. Management believes that the proceeds obtained through a liquidation of such collateral would be sufficient to cover the maximum potential amount of future payments required under the corresponding guarantees. As of June 30, 2018, the Bank established a $2.4 million allowance against letters of credit issued in connection with a commercial borrower that declared bankruptcy. In the first quarter of 2020, the Bank reversed $250 thousand of this reserve as one letter of credit was cancelled. At March 31, 2020 this reserve was $2.1 million. Except for the liability recorded for standby letters of credit, liabilities for credit loss associated with off-balance sheet commitments were not material at March 31, 2020 and December 31, 2019.

Most of the Bank's business activity is with customers located within its primary market and does not involve any significant concentrations of credit to any one entity or industry.

Legal Proceedings

The nature of the Corporation's business generates a certain amount of litigation.

We establish accruals for legal proceedings when information related to the loss contingencies represented by those matters indicates both that a loss is probable, and the amount of the loss can be reasonably estimated. When we are able to do so, we also determine estimates of possible losses, whether in excess of any accrued liability or where there is no accrued liability.

These assessments are based on our analysis of currently available information and are subject to significant judgment and a variety of assumptions and uncertainties. As new information is obtained, we may change our assessments and, as a result, take or adjust the amounts of our accruals and change our estimates of possible losses or ranges of possible losses. Due to the inherent subjectivity of the assessments and the unpredictability of outcomes of legal proceedings, any amounts that may be accrued or included in estimates of possible losses or ranges of possible losses may not represent the actual loss to the Corporation from any legal proceeding. Our exposure and ultimate losses may be higher, possibly significantly higher, than amounts we may accrue or amounts we may estimate.

In management's opinion, we do not anticipate, at the present time, that the ultimate aggregate liability, if any, arising out of all litigation to which the Corporation is a party at this time will have a material adverse effect on our financial position. We cannot now determine, however, whether or not any claim asserted against us will have a material adverse effect on our results of operations in any future reporting period, which will depend on, amount other things, the amount of loss resulting from the claim and the amount of income otherwise reported for the reporting period. Thus, at March 31, 2020, we are unable to provide an evaluation of the likelihood of an unfavorable outcome or an estimate of the amount or range of potential loss with respect to such other matters and, accordingly, have not yet established any specific accrual for such other matters.

No material proceedings are pending or are known to be threatened or contemplated against us by governmental authorities.

Note 15. Risk Factors

In December 2019, a novel strain of coronavirus surfaced in Wuhan, China, and has spread around the world, with resulting business and social disruption. The coronavirus was declared a Pandemic by the World Health Organization on March 11, 2020. The operations and business results of the Corporation could be materially adversely affected. The ability of our customers to make payments on loans could be adversely impacted, resulting in elevated loan losses and an increase in the Corporation's allowance for loan losses. Additionally, it is reasonably possible future evaluations of the carrying amount of goodwill could result in a conclusion that goodwill is impaired. The extent to which the coronavirus may impact business activity or investment results will depend on future developments, which are highly uncertain and cannot be predicted, including new information which may emerge concerning the severity of the coronavirus and the actions required to contain the coronavirus or treat its impact, among others.

Note 16. Reclassification

Certain prior period amounts may have been reclassified to conform to the current year presentation. Such reclassifications did not affect reported net income.

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

Management's Discussion and Analysis of Results of Operations and Financial Condition

For the Three Months Ended March 31, 2020 and 2019

Forward Looking Statements

Certain statements appearing herein which are not historical in nature are forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. Such forward-looking statements refer to a future period or periods, reflecting management's current views as to likely future developments, and use words such as "may," "will," "expect," "believe," "estimate," "anticipate," or similar terms. Because forward-looking statements involve certain risks, uncertainties and other factors over which the Corporation has no direct control, actual results could differ materially from those contemplated in such statements. These factors include (but are not limited to) the following: general economic conditions, particularly with regard to the negative impact of severe and wide-ranging disruptions caused by the spread of the coronavirus COVID-19 pandemic, changes in interest rates, changes in the Corporation's cost of funds, changes in government monetary policy, changes in government regulation and taxation of financial institutions, changes in the rate of inflation, changes in technology, the intensification of competition within the Corporation's market area, and other similar factors. We caution readers not to place undue reliance on these forward-looking statements. They only reflect management's analysis as of this date. The Corporation does not revise or update these forward-looking statements to reflect events or changed circumstances.

Critical Accounting Policies

Management has identified critical accounting policies for the Corporation. These policies are particularly sensitive, requiring significant judgements, estimates and assumptions to be made by Management. There were no changes to the critical accounting policies disclosed in the 2019 Annual Report on Form 10-K in regards to application or related judgments and estimates used. Please refer to Item 7 of the Corporation's 2019 Annual Report on Form 10-K for a more detailed disclosure of the critical accounting policies.

Results of Operations

Summary

The Corporation reported net income of $1.7 million ($.39 per diluted share) for the first quarter of March 31, 2020, compared to $.73 per share in the first quarter of 2019.

Net interest income remained unchanged year over year at $10.3 million. However, the net interest margin fell from 3.86% in 2019 to 3.53% in 2020.

Earning assets for the first quarter averaged $1.2 billion compared to $1.1 billion for the same period in 2019. The average first quarter balance of the loan portfolio declined from $978.5 million to $934.5 million from 2019 to 2020. The average balance of the commercial loan portfolio decreased $44.8 million from the comparable quarter in 2019 due to a decrease in purchased loan participations and slower loan demand that began in the second half of 2019. This decline was more than offset by an increase in the average balance of the investment portfolio of $62.7 million. The yield on earning assets fell by .45% from 4.45% in the first quarter of 2019 to 4.00% in 2020. The decrease in the yield was the primary reason for the decline in interest income. Average interest-bearing deposits increased $55.0 million from the first quarter of 2019 to the first quarter of 2020. The cost of these deposits fell from .75% in 2019 to .61% in 2020. As a result, interest expense on deposits declined $211 thousand helping to stabilize net interest income quarter to quarter.

For the first quarter of 2020, a provision for loan loss expense of $3.0 million was recorded as the economic effects of the COVID-19 pandemic caused several qualitative factors in the allowance for loan loss calculation to increase from moderate risk to very high risk. With this provision expense, the allowance for loan loss ratio was 1.57%. The provision expense for the same quarter in 2019 was $399 thousand with an allowance ratio of 1.29%. The provision expense for the fourth quarter 2019 was $0 resulting in an allowance for loan loss ratio of 1.28% at December 31, 2019. See the Allowance for Loan Loss discussion for more information.

Noninterest income increased $724 thousand over the first quarter of 2019. The factor driving this increase was an $812 thousand gain on a life insurance policy.

Noninterest expense for the first quarter of 2020 increased $116 thousand over the same quarter of 2019. There were no significant increases in any expense category year over year.

Total assets at March 31, 2020 were $1.262 billion compared $1.269 billion at December 31, 2019.

Short-term interest-bearing deposits in other banks decreased $28.0 million since year-end as cash was put into the investment portfolio which increased $20.6 million.

The loan portfolio increased $1.8 million during the first quarter of 2020 over year-end 2019. The portfolio increased in residential real estate and construction loans but was partially offset by a decline in commercial loans.

Deposits decreased $8.0 million, primarily in interest-bearing checking accounts.

Shareholders' equity increased $1.5 million due primarily to an increase in accumulated other comprehensive income. Retained earnings increased only $413 thousand due to the lower quarterly earnings. The book value of the Corporation's common stock increased from $29.40 to $29.74 per share since year-end. The Corporation suspended activity in its stock repurchase plan on March 19, 2020.

Management believes current asset quality is stable with a nonperforming loan ratio of .40% of total gross loans and the allowance for loan loss ratio has been increased to 1.57% higher than at any time during the great recession. As the Corporation faces the unprecedented circumstances of the COVID-19 pandemic, it believes its current balance sheet and capital position will allow it to meet the challenge. As of April 30, 2020, the Bank funded 512 loans for $50.1 million (5.4% of gross loans as of March 31, 2020) through the Paycheck Protection Program administered by the Small Business Administration which started April 3, 2020. The Bank expects to earn approximately $2.0 million of processing fees recognized over the second and third quarter of 2020. The Bank began processing loans for round two of PPP on April 27, 2020. Liquidity has been strengthened by the Paycheck Protection Program Liquidity Facility and the Bank has no borrowings outstanding. The Corporation's capital position is strong with total risk-based capital ratio of 15.99% and a leverage ratio of 9.85%.

