EVANS BANCORP INC
Form 10-Q
May 02, 2014

United States

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

For quarterly period ended March 31, 2014

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

For the transition period from to .

Commission file number 001-35021

EVANS BANCORP, INC. .

(Exact name of registrant as specified in its charter)

New York	16-1332767
(State or other jurisdiction of	(I.R.S. Employer

incorporation or organization) Identification No.)

One Grimsby Drive, Hamburg, NY 14075

(Address of principal executive offices) (Zip Code)

(716) 926-2000 .

(Registrant's telephone number, including area code)

.

(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 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 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. (Check one):

Large accelerated filer Accelerated filer

Non-accelerated filer (Do not check if 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 No

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

Common Stock, $.50 par value: 4,170,621 shares as of April 30, 2014

Table of Contents

INDEX

EVANS BANCORP, INC. AND SUBSIDIARIES

Table of Contents

PART I - FINANCIAL INFORMATION
ITEM 1 - FINANCIAL STATEMENTS
EVANS BANCORP, INC. AND SUBSIDIARIES
UNAUDITED CONSOLIDATED BALANCE SHEETS
MARCH 31, 2014 AND DECEMBER 31, 2013
(in thousands, except share and per share amounts)

	March 31, 2014	December 31, 2013
ASSETS		
Cash and due from banks	$ 16,743	$ 14,698
Interest-bearing deposits at banks	30,102	27,256
Securities:		
Available for sale, at fair value (amortized cost: $93,698 at March 31, 2014; $99,353 at December 31, 2013)	94,598	99,665
Held to maturity, at amortized cost (fair value: $2,322 at March 31, 2014; $2,319 at December 31, 2013)	2,373	2,384
Federal Home Loan Bank common stock, at amortized cost	1,364	1,364
Federal Reserve Bank common stock, at amortized cost	1,476	1,467
Loans and leases, net of allowance for loan and lease losses of $11,734 at March 31, 2014 and $11,503 at December 31, 2013	648,961	635,493
Properties and equipment, net of accumulated depreciation of $14,499 at March 31, 2014 and $14,226 at December 31, 2013	11,117	11,163
Goodwill	8,101	8,101
Intangible assets	67	108
Bank-owned life insurance	19,986	19,840
Other assets	11,988	11,959
TOTAL ASSETS	$ 846,876	$ 833,498
LIABILITIES AND STOCKHOLDERS' EQUITY		
LIABILITIES		
Deposits:		
Demand	$ 139,975	$ 139,973
NOW	79,531	65,927
Regular savings	393,735	390,575
Time	108,702	110,137
Total deposits	721,943	706,612
Securities sold under agreement to repurchase	11,374	13,351
Other short term borrowings	9,000	9,000
Other liabilities	12,712	12,493
Junior subordinated debentures	11,330	11,330

Total liabilities	766,359	752,786
CONTINGENT LIABILITIES AND COMMITMENTS		
STOCKHOLDERS' EQUITY:		
Common stock, $.50 par value, 10,000,000 shares authorized; 4,211,476 and 4,208,459 shares issued at March 31, 2014 and December 31, 2013, respectively, and 4,147,666 and 4,201,362 outstanding at March 31, 2014 and December 31, 2013, respectively	2,108	2,106
Capital surplus	42,710	42,619
Treasury stock, at cost, 62,983 shares and 4,906 at March 31, 2014 and December 31, 2013, respectively	(1,498)	(120)
Retained earnings	38,078	37,370
Accumulated other comprehensive (loss) gain, net of tax	(881)	(1,263)
Total stockholders' equity	80,517	80,712
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	$ 846,876	$ 833,498

See Notes to Unaudited Consolidated Financial Statements

1

Table of Contents

PART I - FINANCIAL INFORMATION
ITEM 1 - FINANCIAL STATEMENTS
EVANS BANCORP, INC. AND SUBSIDIARIES
UNAUDITED CONSOLIDATED STATEMENTS OF INCOME
THREE MONTHS ENDED MARCH 31, 2014 AND 2013
(in thousands, except share and per share amounts)

	Three Months Ended March 31,	
	2014	2013
INTEREST INCOME		
Loans and leases	$ 7,510	$ 7,252
Interest bearing deposits at banks	15	18
Securities:		
Taxable	449	417
Non-taxable	245	269
Total interest income	8,219	7,956
INTEREST EXPENSE		
Deposits	756	890
Other borrowings	86	161
Junior subordinated debentures	79	79
Total interest expense	921	1,130
NET INTEREST INCOME	7,298	6,826
PROVISION FOR LOAN AND LEASE LOSSES	153	450
NET INTEREST INCOME AFTER PROVISION FOR LOAN AND LEASE LOSSES	7,145	6,376
NON-INTEREST INCOME		
Bank charges	461	482
Insurance service and fees	2,132	1,999
Data center income	107	114
Gain on loans sold	-	25
Bank-owned life insurance	145	113
Other	550	577
Total non-interest income	3,395	3,310
NON-INTEREST EXPENSE		
Salaries and employee benefits	4,695	4,289
Occupancy	743	816
Repairs and maintenance	176	178
Advertising and public relations	222	124

