AMERISERV FINANCIAL INC /PA/
Form 10-Q
November 09, 2018

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

FORM 10-Q

Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
For the quarterly period ended September 30, 2018
Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
For the transition period from to
Commission File Number 0-11204

AmeriServ Financial, Inc.
(Exact name of registrant as specified in its charter)

Pennsylvania	25-1424278
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

Main & Franklin Streets,	
P.O. Box 430, Johnstown, PA	15907-0430
(Address of principal executive offices)	(Zip Code)

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

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No
Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit such files). Yes No
Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a smaller reporting company, or an emerging growth company. See the definitions of "large accelerated filer," "accelerated filer," "smaller reporting company," and "emerging growth company" in Rule 12b-2 of the Exchange Act.

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

Emerging growth company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.
Indicate by check mark whether the registrant is a shell company (as defined by Rule 12b-2 of the Exchange Act).
Yes No
Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

Class	Outstanding at November 1, 2018
Common Stock, par value $0.01	17,746,691

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Item 1. Financial Statements
AmeriServ Financial, Inc.

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

	September 30, 2018	December 31, 2017
ASSETS		
Cash and due from depository institutions	$ 23,806	$ 26,234
Interest bearing deposits	2,699	2,698
Short-term investments in money market funds	4,729	5,256
Total cash and cash equivalents	31,234	34,188
Investment securities:		
Available for sale, at fair value	138,753	129,138
Held to maturity (fair value $37,345 on September 30, 2018 and $38,811 on December 31, 2017)	38,673	38,752
Loans held for sale	1,041	3,125
Loans	883,672	890,032
Less: Unearned income	339	399
Allowance for loan losses	9,439	10,214
Net loans	873,894	879,419
Premises and equipment, net	12,276	12,734
Accrued interest income receivable	4,007	3,603
Goodwill	11,944	11,944
Bank owned life insurance	38,260	37,860
Net deferred tax asset	5,985	5,963
Federal Home Loan Bank stock	5,010	4,675
Federal Reserve Bank stock	2,125	2,125
Other assets	5,604	4,129
TOTAL ASSETS	$ 1,168,806	$ 1,167,655
LIABILITIES		
Non-interest bearing deposits	$ 152,959	$ 183,603
Interest bearing deposits	791,254	764,342
Total deposits	944,213	947,945
Short-term borrowings	61,254	49,084
Advances from Federal Home Loan Bank	42,545	46,229
Guaranteed junior subordinated deferrable interest debentures, net	12,935	12,923
Subordinated debt, net	7,482	7,465
Total borrowed funds	124,216	115,701
Other liabilities	3,198	8,907
TOTAL LIABILITIES	1,071,627	1,072,553

SHAREHOLDERS’ EQUITY		
Common stock, par value $0.01 per share; 30,000,000 shares authorized; 26,609,811 shares issued and 17,767,313 outstanding on September 30, 2018; 26,585,403 shares issued and 18,128,247 outstanding on December 31, 2017	266	266
Treasury stock at cost, 8,842,498 shares on September 30, 2018 and 8,457,156 on December 31, 2017	(79,941)	(78,233)
Capital surplus	145,779	145,707
Retained earnings	45,160	40,312
Accumulated other comprehensive loss, net	(14,085)	(12,950)
TOTAL SHAREHOLDERS’ EQUITY	97,179	95,102
TOTAL LIABILITIES AND SHAREHOLDERS’ EQUITY	$ 1,168,806	$ 1,167,655

See accompanying notes to unaudited consolidated financial statements.

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AmeriServ Financial, Inc.

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

	Three months ended September 30,		Nine months ended September 30,	
	2018	2017	2018	2017
INTEREST INCOME				
Interest and fees on loans	$ 10,607	$ 9,855	$ 30,550	$ 29,189
Interest bearing deposits	5	3	14	8
Short-term investments in money market funds	60	42	150	93
Investment securities:				
Available for sale	1,144	973	3,274	2,819
Held to maturity	333	314	981	877
Total Interest Income	12,149	11,187	34,969	32,986
INTEREST EXPENSE				
Deposits	2,164	1,618	5,918	4,558
Short-term borrowings	267	44	529	130
Advances from Federal Home Loan Bank	199	178	577	511
Guaranteed junior subordinated deferrable interest debentures	280	280	840	840
Subordinated debt	130	130	390	390
Total Interest Expense	3,040	2,250	8,254	6,429
NET INTEREST INCOME	9,109	8,937	26,715	26,557
Provision for loan losses	—	200	100	750
NET INTEREST INCOME AFTER PROVISION FOR LOAN LOSSES	9,109	8,737	26,615	25,807
NON-INTEREST INCOME				
Wealth management fees	2,359	2,208	7,232	6,758
Service charges on deposit accounts	326	409	1,066	1,168
Net gains on sale of loans	176	217	393	517
Mortgage related fees	54	69	165	227
Net realized gains (losses) on investment securities	—	56	(148)	115
Bank owned life insurance	135	143	400	594
Other income	536	527	1,794	1,567
Total Non-Interest Income	3,586	3,629	10,902	10,946
NON-INTEREST EXPENSE				
Salaries and employee benefits	5,815	5,943	18,126	17,808
Net occupancy expense	585	634	1,866	1,947
Equipment expense	335	343	1,104	1,196
Professional fees	1,321	1,213	3,757	3,828
Supplies, postage and freight	159	161	491	516