Key performance ratios as of, or for the three months ended March 31, 2020 and 2019 and the year ended December 31, 2019 are listed below:

(Dollars in thousands, except per share)	**March 31, 2020**	December 31, 2019	March 31, 2019
Balance Sheet Highlights			
Total assets	**$ 1,262,126**	$ 1,269,157	$ 1,212,960
Investment and equity securities	**208,353**	187,873	128,258
Loans, net	**921,656**	922,609	967,785
Deposits	**1,117,433**	1,125,392	1,076,491
Shareholders' equity	**129,005**	127,528	121,491
Summary of Operations			
Interest income	**$ 11,665**	$ 49,235	$ 11,989
Interest expense	**1,413**	7,113	1,660
Net interest income	**10,252**	42,122	10,329
Provision for loan losses	**3,000**	237	399
Net interest income after provision for loan losses	**7,252**	41,885	9,930
Noninterest income	**3,889**	15,424	3,165
Noninterest expense	**9,528**	38,314	9,412
Income before income taxes	**1,613**	18,995	3,683
Federal income tax (benefit) expense	**(106)**	2,880	446
Net income	**$ 1,719**	$ 16,115	$ 3,237
Performance Measurements			
Return on average assets*	**0.54%**	1.29%	1.08%
Return on average equity*	**5.31%**	13.17%	10.90%
Return on average tangible equity (1)*	**5.70%**	14.22%	11.79%
Efficiency ratio (1)	**65.36%**	65.36%	67.93%
Net interest margin*	**3.53%**	3.68%	3.86%
Shareholders' Value (per common share)			
Diluted earnings per share	**$ 0.39**	$ 3.67	$ 0.73
Basic earnings per share	**0.40**	3.68	0.73
Regular cash dividends declared	**0.30**	1.17	0.27
Book value	**29.74**	29.30	27.54
Tangible book value (1)	**27.66**	27.23	25.50
Market value (2)	**27.45**	38.69	36.00
Market value/book value ratio	**92.30%**	132.05%	130.72%
Market value/tangible book value ratio	**99.24%**	142.11%	141.18%
Price/earnings multiple*	**17.60**	10.54	12.33
Current quarter dividend yield	**4.37%**	3.10%	3.00%
Dividend payout ratio year-to-date	**75.97%**	31.74%	36.82%
Safety and Soundness			
Average equity/average assets	**10.24%**	9.78%	9.94%
Risk-based capital ratio (Total)	**15.99%**	16.08%	14.85%
Leverage ratio (Tier 1)	**9.85%**	9.72%	9.57%
Common equity ratio (Tier 1)	**14.73%**	14.82%	13.60%
Nonperforming loans/gross loans	**0.40%**	0.42%	0.60%
Nonperforming assets/total assets	**0.29%**	0.31%	0.70%
Allowance for loan losses as a % of loans	**1.57%**	1.28%	1.29%
Net loans charged-off/average loans*	**0.10%**	0.07%	0.05%
Assets under Management			
Trust assets under management (fair value)	**$ 674,189**	$ 790,949	$ 753,086
Held at third-party brokers (fair value)	**109,145**	127,976	127,515

**Year-to-date annualized*

(1) See the section titled "GAAP versus Non-GAAP Presentation" that follows.

(2) As quoted on the OTCQX for March 31, 2019 and the Nasdaq Capital Market for all other periods.

GAAP versus non-GAAP Presentations – The Corporation supplements its traditional GAAP measurements with certain non-GAAP measurements to evaluate its performance and to eliminate the effect of intangible assets. By eliminating intangible assets (Goodwill), the Corporation believes it presents a measurement that is comparable to companies that have no intangible assets or to companies that have eliminated intangible assets in similar calculations. However, not all companies may use the same calculation method for each measurement. The non-GAAP measurements are not intended to be used as a substitute for the related GAAP measurements. Non-GAAP financial measures should be viewed in addition to, and not as an alternative for, our reported results prepared in accordance with GAAP. In the event of such a disclosure or release, the Securities and Exchange Commission's Regulation G requires: (i) the presentation of the most directly comparable financial measure calculated and presented in accordance with GAAP and (ii) a reconciliation of the differences between the non-GAAP financial measure presented and the most directly comparable financial measure calculated and presented in accordance with GAAP. The following table shows the calculation of the non-GAAP measurements.

(Dollars in thousands, except per share)	**Three Months Ended March 31, 2020**	Twelve Months Ended December 31, 2019	Three Months Ended March 31, 2019
Return on Tangible Equity (non-GAAP)			
Net income	$ **1,719**	$ 16,115	$ 3,237
Average shareholders' equity	**129,613**	122,377	118,793
Less average intangible assets	**(9,016)**	(9,016)	(9,016)
Average tangible equity (non-GAAP)	**120,597**	113,361	109,777
Return on average tangible equity (non-GAAP)*	**5.70%**	14.22%	11.79%
Tangible Book Value (per share) (non-GAAP)			
Shareholders' equity	$ **129,005**	$ 127,528	$ 121,491
Less intangible assets	**(9,016)**	(9,016)	(9,016)
Tangible book value (non-GAAP)	**119,989**	118,512	112,475
Shares outstanding (in thousands)	**4,338**	4,353	4,411
Tangible book value per share (non-GAAP)	**27.66**	27.23	25.50
Efficiency Ratio			
Noninterest expense	$ **9,528**	$ 38,314	$ 9,412
Net interest income	**10,252**	42,122	10,329
Plus tax equivalent adjustment to net interest income	**300**	1,393	388
Plus noninterest income, net of securities transactions	**4,026**	15,102	3,138
Total revenue	**14,578**	58,617	13,855
Efficiency ratio (Noninterest expense/total revenue)	**65.36%**	65.36%	67.93%

* Year-to-date annualized

Net Interest Income

The largest source of the Corporation's earnings is net interest income, which is defined as the difference between income on interest-earning assets and the expense of interest-bearing liabilities supporting those assets. Principal categories of interest-earning assets are loans and securities, while deposits, short-term borrowings and long-term debt are the principal categories of interest-bearing liabilities. Demand deposits enhance net interest income because they are noninterest-bearing deposits. For the purpose of this discussion, balance sheet items refer to the average balance for the year and net interest income is adjusted to a fully taxable-equivalent basis. This tax-equivalent adjustment facilitates performance comparisons between taxable and tax-free assets by increasing the tax-free income by an amount equivalent to the Federal income taxes that would have been paid if this income were taxable at the Corporation's 21% Federal statutory rate.

Comparison of the three months ended March 31, 2020 to the three months ended March 31, 2019:

Tax equivalent net interest income decreased $165 thousand to $10.6 million in the first quarter of 2020 compared to $10.7 million for the same period in 2019. Balance sheet volume contributed $77 thousand to tax equivalent net interest but was more than offset by a $242 thousand reduction due to rates.

The following table presents average balances, tax-equivalent (T/E) interest income, and yields earned or rates paid on the assets or liabilities. Nonaccrual loans are included in the average loan balance used to calculate the yield. All nontaxable interest income has been adjusted to a tax-equivalent basis using a tax rate of 21%.

	For the Three Months Ended March 31,					
	2020			2019		
(Dollars in thousands)	**Average balance**	**Income or expense**	**Average yield/rate**	Average balance	Income or expense	Average yield/rate
Interest-earning assets:						
Interest-bearing obligations of other banks and federal funds sold	**$ 68,975**	**$ 258**	**1.50%**	$ 15,112	$ 97	2.60%
Investment securities:						
Taxable	**172,319**	**1,068**	**2.49%**	82,297	545	2.69%
Tax Exempt	**23,861**	**216**	**3.62%**	51,167	425	3.33%
Investments	**196,180**	**1,284**	**2.63%**	133,464	970	2.95%
Loans:						
Commercial, industrial and agricultural	**793,085**	**8,890**	**4.45%**	837,906	9,644	4.60%
Residential mortgage	**68,346**	**728**	**4.27%**	69,466	752	4.32%
Home equity loans and lines	**66,599**	**724**	**4.36%**	65,981	832	5.11%
Consumer	**6,509**	**81**	**4.99%**	5,124	82	6.49%
Loans	**934,539**	**10,423**	**4.43%**	978,477	11,310	4.63%
Total interest-earning assets	**1,199,694**	**$ 11,965**	**4.00%**	1,127,053	$ 12,377	4.45%
Other assets	**65,814**			67,718		
Total assets	**$ 1,265,508**			$ 1,194,771		
Interest-bearing liabilities:						
Deposits:						
Interest-bearing checking	**$ 325,300**	**$ 274**	**0.34%**	$ 295,786	$ 263	0.36%
Money Management	**432,270**	**740**	**0.69%**	424,969	1,046	1.00%
Savings	**84,059**	**58**	**0.28%**	81,156	107	0.54%
Time	**87,774**	**341**	**1.56%**	72,481	208	1.16%
Total interest-bearing deposits	**929,403**	**1,413**	**0.61%**	874,392	1,624	0.75%
Other borrowings	**—**	**—**	**—**	5,386	36	2.61%
Total interest-bearing liabilities	**929,403**	**1,413**	**0.61%**	879,778	1,660	0.77%
Noninterest-bearing deposits	**188,735**			183,809		
Other liabilities	**17,757**			12,391		
Shareholders' equity	**129,613**			118,793		
Total liabilities and shareholders' equity	**$ 1,265,508**			$ 1,194,771		
T/E net interest income/Net interest margin		**10,552**	**3.53%**		10,717	3.86%
Tax equivalent adjustment		**(300)**			(388)	
Net interest income		**$ 10,252**			$ 10,329	
Net Interest Spread			**3.39%**			3.68%
Cost of Funds			**0.51%**			0.63%

Provision for Loan Losses

Following its first quarter assessment and analysis, the Bank expensed $3.0 million of its provision for loan loss expense for the first quarter as the economic effects of the COVID-19 pandemic caused several qualitative factors in the allowance for loan loss calculation to increase from moderate risk to very high risk. The provision expense was $399 thousand in the first quarter of 2019. For more information refer to the Loan Quality and Allowance for Loan Losses discussion in the Financial Condition section.

Noninterest Income

For the first quarter of 2020, noninterest income increased $724 thousand from the same period in 2019. Loan service charges increased as mortgage production was higher in 2020 due to increased mortgage originator staff. Debit card income was higher due to an increase in transaction volume on commercial accounts. The life insurance gain was from a

bank-owned life insurance policy. The change in the fair value of equity investments recorded through income was a loss of $127 thousand compared to a gain of $3 thousand in the same period in 2019.