Professional services	518	454
Technology and communications	300	291
Amortization of intangibles	41	63
FDIC insurance	162	138
Other	761	723
Total non-interest expense	7,618	7,076
INCOME BEFORE INCOME TAXES	2,922	2,610
INCOME TAX PROVISION	909	794
NET INCOME	$ 2,013	$ 1,816
Net income per common share-basic	$ 0.48	$ 0.44
Net income per common share-diluted	$ 0.47	$ 0.43
Cash dividends per common share	$ 0.31	$ -
Weighted average number of common shares outstanding	4,200,519	4,173,978
Weighted average number of diluted shares outstanding	4,284,016	4,210,595

See Notes to Unaudited Consolidated Financial Statements

2

Table of Contents

PART I - FINANCIAL INFORMATION
ITEM 1 - FINANCIAL STATEMENTS
EVANS BANCORP, INC. AND SUBSIDIARIES
UNAUDITED STATEMENTS OF CONSOLIDATED COMPREHENSIVE INCOME
THREE MONTHS ENDED MARCH 31, 2014 AND 2013
(in thousands, except share and per share amounts)

	Three Months Ended March 31,			
	2014		2013	
NET INCOME		$ 2,013		$ 1,816
OTHER COMPREHENSIVE INCOME (LOSS), NET OF TAX:				
Unrealized gain (loss) on available-for-sale securities:				
Unrealized gain (loss) on available-for-sale securities	361		(261)	
Less: Reclassification of gain on sale of securities	-		-	
		361		(261)
Defined benefit pension plans:				
Amortization of prior service cost	5		10	
Amortization of actuarial loss	16		27	
Total		21		37
OTHER COMPREHENSIVE INCOME (LOSS), NET OF TAX		382		(224)
COMPREHENSIVE INCOME		$ 2,395		$ 1,592

See Notes to Unaudited Consolidated Financial Statements

3

Table of Contents

PART I - FINANCIAL INFORMATION
ITEM 1 - FINANCIAL STATEMENTS
EVANS BANCORP, INC. AND SUBSIDIARIES
UNAUDITED CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY
THREE MONTHS ENDED MARCH 31, 2014 AND 2013
(in thousands, except share and per share amounts)

	Common Stock	Capital Surplus	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Treasury Stock	Total
Balance, December 31, 2012	$ 2,087	$ 42,029	$ 30,611	$ 101	$ -	$ 74,828
Net Income			1,816			1,816
Other comprehensive (loss)				(224)		(224)
Stock options and restricted stock expense		75				75
Issued 18,784 restricted shares	9	(9)				-
Balance, March 31, 2013	$ 2,096	$ 42,095	$ 32,427	$ (123)	$ -	$ 76,495
Balance, December 31, 2013	$ 2,106	$ 42,619	$ 37,370	$ (1,263)	$ (120)	$ 80,712
Net Income			2,013			2,013
Other comprehensive income (loss)				382		382
Cash dividends ($0.31 per common share)			(1,305)			(1,305)
Stock options and restricted stock expense		99				99
Excess tax expense from stock-based compensation		21				21
Issued 3,017 restricted shares	2	(2)				-
Repurchased 59,800 shares					(1,436)	(1,436)
Reissued 3,087 shares in stock option exercise		(27)			58	31
Balance, March 31, 2014	$ 2,108	$ 42,710	$ 38,078	$ (881)	$ (1,498)	$ 80,517

See Notes to Unaudited Consolidated Financial Statements

Table of Contents

ITEM 1 - FINANCIAL STATEMENTS
EVANS BANCORP, INC. AND SUBSIDIARIES
UNAUDITED CONSOLIDATED STATEMENTS OF CASH FLOWS
THREE MONTHS ENDED MARCH 31, 2014 AND 2013
(in thousands)

	Three Months Ended March 31,	
	2014	2013
OPERATING ACTIVITIES:		
Interest received	$ 8,105	$ 7,638
Fees received	3,388	3,301
Interest paid	(937)	(1,147)
Cash paid to employees and vendors	(8,368)	(8,009)
Cash contributed to pension plan	-	(95)
Income taxes paid	(960)	(461)
Proceeds from sale of loans held for resale	-	776
Originations of loans held for resale	(123)	(233)
Net cash provided by operating activities	1,105	1,770
INVESTING ACTIVITIES:		
Available for sales securities:		
Purchases	-	(3,487)
Proceeds from maturities, calls, and payments	5,543	3,759
Held to maturity securities:		
Proceeds from maturities, calls, and payments	11	11
Additions to properties and equipment	(226)	(47)
Net increase in loans	(13,493)	(5,865)
Net cash used in investing activities	(8,165)	(5,629)
FINANCING ACTIVITIES:		
Proceeds from (repayments of) borrowings	(1,977)	(5,328)
Net increase in deposits	15,333	19,308
Repurchase of treasury stock	(1,436)	-
Reissuance of treasury stock	31	-
Net cash provided by financing activities	11,951	13,980
Net increase (decrease) in cash and equivalents	4,891	10,121
CASH AND CASH EQUIVALENTS:		

