NORWOOD FINANCIAL CORP
Form 10-Q
November 06, 2015

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

FORM 10-Q

(Mark One)
[x] QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended September 30, 2015

OR

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

For the transition period from ____ to ___________________________________

Commission file number 0-28364

Norwood Financial Corp.
(Exact name of registrant as specified in its charter)

Pennsylvania	23-2828306
(State or other jurisdiction of incorporation or organization)	(I.R.S. employer identification no.)
717 Main Street, Honesdale, Pennsylvania	18431
(Address of principal executive offices)	(Zip Code)

Registrant's telephone number, including area code (570) 253-1455

N/A
(Former name, former address and former fiscal year, if changed since last report)

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 [X] No [ ]

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes [X] No [ ]

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

Large accelerated filer [ ]	Accelerated filer [X]
Non-accelerated filer [ ] (Do not check if a smaller reporting company)	Smaller reporting company [ ]

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act): [ ] Yes [X] No

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

Class	Outstanding as of November 2, 2015
Common stock, par value $0.10 per share	3,684,719

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NORWOOD FINANCIAL CORP.
FORM 10-Q
FOR THE QUARTER ENDED SEPTEMBER 30, 2015

PART I. FINANCIAL INFORMATION
Item 1. Financial Statements
NORWOOD FINANCIAL CORP.
Consolidated Balance Sheets (unaudited)
(dollars in thousands, except share and per share data)

	September 30, 2015	December 31, 2014
ASSETS		
Cash and due from banks	$ 11,164	$ 8,081
Interest bearing deposits with banks	552	4,295
Cash and cash equivalents	11,716	12,376
Securities available for sale, at fair value	153,305	156,395
Loans receivable	543,536	501,135
Less: Allowance for loan losses	5,747	5,875
Net loans receivable	537,789	495,260
Regulatory stock, at cost	2,488	1,714
Bank premises and equipment, net	6,503	6,734
Bank owned life insurance	18,686	18,284
Accrued interest receivable	2,499	2,339
Foreclosed real estate owned	1,345	3,726
Goodwill	9,715	9,715
Other intangibles	309	389
Deferred tax asset	3,345	3,285
Other assets	1,629	1,418
TOTAL ASSETS	$ 749,329	$ 711,635
LIABILITIES		
Deposits:		
Non-interest bearing demand	$ 115,313	$ 98,064
Interest-bearing	456,040	461,880
Total deposits	571,353	559,944
Short-term borrowings	41,546	25,695
Other borrowings	29,162	22,200
Accrued interest payable	996	966
Other liabilities	4,332	3,789
TOTAL LIABILITIES	647,389	612,594
STOCKHOLDERS’ EQUITY		
Common stock, $.10 par value per share, authorized 10,000,000 shares; issued 3,718,018 shares	372	372
Surplus	35,310	35,206
Retained earnings	66,431	64,078
Treasury stock at cost: 2015: 33,299 shares, 2014: 40,576 shares	(894)	(1,077)
Accumulated other comprehensive income	721	462

TOTAL STOCKHOLDERS’ EQUITY	101,940	99,041
TOTAL LIABILITIES AND STOCKHOLDERS’ EQUITY	$ 749,329	$ 711,635

See accompanying notes to the unaudited consolidated financial statements.

NORWOOD FINANCIAL CORP.
Consolidated Statements of Income (unaudited)
(dollars in thousands, except per share data)

	Three Months Ended September 30, 2015	Three Months Ended September 30, 2014	Nine Months Ended September 30, 2015	Nine Months Ended September 30, 2014
INTEREST INCOME				
Loans receivable, including fees	$5,958	$5,972	$17,943	$17,885
Securities	911	968	2,884	2,981
Other	3	1	15	3
Total interest income	6,872	6,941	20,842	20,869
INTEREST EXPENSE				
Deposits	611	600	1,833	1,852
Short-term borrowings	19	19	47	62
Other borrowings	189	168	553	501
Total interest expense	819	787	2,433	2,415
NET INTEREST INCOME	6,053	6,154	18,409	18,454
PROVISION FOR LOAN LOSSES	720	420	1,760	1,260
NET INTEREST INCOME AFTER PROVISION FOR LOAN LOSSES	5,333	5,734	16,649	17,194
OTHER INCOME				
Service charges and fees	595	587	1,789	1,746
Income from fiduciary activities	126	125	341	328
Net realized gains on sales of securities	63	301	508	904
Gains (losses) on sale of loans and servicing rights, net	13	(15)	43	50
Earnings and proceeds on bank owned life insurance	167	170	497	514
Other	107	94	305	241
Total other income	1,071	1,262	3,483	3,783
OTHER EXPENSES				
Salaries and employee benefits	2,175	2,028	6,383	6,364
Occupancy, furniture & equipment, net	473	505	1,571	1,601
Data processing related	247	240	682	680
Taxes, other than income	175	161	525	488
Professional fees	140	136	447	475
Federal Deposit Insurance Corporation insurance assessment	119	104	278	320
Foreclosed real estate owned	47	271	436	733
Amortization of intangibles	24	28	80	92
Other	670	651	2,023	1,976
Total other expenses	4,070	4,124	12,425	12,729
INCOME BEFORE INCOME TAXES	2,334	2,872	7,707	8,248
INCOME TAX EXPENSE	557	754	1,926	2,132
NET INCOME	$1,777	$2,118	$5,781	$6,116

BASIC EARNINGS PER SHARE	$0.48	$0.58	$1.57	$1.68
DILUTED EARNINGS PER SHARE	$0.48	$0.58	$1.57	$1.68

See accompanying notes to the unaudited consolidated financial statements.

NORWOOD FINANCIAL CORP.
Consolidated Statements of Comprehensive Income (unaudited)
(dollars in thousands)

	Three Months Ended September 30,	
	2015	2014
Net income	$1,777	$2,118
Other comprehensive income (loss):		
Investment securities available for sale:		
Unrealized holding gains	1,938	186
Tax effect	(654)	(63)
Reclassification of gains recognized in net income	(63)	(301)
Tax effect	22	102
Other comprehensive income (loss):	1,243	(76)
Comprehensive Income	$3,020	$2,042

	Nine Months Ended September 30,	
	2015	2014
Net income	$5,781	$6,116
Other comprehensive income:		
Investment securities available for sale:		
Unrealized holding gains	890	4,742
Tax effect	(296)	(1,614)
Reclassification of gains recognized in net income	(508)	(904)
Tax effect	173	307
Other comprehensive income:	259	2,531
Comprehensive Income	$6,040	$8,647

See accompanying notes to the unaudited consolidated financial statements.

NORWOOD FINANCIAL CORP.
Consolidated Statements of Changes in Stockholders' Equity (unaudited)
Nine Months Ended September 30, 2015
(dollars in thousands, except share and per share data)

	Common Stock			Retained	Treasury Stock		Accumulated Other Comprehensive	
	Shares	Amount	Surplus	Earnings	Shares	Amount	Income	Total
Balance, December 31, 2014	3,718,018	$ 372	$ 35,206	$ 64,078	40,576	$ (1,077)	$ 462	$ 99,041
Net Income				5,781				5,781
Other comprehensive income							259	259
Cash dividends declared ($.93 per share)				(3,428)				(3,428)
Compensation expense related to restricted stock			49		280	(8)		41
Acquisition of treasury stock					4,374	(127)		(127)
Stock options exercised			(8)		(11,931)	318		310
Tax benefit of stock options			14					14
Compensation expense related to stock options			49					49
Balance, September 30, 2015	3,718,018	$ 372	$ 35,310	$ 66,431	33,299	$ (894)	$ 721	$ 101,940

See accompanying notes to the unaudited consolidated financial statements.

NORWOOD FINANCIAL CORP.
Consolidated Statements of Cash Flows (Unaudited)
(dollars in thousands)

	Nine Months Ended September 30, 2015	2014
CASH FLOWS FROM OPERATING ACTIVITIES		
Net Income	$ 5,781	$ 6,116
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for loan losses	1,760	1,260
Depreciation	414	433
Amortization of intangible assets	80	92
Deferred income taxes	184	(179)
Net amortization of securities premiums and discounts	711	645
Net realized gain on sales of securities	(508)	(904)
Earnings and proceeds on bank owned life insurance	(497)	(514)
Loss on sale of foreclosed real estate	271	182
Gain on sale of mortgage loans	(56)	(72)
Mortgage loans originated for sale	(2,605)	(2,228)
Proceeds from sale of mortgage loans originated for sale	2,661	2,300
Compensation expense related to stock options	49	120
Compensation expense related to restricted stock	49	-
Increase in accrued interest receivable and other assets	(609)	(157)
Increase in accrued interest payable and other liabilities	531	659
Net cash provided by operating activities	8,216	7,753
CASH FLOWS FROM INVESTING ACTIVITIES		
Securities available for sale:		
Proceeds from sales	28,850	39,117
Proceeds from maturities and principal reductions on mortgage-backed securities	19,408	12,021
Purchases	(44,987)	(47,611)
Proceeds from maturities on securities held to maturity	-	175
Purchase of regulatory stock	(1,830)	(1,811)
Redemption of regulatory stock	1,056	1,478
Net increase in loans	(44,592)	(3,752)
Proceeds from life insurance policies	-	75
Purchase of premises and equipment	(184)	(145)
Proceeds from sale of foreclosed real estate	2,378	547
Net cash (used in) provided by investing activities	(39,901)	94
CASH FLOWS FROM FINANCING ACTIVITIES		
Net increase in deposits	11,409	7,156
Net increase (decrease) in short-term borrowings	15,851	(5,210)
Repayments of other borrowings	(9,038)	(1,169)

Proceeds from other borrowings		16,000		-
Stock options exercised		310		227
Tax benefit of stock options exercised		14		5
Purchase of treasury stock		(135)		(179)
Cash dividends paid		(3,386)		(3,277)
Net cash provided by (used in) financing activities		31,025		(2,447)
(Decrease) increase in cash and cash equivalents		(660)		5,400
CASH AND CASH EQUIVALENTS, BEGINNING OF PERIOD		12,376		7,863
CASH AND CASH EQUIVALENTS, END OF PERIOD	$	11,716	$	13,263

See accompanying notes to the unaudited consolidated financial statements.

NORWOOD FINANCIAL CORP.
Consolidated Statements of Cash Flows (Unaudited) (continued)

(dollars in thousands)

	Nine Months Ended September 30, 2015	2014
Supplemental Disclosures of Cash Flow Information		
Cash payments for:		
Interest on deposits and borrowings	$ 2,403	$ 2,462
Income taxes paid, net of refunds	1,881	2,016
Supplemental Schedule of Noncash Investing Activities		
Transfers of loans to foreclosed real estate and repossession of other assets	$ 290	$ 4,670
Cash dividends declared	1,142	1,094

See accompanying notes to the unaudited consolidated financial statements.

Notes to the Unaudited Consolidated Financial Statements

1. Basis of Presentation

The unaudited consolidated financial statements include the accounts of Norwood Financial Corp. (Company) and its wholly-owned subsidiary, Wayne Bank (Bank) and the Bank's wholly-owned subsidiaries, WCB Realty Corp., Norwood Investment Corp., Norwood Settlement Services, LLC, and WTRO Properties, Inc. All significant intercompany transactions have been eliminated in consolidation.

The accompanying unaudited consolidated financial statements have been prepared in conformity with generally accepted accounting principles for interim financial statements and with instructions to Form 10-Q. Accordingly, they do not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements. In preparing the financial statements, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities as of the date of the balance sheet and revenues and expenses for the period. Actual results could differ from those estimates. The financial statements reflect, in the opinion of management, all normal, recurring adjustments necessary to present fairly the financial position and results of operations of the Company. The operating results for the three and nine month periods ended September 30, 2015 are not necessarily indicative of the results that may be expected for the year ending December 31, 2015 or any other future interim period.

These statements should be read in conjunction with the consolidated financial statements and related notes which are incorporated by reference in the Company's Annual Report on Form 10-K for the year-ended December 31, 2014.

2. Earnings Per Share

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

The following table sets forth the weighted average shares outstanding used in the computations of basic and diluted earnings per share.