The following table presents a comparison of noninterest income for the three months ended March 31, 2020 and 2019:

(Dollars in thousands)	For the Three Months Ended March 31, 2020	2019	Change Amount	%
Noninterest Income				
Investment and trust services fees	**$ 1,445**	$ 1,452	$ (7)	(0.5)
Loan service charges	**285**	203	82	40.4
Deposit service charges and fees	**565**	545	20	3.7
Other service charges and fees	**347**	353	(6)	(1.7)
Debit card income	**418**	402	16	4.0
Increase in cash surrender value of life insurance	**124**	127	(3)	(2.4)
Life insurance gain	**812**	—	812	NA
Net (losses)/gains on sales of debt securities	**(10)**	24	(34)	(141.7)
Change in fair value of equity securities	**(127)**	3	(130)	(4,333.3)
Other	**30**	56	(26)	(46.4)
Total noninterest income	**$ 3,889**	$ 3,165	$ 724	22.9

Noninterest Expense

Noninterest expense for the first quarter of 2020 increased $116 thousand compared to the same period in 2019. The increase in salaries and benefits was primarily due to an increase in salary expense ($355 thousand) from merit increases, net of a decrease in health insurance ($210 thousand), compared to the same period in 2019. Pennsylvania shares tax decreased as the Bank received certain tax credits associated with a portion of the increase in charitable donations (in other expenses) related to Pennsylvania's Educational Improvement Tax Credit program, which allowed the Bank to reduce its expense.

The following table presents a comparison of noninterest expense for the three months ended March 31, 2020 and 2019:

(Dollars in thousands)	For the Three Months Ended March 31, 2020	2019	Change Amount	%
Noninterest Expense				
Salaries and benefits	**$ 5,535**	$ 5,442	$ 93	1.7
Net occupancy	**830**	856	(26)	(3.0)
Marketing and advertising	**455**	402	53	13.2
Legal and professional	**395**	430	(35)	(8.1)
Data processing	**806**	705	101	14.3
Pennsylvania bank shares tax	**175**	243	(68)	(28.0)
FDIC insurance	**60**	65	(5)	(7.7)
ATM/debit card processing	**264**	258	6	2.3
Telecommunications	**105**	105	—	—
Other	**903**	906	(3)	(0.3)
Total noninterest expense	**$ 9,528**	**$** 9,412	**$** 116	1.2

Provision for Income Taxes

For the first quarter, the Corporation recorded a Federal income tax benefit of $106 thousand compared to a tax expense of $446 thousand for the same quarter in 2019. The effective tax rate for the first quarter of 2020 was (6.5)%, compared to 12.1% for the same quarter in 2019. The decrease in the effective tax rate was due to lower pre-tax income offset by tax-free income. The federal statutory tax rate is 21% for 2020 and 2019.

Financial Condition

Cash and Cash Equivalents:

Cash and cash equivalents totaled $53.4 million at March 31, 2020, a decrease of $30.5 million from the prior year-end balance of $83.8 million. The decrease was mainly due to lower interest-bearing balances at the Federal Reserve from purchases in the investment portfolio. Interest-bearing deposits are held primarily at the Federal Reserve ($36.9 million) and in short-term bank-owned certificates of deposit ($3.5 million).

Investment Securities:

AFS Securities: The AFS securities portfolio has increased $18.5 million on a cost basis, since year-end 2019. The composition of the portfolio has remained consistent with municipal securities and U.S. Agency mortgage-backed securities comprising the greatest portion of the portfolio at approximately 47% and 34% of the portfolio fair value, respectively. The average life of the portfolio was 5.9 years.

The AFS securities portfolio had a net unrealized gain of $2.3 million at March 31, 2020 compared to a net unrealized gain of $234 thousand at the prior year-end. The portfolio averaged $196.2 million with a yield of 2.63% for the first three months of 2020. This compares to an average of $133.5 million and a yield of 2.95% for the same period in 2019.

The municipal bond portfolio is well diversified geographically (108 issuers) and is comprised primarily of general obligation bonds (61%). Many municipal bonds have credit enhancements in the form of private bond insurance or other credit support. The largest geographic municipal bond exposure is in the states of Texas (13%), California (13%), and Michigan (6%). The average rating of the municipal portfolio from Moody's is AA. No municipal bonds are rated below investment grade.

The unrealized loss in the municipal bond portfolio decreased to $242 thousand from $997 thousand at December 31, 2019. There are twenty-two securities in this portfolio with an unrealized loss and the loss in this portfolio is deemed to be non-credit related and no other-than-temporary impairment charges have been recorded.

The trust preferred portfolio contains five securities with a fair value of $3.5 million and an unrealized loss of $556 thousand. The trust-preferred securities held by the Bank are single entity issues, not pooled trust preferred securities. Therefore, the impairment review of these securities is based only on the issuer and the security cannot be impaired by the performance of other issuers as if it was a pooled trust-preferred bond. All of the Bank's trust preferred securities are single issue, variable rate notes with long maturities (2027–2028). None of these issuers have suspended or missed a dividend payment. At March 31, 2020, the Bank believes it will be able to collect all interest and principal due on these bonds and no other-than-temporary-impairment charges were recorded.

The unrealized loss in the Asset-backed securities portfolio increased $731 thousand from December 31, 2019. This sector had the largest unrealized loss of $1.0 million, 44.4% of the total unrealized losses ($2.3 million). FFELP (Federal Family Education Loan Program) bonds make up the majority of this sector and have a 97% guarantee from the US Department of Education. The FFELP bonds are all rated AAA. Management fully expects to be paid back at par and no other-than-temporary impairment charges have been recorded.

Equity securities at Fair Value: The Corporation owns one equity investment. At March 31, 2020 and December 31, 2019, this investment was reported at fair value of $313 thousand and $440 thousand, respectively, with changes in value reported through income.

Restricted Stock at Cost: The Bank held $465 thousand of restricted stock at March 31, 2020. Except for $30 thousand, this investment represents stock in FHLB Pittsburgh. The Bank is required to hold this stock to be a member of FHLB and it is carried at cost of $100 per share. The level of FHLB stock held is determined by FHLB and is comprised of a minimum membership amount plus a variable activity amount. FHLB stock is evaluated for impairment primarily based on an assessment of the ultimate recoverability of its cost. As a government sponsored entity, FHLB has the ability to raise funding through the U.S. Treasury that can be used to support its operations. There is not a public market for FHLB stock and the benefits of FHLB membership (e.g., liquidity and low-cost funding) add value to the stock beyond purely financial measures. Management intends to remain a member of the FHLB and believes that it will be able to fully recover the cost basis of this investment.

See Note 4 of the accompanying financial statements for additional information on Investment Securities.

Loans:

Residential real estate: This category is comprised of consumer purpose loans secured by residential real estate and to a lesser extent, commercial purpose loans secured by residential real estate. The consumer purpose category represents traditional residential mortgage loans and home equity products (primarily junior liens and lines of credit). Commercial purpose loans in this category represent loans made for various business needs but are secured with residential real estate. In addition to the real estate collateral, it is possible that additional security is provided by personal guarantees or UCC filings. These loans are underwritten as commercial loans and are not originated to be sold.

Total residential real estate loans increased $3.4 million over year-end 2019, as the Bank retained a higher percentage of its originations. For the first three months of 2020, the Bank originated $9.2 million and sold $8.5 million in mortgages for a fee through third party brokerage agreements. The Bank does not originate or hold any loans that would be considered sub-prime or Alt-A and does not generally originate mortgages outside of its primary market area.

Residential real estate construction: This category contains loans for the vertical construction of 1-4 family residential properties. The largest component of this category represents loans to residential real estate developers ($11.0 million), while loans for individuals to construct personal residences totaled $4.5 million at March 31, 2020. The Bank's exposure to residential construction loans is concentrated primarily in south central Pennsylvania. Real estate construction loans, including residential real estate and land development loans, occasionally provide an interest reserve in order to assist the developer during the development stage when minimal cash flow is generated. All real estate construction loans are underwritten in the same manner, regardless of the use of an interest reserve.

At March 31, 2020, the Bank had $17.1 million in real estate construction loans funded with an interest reserve and capitalized $222 thousand of interest in 2020 from these reserves on active projects for commercial construction. Real estate construction loans are monitored on a regular basis by either an independent third-party inspector or the assigned loan officer depending on loan amount or complexity of the project. This monitoring process includes at a minimum, the submission of invoices and AIA documents (depending on the complexity of the project) detailing costs incurred by the borrower, on-site inspections, and a signature by the assigned loan officer for disbursement of funds.

Commercial real estate (CRE): This category includes commercial, industrial, farm and agricultural loans and land development loans, where real estate serves as the primary collateral for the loans. Total commercial real estate loans remained flat at $494.1 million from $494.2 million at the end of 2019, as originations kept pace with pay-downs. The largest sectors (by collateral) in the commercial real estate category are: hotels and motels ($69.1 million), land development ($65.3 million), office buildings ($55.2 million), warehouse facilities ($31.9 million) and manufacturing facility ($31.7 million). The majority of the Bank's hotel exposure is located along the Interstate 81 (I-81) corridor through south-central Pennsylvania. The portfolio is comprised of properties operating under 16 flagged brands, representing 10 hotel chains. Independent hotels represent only 4% of the hotel portfolio.