Beginning of period	41,954	90,477
End of period	$ 46,845	$ 100,598

(continued)

5

Table of Contents

PART I - FINANCIAL INFORMATION
ITEM 1 - FINANCIAL STATEMENTS
EVANS BANCORP, INC. AND SUBSIDIARIES
UNAUDITED CONSOLIDATED STATEMENTS OF CASH FLOWS
THREE MONTHS ENDED MARCH 31, 2014 AND 2013
(in thousands)

	Three Months Ended March 31, 2014	2013
RECONCILIATION OF NET INCOME TO NET CASH PROVIDED BY OPERATING ACTIVITIES:		
Net income	$ 2,013	$ 1,816
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	382	567
Deferred tax expense (benefit)	(13)	109
Provision for loan and lease losses	153	450
Gain on loans sold	-	(25)
Stock options and restricted stock expense	99	75
Proceeds from sale of loans held for resale	-	776
Originations of loans held for resale	(123)	(233)
Cash contributed to pension plan	-	(95)
Changes in assets and liabilities affecting cash flow:		
Other assets	(613)	(699)
Other liabilities	(793)	(971)
NET CASH PROVIDED BY OPERATING ACTIVITIES	$ 1,105	$ 1,770

See Notes to Unaudited Consolidated Financial Statements

Table of Contents

PART 1 – FINANCIAL INFORMATION

ITEM 1 – FINANCIAL STATEMENTS

EVANS BANCORP, INC. AND SUBSIDIARIES

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

THREE MONTHS ENDED MARCH 31, 2014 AND 2013

1. ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The accounting and reporting policies followed by Evans Bancorp, Inc. (the "Company"), a financial holding company, and its two direct, wholly-owned subsidiaries: (i) Evans Bank, National Association (the "Bank"), and the Bank's subsidiaries, Evans National Leasing, Inc. ("ENL"), Evans National Holding Corp. ("ENHC") and Suchak Data Systems, LLC ("SDS"); and (ii) Evans National Financial Services, LLC ("ENFS"), and ENFS's subsidiary, The Evans Agency, LLC ("TEA"), and TEA's subsidiaries, Frontier Claims Services, Inc. ("FCS") and ENB Associates Inc. ("ENBA"), in the preparation of the accompanying interim unaudited consolidated financial statements conform with U.S. generally accepted accounting principles ("GAAP") and with general practice within the industries in which it operates. Except as the context otherwise requires, the Company and its direct and indirect subsidiaries are collectively referred to in this report as the "Company."

The results of operations for the three month period ended March 31, 2014 are not necessarily indicative of the results to be expected for the full year. The accompanying unaudited consolidated financial statements should be read in conjunction with the Audited Consolidated Financial Statements and the Notes thereto included in our Annual Report on Form 10-K for the year ended December 31, 2013.

Table of Contents

2. SECURITIES

The amortized cost of securities and their approximate fair value at March 31, 2014 and December 31, 2013 were as follows:

	March 31, 2014 (in thousands)			
	Amortized Cost	Unrealized Gains	Losses	Fair Value
Available for Sale:				
Debt securities:				
U.S. government agencies	$ 28,075	$ 394	$ (457)	$ 28,012
States and political subdivisions	31,066	979	(107)	31,938
Total debt securities	$ 59,141	$ 1,373	$ (564)	$ 59,950
Mortgage-backed securities:				
FNMA	$ 12,698	$ 388	$ (32)	$ 13,054
FHLMC	6,865	112	(108)	6,869
GNMA	7,212	143	(70)	7,285
CMO	7,782	8	(350)	7,440
Total mortgage-backed securities	$ 34,557	$ 651	$ (560)	$ 34,648
Total securities designated as available for sale	$ 93,698	$ 2,024	$ (1,124)	$ 94,598
Held to Maturity:				
Debt securities				
States and political subdivisions	$ 2,373	$ 7	$ (58)	$ 2,322
Total securities designated as held to maturity	$ 2,373	$ 7	$ (58)	$ 2,322

	December 31, 2013 (in thousands)			
	Amortized Cost	Unrealized Gains	Losses	Fair Value