(in thousands)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2015	2014	2015	2014
Weighted average shares outstanding	3,683	3,642	3,681	3,641
Less: Unvested restricted shares	(9)	-	(9)	-
Basic EPS weighted average shares outstanding	3,674	3,642	3,672	3,641
Weighted average shares outstanding	3,683	3,642	3,681	3,641
Dilutive effect of stock options	9	10	10	10

Diluted EPS weighted average shares outstanding	3,692	3,652	3,691	3,651

Stock options which had no intrinsic value, because their effect would be anti-dilutive and therefore would not be included in the diluted EPS calculation were 12,000 as of September 30, 2015 based upon the closing price of Norwood common stock of $29.00 per share on September 30, 2015. There were 19,600 anti-dilutive shares at September 30, 2014 based on Norwood's closing price of $28.60.

3. Stock-Based Compensation

No awards were granted during the nine-month period ending September 30, 2015. As of September 30, 2015, there was $16,000 of total unrecognized cost related to non-vested stock options granted in 2014 under the 2006 Stock Option Plan, which will be fully amortized by December 31, 2015. Total compensation cost related to stock options during the nine-month period ending September 30, 2015 was $49,000.

A summary of stock options from all plans, adjusted for stock dividends declared, is shown below.

	Options	Weighted Average Exercise Price Per Share		Weighted Average Remaining Contractual Term	Aggregate Intrinsic Value ($000)	
Outstanding at January 1, 2015	206,463	$	26.74	5.7Yrs.	$	478
Granted	-		-	-		-
Exercised	(11,931)		26.00	4.4		-
Forfeited	(9,583)		27.02	4.3		-
Outstanding at September 30, 2015	184,949	$	26.77	5.0 Yrs.	$	413
Exercisable at September 30, 2015	172,949	$	26.61	4.7 Yrs.	$	413

Intrinsic value represents the amount by which the market price of the stock on the measurement date exceeded the exercise price of the option. The stock price was $29.00 as of September 30, 2015 and $29.05 as of December 31, 2014

A summary of the Company's restricted stock activity and related information for the nine-month period ended September 30, 2015, is as follows:

	Number of Restricted Stock	Weighted-Average Grant Date Fair Value	
Outstanding, January 1, 2015	9,300	$	29.08
Granted	-		-
Vested	(70)		29.08
Forfeited	(280)		29.08
Non-vested at September 30, 2015	8,950	$	29.08

The expected future compensation expense relating to the 8,950 shares of non-vested restricted stock outstanding as of September 30, 2015 is $222,000 to be recognized over the next 4.25 years. Total compensation cost related to restricted stock during the nine-month period ending September 30, 2015 was $41,000.

4. Accumulated Other Comprehensive Income

The following tables present the changes in accumulated other comprehensive income (in thousands) by component net of tax for the three months and nine months ended September 30, 2015 and 2014:

	Unrealized gains (losses) on available for sale securities (a)		
Balance as of December 31, 2014	$	462	
Other comprehensive income before reclassification		594	
Amount reclassified from accumulated other comprehensive income (loss)		(335	)
Total other comprehensive income		259	
Balance as of September 30, 2015	$	721	

	Unrealized gains (losses) on available for sale securities (a)		
Balance as of December 31, 2013	$	(2,602	)
Other comprehensive income before reclassification		3,128	
Amount reclassified from accumulated other comprehensive (loss)		(597	)
Total other comprehensive income		2,531	
Balance as of September 30, 2014	$	(71	)

	Unrealized gains (losses) on available for sale securities (a)		
Balance as of June 30, 2015	$	(522	)
Other comprehensive income before reclassification		1,285	
Amount reclassified from accumulated other comprehensive income		(42	)
Total other comprehensive income		1,243	
Balance as of September 30, 2015	$	721	

	Unrealized gains (losses) on available for sale securities (a)		
Balance as of June 30, 2014	$	5	
Other comprehensive income before reclassification		123	
Amount reclassified from accumulated other comprehensive (loss)		(199	)
Total other comprehensive (loss)		(76	)
Balance as of September 30, 2014	$	(71	)

(a) All amounts are net of tax. Amounts in parentheses indicate debits.

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The following tables present significant amounts reclassified out of each component of accumulated other comprehensive income (loss) (in thousands) for the three and nine months ended September 30, 2015 and 2014:

Details about other comprehensive income (loss)	Amount Reclassified From Accumulated Other Comprehensive Income (Loss) (a)		Affected Line Item in the Statement Where Net Income is Presented
	Three months ended September 30,		
	2015	2014	
Unrealized gains on available for sale securities	$ 63	$ 301	Net realized gains on sales of securities
	(22)	(102)	Income tax expense
	$ 41	$ 199	Net of tax
	Nine months ended September 30,		
	2015	2014	
Unrealized gains on available for sale securities	$ 508	$ 904	Net realized gains on sales of securities
	(173)	(307)	Income tax expense
	$ 335	$ 597	Net of tax

(a) Amounts in parentheses indicate debits to net income

5. Off-Balance Sheet Financial Instruments and Guarantees

The Bank is a party to financial instruments with off-balance-sheet risk in the normal course of business to meet the financing needs of its customers. These financial instruments include commitments to extend credit and letters of credit. Those instruments involve, to varying degrees, elements of credit and interest rate risk in excess of the amount recognized in the balance sheets.

The Bank's exposure to credit loss in the event of nonperformance by the other party to the financial instrument for commitments to extend credit and letters of credit is represented by the contractual amount of those instruments. The Bank uses the same credit policies in making commitments and conditional obligations as it does for on-balance sheet instruments.

A summary of the Bank's financial instrument commitments is as follows:

(in thousands)	September 30, 2015	2014
Unfunded availability under loan commitments	$21,279	$26,495
Unfunded commitments under lines of credit	51,489	45,830
Standby letters of credit	5,504	5,688
	$78,272	$78,013

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 and may require payment of a fee. Since some of the commitments are expected to expire without being drawn upon, the total commitment amount does not necessarily represent future cash requirements. The Bank evaluates each customer's credit worthiness on a case-by-case basis. The amount of collateral obtained, if deemed necessary by the Bank upon extension of credit, is based on management's credit evaluation of the customer and generally consists of real estate.

The Bank does not issue any guarantees that would require liability recognition or disclosure, other than its standby letters of credit. Standby letters of credit written are conditional commitments issued by the Bank to guarantee the performance of a customer to a third party. Generally, all letters of credit, when issued, have expiration dates within one year. The credit risk involved in issuing letters of credit is essentially the same as those that are involved in extending loan facilities to customers. The Bank, generally, holds collateral and/or personal guarantees supporting these commitments. Management believes that the proceeds obtained through a liquidation of collateral and the enforcement of guarantees would be sufficient to cover the potential amount of future payments required under the corresponding guarantees. The current amount of the liability as of September 30, 2015 for guarantees under standby letters of credit issued is not material.

6. Securities

The amortized cost and fair value of securities were as follows:

	September 30, 2015			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
	(In Thousands)			
Available for Sale:				
U.S. Government agencies	$18,310	$81	$(31)	$18,360
States and political subdivisions	62,078	1,247	(395)	62,930
Corporate obligations	4,961	97	-	5,058
Mortgage-backed securities-government sponsored entities	66,571	402	(384)	66,589
Total debt securities	151,920	1,827	(810)	152,937
Equity securities-financial services	292	76	-	368
	$152,212	$1,903	$(810)	$153,305

	December 31, 2014			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
	(In Thousands)			
Available for Sale:				
U.S. Government agencies	$29,289	$42	$(356)	$28,975
States and political subdivisions	52,685	1,750	(103)	54,332
Corporate obligations	6,387	110	(11)	6,486
Mortgage-backed securities-government sponsored entities	67,032	109	(937)	66,204
Total debt securities	155,393	2,011	(1,407)	155,997
Equity securities-financial services	292	106	-	398
	$155,685	$2,117	$(1,407)	$156,395

The following tables show the Company's investment securities gross unrealized losses and fair value aggregated by length of time that individual securities have been in a continuous unrealized loss position (in thousands):

	September 30, 2015					
	Less than 12 Months		12 Months or More		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
U.S. Government agencies	$4,033	$(5)	$3,150	$(26)	$7,183	$(31)
States and political subdivisions	18,993	(359)	2,186	(36)	21,179	(395)
Corporate obligations	-	-	-	-	-	-
Mortgage-backed securities-government sponsored agencies	7,597	(50)	17,540	(334)	25,137	(384)
	$30,623	$(414)	$22,876	$(396)	$53,499	$(810)

	December 31, 2014					
	Less than 12 Months		12 Months or More		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
U.S. Government agencies	$4,965	$(17)	$15,051	$(339)	$20,016	$(356)
States and political subdivisions	3,195	(20)	4,633	(83)	7,828	(103)
Corporate obligations	-	-	1,144	(11)	1,144	(11)
Mortgage-backed securities-government sponsored agencies	22,090	(189)	26,050	(748)	48,140	(937)

$30,250	$(226)	$46,878	$(1,181)	$77,128	$(1,407)

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At September 30, 2015, the Company has 44 debt securities in an unrealized loss position in the less than twelve months category and 25 debt securities in the twelve months or more category. In Management's opinion the unrealized losses reflect changes in interest rates subsequent to the acquisition of specific securities. No other-than-temporary-impairment charges were recorded in 2015. Management believes that all unrealized losses represent temporary impairment of the securities as the Company does not have the intent to sell the securities and it is more likely than not that it will not have to sell the securities before recovery of its cost basis.

The amortized cost and fair value of debt securities as of September 30, 2015 by contractual maturity are shown below. Expected maturities may differ from contractual maturities because borrowers may have the right to prepay obligations with or without call or prepayment penalties.

	Available for Sale	
(In Thousands)	Amortized Cost	Fair Value
Due in one year or less	$ 1,140	$ 1,155
Due after one year through five years	22,596	22,748
Due after five years through ten years	9,542	9,636
Due after ten years	52,071	52,809
Mortgage-backed securities-government sponsored agencies	66,571	66,589
	$ 151,920	$ 152,937

Gross realized gains and gross realized losses on sales of securities available for sale were as follows (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2015	2014	2015	2014
Gross realized gains	$63	$301	$508	$918
Gross realized losses	-	-	-	(14)
Net realized gain	$63	$301	$508	$904
Proceeds from sales of securities	$5,466	$7,252	$28,850	$39,117

7. Loans Receivable and Allowance for Loan Losses

Set forth below is selected data relating to the composition of the loan portfolio at the dates indicated:

Types of loans
(dollars in thousands)

	September 30, 2015		December 31, 2014	
Real Estate Loans:				
Residential	$162,328	29.8 %	$158,139	31.5 %
Commercial	266,035	48.9	261,956	52.2
Construction	20,047	3.7	19,221	3.9
Commercial, financial and agricultural	68,264	12.6	42,514	8.5
Consumer loans to individuals	27,183	5.0	19,704	3.9
Total loans	543,857	100.0 %	501,534	100.0 %
Deferred fees, net	(321)		(399)	
Total loans receivable	543,536		501,135	
Allowance for loan losses	(5,747)		(5,875)	
Net loans receivable	$537,789		$495,260	

Changes in the accretable yield for purchased credit-impaired loans were as follows for the nine months ended September 30 (in thousands):

	2015	2014
Balance at beginning of period	$8	$20
Accretion	(1)	(12)
Reclassification and other	-	-
Balance at end of period	$7	$8

The following table presents additional information regarding loans acquired and accounted for in accordance with ASC 310-30 (in thousands):

	September 30, 2015	December 31, 2014
Outstanding Balance	$ 585	$ 1,057
Carrying Amount	$ 578	$ 1,049

There were no material increases or decreases in the expected cash flows of these loans since the acquisition date. As of December 31, 2014, for loans that were acquired with or without specific evidence of deterioration in credit quality, adjustments to the allowance for loan losses have been accounted for through the allowance for loan loss adequacy calculation.