Commercial: This category includes commercial, industrial, farm, agricultural, and municipal loans. Commercial loans decreased $3.9 million to $226.1 million at March 31, 2020, compared to $230.0 million at the end of 2019, primarily due to paydowns. At March 31, 2020, the Bank had approximately $138 million in tax-free loans in the commercial portfolio. The largest sectors (by industry) in the commercial category are: public administration ($69.9 million), utilities ($33.5 million), educational services ($22.8 million), real estate rental and leasing ($13.0 million) and finance and insurance ($12.2 million). The Bank expects that commercial lending will continue to be the primary area of loan growth in the future via in-market lending.

Participations: The Bank may supplement its own commercial loan production by purchasing loan participations. These participations are primarily located in south-central Pennsylvania. At March 31, 2020, the outstanding commercial participations accounted for 6.4%, or $60.3 million, of total gross loans compared to 9.4% and $67.7 million at December 31, 2019. The Bank's total exposure (including outstanding balances and unfunded commitments) to purchased participations is $75.7 million, compared to $84.0 million at December 31, 2019. The commercial loan participations are comprised of $14.9 million of Commercial loans and $45.4 million of CRE loans, reported in the respective loan class.

Consumer loans: This category increased by $221 thousand to $6.7 million at March 31, 2020, compared to $6.5 million at prior year-end and is mainly comprised of unsecured personal lines of credit.

The following table presents a summary of loans outstanding, by class as of:

(Dollars in thousands)	March 31, 2020	December 31, 2019	Change Amount	%
Residential Real Estate 1-4 Family				
Consumer first liens	**$ 82,719**	$ 85,319	$ (2,600)	(3.0)
Commercial first lien	**60,587**	57,627	2,960	5.1
Total first liens	**143,306**	142,946	360	0.3
Consumer junior liens and lines of credit	**45,269**	42,715	2,554	6.0
Commercial junior liens and lines of credit	**5,397**	4,882	515	10.5
Total junior liens and lines of credit	**50,666**	47,597	3,069	6.4
Total residential real estate 1-4 family	**193,972**	190,543	3,429	1.8
Residential real estate - construction				
Consumer	**4,523**	4,107	416	10.1
Commercial	**10,959**	9,216	1,743	18.9
Total residential real estate construction	**15,482**	13,323	2,159	16.2
Commercial real estate	**494,143**	494,262	(119)	(0.0)
Commercial	**226,128**	230,007	(3,879)	(1.7)
Total commercial	**720,271**	724,269	(3,998)	(0.6)
Consumer	**6,661**	6,440	221	3.4
	936,386	934,575	1,811	0.2
Less: Allowance for loan losses	**(14,730)**	(11,966)	(2,764)	23.1
Net Loans	**$ 921,656**	$ 922,609	$ (953)	(0.1)

Loan Quality:

Management utilizes a risk rating scale ranging from 1-Prime to 9-Loss to evaluate loan quality. This risk rating scale is used primarily for commercial purpose loans. Consumer purpose loans are identified as either a pass or substandard rating based on the performance status of the loans. Substandard consumer loans are loans that are 90 days or more past due and still accruing. Loans rated 1 – 4 are considered pass credits. Loans rated 5 are pass credits but have been identified as credits that are likely to warrant additional attention and monitoring. Loans rated 6-Other Asset Especially Mentioned (OAEM) or worse begin to receive enhanced monitoring and reporting by the Bank. Loans rated 7-Substandard or 8-Doubtful exhibit the greatest financial weakness and present the greatest possible risk of loss to the Bank. Nonaccrual loans are rated no better than 7-Substandard. The following factors represent some of the factors used in determining the risk rating of a borrower: cash flow, debt coverage, liquidity, management, and collateral. Risk ratings, for pass credits, are generally reviewed annually for term debt and at renewal for revolving or renewing debt. The Bank monitors loan quality by reviewing three primary measurements: (1) loans rated 6-OAEM or worse (collectively "watch list"), (2) delinquent loans, and (3) net-charge-offs.,

Watch list loans exhibit financial weaknesses that increase the potential risk of default or loss to the Bank. However, inclusion on the watch list, does not by itself, mean a loss is certain. The watch list totaled $11.1 million at quarter end compared to $11.6 million at December 31, 2019. The watch list includes both performing and nonperforming loans. Included in the substandard total are $3.7 million of nonaccrual loans. The credit composition of the watch list (loans rated 6, 7, or 8), by primary collateral is shown in Note 6 of the accompanying financial statements.

Delinquent loans are a result of borrowers' cash flow and/or alternative sources of cash being insufficient to repay loans. The Bank's likelihood of collateral liquidation to repay the loans becomes more probable the further behind a borrower falls, particularly when loans reach 90 days or more past due. Management monitors the performance status of loans by the use of an aging report. The aging report can provide an early indicator of loans that may become severely delinquent and possibly result in a loss to the Bank. See Note 6 in the accompanying financial statements for a table that presents the aging of payments in the loan portfolio.

Nonaccruing loans generally represent Management's determination that the borrower will be unable to repay the loan in accordance with its contractual terms and that collateral liquidation may or may not fully repay both interest and principal. It is the Bank's policy to evaluate the probable collectability of principal and interest due under terms of loan contracts for all loans 90-days or more, nonaccrual loans, or impaired loans. Further, it is the Bank's policy to discontinue accruing interest on loans that are not adequately secured and in the process of collection. Upon determination of nonaccrual status, the Bank subtracts any current year accrued and unpaid interest from its income, and any prior year

accrued and unpaid interest from the allowance for loan losses. Management continually monitors the status of nonperforming loans, the value of any collateral and potential of risk of loss. Nonaccrual loans are rated no better than 7-Substandard.

The Bank's Loan Management Committee reviews these loans and risk ratings on a quarterly basis in order to proactively identify and manage problem loans. In addition, a committee meets monthly to discuss possible workout strategies for and all credits rated 7-Substandard or worse. Management also tracks other commercial loan risk measurements including high loan to value loans, concentrations, participations and policy exceptions and reports these to the Credit Risk Oversight Committee of the Board of Directors. The Bank also uses a third-party consultant to assist with internal loan review with a goal of reviewing 60% of commercial loans each year. The FDIC defines certain supervisory loan-to-value lending limits. The Bank's internal loan–to-value limits are all equal to, or have a lower loan-to-value limit than, the supervisory limits. However, in certain instances, the Bank may make a loan that exceeds the supervisory loan-to-value limit. At March 31, 2020 the Bank had loans of $22 million (2.4% of gross loans) that exceeded the supervisory limit, compared to 2.69% at year-end 2019.

Loan quality, overall, has remained stable during the first quarter of 2020. Both nonaccrual loans, and loans past due 90 days or more and still accruing have declined slightly since year-end 2019. Potential problem loans, defined as watch list loans less loans on nonaccrual or past due more than 90 days declined to $6.3 million at March 31, 2020 compared to $7.7 million at December 31, 2019 as a result of the commercial real estate loan moving to nonaccrual. The following table presents a summary of nonperforming assets as of:

(Dollars in thousands)	**March 31, 2020**	December 31, 2019
Nonaccrual loans		
Residential Real Estate 1-4 Family		
First liens	**$ 41**	$ 68
Junior liens and lines of credit	**14**	31
Total	**55**	99
Residential real estate - construction	**521**	523
Commercial real estate	**2,922**	3,009
Commercial	**175**	197
Total nonaccrual loans	**3,673**	3,828
Loans past due 90 days or more and still accruing		
Residential Real Estate 1-4 Family		
First liens	**1**	31
Junior liens and lines of credit	**31**	46
Total	**32**	77
Total loans past due 90 days or more and still accruing	**32**	77
Total nonperforming loans	**3,705**	3,905
Other real estate owned	**—**	—
Total nonperforming assets	**$ 3,705**	$ 3,905
Nonperforming loans to total gross loans	**0.40%**	0.42%
Nonperforming assets to total assets	**0.29%**	0.31%
Allowance for loan losses to nonperforming loans	**397.57%**	306.43%

The following table identifies the most significant loans in nonaccrual status. These two nonaccrual loans account for 63% of the total nonaccrual balance.

(Dollars in thousands)

	Balance	ALL Reserve	Nonaccrual Date	TDR Status	Collateral	Location	Collateral Value (1)
Credit 1	$ 1,319	$ —	Mar-12	Y	1st and 2nd liens on commercial real estate, residential real estate and business assets	PA	$ 3,064
Credit 2	1,004	—	Mar-19	N	land for residential development, residential and commercial real estate	PA	$ 1,517
	$ 2,323	$ —					

(1) Includes any estimated discount on appraised value and cost to sell.

In addition to monitoring nonaccrual loans, the Bank also closely monitors impaired loans and troubled debt restructurings (TDR). A loan is considered to be impaired when, based on current information and events, it is probable that the Bank will be unable to collect all interest and principal payments due according to the originally contracted terms of the loan agreement. Nonaccrual loans (excluding consumer purpose loans) and TDR loans are considered impaired.

A loan is considered a troubled debt restructuring if the creditor (the Bank), for economic or legal reasons related to the debtor's financial difficulties, grants a concession to the debtor that it would not otherwise consider. These concessions may include lowering the rate, extending the maturity, re-amortization of the payment, or a combination of multiple concessions. The Bank reviews all loans rated 6-OAEM or worse when it is providing a loan restructure, modification or new credit facility to determine if the action is a TDR. If a TDR loan is placed on nonaccrual status, it remains on nonaccrual status for at least six months to ensure performance.

In accordance with financial accounting standards, TDR loans are always considered impaired until they are paid off or in certain circumstances, refinanced. However, an impaired TDR loan can be a performing loan. Impaired loans decreased to $12.0 million at quarter-end compared to $12.2 million at year-end 2019.