Miscellaneous taxes and insurance	276	319	842	924
Federal deposit insurance expense	140	156	457	468
Other expense	1,483	1,345	3,901	3,829
Total Non-Interest Expense	10,114	10,114	30,544	30,516
PRETAX INCOME	2,581	2,252	6,973	6,237
Provision for income tax expense	252	701	1,133	1,949
NET INCOME	2,329	1,551	5,840	4,288

See accompanying notes to unaudited consolidated financial statements.

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

	Three months ended September 30,		Nine months ended September 30,	
	2018	2017	2018	2017
PER COMMON SHARE DATA:				
Basic:				
Net income	$ 0.13	$ 0.08	$ 0.32	$ 0.23
Average number of shares outstanding	17,924	18,380	18,013	18,590
Diluted:				
Net income	$ 0.13	$ 0.08	$ 0.32	$ 0.23
Average number of shares outstanding	18,036	18,481	18,117	18,689
Cash dividends declared	$ 0.020	$ 0.015	$ 0.055	$ 0.045

See accompanying notes to unaudited consolidated financial statements.

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
COMPREHENSIVE INCOME				
Net income	$ 2,329	$ 1,551	$ 5,840	$ 4,288
Other comprehensive income (loss), before tax:				
Pension obligation change for defined benefit plan	390	396	1,824	870
Income tax effect	(82)	(135)	(383)	(297)
Unrealized holding gains (losses) on available for sale securities arising during period	(919)	176	(3,409)	538
Income tax effect	193	(60)	716	(182)
Reclassification adjustment for (gains) losses on available for sale securities included in net income	—	(56)	148	(115)
Income tax effect	—	19	(31)	39
Other comprehensive income (loss)	(418)	340	(1,135)	853
Comprehensive income	$ 1,911	$ 1,891	$ 4,705	$ 5,141

See accompanying notes to unaudited consolidated financial statements.

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

	Nine months ended September 30, 2018	2017
OPERATING ACTIVITIES		
Net income	$ 5,840	$ 4,288
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for loan losses	100	750
Depreciation expense	1,149	1,224
Net amortization of investment securities	273	346
Net realized (gains) losses on investment securities available for sale	148	(115)
Net gains on sale of loans	(393)	(517)
Amortization of deferred loan fees	(115)	(117)
Origination of mortgage loans held for sale	(23,361)	(34,045)
Sales of mortgage loans held for sale	25,838	35,876
Increase in accrued interest income receivable	(404)	(387)
Increase (decrease) in accrued interest payable	366	(18)
Earnings on bank owned life insurance	(400)	(427)
Deferred income taxes	249	975
Stock based compensation expense	72	170
Other, net	(5,534)	(2,463)
Net cash provided by operating activities	3,828	5,540
INVESTING ACTIVITIES		
Purchases of investment securities – available for sale	(30,371)	(27,581)
Purchases of investment securities – held to maturity	(3,405)	(9,465)
Proceeds from sales of investment securities – available for sale	4,479	8,143
Proceeds from maturities of investment securities – available for sale	12,662	17,341
Proceeds from maturities of investment securities – held to maturity	3,417	1,054
Purchases of regulatory stock	(14,193)	(12,894)
Proceeds from redemption of regulatory stock	13,858	11,824
Long-term loans originated	(124,519)	(122,029)
Principal collected on long-term loans	139,836	112,626
Loans purchased or participated	(11,443)	(6,121)
Loans sold or participated	1,500	2,800
Proceeds from sale of other real estate owned	34	60
Proceeds from life insurance policies	—	614
Purchases of premises and equipment	(691)	(2,188)

Net cash used in investing activities	(8,836)	(25,816)

See accompanying notes to unaudited consolidated financial statements.

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

	Nine months ended September 30, 2018	2017
FINANCING ACTIVITIES		
Net decrease in deposit balances	(3,732)	(865)
Net increase in other short-term borrowings	12,170	20,839
Principal borrowings on advances from Federal Home Loan Bank	6,316	9,500
Principal repayments on advances from Federal Home Loan Bank	(10,000)	(11,000)
Purchase of treasury stock	(1,708)	(2,757)
Common stock dividends	(992)	(839)
Net cash provided by financing activities	2,054	14,878
NET DECREASE IN CASH AND CASH EQUIVALENTS	(2,954)	(5,398)
CASH AND CASH EQUIVALENTS AT JANUARY 1	34,188	34,073
CASH AND CASH EQUIVALENTS AT SEPTEMBER 30	$ 31,234	$ 28,675

See accompanying notes to unaudited consolidated financial statements.