The Company maintains a loan review system, which allows for a periodic review of our loan portfolio and the early identification of potential impaired loans. Such system takes into consideration, among other things, delinquency status, size of loans, type and market value of collateral and financial condition of the borrowers. Specific loan loss allowances are established for identified losses based on a review of such information. A loan evaluated for impairment is considered to be impaired when, based on current information and events, it is probable that we will be unable to collect all amounts due according to the contractual terms of the loan agreement. All loans identified as impaired are evaluated independently. We do not aggregate such loans for evaluation purposes. Impairment is measured on a loan-by-loan basis for commercial and construction loans by the present value of expected future cash flows discounted at the loan's effective interest rate, the loan's obtainable market price, or the fair value of the collateral if the loan is collateral-dependent.

Large groups of smaller balance homogeneous loans are collectively evaluated for impairment. Accordingly, the Company does not separately identify individual consumer and residential mortgage loans for impairment disclosures, unless such loans are part of a larger relationship that is impaired, or are classified as a troubled debt restructuring.

A loan is considered to be a troubled debt restructuring ("TDR") loan when the Company grants a concession to the borrower because of the borrower's financial condition that it would not otherwise consider. Such concessions include the reduction of interest rates, forgiveness of principal or interest, or other modifications of interest rates that are less than the current market rate for new obligations with similar risk.

Foreclosed assets acquired in settlement of loans are carried at fair value less estimated costs to sell and are included in foreclosed real estate owned on the Consolidated Balance Sheets. As of September 30, 2015 and December 31, 2014, foreclosed real estate owned totaled $1,345,000 and $3,726,000, respectively. As of September 30, 2015, included within foreclosed real estate owned is $63,000 of consumer residential mortgages that were foreclosed on or received via a deed in lieu transaction prior to the period end. As of September 30, 2015, the Company has initiated formal foreclosure proceedings on $503,000 of consumer residential mortgage loans.

The following tables show the amount of loans in each category that were individually and collectively evaluated for impairment at the dates indicated:

	Real Estate Loans					
	Residential	Commercial	Construction	Commercial Loans	Consumer Loans	Total
September 30, 2015			(In thousands)			
Individually evaluated for impairment	$34	$9,828	$-	$-	$-	$9,862
Loans acquired with deteriorated credit quality	214	364	-	-	-	578
	162,080	255,843	20,047	68,264	27,183	533,417

Collectively evaluated for impairment						
Total Loans	$162,328	$266,035	$20,047	$68,264	$27,183	$543,857

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	Real Estate Loans					
	Residential	Commercial	Construction	Commercial Loans	Consumer Loans	Total
			(In thousands)			
December 31, 2014						
Individually evaluated for impairment	$-	$10,556	$-	$-	$-	$10,556
Loans acquired with deteriorated credit quality	225	824	-	-	-	1,049
Collectively evaluated for impairment	157,914	250,576	19,221	42,514	19,704	489,929
Total Loans	$158,139	$261,956	$19,221	$42,514	$19,704	$501,534

The following tables includes the recorded investment and unpaid principal balances for impaired loans with the associated allowance amount, if applicable.

	Recorded Investment	Unpaid Principal Balance (in thousands)	Associated Allowance
September 30, 2015			
With no related allowance recorded:			
Real Estate Loans			
Residential	$248	$255	$-
Commercial	8,544	10,229	-
Subtotal	8,792	10,484	-
With an allowance recorded:			
Real Estate Loans			
Commercial	1,648	1,705	389
Subtotal	1,648	1,705	389
Total:			
Real Estate Loans			
Residential	248	255	-
Commercial	10,192	11,934	389
Total Impaired Loans	$10,440	$12,189	$389

December 31, 2014	Recorded Investment (in thousands)	Unpaid Principal Balance	Associated Allowance
With no related allowance recorded:			
Real Estate Loans			
Residential	$225	$233	$-
Commercial	8,407	8,566	-
Subtotal	8,632	8,799	-
With an allowance recorded:			
Real Estate Loans			
Commercial	2,973	3,837	293
Subtotal	2,973	3,837	293
Total:			
Real Estate Loans			
Residential	225	233	-
Commercial	11,380	12,403	293
Total Impaired Loans	$11,605	$12,636	$293

The following information for impaired loans is presented (in thousands) for the nine months ended September 30, 2015 and 2014:

	Average Recorded Investment		Interest Income Recognized	
	2015	2014	2015	2014
Real Estate Loans:				
Residential	$236	$235	$3	$4
Commercial	10,477	6,577	510	150
Total	$10,713	$6,812	$513	$154

The following information for impaired loans is presented (in thousands) for the three months ended September 30, 2015 and 2014:

Average Recorded Investment	Interest Income Recognized

	2015	2014	2015	2014
Real Estate Loans:				
Residential	$249	$230	$1	$2
Commercial	10,294	6,730	45	51
Total	$10,543	$6,960	$46	$53

Troubled debt restructured loans are those loans whose terms have been renegotiated to provide a reduction or deferral of principal or interest as a result of financial difficulties experienced by the borrower, who could not obtain comparable terms from alternate financing sources. As of September 30, 2015, troubled debt restructured loans totaled $8.5 million and resulted in a specific allowance of $389,000. For the period ended September 30, 2015, there were no new loans identified as troubled debt restructurings. In 2015, the Company recognized write-downs in the amount of $439,000 on three loans previously identified as troubled debt restructurings with a carrying value of $2.5 million as of September 30, 2015. As of December 31, 2014, troubled debt restructured loans totaled $8.8 million and resulted in a specific allowance of $293,000.

For the period ended September 30, 2014, there were no new loans identified as troubled debt restructurings. During the nine month period ended September 30, 2014, the Company recognized write-downs in the amount of $227,000 on two loans identified as troubled debt restructurings with a carrying value of $1.2 million as of September 30, 2014.

Management uses an eight point internal risk rating system to monitor the credit quality of the overall loan portfolio. The first four categories are considered not criticized, and are aggregated as “Pass” rated. The criticized rating categories utilized by management generally follow bank regulatory definitions. The Special Mention category includes assets that are currently protected but are potentially weak, resulting in an undue and unwarranted credit risk, but not to the point of justifying a Substandard classification. Loans in the Substandard category have well-defined weaknesses that jeopardize the liquidation of the debt, and have a distinct possibility that some loss will be sustained if the weaknesses are not corrected. All loans greater than 90 days past due are considered Substandard. Any portion of a loan that has been charged off is placed in the Loss category.

To help ensure that risk ratings are accurate and reflect the present and future capacity of borrowers to repay a loan as agreed, the Bank has a structured loan rating process with several layers of internal and external oversight. Generally, consumer and residential mortgage loans are included in the Pass categories unless a specific action, such as non performance, repossession, or death occurs to raise awareness of a possible credit event. The Company’s Loan Review Department is responsible for the timely and accurate risk rating of the loans on an ongoing basis. Every credit which must be approved by Loan Committee or the Board of Directors is assigned a risk rating at time of consideration. Loan Review also annually reviews relationships of $1,000,000 and over to assign or re-affirm risk ratings. Loans in the Substandard categories that are collectively evaluated for impairment are given separate consideration in the determination of the allowance.

The following tables present the classes of the loan portfolio summarized by the aggregate Pass and the criticized categories of Special Mention, Substandard, Doubtful and Loss within the internal risk rating system as of September 30, 2015 and December 31, 2014 (in thousands):

	Pass	Special Mention	Substandard	Doubtful or Loss	Total
September 30, 2015					
Commercial real estate loans	$251,153	$2,653	$12,229	$-	$266,035
Commercial loans	68,264	-	-	-	68,264
Total	$319,417	$2,653	$12,229	$-	$334,299

	Pass	Special Mention	Substandard	Doubtful or Loss	Total
December 31, 2014					
Commercial real estate loans	$246,629	$1,983	$13,344	$-	$261,956
Commercial loans	42,514	-	-	-	42,514
Total	$289,143	$1,983	$13,344	$-	$304,470

For residential real estate loans, construction loans and consumer loans, the Company evaluates credit quality based on the performance of the individual credits. The following tables present the recorded investment in the loan classes based on payment activity as of September 30, 2015 and December 31, 2014 (in thousands):

	Performing	Nonperforming	Total
September 30, 2015			
Residential real estate loans	$161,375	$ 953	$162,328
Construction	20,047	-	20,047
Consumer loans	27,182	1	27,183
Total	$208,604	$ 954	$209,558

	Performing	Nonperforming	Total
December 31, 2014			
Residential real estate loans	$156,464	$ 1,675	$158,139
Construction	19,221	-	19,221
Consumer loans	19,700	4	19,704

Total	$195,385	$ 1,679	$197,064

Management further monitors the performance and credit quality of the loan portfolio by analyzing the age of the portfolio as determined by the length of time a recorded payment is past due. The following tables present the classes of the loan portfolio summarized by the aging categories of performing loans and nonaccrual loans as of September 30, 2015 and December 31, 2014 (in thousands):

	Current	31-60 Days Past Due	61-90 Days Past Due	Greater than 90 Days Past Due and still accruing	Non-Accrual	Total Past Due and Non-Accrual	Total Loans
September 30, 2015							
Real Estate loans							
Residential	$160,916	$374	$85	$-	$ 953	$ 1,412	$162,328
Commercial	257,694	61	103	-	8,177	8,341	266,035
Construction	20,047	-	-	-	-	-	20,047
Commercial loans	68,264	-	-	-	-	-	68,264
Consumer loans	27,104	69	9	-	1	79	27,183
Total	$534,025	$504	$197	$-	$ 9,131	$ 9,832	$543,857

	Current	31-60 Days Past Due	61-90 Days Past Due	Greater than 90 Days Past Due and still accruing	Non-Accrual	Total Past Due and Non-Accrual	Total Loans
December 31, 2014							
Real Estate loans							
Residential	$156,242	$222	$-	$-	$ 1,675	$ 1,897	$158,139
Commercial	252,495	5,100	440	-	3,921	9,461	261,956
Construction	19,221	-	-	-	-	-	19,221
Commercial loans	42,500	14	-	-	-	14	42,514
Consumer loans	19,606	94	-	-	4	98	19,704
Total	$490,064	$5,430	$440	$-	$ 5,600	$ 11,470	$501,534

The following tables present the allowance for loan losses by the classes of the loan portfolio:

(In thousands)	Residential Real Estate	Commercial Real Estate	Construction	Commercial	Consumer	Total
Beginning balance, December 31, 2014	$ 1,323	$ 3,890	$ 222	$ 256	$ 184	$ 5,875
Charge Offs	(159)	(1,692)	-	-	(59)	(1,910)
Recoveries	4	-	-	-	18	22
Provision for loan losses	(181)	1,980	(137)	28	70	1,760
Ending balance, September 30, 2015	$ 987	$ 4,178	$ 85	$ 284	$ 213	$ 5,747
Ending balance individually evaluated for impairment	$ -	$ 389	$ -	$ -	$ -	$ 389
Ending balance collectively evaluated for impairment	$ 987	$ 3,789	$ 85	$ 284	$ 213	$ 5,358

(In thousands)	Residential Real Estate	Commercial Real Estate	Construction	Commercial	Consumer	Total
Beginning balance, June 30, 2015	$1,085	$4,152	$97	$405	$208	$5,947
Charge Offs	(46)	(865)	-	-	(16)	(927)
Recoveries	-	-	-	-	7	7
Provision for loan losses	(52)	891	(12)	(121)	14	720
Ending balance, September 30, 2015	$987	$4,178	$85	$284	$213	$5,747

(In thousands)	Residential Real Estate	Commercial Real Estate	Construction	Commercial	Consumer	Total
Beginning balance, December 31, 2013	$1,441	$3,025	$898	$184	$160	$5,708
Charge Offs	(132)	(1,177)	-	-	(36)	(1,345)
Recoveries	-	-	-	-	28	28
Provision for loan losses	(57)	2,005	(704)	14	2	1,260
Ending balance, September 30, 2014	$1,252	$3,853	$194	$198	$154	$5,651
Ending balance individually evaluated for impairment	$-	$61	$-	$-	$-	$61
Ending balance collectively evaluated for impairment	$1,252	$3,792	$194	$198	$154	$5,590

(In thousands)	Residential Real Estate	Commercial Real Estate	Construction	Commercial	Consumer	Total
Beginning balance, June 30, 2014	$1,194	$3,900	$205	$179	$133	$5,611
Charge Offs	(34)	(348)	-	-	(9)	(391)
Recoveries	-	-	-	-	11	11
Provision for loan losses	92	301	(11)	19	19	420
Ending balance, September 30, 2014	$1,252	$3,853	$194	$198	$154	$5,651

The Company’s primary business activity as of September 30, 2015 and December 31, 2014 is with customers located in northeastern Pennsylvania. Accordingly, the Company has extended credit primarily to commercial entities and individuals in this area whose ability to honor their contracts is influenced by the region’s economy.