Pandemic Effect on Loan Quality The credit quality of the Bank's loan portfolio as of March 31, 2020 is stable. The ratio of nonperforming loans to total gross loans is .40%. However, the pandemic outbreak has the potential to affect the credit quality of the loan portfolio in future periods. The pandemic has resulted in certain federal, state and local governmental authorities taking action to stop the spread of the pandemic. These actions have included stay-at-home orders, restrictions on business activity, and proclamations and/or directives aimed at minimizing the spread of the pandemic by restricting the movement of people, products and services in the economy. As a result of these actions, the economic activity of the Bank's market area has been curtailed, businesses have been shut down and unemployment has dramatically increased. The repayment of every loan is dependent, in some way, on an efficiently functioning economy. Any action that has the effect of restricting economic activity has the potential to reduce cash flow available to repay loans. At this time, the length of this economic downturn is uncertain, as is the effect on the Bank's loan portfolio.

As addressed below in the Allowance for Loan Losses (ALL) section, the ALL was increased by $3.0 million in the first quarter of 2020 based on higher risk factors in the qualitative allowance. In evaluating the loan portfolio, the most significant things considered were; loan deferrals or modifications, the Paycheck Protection Program, and composition of the portfolio by industry segments.

Loan Deferrals. As the economy quickly contracted in March 2020 as the result of the pandemic, the Bank began to receive requests for payment modifications. Unlike past economic downturns, bank regulators provided favorable guidance for banks allowing them wide latitude to make modifications. This guidance, allowed under certain circumstances, banks to avoid reporting modifications as delinquent, nonperforming or as a trouble debt restructuring. As of April 30, 2020, the Bank has granted approximately $154 million loan deferrals or modifications (approximately 16% of gross loans). These modifications include the deferral of principal and interest payments, deferral of interest payments for interest only lines of credit or providing for an interest only payment. Any interest that is deferred is due and payable at the end of the deferral period. Principal that is deferred will be added to the end of the loan as an extension of the maturity date or as a balloon payment, depending on the loan structure. The Bank will continue to accrue interest during the deferral period. The majority of deferrals were for 3 months.

The following tables show the loan deferrals made as of April 30, 2020 by North American Industry Classification System (NAICS) code and type of collateral.

(Dollars in thousands)

Industry Description	Balance	Percent of Gross Loans	Collateral	
			Real Estate	Non Real Estate
Accommodation and Food Services	$ 68,796	7%	$ 68,668	$ 128
Retail Trade	36,826	4%	36,115	711
Real Estate and Rental and Leasing	26,433	3%	26,382	51
Health Care and Social Assistance	6,133	1%	4,531	1,602
Construction	4,613	< 1%	2,514	2,099
Arts, Entertainment, and Recreation	3,408	< 1%	3,077	331
Other Services (except Public Administration)	3,260	< 1%	2,963	297
Agriculture, Forestry, Fishing and Hunting	1,798	< 1%	1,715	83
Transportation and Warehousing	1,280	< 1%	439	841
Administrative/Support & Waste Mgt Services	496	< 1%	238	258
Public Administration	396	< 1%	396	—
Manufacturing	321	< 1%	120	201
Professional, Scientific, and Technical Services	170	< 1%	—	170
Total	$ 153,930	16%	$ 147,158	$ 6,772

The performance of these loans as they come out of the deferral period will be critical in predicting the credit quality of the loans in the future. The Bank expects the balance of modifications and deferrals to increase during the second quarter.

Paycheck Protection Program. The Bank participated in the Paycheck Protection Program (PPP) administered by the Small Business Administration (SBA). The PPP is a small business loan program designed to assist in allowing small businesses to keep workers on the payroll during the COVID-19 pandemic. When workers are kept on the payroll for the qualifying period, the loan could be forgiven if the small business incurs eligible expenses. The PPP loans, are 100 percent guaranteed by the SBA, have a maturity of two-years and have a fixed interest rate of 1% for the life of the loan. Borrowers of PPP loans do not have to make payments on the loan for the first six months, then it is fully amortizing for the remainder of the two-year term. The SBA pays originating banks a processing fee ranging from 3% to 5% of the loan, depending on the loan balance. The Bank focused its efforts for the first round of the PPP on its current customers and funded 90% of all approved applications it received for approximately $50.1 million. The Bank expects to receive fee income of approximately $2 million of processing fees from PPP loans recognized over the second and third quarter of 2020. The PPP loans are 100% guaranteed by the SBA, thereby presenting no credit risk to the Bank once the SBA guarantee is fulfilled, if necessary. However, the PPP loan is only designed to cover short-term operating needs of the borrower. If the economy does not recover quickly from the pandemic and the borrower experiences long-term operational problems beyond the PPP funding, the performance of other loans to these customers could begin to deteriorate.

Industry Exposure. With the pandemic shut down of non-essential businesses and stay at home orders, nearly every business and industry has been affected. Certain businesses have had a complete stoppage of operations, while many others have seen their business significantly reduced. Some businesses have requested loan modifications and others have taken PPP loans to continue operations.

To better understand the risk in the portfolio from the pandemic, the Bank has segregated its portfolio by industry and the perceived exposure to be economically affected by the pandemic.

The following table shows the loan portfolio by perceived pandemic risk at March 31, 2020.

(Dollars in thousands)

Low	$ 448,945
Medium	359,362
High	128,079
Total	$ 936,386

The following tables show the medium and high perceived pandemic risk by industry and collateral at March 31, 2020.

(Dollars in thousands)

Medium Risk		Percent of Gross Loans	Real Estate Secured	Non-Real Estate Secured
Retail - Consumer Loans - Non Real Estate	$ 5,744	1%	$ —	$ 5,744
Construction	71,260	8%	61,228	10,031
Real Estate and Rental and Leasing	282,358	30%	265,772	16,587
Total	$ 359,362	38%	$ 327,000	$ 32,362
High Risk				
Arts, Entertainment, and Recreation	$ 15,393	2%	$ 14,903	$ 490
Retail Trade - Non Operating Sectors	34,447	4%	32,006	2,442
Accommodation and Food Services	78,239	8%	76,697	1,543
Total	$ 128,079	14%	$ 123,606	$ 4,475

Allowance for Loan Losses:

Management monitors loan performance on a monthly basis and performs a quarterly evaluation of the adequacy of the allowance for loan losses (ALL). The ALL is determined by segmenting the loan portfolio based on the loan's collateral. When calculating the ALL, consideration is given to a variety of factors in establishing this estimate including, but not limited to, current economic conditions, diversification of the loan portfolio, delinquency statistics, results of internal loan reviews, historical charge-offs, the adequacy of the underlying collateral (if collateral dependent) and other relevant factors. The Bank begins enhanced monitoring of all loans rated 6-OAEM, or worse, and obtains a new appraisal or asset valuation for any placed on nonaccrual and rated 7-Substandard or worse. Management, at its discretion, may determine that additional adjustments to the appraisal or valuation are required. Valuation adjustments will be made as necessary based on factors, including, but not limited to; the economy, deferred maintenance, industry, type of property/equipment, age of the appraisal, etc. and the knowledge Management has about a particular situation. In addition, the cost to sell or liquidate the collateral is also estimated and deducted from the valuation in order to determine the net realizable value to the Bank. When determining the allowance for loan losses, certain factors involved in the evaluation are inherently subjective and require material estimates that may be susceptible to significant change, including the amounts and timing of future cash flows expected to be received on impaired loans. Management monitors the adequacy of the allowance for loan losses on an ongoing basis and reports its adequacy quarterly to the Credit Risk Oversight Committee of the Board of Directors. Management believes that the allowance for loan losses at March 31, 2020 is adequate.

The analysis for determining the ALL is consistent with guidance set forth in generally accepted accounting principles (GAAP) and the Interagency Policy Statement on the Allowance for Loan and Lease Losses. The analysis has three components; specific, general and unallocated. The specific component addresses specific reserves established for impaired loans. A loan is considered to be impaired when, based on current information and events, it is probable that the Bank will be unable to collect all interest and principal payments due according to the originally contracted terms of the loan agreement. Collateral values discounted for market conditions and selling costs are used to establish specific allocations for impaired loans. However, it is possible that as a result of the credit analysis, a specific reserve is not required for an impaired loan. Commercial loans with a balance less than $250 thousand, and all consumer purpose loans are not included in the specific reserve analysis as impaired loans but are added to the general allocation pool. These loans totaled $412 thousand at March 31, 2020 and are comprised primarily of loans secured by residential real estate. Management does not believe that excluding these loans from the specific reserve analysis presents any additional risk. There was no specific reserve established for any of the impaired loans. Note 6 of the accompanying financial statements provides additional information about the ALL established for impaired loans.

The general allocation component addresses the reserves established for pools of homogenous loans. The general component includes a quantitative and qualitative analysis. When calculating the general allocation, the Bank segregates its loan portfolio into the following segments based primarily on the type of supporting collateral: residential real estate, commercial, industrial or agricultural real estate; commercial and industrial (C&I non-real estate), and consumer. Each segment may be further segregated by type of collateral, lien position, or owner/nonowner occupied properties. The quantitative analysis uses the Bank's twenty quarter rolling historical loan loss experience as determined for each loan segment to determine a loss factor applicable to each loan segment. The allowance established as a result of the quantitative analysis was $2.9 million at March 31, 2020, unchanged from year-end 2019.