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AmeriServ Financial, Inc.

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

1.

Principles of Consolidation

The accompanying consolidated financial statements include the accounts of AmeriServ Financial, Inc. (the Company) and its wholly-owned subsidiaries, AmeriServ Financial Bank (the Bank), AmeriServ Trust and Financial Services Company (the Trust Company), and AmeriServ Life Insurance Company (AmeriServ Life). The Bank is a Pennsylvania state-chartered full service bank with 15 locations in Pennsylvania. The Trust Company offers a complete range of trust and financial services and administers assets valued at $2.3 billion that are not reported on the Company’s Consolidated Balance Sheet at September 30, 2018. AmeriServ Life is a captive insurance company that engages in underwriting as a reinsurer of credit life and disability insurance.

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

2.

Basis of Preparation

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

For further information, refer to the consolidated financial statements and accompanying notes included in the Company’s Annual Report on Form 10-K for the year ended December 31, 2017.

3.

Recent Accounting Pronouncements

In February 2016, the FASB issued ASU 2016-02, Leases (Topic 842). The standard requires lessees to recognize the assets and liabilities that arise from leases on the balance sheet. A lessee should recognize in the statement of financial position a liability to make lease payments (the lease liability) and a right-of-use asset representing its right to use the underlying asset for the lease term. A short-term lease is defined as one in which (a) the lease term is 12 months or less and (b) there is not an option to purchase the underlying asset that the lessee is reasonably certain to exercise. For short-term leases, lessees may elect to recognize lease payments over the lease term on a straight-line basis. For public business entities, the amendments in this Update are effective for fiscal years beginning after December 15, 2018, and interim periods within those years. For all other entities, the amendments in this Update are effective for fiscal years beginning after December 15, 2019, and for interim periods within fiscal years beginning after December 15, 2020. The amendments should be applied at the beginning of the earliest period presented using a modified retrospective approach with earlier application permitted as of the beginning of an interim or annual reporting period. The Company is currently assessing the practical measures it may elect at adoption, but does not anticipate the amendment will have a significant impact to the financial statements. Based on the Company’s preliminary analysis of its current portfolio, the Company expects to recognize a right of use asset and a lease liability for its operating leases commitments. The Company also anticipates additional disclosures to be provided at adoption.

In June 2016, the FASB issued ASU 2016-13, Financial Instruments — Credit Losses: Measurement of Credit Losses on Financial Instruments (“ASU 2016-13”), which changes the impairment model for most financial assets. This Update is intended to improve financial reporting by requiring timelier recording of credit losses on loans and other financial instruments held by financial institutions and other organizations. The underlying premise of the Update is that financial assets measured at amortized cost should be presented at the net amount expected to be collected, through an allowance for credit losses that is deducted from the amortized cost basis. The allowance for credit losses should reflect management’s current estimate of credit losses that are expected to occur over the remaining life of a financial asset. The income statement will be effected for the measurement of credit losses for newly recognized financial assets, as well as the

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expected increases or decreases of expected credit losses that have taken place during the period. ASU 2016-13 is effective for annual and interim periods beginning after December 15, 2019, and early adoption is permitted for annual and interim periods beginning after December 15, 2018. With certain exceptions, transition to the new requirements will be through a cumulative effect adjustment to opening retained earnings as of the beginning of the first reporting period in which the guidance is adopted. The Company is currently evaluating the impact that the Update will have on our consolidated financial statements. The overall impact of the amendment will be affected by the portfolio composition and quality at the adoption date as well as economic conditions and forecasts at that time.

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

4.
Adoption of Accounting Standards

Effective January 1, 2018, the Company adopted ASU 2014-09, Revenue from Contracts with Customers — Topic 606 and all subsequent ASUs that modified ASC 606. The standard required a company to recognize the amount of revenue to which it expects to be entitled for the transfer of promised goods or services to customers at the time the transfer of goods or services takes place. The Company completed an assessment of revenue streams and review of the related contracts potentially affected by the new standard and concluded that ASU 2014-09 did not materially change the method in which it recognizes revenue. Therefore, implementation of the new standard had no material impact to the measurement or recognition of revenue of prior periods. However, additional disclosures were added in the current period, which can be found in Note 5.

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

The Company has adopted this standard during the reporting period. On a prospective basis, the Company implemented changes to the measurement of the fair value of financial instruments using an exit price notion for disclosure purposes included in Note 19 to the financial statements. The December 31, 2017, fair value of each class of financial instruments disclosure did not utilize the exit price notion when measuring fair value and, therefore, would not be comparable to the September 30, 2018 disclosure. The Company estimated the fair value based on guidance from ASC 820-10, Fair Value Measurements, which defines fair value as the price which would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. There is no active observable market for sale information on many types of community bank loans and, thus, Level III fair value procedures were utilized, primarily in the use of present value techniques incorporating assumptions that market participants would use in estimating fair values.