As of September 30, 2015, the Company considered its concentration of credit risk to be acceptable. The highest concentration was in the hospitality lodging industry with loans outstanding of $61.8 million, or 11.4% of loans outstanding. During 2015, the Company recorded a charge-off of $643,000 on a motel property which has been sold.

Gross realized gains and gross realized losses on sales of residential mortgage loans were $56,000 and $0, respectively, in the first nine months of 2015 compared to $72,000 and $0, respectively, in the same period in 2014. The proceeds from the sales of residential mortgage loans totaled $2.7 million and $2.3 million for the nine months ended September 30, 2015 and 2014, respectively.

Gross realized gains and gross realized losses on sales of residential mortgage loans were $16,000 and $0, respectively, for the three months ended September 30, 2015. The proceeds from the sales of residential mortgage loans totaled $818,000 for the three months ended September 30, 2015. There were no sales of residential mortgages during the three months ended September 30, 2014.

8. Fair Value Measurements

Fair value estimates are based on quoted market prices, if available, quoted market prices of similar assets or liabilities, or the present value of expected future cash flows and other valuation techniques. These valuations are significantly affected by discount rates, cash flow assumptions and risk assumptions used. Therefore, fair value estimates may not be substantiated by comparison to independent markets and are not intended to reflect the proceeds that may be realizable in an immediate settlement of the instruments.

Fair value is determined at one point in time and is not representative of future value. These amounts do not reflect the total value of a going concern organization. Management does not have the intention to dispose of a significant portion of its assets and liabilities and therefore, the unrealized gains or losses should not be interpreted as a forecast of future earnings and cash flows.

The following is a discussion of assets and liabilities measured at fair value on a recurring basis and valuation techniques applied:

Securities:

The fair value of securities available for sale (carried at fair value) are determined by obtaining quoted market prices on nationally recognized securities exchanges (Level 1), or matrix pricing (Level 2), which is a mathematical technique used widely in the industry to value debt securities without relying exclusively on quoted market prices for the specific securities but rather by relying on the securities' relationship to other benchmark quoted prices. For certain securities which are not traded in active markets or are subject to transfer restrictions, valuations are adjusted to reflect illiquidity and/or non-transferability, and such adjustments are generally based on available market evidence (Level 3). In the absence of such evidence, management's best estimate is used. Management's best estimate consists of both internal and external support on certain Level 3 investments. Internal cash flow models using a present value formula that includes assumptions market participants would use along with indicative exit pricing obtained from broker/dealers (where available) are used to support fair values of certain Level 3 investments, if applicable.

For financial assets measured at fair value on a recurring basis, the fair value measurements by level within the fair value hierarchy used at September 30, 2015 and December 31, 2014 are as follows:

		Fair Value Measurement Using Reporting Date		
Description	Total	Level 1	Level 2	Level 3
		(In thousands)		
September 30, 2015				
Available for Sale:				
U.S. Government agencies	$18,360	$-	$18,360	$-
States and political subdivisions	62,930	-	62,930	-
Corporate obligations	5,058	-	5,058	-
Mortgage-backed securities-government sponsored agencies	66,589	-	66,589	-

Equity securities-financial services	368	368	-	-
Total	$153,305	$368	$152,937	$-

Description	Total	Level 1	Level 2	Level 3
		(In thousands)		
December 31, 2014				
Available for Sale:				
U.S. Government agencies	$28,975	$-	$28,975	$-
States and political subdivisions	54,332	-	54,332	-
Corporate obligations	6,486	-	6,486	-
Mortgage-backed securities-government sponsored agencies	66,204	-	66,204	-
Equity securities-financial services	398	398	-	-
Total	$156,395	$398	$155,997	$-

The following is a discussion of assets and liabilities measured at fair value on a non-recurring basis and valuation techniques applied:

Impaired loans (generally carried at fair value):

The Company measures impairment generally based on the fair value of the loan's collateral. Fair value is generally determined based upon independent third-party appraisals of the properties, or discounted cash flows based upon the lowest level of input that is significant to the fair value measurements.

Foreclosed real estate owned (carried at fair value):

Real estate properties acquired through, or in lieu of loan foreclosure are to be sold and are carried at fair value less estimated cost to sell. Fair value is based upon independent market prices, appraised value of the collateral or management's estimation of the value of the collateral. These assets are included in Level 3 fair value based upon the lowest level of input that is significant to the fair value measurement.

For financial assets measured at fair value on a nonrecurring basis, the fair value measurements by level within the fair value hierarchy used at September 30, 2015 and December 31, 2014 are as follows:

		Fair Value Measurement Reporting Date using Reporting Date		
(In thousands)				
Description	Total	Level 1	Level 2	Level 3
September 30, 2015				
Impaired Loans	$10,051	$-	$-	$10,051
Foreclosed Real Estate Owned	1,345	-	-	1,345

December 31, 2014				
Impaired Loans	$11,312	$-	$-	$11,312
Foreclosed Real Estate Owned	3,726	-	-	3,726

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

		Quantitative Information about Level 3 Fair Value Measurements			
(dollars in thousands)	Fair Value Estimate	Valuation Techniques	Unobservable Input	Range (Weighted Average)	
September 30, 2015					
Impaired loans	$ 9,625	Appraisal of collateral(1)	Appraisal adjustments(2)	10%-25%	(17.36%)
Impaired loans	$ 426	Present value of future cash flows	Loan discount rate	5.75%-6.75%	(6.25%)
Foreclosed real estate owned	$ 1,345	Appraisal of collateral(1)	Liquidation Expenses(2)	10	%

		Quantitative Information about Level 3 Fair Value Measurements			
(dollars in thousands)	Fair Value Estimate	Valuation Techniques	Unobservable Input	Range (Weighted Average)	
December 31, 2014					
Impaired loans	$ 11,312	Appraisal of collateral(1)	Appraisal adjustments(2)	6-33%	(23.35%)
Foreclosed real estate owned	$ 3,726	Appraisal of collateral(1)	Liquidation Expenses(2)	10	%

(1) Fair value is generally determined through independent appraisals of the underlying collateral, which generally include various Level 3 inputs which are not identifiable, less any associated allowance.
(2) Appraisals may be adjusted by management for qualitative factors such as economic conditions and estimated liquidation expenses. The range and weighted average of liquidation expenses and other appraisal adjustments are presented as a percent of the appraisal.

The following information should not be interpreted as an estimate of the fair value of the entire Company since a fair value calculation is only provided for a limited portion of the Company'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 Company'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 Company's financial instruments at September 30, 2015 and December 31, 2014.

Cash and cash equivalents (carried at cost):
The carrying amounts reported in the consolidated balance sheet for cash and short-term instruments approximate those assets' fair values.

Securities:
The fair value of securities available for sale (carried at fair value) and held to maturity (carried at amortized cost) are determined by obtaining quoted market prices on nationally recognized securities exchanges (Level 1), or matrix pricing (Level 2), which is a mathematical technique used widely in the industry to value debt securities without relying exclusively on quoted market prices for the specific securities but rather by relying on the securities' relationship to other benchmark quoted prices. For certain securities which are not traded in active markets or are subject to transfer restrictions, valuations are adjusted to reflect illiquidity and/or non-transferability, and such adjustments are generally based on available market evidence (Level 3). In the absence of such evidence, management's best estimate is used. Management's best estimate consists of both internal and external support on certain Level 3 investments. Internal cash flow models using a present value formula that includes assumptions market participants would use along with indicative exit pricing obtained from broker/dealers (where available) are used to support fair values of certain Level 3 investments, if applicable.

Loans receivable (carried at cost):
The fair values of loans are estimated using discounted cash flow analyses, using market rates at the balance sheet date that reflect the credit and interest rate-risk inherent in the loans. Projected future cash flows are calculated based upon contractual maturity or call dates, projected repayments and prepayments of principal. Generally, for variable rate loans that reprice frequently and with no significant change in credit risk, fair values are based on carrying values.

Impaired loans (generally carried at fair value):
The Company measures impairment generally based on the fair value of the loan's collateral. Fair value is generally determined based upon independent third-party appraisals of the properties, or discounted cash flows based upon the lowest level of input that is significant to the fair value measurements.

As of September 30, 2015, the fair value investment in impaired loans totaled $10,051,000 which included one loan relationship for $1,648,000 for which a valuation allowance of $389,000 had been provided based on the estimated value of the collateral or the present value of estimated cash flows, and sixteen loan relationships for $8,792,000 which did not require a valuation allowance since the estimated realizable value of the collateral exceeded the recorded investment in the loan. As of September 30, 2015, the Company has recognized charge-offs against the allowance for loan losses on these impaired loans in the amount of $1,742,000 over the life of the loans.

As of December 31, 2014, the fair value investment in impaired loans totaled $11,312,000 which included three loans for $2,973,000 for which a valuation allowance of $293,000 had been provided based on the estimated value of the collateral or the present value of estimated cash flows, and fourteen loans for $8,632,000 which did not require a valuation allowance since the estimated realizable value of the collateral exceeded the recorded investment in the loan. As of December 31, 2014, the Company had recognized charge-offs against the allowance for loan losses on these impaired loans in the amount of $1,022,000 over the life of the loans.

Mortgage servicing rights (generally carried at cost)
The Company utilizes a third party provider to estimate the fair value of certain loan servicing rights. Fair value for the purpose of this measurement is defined as the amount at which the asset could be exchanged in a current transaction between willing parties, other than in a forced liquidation.

Foreclosed real estate owned (carried at fair value):
Real estate properties acquired through, or in lieu of loan foreclosure are to be sold and are carried at fair value less estimated cost to sell. Fair value is based upon independent market prices, appraised value of the collateral or management's estimation of the value of the collateral. These assets are included in Level 3 fair value based upon the lowest level of input that is significant to the fair value measurement.

Restricted investment in Federal Home Loan Bank stock (carried at cost):
The Company, as a member of the Federal Home Loan Bank (FHLB) system is required to maintain an investment in capital stock of its district FHLB according to a predetermined formula. This regulatory stock has no quoted market value and is carried at cost.

Bank owned life insurance (carried at cost):
The fair value is equal to the cash surrender value of the Bank owned life insurance.

Accrued interest receivable and payable (carried at cost):
The carrying amount of accrued interest receivable and accrued interest payable approximates its fair value.

Deposit liabilities (carried at cost):
The fair values disclosed for demand deposits (e.g., interest and noninterest checking, passbook savings and money market accounts) are, by definition, equal to the amount payable on demand at the reporting date (i.e., their carrying amounts). Fair values for fixed-rate certificates of deposit are estimated using a discounted cash flow calculation that applies interest rates currently being offered in the market on certificates to a schedule of aggregated expected monthly maturities on time deposits.

Short-term borrowings (carried at cost):
The carrying amounts of short-term borrowings approximate their fair values.

Other borrowings (carried at cost):
Fair values of FHLB advances are estimated using discounted cash flow analysis, based on quoted prices for new FHLB advances with similar credit risk characteristics, terms and remaining maturity. These prices obtained from this active market represent a market value that is deemed to represent the transfer price if the liability were assumed by a third party.

Off-balance sheet financial instruments (disclosed at cost):
Fair values for the Company's off-balance sheet financial instruments (lending commitments and letters of credit) are based on fees currently charged in the market to enter into similar agreements, taking into account, the remaining terms of the agreements and the counterparties' credit standing.