The qualitative analysis utilizes a risk matrix that incorporates four primary risk factors: economic conditions, delinquency, classified loans, and level of risk, and assigns a risk score (as measured in basis points) to each factor. The

economic condition factor is primarily based on unemployment rates. The delinquency factor considers the level of past due loans and charge-offs. The classified loan factor considers the internal credit risk score of the portfolio. The level of risk factor considers operational factors such as: loan volume, management, loan review process, credit concentrations, competition, and legal and regulatory issues. The risk score (as measured in basis points) for each of the four risk factors is minimal, low, moderate, high and very high and is determined independently for commercial loans, residential mortgage loans and consumer loans. At March 31, the Bank increased the risk score for economic conditions and level of risk from a moderate range to a very high range for all loan portfolios to reflect increased risk presented by the pandemic. The risk score for delinquency and classified loan factors remained unchanged but could increase depending loan performance in the future. These changes resulted in a $2.6 million increase in the qualitative component of the ALL to $10.3 million March 31, 2020.

The unallocated component is maintained to cover uncertainties that could affect Management's estimate of probable loss. The unallocated component of the ALL reflects the margin of imprecision inherent in the underlying assumptions used in the methodologies for estimating specific and general losses in the portfolio.

The following table shows, by loan segment, the activity in the ALL, the amount of allowance established in each category and the loans that were evaluated for the ALL under a specific reserve (individually) and those that were evaluated under a general reserve (collectively) as of March 31, 2020.

	Residential Real Estate 1-4 Family							
	First	Junior Liens &		Commercial				
(Dollars in thousands)	Liens	Lines of Credit	Construction	Real Estate	Commercial	Consumer	Unallocated	Total
ALL at December 31, 2019	$ 416	$ 119	$ 184	$ 6,022	$ 3,815	$ 84	$ 1,326	$ 11,966
Charge-offs	—	—	—	—	(220)	(30)	—	(250)
Recoveries	3	—	—	—	5	6	—	14
Provision	144	59	82	1,582	886	38	209	3,000
ALL at March 31, 2020	$ 563	$ 178	$ 266	$ 7,604	$ 4,486	$ 98	$ 1,535	$ 14,730

	Residential Real Estate 1-4 Family							
	First	Junior Liens &		Commercial				
(Dollars in thousands)	Liens	Lines of Credit	Construction	Real Estate	Commercial	Consumer	Unallocated	Total
March 31, 2020								
Loans evaluated for ALL:								
Individually	$ 653	$ —	$ 521	$ 10,795	$ —	$ —	$ —	11,969
Collectively	142,653	50,666	14,961	483,348	226,128	6,661	—	924,417
Total	$ 143,306	$ 50,666	$ 15,482	$ 494,143	$ 226,128	$ 6,661	$ —	936,386
ALL established for loans evaluated:								
Individually	$ —	$ —	$ —	$ —	$ —	$ —	$ —	—
Collectively	563	178	266	7,604	4,486	98	1,535	14,730
ALL at March 31, 2020	$ 563	$ 178	$ 266	$ 7,604	$ 4,486	$ 98	$ 1,535	14,730

Real estate appraisals and collateral valuations are an important part of the Bank's process for determining potential loss on collateral dependent loans and thereby have a direct effect on the determination of loan reserves, charge-offs and the calculation of the allowance for loan losses. As long as the loan remains a performing loan, no further updates to appraisals are required. If a loan or relationship migrates to nonaccrual and a risk rating of 7-Substandard or worse, an evaluation for impairment status is made based on the current information available at the time of downgrade and a new appraisal or collateral valuation is obtained. We believe this practice complies with the regulatory guidance.

In determining the allowance for loan losses, Management, at its discretion, may determine that additional adjustments to the fair value obtained from an appraisal or collateral valuation are required. Adjustments will be made as necessary based on factors, including, but not limited to the economy, deferred maintenance, industry, type of property or equipment etc., and the knowledge Management has about a particular situation. In addition, the cost to sell or liquidate the collateral is also estimated and deducted from the valuation in order to determine the net realizable value to the Bank. If an appraisal is not available, Management may make its best estimate of the real value of the collateral or use last

known market value and apply appropriate discounts. If an adjustment is made to the collateral valuation, this will be documented with appropriate support and reported to the Loan Management Committee.

The allocation of the allowance for loan losses is based on estimates and is not intended to imply limitations on the usage of the allowance. The entire allowance is available to absorb any losses without regard to the category in which the loan is classified.

The following table shows the ALL and charge-off ratios for the periods ended:

	Three Months Ended March 31, 2020	Year ended December 31, 2019	Three Months Ended March 31, 2019
Net charge-offs (recoveries)/average loans*	**0.10%**	0.07%	0.05%
Net loan charge-offs (recoveries) as a percentage of the provision for loan losses	**7.87%**	289.54%	33.33%
Allowance for loan losses as a % of loans	**1.57%**	1.28%	1.29%
Net charge-offs (recoveries)	$ **236**	$ 686	$ 133

* Annualized

Deposits:

Total deposits decreased $8.0 million during the first three months of 2020 to $1.117 billion. Noninterest-bearing deposits increased $6.3 million (primarily in small business checking deposits) and interest-bearing checking and savings deposits decreased $8.7 million, while time deposits decreased $5.5 million. Interest-bearing checking decreased by $12.0 million, primarily in commercial and municipal deposits, while the Bank's Money Management and remained flat and Savings products increased $2.3 million compared to year-end 2019. Time deposits also decreased since year-end and primarily in retail accounts.

As of March 31, 2020, the Bank had $158.1 million placed in the ICS reciprocal deposit program ($106.3 million in interesting-bearing checking and $48.5 million in money management) and $3.2 million in reciprocal time deposits in the CDARS program included in time deposits. These programs allow the Bank to offer full FDIC coverage to large depositors, but with the convenience to the customer of only having to deal with one bank. The Bank solicits these deposits from within its market and it believes they present no greater risk than any other local deposit. Only reciprocal deposits that exceed 20% of liabilities are considered brokered deposits. At March 31, 2020 the Bank's reciprocal deposits were 14.7% of total liabilities compared to 14.2% at year-end 2019.

(Dollars in thousands)	**March 31, 2020**	December 31, 2019	Change Amount	Change %
Noninterest-bearing checking	**$ 198,384**	$ 192,108	$ 6,276	3.3
Interest-bearing checking	**319,928**	331,886	(11,958)	(3.6)
Money management	**430,138**	429,199	939	0.2
Savings	**85,142**	82,851	2,291	2.8
Total interest-bearing checking and savings	**835,208**	843,936	(8,728)	(1.0)
Time deposits	**83,841**	89,348	(5,507)	(6.2)
Total deposits	**$ 1,117,433**	$ 1,125,392	$ (7,959)	(0.7)
Overdrawn deposit accounts reclassified as loans	**$ 227**	$ 153		

Borrowings:

The Corporation had no borrowings at March 31, 2020 and December 31, 2019.

Shareholders' Equity:

Total shareholders' equity increased $1.5 million to $129.0 million at March 31, 2020, from $127.5 million at the end of 2019. The Corporation's net earnings of $1.7 million were partially offset by the cash dividend of $1.3 million. The Corporation's Dividend Reinvestment Plan (DRIP) added $349 thousand in new capital from optional cash contributions and $211 thousand from the reinvestment of quarterly dividends. The Corporation's dividend payout ratio was 75.97% for the first three months of 2020.

As part of its quarterly dividend decision, the Corporation considers current and future income projections, dividend yield, payout ratio, and current and future capital ratios. For the first quarter of 2020, the Corporation paid a $0.30 per share dividend, compared to $0.27 paid in the first quarter of 2019. On April 16, 2020 the Board of Directors declared a $0.30 per share regular quarterly dividend for the second quarter of 2020, which will be paid on May 27, 2020.

On September 12, 2019, the Board of Directors authorized the 2019 Repurchase Plan for the repurchase of up to 150,000 shares of the Corporation's $1.00 par value common stock at market prices in open market or privately

negotiated transactions beginning September 13, 2019 and continuing through September 12, 2020. During the first quarter of 2020, 36,401 shares were repurchased, under the 2019 plan. The Corporation suspended activity in the stock repurchase plan on March 19, 2020.

Capital adequacy is currently defined by regulatory agencies through the use of several minimum required ratios. The capital ratios to be considered "well capitalized" are: (1) Common Equity Tier 1 (CET1) of 6.5%, (2) Tier 1 Leverage of 5%, (3) Tier 1 Risk-Based Capital of 8%, and (4) Total Risk-Based Capital of 10%. In addition, a capital conservation buffer of 2.50% is applicable to all of the capital ratios except for the Tier 1 Leverage ratio. The capital conservation buffer is equal to the lowest value of the three applicable capital ratios less the regulatory minimum for each respective capital measurement. The Bank's capital conservation buffer at March 31, 2020 was 7.78% (total risk-based capital 15.78% less 8.00%) compared to the 2020 regulatory buffer of 2.50%. Compliance with the capital conservation buffer is required in order to avoid limitations to certain capital distributions and is in addition to the minimum required capital requirements. As of March 31, 2020, the Bank was "well capitalized".

In 2019, the Community Bank Leverage Ratio (CBLR) was approved by federal banking agencies as an optional capital measure available to Qualifying Community Banking Organizations (QCBO). If a bank qualifies as a QCBR and maintains a CBLR of 9% or greater, the bank would be considered "well-capitalized" for regulatory capital purposes and exempt from complying with the risk-based capital rule described above. The CBLR rule took effect January 1, 2020 and banks desiring to opt-in can do so through an election in the first quarter 2020 regulatory filing. The Bank meets the criteria of a QCBR but did not opt-in to the CBLR.