In March 2017, the FASB issued ASU 2017-07, Compensation — Retirement Benefits (Topic 715). The amendments in this Update require that an employer report the service cost component in the same line item or items as other compensation costs arising from services rendered by the pertinent employees during the period. The other components of net benefit cost are required to be presented in the income statement separately from the service cost component. The Company adopted the standard on January 1, 2018, which resulted in a reclassification of $(22,000) and $(62,000), for the third quarter of 2018 and 2017, respectively, and $(66,000) and $(186,000) for the nine month period ending September 30, 2018 and 2017, respectively, from Salaries and employee benefits into Other expense on the Consolidated Statement of Operations. See Note 18 for additional information on the presentation of these pension cost components.

5.
Revenue Recognition

Management determined that the primary sources of revenue associated with financial instruments, including interest income on loans and investments, along with certain noninterest revenue sources including investment security gains, loan servicing charges, gains on the sale of loans, and bank owned life insurance income are not within the scope of Topic 606. As a result, no changes were made during the period related to these sources of revenue, which cumulatively comprise 79.1% of the total revenue of the Company.

Noninterest income within the scope of Topic 606 are as follows:

- Wealth management fees — Wealth management fee income is primarily comprised of fees earned from the management and administration of trusts and customer investment portfolios. The Company's performance obligation is generally satisfied over a period of time and the resulting fees are billed monthly or quarterly, based upon the month end market value of the assets under management. Payment is generally received after month end through a direct charge to customers' accounts. Other performance obligations (such as delivery of account statements to customers) are generally considered immaterial to the overall transactions price. Commissions on transactions are recognized on a trade-date basis as the performance obligation is satisfied at the point in time in which the trade is processed. Also included within wealth management fees are commissions from the sale of mutual funds, annuities, and life insurance products. Commissions on the sale of mutual funds, annuities, and life insurance products are recognized when sold, which is when the Company has satisfied its performance obligation.

- Service charges on deposit accounts — The Company has contracts with its deposit account customers where fees are charged for certain items or services. Service charges include account analysis fees, monthly service fees, overdraft fees, and other deposit account related fees. Revenue related to account analysis fees and service fees is recognized on a monthly basis as the Company has an unconditional right to the fee consideration. Fees attributable to specific performance obligations of the Company (i.e. overdraft fees, etc.) are recognized at a defined point in time based on completion of the requested service or transaction.

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Other noninterest income — Other noninterest income consists of other recurring revenue streams such as safe deposit box rental fees, gain (loss) on sale of other real estate owned and other miscellaneous revenue streams. Safe deposit box rental fees are charged to the customer on an

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annual basis and recognized when billed. However, if the safe deposit box rental fee is prepaid (i.e.paid prior to issuance of annual bill), the revenue is recognized upon receipt of payment. The Company has determined that since rentals and renewals occur consistently over time, revenue is recognized on a basis consistent with the duration of the performance obligation. Gains and losses on the sale of other real estate owned are recognized at the completion of the property sale when the buyer obtains control of the real estate and all the performance obligations of the Company have been satisfied.
The following presents noninterest income, segregated by revenue streams in-scope and out-of-scope of Topic 606, for the three and nine month periods ending September 30, 2018 and 2017 (in thousands).

	Three months ended September 30,		Nine months ended September 30,	
	2018	2017	2018	2017
Noninterest income:				
In-scope of Topic 606				
Wealth management fees	$ 2,359	$ 2,208	$ 7,232	$ 6,758
Service charges on deposit accounts	326	409	1,066	1,168
Other	439	410	1,291	1,236
Noninterest income (in-scope of topic 606)	3,124	3,027	9,589	9,162
Noninterest income (out-of-scope of topic 606)	462	602	1,313	1,784
Total noninterest income	$ 3,586	$ 3,629	$ 10,902	$ 10,946

6.
Earnings Per Common Share

Basic earnings per share include only the weighted average common shares outstanding. Diluted earnings per share include the weighted average common shares outstanding and any potentially dilutive common stock equivalent shares in the calculation. Treasury shares are excluded for earnings per share purposes. For the three and nine month periods ending September 30, 2017, options to purchase 10,000 common shares, with an exercise price of $4.00, were outstanding but were not included in the computation of diluted earnings per common share because to do so would be antidilutive.