The estimated fair values of the Bank’s financial instruments were as follows at September 30, 2015 and December 31, 2014. (In thousands)

		Fair Value Measurements at September 30, 2015			
	Carrying Amount	Fair Value	Level 1	Level 2	Level 3
Financial assets:					
Cash and cash equivalents	$11,716	$11,716	$11,716	$-	$-
Securities	153,305	153,305	368	152,937	-
Loans receivable, net	537,789	548,575	-	-	548,575
Mortgage servicing rights	258	258	258	-	-
Regulatory stock	2,488	2,488	2,488	-	-
Bank owned life insurance	18,686	18,686	18,686	-	-
Accrued interest receivable	2,499	2,499	2,499	-	-
Financial liabilities:					
Deposits	571,353	571,650	372,659	-	198,991
Short-term borrowings	41,546	41,546	41,546	-	-
Other borrowings	29,162	29,747	-	-	29,747
Accrued interest payable	996	996	996	-	-
Off-balance sheet financial instruments:					
Commitments to extend credit and outstanding letters of credit	-	-	-	-	-

		Fair Value Measurements at December 31, 2014			
	Carrying Amount	Fair Value	Level 1	Level 2	Level 3
Financial assets:					
Cash and cash equivalents	$12,376	$12,376	$12,376	$-	$-
Securities	156,395	156,395	398	155,997	-
Loans receivable, net	495,260	507,833	-	-	507,833
Mortgage servicing rights	271	277	-	277	-
Regulatory stock	1,714	1,714	1,714	-	-
Bank owned life insurance	18,284	18,284	18,284	-	-
Accrued interest receivable	2,339	2,339	2,339	-	-
Financial liabilities:					
Deposits	559,944	560,243	338,112	-	222,131
Short-term borrowings	25,695	25,695	25,695	-	-
Other borrowings	22,200	23,228	-	-	23,228

Accrued interest payable	966	966	966	-	-
Off-balance sheet financial instruments:					
Commitments to extend credit and outstanding letters of credit	-	-	-	-	-

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9. New and Recently Adopted Accounting Pronouncements

In January 2014, the Financial Accounting Standards Board (“FASB”) issued Accounting Standards Update (“ASU”) 2014-01, Investments – Equity Method and Joint Ventures (Topic 323): Accounting for Investments in Qualified Affordable Housing Projects. The amendments in this Update permit reporting entities to make an accounting policy election to account for their investments in qualified affordable housing projects using the proportional amortization method if certain conditions are met. Under the proportional amortization method, an entity amortizes the initial cost of the investment in proportion to the tax credits and other tax benefits received and recognizes the net investment performance in the income statement as a component of income tax expense (benefit). The amendments in this Update should be applied retrospectively to all periods presented. A reporting entity that uses the effective yield method to account for its investments in qualified affordable housing projects before the date of adoption may continue to apply the effective yield method for those preexisting investments. The amendments in this Update are effective for public business entities for annual periods and interim reporting periods within those annual periods, beginning after December 15, 2014. Early adoption is permitted. This Update did not have a significant impact on the Company’s financial statements.

In January 2014, the FASB issued ASU 2014-04, Receivables – Troubled Debt Restructurings by Creditors (Subtopic 310-40): Reclassification of Residential Real Estate Collateralized Consumer Mortgage Loans upon Foreclosure. The amendments in this Update clarify that an in substance repossession or foreclosure occurs, and a creditor is considered to have received physical possession of residential real estate property collateralizing a consumer mortgage loan, upon either (1) the creditor obtaining legal title to the residential real estate property upon completion of a foreclosure or (2) the borrower conveying all interest in the residential real estate property to the creditor to satisfy that loan through completion of a deed in lieu of foreclosure or through a similar legal agreement. Additionally, the amendments require interim and annual disclosure of both (1) the amount of foreclosed residential real estate property held by the creditor and (2) the recorded investment in consumer mortgage loans collateralized by residential real estate property that are in the process of foreclosure according to local requirements of the applicable jurisdiction. The amendments in this Update are effective for public business entities for annual periods, and interim periods within those annual periods, beginning after December 15, 2014. An entity can elect to adopt the amendments in this Update using either a modified retrospective transition method or a prospective transition method. The Company has included the disclosures related to this Update in Note 7.

In May 2014, the FASB issued ASU 2014-09, Revenue from Contracts with Customers (a new revenue recognition standard). The Update’s core principle is that a company will recognize revenue to depict the transfer of goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. In addition, this update specifies the accounting for certain costs to obtain or fulfill a contract with a customer and expands disclosure requirements for revenue recognition. This Update is effective for annual reporting periods beginning after December 15, 2016, including interim periods within that reporting period. The Company is evaluating the effect of adopting this new accounting Update.

In June 2014, the FASB issued ASU 2014-11, Transfers and Servicing (Topic 860): Repurchase-to-Maturity Transactions, Repurchase Financings, and Disclosures. The amendments in this Update change the accounting for repurchase-to-maturity transactions to secured borrowing accounting. For repurchase financing arrangements, the amendments require separate accounting for a transfer of a financial asset executed contemporaneously with a repurchase agreement with the same counterparty, which will result in secured borrowing accounting for the repurchase agreement. The amendments also require enhanced disclosures. The

accounting changes in this Update are effective for the first interim or annual period beginning after December 15, 2014. An entity is required to present changes in accounting for transactions outstanding on the effective date as a cumulative-effect adjustment to retained earnings as of the beginning of the period of adoption. Earlier application is prohibited. The disclosure for certain transactions accounted for as a sale is required to be presented for interim and annual periods beginning after December 15, 2014, and the disclosure for repurchase agreements, securities lending transactions, and repurchase-to-maturity transactions accounted for as secured borrowings is required to be presented for annual periods beginning after December 15, 2014, and for interim periods beginning after March 15, 2015. The disclosures are not required to be presented for comparative periods before the effective date. This Update did not have a significant impact on the Company's financial statements.

In June 2014, the FASB issued ASU 2014-12, Compensation – Stock Compensation (Topic 718): Accounting for Share-Based Payments when the Terms of an Award Provide that a Performance Target Could Be Achieved After the Requisite Service Period. The amendments require that a performance target that affects vesting and that could be achieved after the requisite service period be treated as a performance condition. The amendments in this Update are effective for annual periods and interim periods within those annual periods beginning after December 15, 2015. Earlier adoption is permitted. Entities may apply the amendments in this Update either (a) prospectively to all awards granted or modified after the effective date or (b) retrospectively to all awards with performance targets that are outstanding as of the beginning of the earliest annual period presented in the financial statements and to all new or modified awards thereafter. If retrospective transition is adopted, the cumulative effect of applying this Update as of the beginning of the earliest annual period presented in the financial statements should be recognized as an adjustment to the opening retained earnings balance at that date. Additionally, if retrospective transition is adopted, an entity may use hindsight in measuring and recognizing the compensation cost. This Update is not expected to have a significant impact on the Company's financial.

In August 2014, the FASB issued ASU 2014-14, Receivables – Troubled Debt Restructurings by Creditors (Subtopic 310-40). The amendments in this Update require that a mortgage loan be derecognized and that a separate other receivable be recognized upon foreclosure if the following conditions are met: (1) the loan has a government guarantee that is not separable from the loan before foreclosure, (2) at the time of foreclosure, the creditor has the intent to convey the real estate property to the guarantor and make a claim on the guarantee, and the creditor has the ability to recover under that claim, and (3) at the time of foreclosure, any amount of the claim that is determined on the basis of the fair value of the real estate is fixed. Upon foreclosure, the separate other receivable should be measured based on the amount of the loan balance (principal and interest) expected to be recovered from the guarantor. The amendments in this Update are effective for public business entities for annual periods, and interim periods within those annual periods, beginning after December 15, 2014. This Update did not have a significant impact on the Company's financial statements.

In August 2014, the FASB issued ASU 2014-15, Presentation of Financial Statements – Going Concern (Subtopic 205-40). The amendments in this Update provide guidance in accounting principles generally accepted in the United States of America about management's responsibility to evaluate whether there is substantial doubt about an entity's ability to continue as a going concern and to provide related footnote disclosures. The amendments in this Update are effective for the annual period ending after December 15, 2016, and for annual periods and interim periods thereafter. Early application is permitted. This Update is not expected to have a significant impact on the Company's financial statements.

In November 2014, the FASB issued ASU 2014-16, Derivatives and Hedging (Topic 815): Determining Whether the Host Contract in a Hybrid Financial Instrument Issued in the Form of a Share Is More Akin to Debt or to Equity (a consensus of the FASB Emerging Issues Task Force). This Update clarifies how current U.S. GAAP should be interpreted in subjectively evaluating the economic characteristics and risks of a host contract in a hybrid financial instrument that is issued in the form of a share. Public business entities are required to implement the new requirements in fiscal years and interim periods within those fiscal years beginning after December 15, 2015. This Update is not expected to have a significant impact on the Company’s financial statements.

In November 2014, the FASB issued ASU 2014-17, Business Combinations (Topic 805): Pushdown Accounting. The amendments in this Update apply to the separate financial statements of an acquired entity and its subsidiaries that are a business or nonprofit activity (either public or nonpublic) upon the occurrence of an event in which an acquirer (an individual or an entity) obtains control of the acquired entity. An acquired entity may elect the option to apply pushdown accounting in the reporting period in which the change-in-control event occurs. If pushdown accounting is not applied in the reporting period in which the change-in-control event occurs, an acquired entity will have the option to elect to apply pushdown accounting in a subsequent reporting period to the acquired entity's most recent change-in-control event. The amendments in this Update are effective on November 18, 2014. After the effective date, an acquired entity can make an election to apply the guidance to future change-in-control events or to its most recent change-in-control event. This Update did not have a significant impact on the Company’s financial statements.

In January 2015, the FASB issued ASU 2015-01, Income Statement – Extraordinary and Unusual Items, as part of its initiative to reduce complexity in accounting standards. This Update eliminates from U.S. GAAP the concept of extraordinary items. The amendments in this Update are effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2015. A reporting entity may apply the amendments prospectively. A reporting entity may also apply the amendments retrospectively to all prior periods presented in the financial statements. Early adoption is permitted provided that the guidance is applied from the beginning of the fiscal year of adoption. This Update is not expected to have a significant impact on the Company’s financial statements.

In February 2015, the FASB issued ASU 2015-02, Consolidation (Topic 810). The amendments in this Update affect reporting entities that are required to evaluate whether they should consolidate certain legal entities. All legal entities are subject to reevaluation under the revised consolidation model. Specifically, the amendments (1) modify the evaluation of whether limited partnerships and similar legal entities are variable interest entities (“VIEs”) or voting interest entities; (2) eliminate the presumption that a general partner should consolidate a limited partnership; (3) affect the consolidation analysis of reporting entities that are involved with VIEs, particularly those that have fee arrangements and related-party relationships; and (4) provide a scope exception from consolidation guidance for reporting entities with interests in legal entities that are required to comply with or operate in accordance with requirements that are similar to those in Rule 2a-7 of the Investment Company Act of 1940 for registered money market funds. The amendments in this Update are effective for public business entities for fiscal years, and for interim periods within those fiscal years, beginning after December 15, 2015. For all other entities, the amendments in this Update are effective for fiscal years beginning after December 15, 2016, and for interim periods within fiscal years beginning after December 15, 2017. This Update is not expected to have a significant impact on the Company’s financial statements.

In April 2015, the FASB issued ASU 2015-03, Interest – Imputation of Interest (Subtopic 835-30), as part of its initiative to reduce complexity in accounting standards. To simplify presentation of debt issuance costs, the amendments in this Update require that debt issuance costs related to a recognized debt liability be presented in the balance sheet as a direct deduction from the carrying amount of that debt liability, consistent with debt discounts. The recognition and measurement guidance for debt issuance costs are not affected by the amendments in this Update. For public business entities, the amendments in this Update are effective for financial statements issued for fiscal years beginning after December 15, 2015, and interim periods within those fiscal years. For all other entities, the amendments in this Update are effective for financial statements issued for fiscal years beginning after December 15, 2015, and interim periods within fiscal years beginning after December 15, 2016. An entity should apply the new guidance on a retrospective basis, wherein the balance

sheet of each individual period presented should be adjusted to reflect the period-specific effects of applying the new guidance. This Update is not expected to have a significant impact on the Company's financial statements.