The Bank is participating in the Paycheck Protection Program (PPP) and the Paycheck Protection Program Liquidity Facility (PPPLF) to fund PPP Loans. In accordance with regulatory guidance, PPP loans pledged as collateral for PPPLF, and PPPLF advances, are excluded from leverage capital ratios. PPP loans will also carry a 0% risk-weight for risk-based capital rules.

The consolidated asset limit on small bank holding companies is $3 billion and a company with assets under that limit is not subject to the consolidated capital rules but may file reports that include capital amounts and ratios. The Corporation has elected to file those reports.

The following table summarizes the regulatory capital requirements and results as of March 31, 2020 and December 31, 2019 for the Corporation and the Bank:

			Regulatory Ratios	
(Dollars in thousands)	**March 31, 2020**	December 31, 2019	**Adequately Capitalized Minimum**	**Well Capitalized Minimum**
Common Equity Tier 1 Risk-based Capital Ratio (1)				
Franklin Financial Services Corporation	**14.73%**	14.82%	N/A	N/A
Farmers & Merchants Trust Company	**14.52%**	14.62%	4.500%	6.50%
Tier 1 Risk-based Capital Ratio (2)				
Franklin Financial Services Corporation	**14.73%**	14.82%	N/A	N/A
Farmers & Merchants Trust Company	**14.52%**	14.62%	6.000%	8.00%
Total Risk-based Capital Ratio (3)				
Franklin Financial Services Corporation	**15.99%**	16.08%	N/A	N/A
Farmers & Merchants Trust Company	**15.78%**	15.87%	8.000%	10.00%
Tier 1 Leverage Ratio (4)				
Franklin Financial Services Corporation	**9.85%**	9.72%	N/A	N/A
Farmers & Merchants Trust Company	**9.71%**	9.59%	4.000%	5.00%

(1) Common equity Tier 1 capital/ total risk-weighted assets (2) Tier 1 capital / total risk-weighted assets

(3) Total risk-based capital / total risk-weighted assets, (4) Tier 1 capital / average quarterly assets

Economy

The Corporation's primary market area includes Franklin, Fulton, Cumberland and Huntingdon Counties, Pennsylvania. This area is diverse in demographic and economic makeup. County populations range from a low of approximately 15,000 in Fulton County to over 249,000 in Cumberland County. Unemployment in the Bank's market area has remained virtually unchanged over the past year and ranges from a low of 3.5% in Cumberland County to 5.3% in

Huntingdon County. The market area has a diverse economic base and local industries include warehousing, truck & rail shipping centers, light and heavy manufacturers, health-care, higher education institutions, farming and agriculture, and a varied service sector. The Corporation's primary market area is located in South Central PA and provides easy access to the major metropolitan markets on the east coast via trucking and rail transportation. Because of this, warehousing and distribution companies continue to find the area attractive. The local economy is not overly dependent on any one industry or business and Management believes that the Bank's primary market area continues to be well suited for growth.

In early March 2020, the economic outlook changed dramatically driven primarily by the COVID-19 pandemic. The pandemic has resulted in certain federal, state and local governmental authorities taking action to stop the spread of the pandemic. These actions have included stay-at-home orders, restrictions on business activity, and proclamations and/or directives aimed at minimizing the spread of the pandemic by restricting the movement of people, products and services in the economy. As a result of these actions, the economic activity of the Bank's market area has been curtailed, businesses have been shut down and unemployment has dramatically increased. The repayment of every loan is dependent, in some way, on an efficiently functioning economy. Any action that has the effect of restricting economic activity has the potential to reduce cash flow available to repay loans. At this time, the length of this economic downturn and its effect on the Corporation is uncertain.

Impact of Inflation

The impact of inflation upon financial institutions such as the Corporation differs from its effect upon other commercial enterprises. Unlike many companies, the assets and liabilities of the Corporation are financial in nature. As such, interest rates and changes in interest rates may have a more significant effect on the Corporation's financial results than on other types of industries. Because of this, the Corporation watches the actions of the Federal Reserve Open Market Committee (FOMC) as it makes decisions about interest rate changes and how such changes affect market rates and the Corporation. Although inflation (and inflation expectations) may affect the interest rate environment, it is not possible to measure with any precision the affect of inflation on the Corporation.

Liquidity

The Corporation must meet the financial needs of the customers that it serves, while providing a satisfactory return on the shareholders' investment. In order to accomplish this, the Corporation must maintain sufficient liquidity in order to respond quickly to the changing level of funds required for both loan and deposit activity. The goal of liquidity management is to meet the ongoing cash flow requirements of depositors who want to withdraw funds and of borrowers who request loan disbursements. The Bank regularly reviews it liquidity position by measuring its projected net cash flows (in and out) at a 30 and 90-day interval. The Bank stresses the measurements by assuming a level of deposit out-flows that have not historically been realized. In addition to this forecast, other funding sources are reviewed as a method to provide emergency funding if necessary. The objective of this measurement is to identify the amount of cash that could be raised quickly without the need to liquidate assets. The Bank also stresses its liquidity position utilizing different longer-term scenarios. The varying degrees of stress create pressure on deposit flows in its local market, reduce access to wholesale funding and limit access of funds available through brokered deposit channels. In addition to stressing cash flow, specific liquidity risk indicators are monitored to help identify risk areas. This analysis helps identify and quantify the potential cash surplus/deficit over a variety of time horizons to ensure the Bank has adequate funding resources. Assumptions used for liquidity stress testing are subjective. Should an evolving liquidity situation or business cycle present new data, potential assumption changes will be considered. The Bank believes it can meet all anticipated liquidity demands.

Historically, the Corporation has satisfied its liquidity needs from earnings, repayment of loans and amortizing investment securities, maturing investment securities, loan` sales, deposit growth and its ability to access existing lines of credit. All investment securities are classified as available for sale; therefore, securities that are unencumbered (approximately $125.7 million fair value) as collateral for borrowings are an additional source of readily available liquidity, either by selling the security or, more preferably, to provide collateral for additional borrowing. The Bank also has access to other wholesale funding via the brokered CD market.

The FHLB system has always been a major funding source for the Bank. There are no current indicators that lead the Bank to believe the FHLB would discontinue its lending function or restrict the Bank's ability to borrow. If either of these events would occur, it would have a negative effect on the Bank, and it is unlikely that the Bank could replace the level of FHLB funding in a short time. The Bank has established credit at the Federal Reserve Discount Window and at correspondent banks.

The following table shows the Bank's available liquidity at March 31, 2020.

(Dollars in thousands)

Liquidity Source	Capacity	Outstanding	Available
Federal Home Loan Bank	$ 377,600	$ —	$ 377,600
Federal Reserve Bank Discount Window	21,000	—	21,000
Correspondent Banks	21,000	—	21,000
Total	$ 419,600	$ —	$ 419,600

Pandemic Effect on Liquidity - The Bank is closely monitoring it liquidity needs as loans are modified and delinquencies are expected to increase. The Bank expects to see a reduction in monthly cash flow from loan deferrals, as discussed in the Loan Quality section. The Bank expects to be able to absorb this reduction through its current liquidity resources. To support its liquidity position, the Bank is participating in the Paycheck Protection Program Liquidity Facility (PPPLF) established by the Federal Reserve to fund loans made through the Paycheck Protection Program sponsored by the Small Business Administration. The PPPLF is a term financing facility with a fixed interest rate of .35% and a maturity of no more than 2 years for each loan. Loans made through the PPP are used as collateral for PPPLF funding. The PPPLF will allow the Bank to fully fund its PPP loans at a low fixed rate without having to access its normal liquidity sources described above. The Bank also expects to see a temporary increase in funding as the stimulus checks provided by the Coronavirus Aid, Relief and Economic Security Act (CARES Act) are issued and deposited to the bank. However, the Bank expects these funds to be quickly withdrawn. The Bank believes it can meet all anticipated liquidity demands of the pandemic through its current liquidity sources and the government sponsored programs.

The CARES Act also granted the FDIC authority to reinstitute the liquidity guarantee program to offer unlimited FDIC insurance on noninterest bearing deposit. If this is approved by the FDIC, it would provide less incentive for customers to withdraw deposits and possibly strain bank liquidity

Off Balance Sheet Commitments

The Corporation's financial statements do not reflect various commitments that are made in the normal course of business, which may involve some liquidity risk. These commitments consist mainly of unfunded loans and letters of credit made under the same standards as on-balance sheet instruments. Because these instruments have fixed maturity dates, and because many of them will expire without being drawn upon, they do not generally present any significant liquidity risk to the Corporation. Unused commitments and standby letters of credit totaled $329.4 million and $336.6 million, respectively, at March 31, 2020 and December 31, 2019. As of June 30, 2018, the Bank established a $2.4 million allowance against letters of credit issued in connection with a commercial borrower that declared bankruptcy. In the first quarter of 2020, the Bank reversed $250 thousand of this reserve as one letter of credit was cancelled. At March 31, 2020 this reserve was $2.1 million.

The Corporation has entered into various contractual obligations to make future payments. These obligations include time deposits, long-term debt, operating leases, deferred compensation and pension payments. These amounts have not changed materially from those reported in the Corporation's 2019 Annual Report on Form 10-K.

Item 3. Quantitative and Qualitative Disclosures about Market Risk

There were no material changes in the Corporation's exposure to market risk during the three months ended March 31, 2020. For more information on market risk refer to the Corporation's 2019 Annual Report on Form 10-K.