	Three months ended September 30,		Nine months ended September 30,	
	2018	2017	2018	2017
	(In thousands, except per share data)			
Numerator:				
Net income	$ 2,329	$ 1,551	$ 5,840	$ 4,288
Denominator:				
Weighted average common shares outstanding (basic)	17,924	18,380	18,013	18,590
Effect of stock options	112	101	104	99
Weighted average common shares outstanding (diluted)	18,036	18,481	18,117	18,689
Earnings per common share:				
Basic	$ 0.13	$ 0.08	$ 0.32	$ 0.23

Diluted	0.13	0.08	0.32	0.23

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7.
Consolidated Statement of Cash Flows

On a consolidated basis, cash and cash equivalents include cash and due from depository institutions, interest-bearing deposits and short-term investments in money market funds with original maturities of 90 days or less. The Company made $875,000 in income tax payments in the first nine months of 2018 and $975,000 in the same 2017 period. The Company made total interest payments of $7,888,000 in the first nine months of 2018 compared to $6,447,000 in the same 2017 period. The Company had $166,000 non-cash transfers to other real estate owned (OREO) in the first nine months of 2018 compared to $59,000 non-cash transfers in the same 2017 period.
8.
Investment Securities

The cost basis and fair values of investment securities are summarized as follows (in thousands):
Investment securities available for sale (AFS):

	September 30, 2018			
	Cost Basis	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
US Agency	$ 6,731	$ —	$ (308)	$ 6,423
US Agency mortgage- backed securities	87,075	232	(2,308)	84,999
Municipal	11,240	15	(489)	10,766
Corporate bonds	37,380	92	(907)	36,565
Total	$ 142,426	$ 339	$ (4,012)	$ 138,753

Investment securities held to maturity (HTM):

	September 30, 2018			
	Cost Basis	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
US Agency mortgage- backed securities	$ 8,294	$ 65	$ (256)	$ 8,103
Municipal	24,341	25	(956)	23,410
Corporate bonds and other securities	6,038	10	(216)	5,832
Total	$ 38,673	$ 100	$ (1,428)	$ 37,345

Investment securities available for sale (AFS):

	December 31, 2017			
	Cost Basis	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
US Agency	$ 6,612	$ —	$ (40)	$ 6,572
US Agency mortgage- backed securities	79,854	611	(719)	79,746
Municipal	7,198	27	(189)	7,036

Corporate bonds	35,886	322	(424)	35,784
Total	$ 129,550	$ 960	$ (1,372)	$ 129,138

AmeriServ Financial, Inc.
NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

Investment securities held to maturity (HTM):

	December 31, 2017			
	Cost Basis	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
US Agency mortgage- backed securities	$ 9,740	$ 149	$ (45)	$ 9,844
Municipal	22,970	203	(238)	22,935
Corporate bonds and other securities	6,042	38	(48)	6,032
Total	$ 38,752	$ 390	$ (331)	$ 38,811

Maintaining investment quality is a primary objective of the Company's investment policy which, subject to certain limited exceptions, prohibits the purchase of any investment security below a Moody's Investor's Service or Standard & Poor's rating of "A." At September 30, 2018, 57.0% of the portfolio was rated "AAA" as compared to 57.8% at December 31, 2017. Approximately 9.7% of the portfolio was either rated below "A" or unrated at September 30, 2018 and December 31, 2017.

The Company sold no AFS securities during the third quarter of 2018. Total proceeds from the sale of AFS securities for the first nine months of 2018 were $4.5 million resulting in $15,000 of gross investment security gains and $163,000 of gross investment security losses. The Company sold $937,000 AFS securities in the third quarter of 2017 resulting in $56,000 of gross investment security gains and sold $8.1 million AFS securities in the first nine months of 2017 resulting in $115,000 of gross investment security gains.

The book value of securities, both available for sale and held to maturity, pledged to secure public and trust deposits was $110,038,000 at September 30, 2018 and $117,181,000 at December 31, 2017.

The following tables present information concerning investments with unrealized losses as of September 30, 2018 and December 31, 2017 (in thousands):

Total investment securities:

	September 30, 2018					
	Less than 12 months		12 months or longer		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
US Agency	$ 2,734	$ (109)	$ 3,689	$ (199)	$ 6,423	$ (308)
US Agency mortgage-backed securities	49,544	(1,211)	29,471	(1,353)	79,015	(2,564)
Municipal	19,978	(619)	11,847	(826)	31,825	(1,445)
Corporate bonds and other securities	21,320	(547)	12,979	(576)	34,299	(1,123)
Total	$ 93,576	$ (2,486)	$ 57,986	$ (2,954)	$ 151,562	$ (5,440)

Total investment securities:

	December 31, 2017					
	Less than 12 months		12 months or longer		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses

US Agency	$ 5,923	$ (39)	$ 399	$ (1)	$ 6,322	$ (40)
US Agency mortgage-backed securities	36,783	(253)	22,625	(511)	59,408	(764)
Municipal	8,657	(109)	7,727	(318)	16,384	(427)
Corporate bonds and other securities	7,123	(71)	13,655	(401)	20,778	(472)
Total	$ 58,486	$ (472)	$ 44,406	$ (1,231)	$ 102,892	$ (1,703)

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The unrealized losses are primarily a result of increases in market yields from the time of purchase. In general, as market yields rise, the value of securities will decrease; as market yields fall, the fair value of securities will increase. There are 233 positions that are considered temporarily impaired at September 30, 2018. Management generally views changes in fair value caused by changes in interest rates as temporary; therefore, these securities have not been classified as other-than-temporarily impaired. Management has also concluded that based on current information we expect to continue to receive scheduled interest payments as well as the entire principal balance. Furthermore, management does not intend to sell these securities and does not believe it will be required to sell these securities before they recover in value.