In April 2015, the FASB issued ASU 2015-04, Compensation – Retirement Benefits (Topic 715), as part of its initiative to reduce complexity in accounting standards. For an entity with a fiscal year-end that does not coincide with a month-end, the amendments in this Update provide a practical expedient that permits the entity to measure defined benefit plan assets and obligations using the month-end that is closest to the entity's fiscal year-end and apply that practical expedient consistently from year to year. The practical expedient should be applied consistently to all plans if an entity has more than one plan. The amendments in this Update are effective for public business entities for financial statements issued for fiscal years beginning after December 15, 2015, and interim periods within those fiscal years. For all other entities, the amendments in this Update are effective for financial statements issued for fiscal years beginning after December 15, 2016, and interim periods within fiscal years beginning after December 15, 2017. Earlier application is permitted. This Update is not expected to have a significant impact on the Company's financial statements.

In April 2015, the FASB issued ASU 2015-05, Intangibles – Goodwill and Other – Internal-Use Software (Subtopic 350-40), as part of its initiative to reduce complexity in accounting standards. This guidance will help entities evaluate the accounting for fees paid by a customer in a cloud computing arrangement. The amendments in this Update provide guidance to customers about whether a cloud computing arrangement includes a software license. If a cloud computing arrangement includes a software license, then the customer should account for the software license element of the arrangement consistent with the acquisition of other software licenses. If a cloud computing arrangement does not include a software license, the customer should account for the arrangement as a service contract. For public business entities, the FASB decided that the amendments will be effective for annual periods, including interim periods within those annual periods, beginning after December 15, 2015. For all other entities, the amendments will be effective for annual periods beginning after December 15, 2015, and interim periods in annual periods beginning after December 15, 2016. Early adoption is permitted for all entities. This Update is not expected to have a significant impact on the Company's financial statements.

In April 2015, the FASB issued ASU 2015-06, Earnings Per Share (Topic 260): Effects on Historical Earnings per Unit of Master Limited Partnership Dropdown Transactions. Topic 260, Earnings Per Share, contains guidance that addresses master limited partnerships that originated from Emerging Issues Task Force ("EITF") Issue No. 07-4, Application of the Two-Class Method Under FASB Statement No. 128 to Master Limited Partnerships. Under Topic 260, master limited partnerships apply the two-class method of calculating earnings per unit because the general partner, limited partners, and incentive distribution rights holders each participate differently in the distribution of available cash in accordance with the contractual rights contained in the partnership agreement. The amendments in this Update specify that for purposes of calculating historical earnings per unit under the two-class method, the earnings (losses) of a transferred business before the date of a dropdown transaction should be allocated entirely to the general partner. In that circumstance, the previously reported earnings per unit of the limited partners (which is typically the earnings per unit measure presented in the financial statements) would not change as a result of the dropdown transaction. Qualitative disclosures about how the rights to the earnings (losses) differ before and after the dropdown transaction occurs for purposes of computing earnings per unit under the two-class method are also required. The amendments in this Update are effective for fiscal years beginning after December 15, 2015, and interim periods within those fiscal years. Earlier application is permitted. This Update is not expected to have a significant impact on the Company's financial statements.

In May 2015, the FASB issued ASU 2015-07, Disclosures for Investments in Certain Entities that Calculate Net Asset Value per Share (or Its Equivalent). The Update applies to reporting entities that elect to measure the fair value of an investment using the net asset value per share (or its equivalent) practical

expedient. Under the amendments in this Update, investments for which fair value is measured at net asset value per share (or its equivalent) using the practical expedient should not be categorized in the fair value hierarchy. Removing those investments from the fair value hierarchy not only eliminates the diversity in practice resulting from the way in which investments measured at net asset value per share (or its equivalent) with future redemption dates are classified, but also ensures that all investments categorized in the fair value hierarchy are classified using a consistent approach. Investments that calculate net asset value per share (or its equivalent), but for which the practical expedient is not applied will continue to be included in the fair value hierarchy. A reporting entity should continue to disclose information on investments for which fair value is measured at net asset value (or its equivalent) as a practical expedient to help users understand the nature and risks of the investments and whether the investments, if sold, are probable of being sold at amounts different from net asset value. The amendments in this Update are effective for public business entities for fiscal years beginning after December 15, 2015, and interim periods within those fiscal years. For all other entities, the amendments in this Update are effective for fiscal years beginning after December 15, 2016, and interim periods within those fiscal years. A reporting entity should apply the amendments retrospectively to all periods presented. The retrospective approach requires that an investment for which fair value is measured using the net asset value per share practical expedient be removed from the fair value hierarchy in all periods presented in an entity's financial statements. Earlier application is permitted. This Update is not expected to have a significant impact on the Company’s financial statements.

In May 2015, the FASB issued ASU 2015-08, Business Combinations – Pushdown Accounting – Amendment to SEC Paragraphs Pursuant to Staff Accounting Bulletin No. 115. This Update was issued to amend various SEC paragraphs pursuant to the issuance of Staff Accounting Bulletin No. 115. This Update is not expected to have a significant impact on the Company’s financial statements.

In May 2015, the FASB issued ASU 2015-09, Financial Services – Insurance (Topic 944): Disclosure About Short-Duration Contracts. The amendments apply to all insurance entities that issue short-duration contracts as defined in Topic 944, Financial Services – Insurance. The amendments require insurance entities to disclose for annual reporting periods certain information about the liability for unpaid claims and claim adjustment expenses. The amendments also require insurance entities to disclose information about significant changes in methodologies and assumptions used to calculate the liability for unpaid claims and claim adjustment expenses, including reasons for the change and the effects on the financial statements. Additionally, the amendments require insurance entities to disclose for annual and interim reporting periods a rollforward of the liability for unpaid claims and claim adjustment expenses, described in Topic 944. For health insurance claims, the amendments require the disclosure of the total of incurred-but-not-reported liabilities plus expected development on reported claims included in the liability for unpaid claims and claim adjustment expenses. For public business entities, the amendments in this Update are effective for annual periods beginning after December 15, 2015, and interim periods within annual periods beginning after December 15, 2016. For all other entities, the amendments in this Update are effective for annual periods beginning after December 15, 2016, and interim periods within annual periods beginning after December 15, 2017. This Update is not expected to have a significant impact on the Company’s financial statements.

In June 2015, the FASB issued ASU 2015-10, Technical Corrections and Improvements. The amendments in this Update represent changes to clarify the FASB Accounting Standards Codification (“Codification”), correct unintended application of guidance, or make minor improvements to the Codification that are not expected to have a significant effect on current accounting practice or create a significant administrative cost to most entities. Transition guidance varies based on the amendments in this Update. The amendments in this Update that require transition guidance are effective for all entities for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2015. Early adoption is permitted, including adoption in an interim period. All other amendments will be effective upon the issuance of this Update. This Update is not expected to have a significant impact on the Company’s financial statements.

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

In August 2015, the FASB issued ASU 2015-15, Interest-Imputation of Interest (Subtopic 835-30) Presentation and Subsequent Measurement of Debt Issuance Costs Associated with Line-of-Credit Arrangements Amendments to SEC Paragraphs Pursuant to Staff Announcement at June 18, 2015 EITF Meeting. This ASU adds SEC paragraphs pursuant to the SEC Staff Announcement at the June 18, 2015 Emerging Issues Task Force meeting about the presentation and subsequent measurement of debt issuance costs associated with line-of-credit arrangements. This Update is not expected to have a significant impact on the Company’s financial statements.

In September 2015, the FASB issued ASU 2015-16, Business Combinations (Topic 805). The amendments in this Update require that an acquirer recognize adjustments to provisional amounts that are identified during the measurement period in the reporting period in which the adjustment amounts are determined. The amendments in this Update require that the acquirer record, in the same period's financial statements, the effect on earnings of changes in depreciation, amortization, or other income effects, if any, as a result of the change to the provisional amounts, calculated as if the accounting had been completed at the acquisition date. The amendments in this Update require an entity to present separately on the face of the income statement or disclose in the notes the portion of the amount recorded in current-period earnings by line item that would have been recorded in previous reporting periods if the adjustment to the provisional amounts had been recognized as of the acquisition date. For public business entities, the amendments in this Update are effective for fiscal years beginning after December 15, 2015, including interim periods within those fiscal years. For all other entities, the amendments in this Update are effective for fiscal years beginning after December 15, 2016, and interim periods within fiscal years beginning after December 15, 2017. This Update is not expected to have a significant impact on the Company’s financial statements.

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

Forward-Looking Statements

The Private Securities Litigation Reform Act of 1995 contains safe harbor provisions regarding forward-looking statements. When used in this discussion, the words “believes,” “anticipates,” “contemplates,” “expects,” and similar expressions are intended to identify forward-looking statements. Such statements are subject to certain risks and uncertainties which could cause actual results to differ materially from those projected. Those risks and uncertainties are as follows:

- possible future impairment of intangible assets
- our ability to effectively manage future growth
- loan losses in excess of our allowance
- risks inherent in commercial lending
- real estate collateral which is subject to declines in value
- potential other-than-temporary impairments

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- higher deposit insurance premiums
- soundness of other financial institutions
- increased compliance burden under new financial reform legislation
- current market volatility
- potential liquidity risk
- availability of capital
- regional economic factors
- loss of senior officers
- comparatively low legal lending limits
- risks of new capital requirements
- limited market for the Company's stock
- restrictions on ability to pay dividends
- common stock may lose value
- competitive environment
- issuing additional shares may dilute ownership
- extensive and complex governmental regulation and associated cost
- interest rate risks
- cybersecurity

Norwood Financial Corp. undertakes no obligation to publicly release the results of any revisions to those forward-looking statements which may be made to reflect events or circumstances after the date hereof or to reflect the occurrence of unanticipated events.

Critical Accounting Policies

Note 2 to the Company's consolidated financial statements for the year ended December 31, 2014 (incorporated by reference in Item 8 of the Form 10-K) lists significant accounting policies used in the development and presentation of its financial statements. This discussion and analysis, the significant accounting policies, and other financial statement disclosures identify and address key variables and other qualitative and quantitative factors that are necessary for an understanding and evaluation of the Company and its results of operations.

Material estimates that are particularly susceptible to significant change in the near term relate to the determination of the allowance for loan losses, the valuation of deferred tax assets, the fair value of financial instruments, the determination of goodwill impairment and the determination of other-than-temporary impairment on securities. Please refer to the discussion of the allowance for loan losses calculation under "Allowance for Loan Losses and Non-performing Assets" in the "Changes in Financial Condition" section.

The Company uses the modified prospective transition method to account for stock options. Under this method companies are required to record compensation expense, based on the fair value of options over the vesting period. Restricted shares vest over a five year period. The product of the number of shares granted and the grant date market price of the Company's common stock determines the fair value of restricted stock.

Deferred income taxes reflect temporary differences in the recognition of the revenue and expenses for tax reporting and financial statement purposes, principally because certain items are recognized in different periods for financial reporting and tax return purposes. Although realization is not assured, the Company believes that it is more likely than not that all deferred tax assets will be realized.

Bonds, notes and debentures for which the Company has the positive intent and ability to hold to maturity are reported at cost, adjusted for premiums and discounts that are recognized in interest income using the interest method over the term of the security.

Management determines the appropriate classification of debt securities at the time of purchase and re-evaluates such designation as of each Consolidated Balance Sheet date.

Declines in the fair value of held to maturity and available for sale securities below their cost that are deemed to be other than temporary are reflected in earnings as realized losses. In estimating other-than-temporary impairment losses, the Company considers (1) the length of time and the extent to which the fair value has been less than cost, (2) the financial condition and near-term prospects of the issuer, and (3) the intent of the Company to not sell the securities and it is more likely than not that it will not have to sell the securities before recovery of their cost basis. The Company believes that the unrealized loss on all other securities at September 30, 2015 and December 31, 2014 represent temporary impairment of the securities, related to changes in interest rates.