Available for Sale:				
Debt securities:				
U.S. government agencies	$ 32,176	$ 439	$ (623)	$ 31,992
States and political subdivisions	31,266	802	(188)	31,880
Total debt securities	$ 63,442	$ 1,241	$ (811)	$ 63,872
Mortgage-backed securities:				
FNMA	$ 13,204	$ 354	$ (57)	$ 13,501
FHLMC	7,156	109	(147)	7,118
GNMA	7,570	99	(96)	7,573
CMO	7,981	9	(389)	7,601
Total mortgage-backed securities	$ 35,911	$ 571	$ (689)	$ 35,793
Total securities designated as available for sale	$ 99,353	$ 1,812	$ (1,500)	$ 99,665
Held to Maturity:				
Debt securities				
States and political subdivisions	$ 2,384	$ 6	$ (71)	$ 2,319
Total securities designated as held to maturity	$ 2,384	$ 6	$ (71)	$ 2,319

Table of Contents

Available for sale securities with a total fair value of $93.6 million and $71.1 million at March 31, 2014 and December 31, 2013, respectively, were pledged as collateral to secure public deposits and for other purposes required or permitted by law.

The Company uses the Federal Home Loan Bank of New York (“FHLBNY”) as its primary source of overnight funds and also has several long-term advances with FHLBNY. The Company had a total of $9 million in borrowed funds with FHLBNY at March 31, 2014 and December 31, 2013, respectively. The Company has placed sufficient collateral in the form of residential and commercial real estate loans at FHLBNY that meet FHLB collateral requirements. As a member of the Federal Home Loan Bank (“FHLB”) System, the Bank is required to hold stock in FHLBNY. The Bank held $1.4 million in FHLBNY stock as of March 31, 2014 and December 31, 2013 at amortized cost. The Company regularly evaluates investments in FHLBNY for impairment, considering liquidity, operating performance, capital position, stock repurchase and dividend history. At this time, the Company does not believe any impairment in FHLBNY stock is warranted.

The scheduled maturities of debt and mortgage-backed securities at March 31, 2014 and December 31, 2013 are summarized below. All maturity amounts are contractual maturities. Actual maturities may differ from contractual maturities because certain issuers have the right to call or prepay obligations with or without call premiums.

	March 31, 2014		December 31, 2013	
	Amortized cost	Estimated fair value	Amortized cost	Estimated fair value
	(in thousands)		(in thousands)	
Debt securities available for sale:				
Due in one year or less	$ 547	$ 557	$ 447	$ 454
Due after one year through five years	25,494	26,215	23,732	24,419
Due after five years through ten years	25,490	25,280	31,450	30,946
Due after ten years	7,610	7,898	7,813	8,053
	59,141	59,950	63,442	63,872
Mortgage-backed securities available for sale	34,557	34,648	35,911	35,793

Total available for sale securities	$ 93,698	$ 94,598	$ 99,353	$ 99,665
Debt securities held to maturity:				
Due in one year or less	$ 1,023	$ 1,021	$ 1,023	$ 1,020
Due after one year through five years	172	174	178	179
Due after five years through ten years	1,059	1,020	1,064	1,015
Due after ten years	119	107	119	105
	2,373	2,322	2,384	2,319
Total held to maturity securities	$ 2,373	$ 2,322	$ 2,384	$ 2,319

Information regarding unrealized losses within the Company's available for sale securities at March 31, 2014 and December 31, 2013, is summarized below. The securities are primarily U.S. government-guaranteed agency securities or municipal securities. All unrealized losses are considered temporary and related to market interest rate fluctuations.

Table of Contents

	March 31, 2014					
	Less than 12 months		12 months or longer		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
	(in thousands)					
Available for Sale:						
Debt securities:						
U.S. government agencies	$ 8,686	$ (352)	$ 1,894	$ (105)	$ 10,580	$ (457)
States and political subdivisions	6,662	(81)	601	(26)	7,263	(107)
Total debt securities	$ 15,348	$ (433)	$ 2,495	$ (131)	$ 17,843	$ (564)
Mortgage-backed securities:						
FNMA	$ 4,657	$ (32)	$ -	$ -	$ 4,657	$ (32)
FHLMC	2,564	(24)	1,665	(84)	4,229	(108)
GNMA	2,582	(70)	-	-	2,582	(70)
CMO'S	6,362	(350)	-	-	6,362	(350)
Total mortgage-backed securities	$ 16,165	$ (476)	$ 1,665	$ (84)	$ 17,830	$ (560)
Held To Maturity:						
Debt securities:						
States and political subdivisions	$ 1,234	$ (16)	$ 551	$ (42)	$ 1,785	$ (58)
Total temporarily impaired securities	$ 32,747	$ (925)	$ 4,711	$ (257)	$ 37,458	$ (1,182)