Contractual maturities of securities at September 30, 2018 are shown below (in thousands). Expected maturities may differ from contractual maturities because issuers may have the right to call or prepay obligations with or without prepayment penalties. The weighted average duration of the total investment securities portfolio at September 30, 2018 is 48.2 months and is higher than the duration at December 31, 2017 which was 44.3 months. The duration remains within our internal established guideline range of 24 to 60 months which we believe is appropriate to maintain proper levels of liquidity, interest rate risk, market valuation sensitivity and profitability.

Total investment securities:

	September 30, 2018			
	Available for sale		Held to maturity	
	Cost Basis	Fair Value	Cost Basis	Fair Value
Within 1 year	$ 48	$ 49	$ 1,000	$ 973
After 1 year but within 5 years	20,140	19,890	3,658	3,471
After 5 years but within 10 years	47,068	45,673	18,017	17,362
After 10 years but within15 years	29,952	29,194	11,605	11,292
Over 15 years	45,218	43,947	4,393	4,247
Total	$ 142,426	$ 138,753	$ 38,673	$ 37,345

9.
Loans

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

	September 30, 2018	December 31, 2017
Commercial:		
Commercial and industrial	$ 165,522	$ 159,192
Commercial loans secured by owner occupied real estate	95,594	89,935
Commercial loans secured by non-owner occupied real estate	363,532	373,845
Real estate — residential mortgage	240,591	247,278
Consumer	18,094	19,383
Loans, net of unearned income	$ 883,333	$ 889,633

Loan balances at September 30, 2018 and December 31, 2017 are net of unearned income of $339,000 and $399,000, respectively. Real estate-construction loans comprised 3.9% and 4.1% of total loans, net of unearned income at

September 30, 2018 and December 31, 2017, respectively.
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10.
Allowance for Loan Losses

The following tables summarize the rollforward of the allowance for loan losses by portfolio segment for the three and nine month periods ending September 30, 2018 and 2017 (in thousands).

	Three months ended September 30, 2018				
	Balance at June 30, 2018	Charge-Offs	Recoveries	Provision (Credit)	Balance at September 30, 2018
Commercial	$ 3,566	$ —	$ 17	$ 175	$ 3,758
Commercial loans secured by non-owner occupied real estate	3,686	—	12	(310)	3,388
Real estate – residential mortgage	1,253	(123)	34	75	1,239
Consumer	125	(29)	7	25	128
Allocation for general risk	891	—	—	35	926
Total	$ 9,521	$ (152)	$ 70	$ —	$ 9,439

	Three months ended September 30, 2017				
	Balance at June 30, 2017	Charge-Offs	Recoveries	Provision (Credit)	Balance at September 30, 2017
Commercial	$ 3,824	$ (228)	$ 9	$ 562	$ 4,167
Commercial loans secured by non-owner occupied real estate	4,488	—	20	(662)	3,846
Real estate – residential mortgage	1,150	(109)	53	70	1,164
Consumer	139	(42)	52	(10)	139
Allocation for general risk	790	—	—	240	1,030
Total	$ 10,391	$ (379)	$ 134	$ 200	$ 10,346

	Nine months ended September 30, 2018				
	Balance at December 31, 2017	Charge-Offs	Recoveries	Provision (Credit)	Balance at September 30, 2018
Commercial	$ 4,298	$ (574)	$ 29	$ 5	$ 3,758
Commercial loans secured by non-owner occupied real estate	3,666	—	38	(316)	3,388
Real estate – residential mortgage	1,102	(340)	111	366	1,239
Consumer	128	(181)	42	139	128
Allocation for general risk	1,020	—	—	(94)	926
Total	$ 10,214	$ (1,095)	$ 220	$ 100	$ 9,439

	Nine months ended September 30, 2017				
	Balance at December 31, 2016	Charge-Offs	Recoveries	Provision (Credit)	Balance at September 30, 2017
Commercial	$ 4,041	$ (228)	$ 22	$ 332	$ 4,167
Commercial loans secured by non-owner occupied real estate	3,584	(14)	44	232	3,846
Real estate – residential mortgage	1,169	(263)	128	130	1,164
Consumer	151	(138)	113	13	139
Allocation for general risk	987	—	—	43	1,030
Total	$ 9,932	$ (643)	$ 307	$ 750	$ 10,346