The Company, as a member of the Federal Home Loan Bank (FHLB) system, is required to maintain an investment in capital stock of its district FHLB according to a predetermined formula. This restricted stock has no quoted market value and is carried at cost.

Management evaluates the restricted stock for impairment. Management's determination of whether these investments are impaired is based on their assessment of the ultimate recoverability of their cost rather than by recognizing temporary declines in value. The determination of whether a decline affects the ultimate recoverability of their cost is influenced by criteria such as (1) the significance of the decline in net assets of the FHLB as compared to the capital stock amount for the FHLB and the length of time this situation has persisted, (2) commitments by the FHLB to make payments required by law or regulation and the level of such payments in relation to the operating performance of the FHLB, and (3) the impact of legislative and regulatory changes on institutions and, accordingly, on the customer base of the FHLB.

Management considered that the FHLB's regulatory capital ratios have increased from prior years, liquidity appears adequate, and the new shares of FHLB stock continue to change hands at the $100 par value. Management believes no impairment charge is necessary related to FHLB stock as of September 30, 2015.

In connection with the acquisition of North Penn Bancorp, Inc. ("North Penn"), the Company recorded goodwill in the amount of $9.7 million, representing the excess of amounts paid over the fair value of net assets of the institution acquired in a purchase transaction, at its fair value at the date of acquisition. Goodwill is tested and deemed impaired when the carrying value of goodwill exceeds its implied fair value. The value of the goodwill can change in the future. We expect the value of the goodwill to decrease if there is a significant decrease in the franchise value of the Bank. If an impairment loss is determined in the future, we will reflect the loss as an expense for the period in which the impairment is determined, leading to a reduction of our net income for that period by the amount of the impairment loss.

Changes in Financial Condition

General

Total assets as of September 30, 2015 were $749.3 million compared to $711.6 million as of December 31, 2014, an increase of $37.7 million due primarily to a $42.4 million increase in loans receivable which was funded by an $11.4 million increase in deposits, a $7.0 million increase in term borrowings and a $15.8 million increase in short-term borrowings.

Securities

The fair value of securities available for sale as of September 30, 2015 was $153.3 million compared to $156.4 million as of December 31, 2014. The Company purchased $45.0 million of securities principally using the proceeds from $48.3 million of sales, maturities and principal reductions of securities.

The carrying value of the Company's securities portfolio (Available-for Sale and Held-to Maturity) consisted of the following:

	September 30, 2015			December 31, 2014		
(dollars in thousands)	Amount	% of portfolio		Amount	% of portfolio	
U.S. Government agencies	$18,360	12.0	%	$28,975	18.5	%
States and political subdivisions	62,930	41.1		54,332	34.7	
Corporate obligations	5,058	3.3		6,486	4.2	
Mortgage-backed securities- government sponsored entities	66,589	43.4		66,204	42.3	
Equity securities-financial services	368	0.2		398	0.3	
Total	$153,305	100.0	%	$156,395	100.0	%

The Company has securities in an unrealized loss position. In management's opinion, the unrealized losses reflect changes in interest rates subsequent to the acquisition of specific securities. Management believes that the unrealized losses on all holdings represent temporary impairment of the securities, as the Company has the intent and ability to hold these investments until maturity or market price recovery.

Loans

Loans receivable totaled $543.5 million at September 30, 2015 compared to $501.1 million as of December 31, 2014. The $42.4 million increase recorded in the nine-month period ending September 30, 2015 was attributed to a $25.7 million increase in commercial loans, primarily municipal financing, and a $7.5 million increase in consumer loans due to indirect dealer financing. Commercial real estate loans increased $4.1 million during the period while residential mortgage loans increased $4.2 million.

The allowance for loan losses totaled $5,747,000 as of September 30, 2015 and represented 1.06% of total loans, compared to $5,875,000, or 1.17% of total loans, at December 31, 2014, and $5,651,000, or 1.13% of total loans, as of September 30, 2014. The Company had net charge-offs for the nine months ended September 30, 2015 of $1,888,000 compared to $1,317,000 in the corresponding period in 2014. The Company's loan review process assesses the adequacy of the allowance for loan losses on a quarterly basis. The process includes an analysis of the risks inherent in the loan portfolio. It includes an analysis of impaired loans and a historical review of credit losses by loan type. Other factors considered include: concentration of credit in specific industries, economic and industry conditions, trends in delinquencies and loan classifications, large dollar exposures and loan growth. Management considers the allowance adequate at September 30, 2015 based on the Company's criteria. However, there can be no assurance that the allowance for loan losses will be adequate to cover significant losses, if any, that might be incurred in the future.

As of September 30, 2015, non-performing loans totaled $9.1 million, or 1.69% of total loans compared to $5.6 million, or 1.12% of total loans at December 31, 2014. The increase was due primarily to the transfer of a $5.0 million credit to nonaccrual status during the second quarter of 2015 due to weak cash flow projections. At September 30, 2015, non-performing assets totaled $10.5 million, or 1.40%, of total assets compared to $9.3 million, or 1.31%, of total assets at December 31, 2014. The increase includes the transfer of the previously mentioned credit to nonaccrual status, which was partially offset by a reduction in foreclosed real estate owned due to the sale of a property with a carrying value of $1.9 million as of December 31, 2014.

The following table sets forth information regarding non-performing loans and foreclosed real estate at the dates indicated:

(dollars in thousands)	September 30, 2015			December 31, 2014		
Loans accounted for on a non-accrual basis:						
Commercial	$	-		$	-	
Real Estate		9,130			5,596	
Consumer		1			4	
Total non-accrual loans *		9,131			5,600	
Accruing loans which are contractually past due 90 days or more		-			-	
Total non-performing loans		9,131			5,600	
Foreclosed real estate		1,345			3,726	
Total non-performing assets	$	10,476		$	9,326	
Allowance for loans losses	$	5,747		$	5,875	
Coverage of non-performing loans		62.94	X		104.91	X
Non-performing loans to total loans		1.69	%		1.12	%
Non-performing loans to total assets		1.22	%		0.79	%
Non-performing assets to total assets		1.40	%		1.31	%

*Includes non-accrual TDRs of $7.4 million as of September 30, 2015 and $2.2 million on December 31, 2014. The Company also had $1.1 million and $6.6 million of accruing TDRs on those dates.

Deposits

During the period, total deposits increased $11.4 million due primarily to a $17.2 million increase in non-interest bearing demand deposits and a $15.4 million increase in NOW and money market accounts, which was partially offset by a $20.4 million decrease in time deposits over $100,000. The decrease in certificates of deposit over $100,000 is seasonal as municipalities utilized funds to meet cash flow needs. All other deposit products increased $800,000, net.

The following table sets forth deposit balances as of the dates indicated:

(dollars in thousands)	September 30, 2015		December 31, 2014	
Non-interest bearing demand	$	115,313	$	98,064

Interest bearing demand		56,430		46,441
Money market deposit accounts		126,041		120,603
Savings		74,875		73,004
Time deposits <$100,000		123,388		126,118
Time deposits >$100,000		75,306		95,714
Total	$	571,353	$	559,944

Borrowings

Short-term borrowings as of September 30, 2015 totaled $41.5 million compared to $25.7 million as of December 31, 2014. Short-term borrowings, which consist of securities sold under agreements to repurchase and overnight borrowings from the FHLB, increased $15.8 million principally due to a $14.1 million increase in overnight borrowings from the FHLB to meet temporary cash flow needs.

Other borrowings consisted of the following:

(dollars in thousands)

	September 30, 2015	December 31, 2014
Notes with the FHLB:		
Convertible note due July 2015 at 4.34%	$ -	$ 7,111
Convertible note due January 2017 at 4.71%	10,000	10,000
Amortizing fixed rate borrowing due January 2018 at 0.91%	1,417	1,866
Amortizing fixed rate borrowing due December 2018 at 1.425%	2,632	3,223
Amortizing fixed rate borrowing due June 2020 at 1.490%	9,518	-
Amortizing fixed rate borrowing due March 2022 at 1.748%	5,595	-
	$ 29,162	$ 22,200

The convertible note contains an option which allows the FHLB, at quarterly intervals to change the note to an adjustable-rate advance at three month LIBOR plus 17 basis points. If the note is converted, the option allows the Bank to put the funds back to the FHLB at no charge.

Stockholders' Equity and Capital Ratios

As of September 30, 2015, stockholders' equity totaled $101.9 million, compared to $99.0 million as of December 31, 2014. The net change in stockholders' equity included $5.8 million of net income that was partially offset by $3.4 million of dividends declared, a $127,000 reduction due to an increase in Treasury Stock, and a $310,000 increase due to the exercise and vesting of stock options. In addition, total equity increased $259,000 due to an increase in the fair value of securities in the available for sale portfolio, net of tax. This increase in fair value is the result of a change in interest rates and spreads, which may impact the value of the securities. Because of interest rate volatility, the Company's accumulated other comprehensive income could materially fluctuate for each interim and year-end period.

A comparison of the Company's consolidated regulatory capital ratios is as follows:

	September 30, 2015	December 31, 2014
Tier 1 Capital		

(To average assets)	12.44	%	12.58	%
Tier 1 Capital				
(To risk-weighted assets)	16.48	%	17.33	%
Common Equity Tier 1 Capital				
(To risk-weighted assets)	16.48	%	N/A	
Total Capital				
(To risk-weighted assets)	17.52	%	18.49	%

Effective January 1, 2015, the Company and the Bank became subject to new regulatory capital rules which, among other things, impose a new common equity Tier 1 minimum capital requirement (4.5% of risk-weighted assets), set the minimum leverage ratio for all banking organizations at a uniform 4% of total assets, increased the minimum Tier 1 capital to risk-based assets requirement (from 4% to 6% of risk-weighted assets) and assigned a higher risk-weight (150%) to exposures that are more than 90 days past due or are on nonaccrual status and to certain commercial real estate facilities that finance the acquisition, development or construction of real property. The new rules also require unrealized gains and losses on certain "available-for-sale" securities holdings to be included for purposes of calculating regulatory capital requirements unless a one-time opt out is exercised, which the Company and the Bank have done. The final rule limits a banking organization's dividends, stock repurchases and other capital distributions, and certain discretionary bonus payments to executive officers, if the banking organization does not hold a "capital conservation buffer" consisting of 2.5% of common equity Tier 1 capital to risk-weighted assets above regulatory minimum risk-based requirements. The capital conservation buffer requirements will be phased in beginning January 1, 2016 and ending January 1, 2019, when the full capital conservation buffer will be effective. The Company and the Bank are in compliance with their respective new capital requirements, including the capital conservation buffer, as of September 30, 2015.

Liquidity

As of September 30, 2015, the Company had cash and cash equivalents of $11.7 million in the form of cash, due from banks and short-term deposits with other institutions. In addition, the Company had total securities available for sale of $153.3 million which could be used for liquidity needs. This totals $165.0 million of liquidity and represents 22.0% of total assets compared to $168.8 million and 23.7% of total assets as of December 31, 2014. The Company also monitors other liquidity measures, all of which were within the Company's policy guidelines as of September 30, 2015 and December 31, 2014. Based upon these measures, the Company believes its liquidity is adequate.

Capital Resources

The Company has a line of credit commitment available from the Federal Home Loan Bank (FHLB) of Pittsburgh for borrowings of up to $20,000,000 which expires in December 2016. Borrowings under this line totaled $14.1 million at September 30, 2015. There were no borrowings under this line as of December 31, 2014.

The Company has a line of credit commitment from Atlantic Community Bankers Bank for $7,000,000 which expires June 30, 2016. There were no borrowings under this line as of September 30, 2015 and December 31, 2014.

The Company has a line of credit commitment available which has no stated expiration date from PNC Bank for $16,000,000. There were no borrowings under this line as of September 30, 2015 and December 31, 2014.

The Company has a line of credit commitment available which has no stated expiration date from Zions Bank for $17,000,000. There were no borrowings under this line as of September 30, 2015 and December 31, 2014.