December 31, 2013

	Less than 12 months		12 months or longer		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
	(in thousands)					
Available for Sale:						
Debt securities:						
U.S. government agencies	$ 10,553	$ (486)	$ 1,863	$ (137)	$ 12,416	$ (623)
States and political subdivisions	7,953	(150)	590	(38)	8,543	(188)
Total debt securities	$ 18,506	$ (636)	$ 2,453	$ (175)	$ 20,959	$ (811)
Mortgage-backed securities:						
FNMA	$ 4,819	$ (57)	$ 21	$ -	$ 4,840	$ (57)
FHLMC	2,677	(46)	1,700	(101)	4,377	(147)
GNMA	2,751	(96)	-	-	2,751	(96)
CMO'S	6,466	(389)	-	-	6,466	(389)
Total mortgage-backed securities	$ 16,713	$ (588)	$ 1,721	$ (101)	$ 18,434	$ (689)
Held To Maturity:						
Debt securities:						
States and political subdivisions	$ 1,210	$ (24)	$ 504	$ (47)	$ 1,714	$ (71)
Total temporarily impaired securities	$ 36,429	$ (1,248)	$ 4,678	$ (323)	$ 41,107	$ (1,571)

Table of Contents

In regard to municipal securities, the Company's general investment policy is that in-state securities must be rated at least Moody's Baa (or equivalent) at the time of purchase. The Company reviews the ratings report and municipality financial statements and prepares a pre-purchase analysis report before the purchase of any municipal securities. Out-of-state issues must be rated by Moody's at least Aa (or equivalent) at the time of purchase. The Company did not own any out-of-state municipal bonds at March 31, 2014 or December 31, 2013. Bonds rated below A are reviewed periodically to ensure their continued credit worthiness. While purchase of non-rated municipal securities is permitted under the Company's investment policy, such purchases are limited to bonds issued by municipalities in the Company's general market area. Those municipalities are typically customers of the Bank whose financial situation is familiar to management. The financial statements of the issuers of non-rated securities are reviewed by the Bank and a credit file of the issuers is kept on each non-rated municipal security with relevant financial information.

Although concerns have been raised in the marketplace recently about the health of municipal bonds, the Company has not experienced any significant credit troubles in this portfolio and does not believe any credit troubles are imminent with respect to its portfolio. Aside from the non-rated municipal securities to local municipalities discussed above that are considered held-to-maturity, all of the Company's available-for-sale municipal bonds are investment-grade government obligation ("G.O.") bonds. G.O. bonds are generally considered safer than revenue bonds because they are backed by the full faith and credit of the government while revenue bonds rely on the revenue produced by a particular project. All of the Company's municipal bonds are issued by municipalities in New York State. To the Company's knowledge, there has never been a default of a NY G.O. in the history of the state. The Company believes that its risk of loss on default of a G.O. municipal bond for the Company is relatively low. However, historical performance does not guarantee future performance.

Management has assessed the securities available for sale in an unrealized loss position at March 31, 2014 and December 31, 2013 and determined the decline in fair value below amortized cost to be temporary. In making this determination, management considered the period of time the securities were in a loss position, the percentage decline in comparison to the securities' amortized cost, and the financial condition of the issuer (primarily government or government-sponsored enterprises). In addition, management does not intend to sell these securities and it is not more likely than not that the Company will be required to sell these securities before recovery of their amortized cost. Management believes the decline in fair value is primarily related to market interest rate fluctuations and not to the credit deterioration of the individual issuers.

The Company had not recorded any other-than-temporary impairment ("OTTI") charges as of March 31, 2014 and did not record any OTTI charges during 2013. The gross unrealized losses in the Company's securities portfolio were at an immaterial level during each of those periods. Nevertheless, it remains possible that there could be deterioration in the asset quality of the securities portfolio in the future. The credit worthiness of the Company's portfolio is largely reliant on the ability of U.S. government sponsored agencies such as FHLB, Federal National Mortgage Association ("FNMA"), Government National Mortgage Association ("GNMA"), and Federal Home Loan Mortgage Corporation ("FHLMC"), and municipalities throughout New York State to meet their obligations. In addition, dysfunctional markets could materially alter the liquidity, interest rate, and pricing risk of the portfolio. The relatively stable past performance is not a guarantee for similar performance of the Company's securities portfolio going forward.

3. FAIR VALUE MEASUREMENTS

The Company follows the provisions of ASC Topic 820, "Fair Value Measurements and Disclosures." Those provisions relate to financial assets and liabilities carried at fair value and fair value disclosures related to financial assets and liabilities. ASC Topic 820 defines fair value and specifies a hierarchy of valuation techniques based on the nature of the inputs used to develop the fair value measures. Fair value is defined as the price that 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 are three levels of inputs to fair value measurements:

- Level 1, meaning the use of quoted prices for identical instruments in active markets;
- Level 2, meaning the use of quoted prices for similar instruments in active markets or quoted prices for identical or similar instruments in markets that are not active or are directly or indirectly observable; and
- Level 3, meaning the use of unobservable inputs.