Item 4. Controls and Procedures

Evaluation of Controls and Procedures

The Corporation carried out an evaluation, under the supervision and with the participation of the Corporation's management, including the Corporation's Chief Executive Officer and Chief Financial Officer, of the effectiveness of its disclosure controls and procedures, as defined in Exchange Act Rules 13a-15(e) and 15d-15(e). Based upon the evaluation, the Corporation's Chief Executive Officer and Chief Financial Officer concluded that as of March 31, 2020, the Corporation's disclosure controls and procedures are effective. Disclosure controls and procedures are controls and procedures that are designed to ensure that information required to be disclosed in the Corporation's reports filed or submitted under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission's rules and forms. There were no changes in the Corporation's internal control

over financial reporting during the quarterly period ended March 31, 2020, that have materially affected, or are reasonably likely to materially affect, the internal control over financial reporting.

The management of the Corporation is responsible for establishing and maintaining adequate internal control over financial reporting. The Corporation's internal control system is designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

Part II – OTHER INFORMATION

Item 1. Legal Proceedings

The nature of the Corporation's business generates a certain amount of litigation.

We establish accruals for legal proceedings when information related to the loss contingencies represented by those matters indicates both that a loss is probable, and the amount of the loss can be reasonably estimated. When we are able to do so, we also determine estimates of possible losses, whether in excess of any accrued liability or where there is no accrued liability.

These assessments are based on our analysis of currently available information and are subject to significant judgment and a variety of assumptions and uncertainties. As new information is obtained, we may change our assessments and, as a result, take or adjust the amounts of our accruals and change our estimates of possible losses or ranges of possible losses. Due to the inherent subjectivity of the assessments and the unpredictability of outcomes of legal proceedings, any amounts that may be accrued or included in estimates of possible losses or ranges of possible losses may not represent the actual loss to the Corporation from any legal proceeding. Our exposure and ultimate losses may be higher, possibly significantly higher, than amounts we may accrue or amounts we may estimate.

In management's opinion, we do not anticipate, at the present time, that the ultimate aggregate liability, if any, arising out of all litigation to which the Corporation is a party will have a material adverse effect on our financial position. We cannot now determine, however, whether or not any claim asserted against us will have a material adverse effect on our results of operations in any future reporting period, which will depend on, amount other things, the amount of loss resulting from the claim and the amount of income otherwise reported for the reporting period. Thus, at March 31, 2020, we are unable to provide an evaluation of the likelihood of an unfavorable outcome or an estimate of the amount or range of potential loss with respect to such other matters and, accordingly, have not yet established any specific accrual for such other matters.

No material proceedings are pending or are known to be threatened or contemplated against us by governmental authorities.

In management's opinion, there are no other proceedings pending to which the Corporation is a party or to which its property is subject which, if determined adversely to the Corporation, would be material. No material proceedings are pending or are known to be threatened or contemplated against us by any governmental authorities.

Item 1A. Risk Factors

During the three months ended March 31, 2020 the Corporation has determined the following risk associated with its business, financial condition, results of operations and common stock. This risk factor supplements the risk factors described in the Corporation's 2019 Annual Report on Form 10-K.

Public health crisis such as epidemics or pandemics could materially and adversely impact our business.

The COVID-19 pandemic has negatively impacted the global, national and local economies, disrupted global and national supply chains, lowered equity market valuations, created significant volatility and disruption in financial markets, and increased unemployment levels. In addition, the pandemic has resulted in temporary closures of many businesses and the institution of social distancing and sheltering in place requirements in many states and communities. As a result, the demand for our products and services may be significantly impacted, which could adversely affect our revenue and results of operations. Furthermore, the pandemic could continue to result in the recognition of credit losses in our loan portfolios and increase in our allowance for credit losses, particularly if businesses remain closed, the impact on the global, national and local economies worsen, or more customers draw on their lines of credit or seek additional loans to help finance their businesses. Similarly, because of changing economic and market conditions affecting issuers, we may be required to recognize further impairments on the securities we hold as well as reductions in other comprehensive income. Our business operations may also be disrupted if significant portions of our workforce are unable to work effectively, including because of illness, quarantines, government actions, or other restrictions in connection with the pandemic. The extent to which the COVID-19 pandemic impacts our business, results of operations, and financial conditions, as well as our regulatory capital and liquidity ratios, will depend on future developments, which are highly uncertain and cannot be predicted, including the scope and duration of the pandemic and actions taken by governmental authorities and other third parties in response to the pandemic.

We continue to closely monitor the COVID-19 pandemic and related risks as they evolve. The magnitude, duration and likelihood of the current outbreak of COVID-19, further outbreaks of COVID-19, future actions taken by governmental authorities and/or other third parties in response to the COVID-19 pandemic, and its future direct and

indirect effects on the global, national and local economy and our business and results of operation are highly uncertain. The COVID-19 pandemic may cause prolonged global or national recessionary economic conditions or longer lasting effects on economic conditions than currently exist, which could have a material adverse effect on our business, results of operations and financial condition.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

(Dollars in thousands, except per share)

Period	Number of Shares Purchased as Part of Publicly Announced Program	Weighted Average Price Paid per Share	Dollar Amount of Shares Purchased as Part of Publicly Announced Program	Shares Yet To Be Purchased Under Program
March 2020	36,401	32.19	1,172	113,499
	36,401		$ 1,172	

On December 20, 2018, the Board of Directors authorized the 2018 Repurchase Plan for the repurchase of up to 100,000 shares of the Corporation's $1.00 par value common stock at market prices in open market or privately negotiated transactions beginning December 21, 2018 and continuing through December 21, 2019. The 2018 Repurchase plan was completed in the third quarter of 2019. On September 12, 2019, the Board of Directors authorized the 2019 Repurchase Plan for the repurchase of up to 150,000 shares of the Corporation's $1.00 par value common stock at market prices in open market or privately negotiated transactions beginning September 13, 2019 and continuing through September 13, 2020. The Corporation suspended activity in the stock repurchase plan on March 19, 2020.

Item 3. Defaults by the Company on its Senior Securities

None

Item 4. Mine Safety Disclosures

Not Applicable

Item 5. Other Information

None

Item 6. Exhibits

Exhibits

3.1	Articles of Incorporation of the Corporation. (Filed as Exhibit 3.1 to Annual Report on Form 10-K for the year ended December 31, 2014 and incorporated herein by reference.)
3.2	Bylaws of the Corporation. (Filed as Exhibit 3.2 to Current Report on Form 8-K, as filed with the commission on December 21, 2018 and incorporated herein by reference.)
31.1	Rule 13a – 14(a)/15d-14(a) Certifications – Principal Executive Officer
31.2	Rule 13a – 14(a)/15d-14(a) Certifications – Principal Financial Officer
32.1	Section 1350 Certifications – Principal Executive Officer
32.2	Section 1350 Certifications – Principal Financial Officer
101	Interactive Data File (XBRL)

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.

Franklin Financial Services Corporation

May 11, 2020	/s/ Timothy G. Henry
	Timothy G. Henry Chief Executive Office and President (Principal Executive Officer)
May 11, 2020	/s/ Mark R. Hollar
	Mark R. Hollar Treasurer and Chief Financial Officer (Principal Financial and Accounting Officer)

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Section 2: EX-31.1 (EX-31.1)

Exhibit 31.1

Rule 13a-14(a)/15d-14(a) Certifications

I, Timothy G. Henry, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Franklin Financial Services Corporation;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:

   a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

   b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

   c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

   d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting and

5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors:

   a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: May 11, 2020

/s/ Timothy G. Henry
Timothy G. Henry
President and Chief Executive Officer

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Section 3: EX-31.2 (EX-31.2)

Exhibit 31.2

Rule 13a-14(a)/15d-14(a) Certifications

I, Mark R. Hollar, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Franklin Financial Services Corporation;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:

   a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

   b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

   c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

   d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting and

5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors:

   a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

   b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: May 11, 2020

/s/ Mark R. Hollar
Mark R. Hollar
Treasurer and Chief Financial Officer

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Section 4: EX-32.1 (EX-32.1)

Exhibit 32.1

Certification Pursuant to 18 U.S.C. Section 1350,

As Adopted Pursuant to Section 906 of the Sarbanes–Oxley Act of 2002

In connection with the Quarterly Report of Franklin Financial Services Corporation (the "Corporation") on Form 10-Q, for the period ending March 31, 2020, as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Timothy G. Henry, Chief Executive Officer of the Corporation, certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes–Oxley Act of 2002 that:

(1) The report fully complies with the requirements of Section 13(a) or 15(d) of the Securities and Exchange Act of 1934; and

(2) The information contained in the Report fairly presents, in all material respects, the financial condition and result of operations of the Company.

/s/ Timothy G. Henry

Timothy G. Henry

President and Chief Executive Officer

May 11, 2020

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Section 5: EX-32.2 (EX-32.2)

Exhibit 32.2

Certification Pursuant to 18 U.S.C. Sections 1350,

As Adopted Pursuant to Section 906 of the Sarbanes–Oxley Act of 2002

In connection with the Quarterly Report of Franklin Financial Services Corporation (the "Corporation") on Form 10-Q for the period ending March 31, 2020 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Mark R. Hollar, Chief Financial Officer of the Corporation, certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes–Oxley Act of 2002 that:

(1) The report fully complies with the requirements of Section 13(a) or 15(d) of the Securities and Exchange Act of 1934; and

(2) The information contained in the Report fairly presents, in all material respects, the financial condition and result of operations of the Company.

/s/ Mark R. Hollar

Mark R. Hollar

Chief Financial Officer

May 11, 2020

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