The Bank's maximum borrowing capacity with the Federal Home Loan Bank was approximately $284,000,000 as of September 30, 2015, of which $43,277,000 and $22,200,000 was outstanding at September 30, 2015 and December 31, 2014, respectively. Advances from the Federal Home Loan Bank are secured by qualifying assets of the Bank.

Non-GAAP Financial Measures

This report contains or references fully taxable-equivalent (fte) interest income and net interest income, which are non-GAAP financial measures. Interest income (fte) and net interest income (fte) are derived from GAAP interest income and net interest income using an assumed tax rate of 34%. We believe the presentation of interest income (fte) and net interest income (fte) ensures comparability of interest income and net interest income arising from both taxable and tax-exempt sources and is consistent with industry practice. Net interest income (fte) is reconciled to GAAP net interest income on pages 43 and 47. Although the Company believes that these non-GAAP financial measures enhance investors' understanding of our business and performance, these non-GAAP financial measures should not be considered an alternative to GAAP measures.

Results of Operations
NORWOOD FINANCIAL CORP.
Consolidated Average Balance Sheets with Resultant Interest and Rates

(Tax-Equivalent Basis, dollars in thousands)	Three Months Ended September 30,					
	2015			2014		
	Average Balance (2)	Interest (1)	Average Rate (3)	Average Balance (2)	Interest (1)	Average Rate (3)
Assets						
Interest-earning assets:						
Interest bearing deposits with banks	$ 4,508	$ 3	0.27 %	$ 2,015	$ 1	0.20 %
Securities available for sale:						
Taxable	93,051	454	1.95	101,199	512	2.02
Tax-exempt (1)	60,100	692	4.61	56,105	691	4.93
Total securities available for sale (1)	153,151	1,146	2.99	157,304	1,203	3.06
Loans receivable (1) (4) (5)	539,487	6,083	4.51	500,739	6,050	4.83
Total interest-earning assets	697,146	7,232	4.15	660,058	7,254	4.40
Non-interest earning assets:						
Cash and due from banks	9,016			8,792		
Allowance for loan losses	(5,815)			(5,751)		
Other assets	43,808			46,981		
Total non-interest earning assets	47,009			50,022		
Total Assets	$ 744,155			$ 710,080		
Liabilities and Stockholders' Equity						
Interest-bearing liabilities:						
Interest bearing demand and money market	$ 182,645	$ 79	0.17	$ 179,665	$ 74	0.16
Savings	75,321	10	0.05	72,625	9	0.05
Time	203,658	522	1.03	195,816	517	1.05
Total interest-bearing deposits	461,624	611	0.53	448,106	600	0.53
Short-term borrowings	33,175	19	0.23	36,552	19	0.22

Other borrowings	30,541	189	2.48	22,797	168	2.95
Total interest-bearing liabilities	525,340	819	0.62	507,455	787	0.62
Non-interest bearing liabilities:						
Demand deposits	113,094			100,720		
Other liabilities	4,376			4,479		
Total non-interest bearing liabilities	117,470			105,199		
Stockholders' equity	101,345			97,426		
Total Liabilities and Stockholders' Equity	$ 744,155			$ 710,080		
Net interest income (tax equivalent basis)		6,413	3.53 %		6,467	3.78 %
Tax-equivalent basis adjustment		(360)			(313)	
Net interest income		$ 6,053			$ 6,154	
Net interest margin (tax equivalent basis)			3.68 %			3.92 %

(1) Interest and yields are presented on a tax-equivalent basis using a marginal tax rate of 34%.
(2) Average balances have been calculated based on daily balances.
(3) Annualized
(4) Loan balances include non-accrual loans and are net of unearned income.
(5) Loan yields include the effect of amortization of deferred fees, net of costs.

Rate/Volume Analysis. The following table shows the fully taxable equivalent effect of changes in volumes and rates on interest income and interest expense.

	Increase/(Decrease) Three months ended September 30, 2015 Compared to Three months ended September 30, 2014 Variance due to		
	Volume	Rate	Net
	(dollars in thousands)		
Interest earning assets:			
Interest bearing deposits with banks	$ 1	$ 1	$ 2
Securities available for sale:			
Taxable	(41)	(17)	(58)
Tax-exempt securities	48	(47)	1
Total securities	7	(64)	(57)
Loans receivable	451	(418)	33
Total interest earning assets	459	(481)	(22)
Interest bearing liabilities:			
Interest-bearing demand and money market	1	4	5
Savings	1	-	1
Time	18	(12)	6
Total interest bearing deposits	20	(8)	12
Short-term borrowings	(2)	1	(1)
Other borrowings	53	(32)	21
Total interest bearing liabilities	71	(39)	32
Net interest income (tax-equivalent basis)	$ 388	$ (442)	$ (54)

Changes in net interest income that could not be specifically identified as either a rate or volume change were allocated proportionately to changes in volume and changes in rate.

Comparison of Operating Results for The Three Months Ended September 30, 2015 to September 30, 2014

General

For the three months ended September 30, 2015, net income totaled $1,777,000 compared to $2,118,000 earned in the similar period in 2014. The decrease in net income for the three months ended September 30, 2015 was due primarily to a $210,000 decrease in gains on the sales of loans and securities and an additional $300,000 provision for loan losses. Earnings per share for the current period were $.48 for basic and fully diluted compared to $.58 per basic and fully diluted share for the three months ended September 30, 2014. The resulting annualized return on average assets and annualized return on average equity for the three months ended September 30, 2015 were 0.95% and 6.95%, respectively, compared to 1.18% and 8.62%, respectively, for the similar period in 2014.

The following table sets forth changes in net income:

(dollars in thousands)	Three months ended September 30, 2015 to September 30, 2014		
Net income three months ended September 30, 2014	$	2,118	
Change due to:			
Net interest income		(101	)
Provision for loan losses		(300	)
Net gain on sales of loans and securities		(210	)
Other income		19	
Salaries and employee benefits		(147	)
Occupancy, furniture and equipment		32	
Foreclosed real estate owned		224	
All other expenses		(55	)
Income tax expense		197	
Net income three months ended September 30, 2015	$	1,777	

Net Interest Income

Net interest income on a fully taxable equivalent basis (fte) for the three months ended September 30, 2015 totaled $6,413,000 which was $54,000 lower than the comparable period in 2014. The decrease in net interest income largely reflects reduced earnings on loans due to growth and repricing in the current low interest rate environment. The fte net interest spread and net interest margin were 3.53% and 3.68%, respectively, for the three months ended September 30, 2015 compared to 3.78% and 3.92%, respectively, for the similar period in 2014.

Interest income (fte) totaled $7,232,000 with a yield on average earning assets of 4.15% compared to $7,254,000 and 4.40% for the 2014 period. Average loans increased $38.7 million over the comparable period of last year but a 32 basis point reduction in the yield earned limited additional earnings to $33,000 of fte loan income. Average earning assets totaled $697.1 million for the three months ended September 30, 2015, an increase of $37.1 million over the average for the similar period in 2014. This increase in average earning assets largely offset the decline in loan yields.

Interest expense for the three months ended September 30, 2015 totaled $819,000 at an average cost of 0.62% compared to $787,000 and 0.62% for the similar period in 2014. The cost of time deposits, which is the most significant component of funding, declined to 1.03% from 1.05% for the similar period in the prior year. As time deposits matured, they repriced at the current lower rates resulting in the decrease. New term borrowings added $21,000 of interest expense compared to the same period of last year, but lower rates on the borrowings reduced the overall cost of this funding source from 2.92% to 2.48%.

Provision for Loan Losses

The Company's provision for loan losses for the three months ended September 30, 2015 was $720,000 compared to $420,000 for the three months ended September 30, 2014. The Company makes provisions for loan losses in an amount necessary to maintain the allowance for loan losses at an acceptable level. Net charge-offs were $920,000 for the quarter ended September 30, 2015 compared to $380,000 for the similar period in 2014.

Other Income

Other income totaled $1,071,000 for the three months ended September 30, 2015 compared to $1,262,000 for the similar period in 2014. Net gains from the sale of loans and securities decreased $210,000 compared to the same period of 2014 due to reduced activity. All other items of other income increased $19,000, net, compared to the third quarter of last year.

Other Expense

Other expense for the three months ended September 30, 2015 totaled $4,070,000 which was $54,000 lower than the same period of 2014. Costs associated with foreclosed real estate properties decreased $224,000 compared to the same three months of last year while salaries and employee benefits increased $147,000 due to incentive accruals. All other operating expenses increased $23,000, net.

Income Tax Expense

Income tax expense totaled $557,000 for an effective tax rate of 23.9% for the period ending September 30, 2015 compared to $754,000 for an effective tax rate of 26.3% for the similar period in 2014.

Results of Operations
NORWOOD FINANCIAL CORP.
Consolidated Average Balance Sheets with Resultant Interest and Rates

(Tax-Equivalent Basis, dollars in thousands)	Nine Months Ended September 30,					
	2015			2014		
	Average Balance (2)	Interest (1)	Average Rate (3)	Average Balance (2)	Interest (1)	Average Rate (3)
Assets						
Interest-earning assets:						
Interest bearing deposits with banks	$ 7,960	$ 15	0.25 %	$ 1,775	$ 3	0.23 %
Securities held-to-maturity (1)	-	-	-	77	5	8.66
Securities available for sale:						
Taxable	97,310	1,509	2.07	99,847	1,513	2.02
Tax-exempt (1)	59,068	2,084	4.70	59,204	2,219	5.00
Total securities available for sale (1)	156,378	3,593	3.06	159,051	3,732	3.13
Loans receivable (1) (4) (5)	523,269	18,230	4.65	500,593	18,093	4.82
Total interest-earning assets	687,607	21,838	4.23	661,496	21,833	4.40
Non-interest earning assets:						
Cash and due from banks	8,492			8,303		
Allowance for loan losses	(6,001)			(5,836)		
Other assets	45,052			44,469		
Total non-interest earning assets	47,543			46,936		
Total Assets	$ 735,150			$ 708,432		
Liabilities and Stockholders' Equity						
Interest-bearing liabilities:						
Interest-bearing demand and money market	$ 178,248	$ 226	0.17	$ 175,069	$ 231	0.18
Savings	74,756	28	0.05	71,445	26	0.05
Time	214,076	1,579	0.98	203,434	1,595	1.05
Total interest-bearing deposits	467,080	1,833	0.52	449,948	1,852	0.55
Short-term borrowings	29,065	47	0.22	38,938	62	0.21
Other borrowings	28,056	553	2.63	23,183	501	2.88

Total interest bearing liabilities	524,201	2,433	0.62	512,069	2,415	0.63
Non-interest bearing liabilities:						
Demand deposits	105,677			96,282		
Other liabilities	4,250			4,202		
Total non-interest bearing liabilities	109,927			100,484		
Stockholders' equity	101,022			95,879		
Total Liabilities and Stockholders' Equity	$ 735,150			$ 708,432		
Net interest income (tax equivalent basis)		19,405	3.62 %		19,418	3.77 %
Tax-equivalent basis adjustment		(996)			(964)	
Net interest income		$ 18,409			$ 18,454	
Net interest margin (tax equivalent basis)			3.76 %			3.91 %

(1) Interest and yields are presented on a tax-equivalent basis using a marginal tax rate of 34%.
(2) Average balances have been calculated based on daily balances.
(3) Annualized
(4) Loan balances include non-accrual loans and are net of unearned income.
(5) Loan yields include the effect of amortization of deferred fees, net of costs.

Rate/Volume Analysis. The following table shows the fully taxable equivalent effect of changes in volumes and rates on interest income and interest expense.

	Increase/(Decrease) Nine months ended September 30, 2015 Compared to Nine months ended September 30, 2014		
	Variance due to		
	Volume	Rate	Net
	(dollars in thousands)		
Interest earning assets:			
Interest bearing deposits with banks	$ 11	$ 1	$ 12
Securities held to maturity	(5)	-	(5)
Securities available for sale:			
Taxable	(27)	23	(4)
Tax-exempt securities	(23)	(112)	(135)
Total securities	(50)	(89)	(139)
Loans receivable	555	(418)	137
Total interest earning assets	511	(506)	5
Interest bearing liabilities:			
Interest-bearing demand and money market	6	(11)	(5)