The Company did not record a provision for loan losses in the third quarter of 2018 compared to a $200,000 provision for loan losses in the third quarter of 2017. For the first nine months of 2018, the Company recorded a $100,000 provision for loan losses compared to a $750,000 provision for loan losses in
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the first nine months of 2017. The lower 2018 provision reflects our overall strong asset quality, the successful workout of several criticized loans, and reduced loan portfolio balances. For the first nine months of 2018, the Company experienced net loan charge-offs of $875,000, or 0.13% of total loans, compared to net loan charge-offs of $336,000, or 0.05% of total loans, in 2017. The higher 2018 net loan charge-offs reflect the final work-out of several non-performing loans on which reserves had previously been established.
The following tables summarize the loan portfolio and allowance for loan loss by the primary segments of the loan portfolio (in thousands).

	At September 30, 2018					
	Commercial	Commercial Loans Secured by Non-Owner Occupied Real Estate	Real Estate-Residential Mortgage	Consumer	Allocation for General Risk	Total
Loans:						
Individually evaluated for impairment	$ —	$ 11	$ —	$ —		$ 11
Collectively evaluated for impairment	261,116	363,521	240,591	18,094		883,322
Total loans	$ 261,116	$ 363,532	$ 240,591	$ 18,094		$ 883,333
Allowance for loan losses:						
Specific reserve allocation	$ —	$ —	$ —	$ —	$ —	$ —
General reserve allocation	3,758	3,388	1,239	128	926	9,439
Total allowance for loan losses	$ 3,758	$ 3,388	$ 1,239	$ 128	$ 926	$ 9,439

	At December 31, 2017					
	Commercial	Commercial Loans Secured by Non-Owner Occupied Real Estate	Real Estate-Residential Mortgage	Consumer	Allocation for General Risk	Total
Loans:						
Individually evaluated for impairment	$ 1,213	$ 547	$ —	$ —		$ 1,760
Collectively evaluated for impairment	247,914	373,298	247,278	19,383		887,873
Total loans	$ 249,127	$ 373,845	$ 247,278	$ 19,383		$ 889,633
Allowance for loan losses:						

Specific reserve allocation	$ 909	$ —	$ —	$ —	$ —	$ 909
General reserve allocation	3,389	3,666	1,102	128	1,020	9,305
Total allowance for loan losses	$ 4,298	$ 3,666	$ 1,102	$ 128	$ 1,020	$ 10,214

The segments of the Company’s loan portfolio are disaggregated into classes that allows management to monitor risk and performance. The loan classes used are consistent with the internal reports evaluated by the Company’s management and Board of Directors to monitor risk and performance within various segments of its loan portfolio. The commercial loan segment includes both the commercial and industrial and the owner occupied commercial real estate loan classes. The residential mortgage loan segment is comprised of first lien amortizing residential mortgage loans and home equity loans secured by residential real estate. The consumer loan segment consists primarily of installment loans and overdraft lines of credit connected with customer deposit accounts.

Management evaluates for possible impairment any individual loan in the commercial or commercial real estate segment with a loan balance in excess of $100,000 that is in nonaccrual status or classified as a Troubled Debt Restructure (TDR). Loans are considered to be impaired when, based on current

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

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

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

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

- the passage of time;
- the volatility of the local market;
- the availability of financing;
- natural disasters;
- the inventory of competing properties;
- new improvements to, or lack of maintenance of, the subject property or competing properties upon physical inspection by the Bank;
-

changes in underlying economic and market assumptions, such as material changes in current and projected vacancy, absorption rates, capitalization rates, lease terms, rental rates, sales prices, concessions, construction overruns and delays, zoning changes, etc.; and/or

- environmental contamination.

The value of the property is adjusted to appropriately reflect the above listed factors and the value is discounted to reflect the value impact of a forced or distressed sale, any outstanding senior liens, any outstanding unpaid real estate taxes, transfer taxes and closing costs that would occur with sale of the real estate. If the Assigned Risk Department personnel determine that a reasonable value cannot be derived

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based on available information, a new appraisal is ordered. The determination of the need for a new appraisal, versus completion of a property valuation by the Bank's Assigned Risk Department personnel rests with the Assigned Risk Department and not the originating account officer.