Observable market data should be used when available.

FINANCIAL INSTRUMENTS MEASURED AT FAIR VALUE ON A RECURRING BASIS

Table of Contents

The following table presents for each of the fair-value hierarchy levels as defined in this footnote, those financial instruments which are measured at fair value on a recurring basis at March 31, 2014 and December 31, 2013:

(in thousands)	Level 1	Level 2	Level 3	Fair Value
March 31, 2014				
Securities available-for-sale:				
U.S. government agencies	$ -	$ 28,012	$ -	$ 28,012
States and political subdivisions	-	31,938	-	31,938
Mortgage-backed securities	-	34,648	-	34,648
Mortgage servicing rights	-	-	471	471
December 31, 2013				
Securities available-for-sale:				
U.S. government agencies	$ -	$ 31,992	$ -	$ 31,992
States and political subdivisions	-	31,880	-	31,880
Mortgage-backed securities	-	35,793	-	35,793
Mortgage servicing rights	-	-	509	509

Securities available for sale

Fair values for securities are determined using independent pricing services and market-participating brokers. The Company's independent pricing service utilizes evaluated pricing models that vary by asset class and incorporate available trade, bid and other market information for structured securities, cash flow and, when available, loan performance data. Because many fixed income securities do not trade on a daily basis, the evaluated pricing applications apply information as applicable through processes, such as benchmarking of like securities, sector groupings, and matrix pricing, to prepare evaluations. In addition, model processes, such as the Option Adjusted Spread model, are used to assess interest rate impact and develop prepayment scenarios. The models and the process take into account market convention. For each asset class, a team of evaluators gathers information from market sources and integrates relevant credit information, perceived market movements and sector news into the evaluated pricing applications and models. The company's service provider may occasionally determine that it does have not sufficient verifiable information to value a particular security. In these cases the Company will utilize valuations from another pricing service.

Management believes that it has a sufficient understanding of the third party service's valuation models, assumptions and inputs used in determining the fair value of securities to enable management to maintain an appropriate system of internal control. On a quarterly basis, the Company reviews changes in the market value of its security portfolio. Individual changes in valuations are reviewed for consistency with general interest rate movements and any known credit concerns for specific securities. Additionally, on an annual basis, the Company has its entire security portfolio priced by a second pricing service to determine consistency with another market evaluator. If, on the Company's review or in comparing with another servicer, a material difference between pricing evaluations were to exist, the Company may submit an inquiry to the service provider regarding the data used to value a particular security.   If the Company determines it has market information that would support a different valuation than the initial evaluation it can submit a challenge for a change to that security's valuation. There were no material differences in valuations noted in the first quarter of 2014 or during fiscal year 2013.

Securities available for sale are classified as Level 2 in the fair value hierarchy as the valuation provided by the third-party provider uses observable market data.

Mortgage servicing rights

Mortgage servicing rights ("MSRs") do not trade in an active, open market with readily observable prices. Accordingly, the Company obtains the fair value of the MSRs using a third-party pricing provider. The provider determines the fair value by discounting projected net servicing cash flows of the remaining servicing portfolio. The valuation model used by the provider considers market loan prepayment predictions and other economic factors which management considers to be significant unobservable inputs. The fair value of MSRs is mostly affected by changes in mortgage interest rates since rate changes cause the loan prepayment acceleration factors to increase or decrease. All assumptions are market driven. Management has a sufficient understanding of the third party service's valuation models, assumptions and inputs used in determining the fair value of MSRs to enable management to maintain an appropriate system of internal control. Mortgage servicing rights are classified within Level 3 of the fair value hierarchy as the valuation is model driven and primarily based on unobservable inputs.

Table of Contents

The following table summarizes the changes in fair value for mortgage servicing rights during the three month periods ended March 31, 2014 and 2013, respectively:

	Three months ended March 31, 2014	2013
Mortgage servicing rights - December 31	$ 509	$ 467
Gains (losses) included in earnings	(38)	(20)
Additions from loan sales	-	8
Mortgage servicing rights - March 31	$ 471	$ 455

Quantitative information about the significant unobservable inputs used in the fair value measurement of MSRs at the respective dates is as follows:

	3/31/2014	12/31/2013
Servicing fees	0.25 %	0.25 %
Discount rate	10.04 %	10.04 %
Prepayment rate (CPR)	9.86 %	9.31 %

FINANCIAL INSTRUMENTS MEASURED AT FAIR VALUE ON A NONRECURRING BASIS

The Company is required, on a nonrecurring basis, to adjust the carrying value of certain assets or provide valuation allowances related to certain assets using fair value measurements. The following table presents for each of the fair-value hierarchy levels as defined in this footnote, those financial instruments which are measured at fair value on a nonrecurring basis at March 31, 2014 and December 31, 2013:

(in thousands)	Level 1	Level 2	Level 3	Fair Value
March 31, 2014				
Impaired loans	$ -	-	16,862	$ 16,862
December 31, 2013				
Impaired loans	$ -	-	17,378	$ 17,378

Impaired loans

The Company evaluates and values impaired loans at the time the loan is identified as impaired, and the fair values of such loans are estimated using Level 3 inputs in the fair value hierarchy. Each loan's collateral has a unique appraisal and management's discount of the value is based on factors unique to each impaired loan. The significant unobservable input in determining the fair value is management's subjective discount on appraisals of the collateral securing the loan, which ranges from 10%-50%. Collateral may consist of real estate and/or business assets including equipment, inventory and/or accounts receivable and the value of these assets is determined based on appraisals by qualified licensed appraisers hired by the Company. Appraised and reported values may be discounted based on management's historical knowledge, changes in market conditions from the time of valuation, estimated costs to sell, and/or management's expertise and knowledge of the client and the client's business.

Table of Contents

The Company has an appraisal policy in which appraisals are obtained upon a commercial loan being downgraded on the Company internal loan rating scale to a 5 (special mention) or a 6 (substandard) depending on the amount of the loan, the type of loan and the type of collateral. All impaired commercial loans are either graded a 6 or 7 on the internal loan rating scale. For consumer loans, the Company obtains appraisals when a loan becomes 90 days past due or is determined to be impaired, whichever occurs first. Subsequent to the downgrade or reaching 90 days past due, if the loan remains outstanding and impaired for at least one year more, management may require another follow-up appraisal. Between receipts of updated appraisals, if necessary, management may perform an internal valuation based on any known changing conditions in the marketplace such as sales of similar properties, a change in the condition of the collateral, or feedback from local appraisers. Impaired loans had a gross value of $18.3 million, with a valuation allowance of $1.4 million, at March 31, 2014, compared to a gross value for impaired loans of $18.9 million, with a valuation allowance of $1.5 million, at December 31, 2013.

FAIR VALUE OF FINANCIAL INSTRUMENTS

At March 31, 2014 and December 31, 2013, the estimated fair values of the Company's financial instruments, including those that are not measured and reported at fair value on a recurring basis or nonrecurring basis, were as follows:

	March 31, 2014		December 31, 2013	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
	(in thousands)		(in thousands)	
Financial assets:				
Level 1:				
Cash and cash equivalents	$ 46,845	$ 46,845	$ 41,954	$ 41,954
Level 2:				
Available for sale securities	94,598	94,598	99,665	99,665
FHLB and FRB stock	2,840	2,840	2,831	2,831
Level 3:				
Held to maturity securities	2,373	2,322	2,384	2,319
Loans and leases, net	648,961	659,755	635,493	640,770
Mortgage servicing rights	471	471	509	509

Financial liabilities:				
Level 1:				
Demand deposits	$ 139,975	$ 139,975	$ 139,973	$ 139,973
NOW deposits	79,531	79,531	65,927	65,927
Regular savings deposits	393,735	393,735	390,575	390,575
Junior subordinated debentures	11,330	11,330	11,330	11,330
Commitments to extend credit	360	360	401	401
Securities sold under agreement to repurchase	11,374	11,374	13,351	13,351
Level 2:				
Other borrowed funds	9,000	9,105	9,000	9,171
Level 3:				
Time deposits	108,702	110,654	110,137	112,270

The following methods and assumptions were used to estimate the fair value of each class of financial instruments for which it is practical to estimate that value.

Cash and Cash Equivalents. For these short-term instruments, the carrying amount is a reasonable estimate of fair value. "Cash and Cash Equivalents" includes interest-bearing deposits at other banks.

FHLB and FRB stock. The carrying value of FHLB and FRB stock approximate fair value.

Table of Contents

Securities held to maturity. The Company holds certain municipal bonds as held-to-maturity. These bonds are generally small in dollar amount and are issued only by certain local municipalities within the Company's market area. The original terms are negotiated directly and on an individual basis consistent with our loan and credit guidelines. These bonds are not traded on the open market and management intends to hold the bonds to maturity. The fair value of held-to-maturity securities is estimated by discounting the future cash flows using the current rates at which similar agreements would be made with municipalities with similar credit ratings and for the same remaining maturities.

Loans and Leases, net. The fair value of fixed rate loans is estimated by discounting the future cash flows using the current rates at which similar loans would be made to borrowers with similar credit ratings and for the same remaining maturities, net of the appropriate portion of the allowance for loan losses. For variable rate loans, the carrying amount is a reasonable estimate of fair value. This fair value calculation is not necessarily indicative of the exit price, as defined in ASC 820.