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

	September 30, 2018				
	Impaired Loans with Specific Allowance		Impaired Loans with no Specific Allowance	Total Impaired Loans	
	Recorded Investment	Related Allowance	Recorded Investment	Recorded Investment	Unpaid Principal Balance
Commercial	$ —	$ —	$ —	$ —	$ —
Commercial loans secured by non-owner occupied real estate	—	—	11	11	33
Total impaired loans	$ —	$ —	$ 11	$ 11	$ 33

	December 31, 2017				
	Impaired Loans with Specific Allowance		Impaired Loans with no Specific Allowance	Total Impaired Loans	
	Recorded Investment	Related Allowance	Recorded Investment	Recorded Investment	Unpaid Principal Balance
Commercial	$ 1,202	$ 909	$ 11	$ 1,213	$ 1,215
Commercial loans secured by non-owner occupied real estate	—	—	547	547	600
Total impaired loans	$ 1,202	$ 909	$ 558	$ 1,760	$ 1,815

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

	Three months ended September 30,		Nine months ended September 30,	
	2018	2017	2018	2017
Average loan balance:				
Commercial	$ —	$ 1,302	$ 532	$ 896
Commercial loans secured by non-owner occupied real estate	12	1,316	146	745
Average investment in impaired loans	$ 12	$ 2,618	$ 678	$ 1,641
Interest income recognized:				

Commercial	$ —	$ 7	$ —	$ 10
Commercial loans secured by non-owner occupied real estate	—	—	—	—
Interest income recognized on a cash basis on impaired loans	$ —	$ 7	$ —	$ 10

Management uses a nine point internal risk rating system to monitor the credit quality of the overall loan portfolio. The first six categories are considered not criticized. The first five “Pass” categories are aggregated, while the Pass-6, Special Mention, Substandard and Doubtful categories are disaggregated to separate pools. The criticized rating categories utilized by management generally follow bank regulatory definitions. The Special Mention category includes assets that are currently protected but are potentially weak, resulting in an undue and unwarranted credit risk, but not to the point of justifying a Substandard classification. Loans in the Substandard category have well-defined weaknesses that jeopardize the

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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, or for which any portion of the loan represents a specific allocation of the allowance for loan losses are placed in Substandard or Doubtful.

To help ensure that risk ratings are accurate and reflect the present and future capacity of borrowers to repay a loan as agreed, the Company has a structured loan rating process, which dictates that, at a minimum, credit reviews are mandatory for all commercial and commercial mortgage loan relationships with aggregate balances in excess of $250,000 within a 12-month period. Generally, consumer and residential mortgage loans are included in the Pass categories unless a specific action, such as bankruptcy, delinquency, or death occurs to raise awareness of a possible credit event. The Company’s commercial relationship managers are responsible for the timely and accurate risk rating of the loans in their portfolios at origination and on an ongoing basis. Risk ratings are assigned by the account officer, but require independent review from the Company’s internal Loan Review Department. The Loan Review Department is an experienced independent function which reports directly to the Board’s Audit Committee. The scope of commercial portfolio coverage by the Loan Review Department is defined and presented to the Audit Committee for approval on an annual basis. The approved scope of coverage for 2018 requires review of a minimum range of 50% to 55% of the commercial loan portfolio.

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

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

	September 30, 2018				
	Pass	Special Mention	Substandard	Doubtful	Total
Commercial and industrial	$ 155,787	$ 7,985	$ 1,750	$ —	$ 165,522
Commercial loans secured by owner occupied real estate	90,629	3,836	1,129	—	95,594
Commercial loans secured by non-owner occupied real estate	356,880	6,373	268	11	363,532
Total	$ 603,296	$ 18,194	$ 3,147	$ 11	$ 624,648

	December 31, 2017				
	Pass	Special Mention	Substandard	Doubtful	Total
Commercial and industrial	$ 156,448	$ 500	$ 2,000	$ 244	$ 159,192
Commercial loans secured by owner occupied real estate	87,215	1,675	759	286	89,935
	362,805	10,153	874	13	373,845

Commercial loans secured by non-owner occupied real estate					
Total	$ 606,468	$ 12,328	$ 3,633	$ 543	$ 622,972

It is generally the policy of the Bank that the outstanding balance of any residential mortgage loan that exceeds 90-days past due as to principal and/or interest is transferred to non-accrual status and an evaluation is completed to determine the fair value of the collateral less selling costs, unless the balance is

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minor. A charge down is recorded for any deficiency balance determined from the collateral evaluation. The remaining non-accrual balance is reported as impaired with no specific allowance. It is generally the policy of the bank that the outstanding balance of any consumer loan that exceeds 90-days past due as to principal and/or interest is charged off. The following tables present the performing and non-performing outstanding balances of the residential and consumer portfolio classes (in thousands).

	September 30, 2018	
	Performing	Non-Performing
Real estate – residential mortgage	$ 239,698	$ 893
Consumer	18,094	—
Total	$ 257,792	$ 893

	December 31, 2017	
	Performing	Non-Performing
Real estate – residential mortgage	$ 246,021	$ 1,257
Consumer	19,383	—
Total	$ 265,404	$ 1,257

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

	September 30, 2018						
	Current	30 – 59 Days Past Due	60 – 89 Days Past Due	90 Days Past Due	Total Past Due	Total Loans	90 Days Past Due and Still Accruing
Commercial and industrial	$ 159,451	$ 6,071	$ —	$ —	$ 6,071	$ 165,522	$ —
Commercial loans secured by owner occupied real estate	95,594	—	—	—	—	95,594	—