Deposits. The fair value of demand deposits, NOW accounts, muni-vest accounts and regular savings accounts is the amount payable on demand at the reporting date. The fair value of time deposits is estimated using the rates currently offered for deposits of similar remaining maturities.

Junior Subordinated Debentures. The carrying amount of Junior Subordinated Debentures is a reasonable estimate of fair value due to the fact that they bear a floating interest rate that adjusts on a quarterly basis.

Commitments to extend credit and standby letters of credit. As described in Note 8 - "Contingent Liabilities and Commitments" to these Unaudited Consolidated Financial Statements, the Company was a party to financial instruments with off-balance sheet risk at March 31, 2014 and December 31, 2013. Such financial instruments consist of commitments to extend permanent financing and letters of credit. If the options are exercised by the prospective borrowers, these financial instruments will become interest-earning assets of the Company. If the options expire, the Company retains any fees paid by the counterparty in order to obtain the commitment or guarantee. The fees collected for these commitments are recorded as "unearned commitment fees" in Other Liabilities. The carrying value approximates the fair value.

Securities Sold Under Agreement to Repurchase. The fair value of the securities sold under agreement to repurchase approximates its carrying value.

Other Borrowed Funds. The fair value of the short-term portion of other borrowed funds approximates its carrying value. The fair value of the long-term portion of other borrowed funds is estimated using a discounted cash flow analysis based on the Company's current incremental borrowing rates for similar types of borrowing arrangements.

15

Table of Contents

4. LOANS, LEASES, AND THE ALLOWANCE FOR LOAN AND LEASE LOSSES

Loan and Lease Portfolio Composition

The following table presents selected information on the composition of the Company's loan and lease portfolio as of the dates indicated:

	March 31, 2014	December 31, 2013
Mortgage loans on real estate:	(in thousands)	
Residential Mortgages	$ 96,435	$ 94,027
Commercial and multi-family	364,012	361,247
Construction-Residential	1,933	1,509
Construction-Commercial	27,761	23,902
Home equities	57,364	57,228
Total real estate loans	547,505	537,913
Commercial and industrial loans	110,944	106,952
Consumer loans	1,054	938
Other	541	323
Net deferred loan origination costs	651	870
Total gross loans	660,695	646,996
Allowance for loan losses	(11,734)	(11,503)
Loans, net	$ 648,961	$ 635,493

The Bank sells certain fixed rate residential mortgages to FNMA, while maintaining the servicing rights for those mortgages. In the three month period ended March 31, 2014, the Bank did not sell any mortgages to FNMA, as compared with $0.8 million sold during the three month period ended March 31, 2013. At March 31, 2014, the Bank had a loan servicing portfolio principal balance of $62.3 million upon which it earns servicing fees, as compared with $63.5 million at December 31, 2013. The value of the mortgage servicing rights for that portfolio was $0.5 million at March 31, 2014 and December 31, 2013. At March 31, 2014, there were $0.1 million in residential mortgage loans held-for-sale, compared with no residential mortgages held for sale at December 31, 2013. The Company had no commercial loans held-for-sale at March 31, 2014 or December 31, 2013. The Company has never been contacted by FNMA to repurchase any loans due to improper documentation or fraud.

As noted in Note 1, these financial statements should be read in conjunction with the Audited Consolidated Financial Statements and the Notes thereto included in our Annual Report on Form 10-K for the year ended December 31, 2013. Disclosures related to the basis for accounting for loans and leases, the method for recognizing interest income on loans and leases, the policy for placing loans and leases on nonaccrual status and the subsequent recording of payments and resuming accrual of interest, the policy for determining past due status, a description of the Company's accounting policies and methodology used to estimate the allowance for loan and lease losses, the policy for charging off loans and leases, the accounting policies for impaired loans, and more descriptive information on the Company's credit risk ratings are all contained in the Notes to the Audited Consolidated Financial Statements in the Company's Annual Report on Form 10-K for the year ended December 31, 2013. Unless otherwise noted in this Form 10-Q, the policies and methodology described in the Annual Report for the year ended December 31, 2013 are consistent with those utilized by the Company in the three months ended March 31, 2014.

Credit Quality Indicators

The Bank monitors the credit risk in its loan portfolio by reviewing certain credit quality indicators ("CQI"). The primary CQI for its commercial mortgage and commercial and industrial ("C&I") portfolios is the individual loan's credit risk rating. The following list provides a description of the credit risk ratings that are used internally by the Bank when assessing the adequacy of its allowance for loan and lease losses:

Table of Contents

- 1-3-Pass
- 4-Watch
- 5-O.A.E.M. (Other Assets Especially Mentioned) or Special Mention
- 6-Substandard
- 7-Doubtful
- 8-Loss

The Company’s consumer loans, including residential mortgages and home equities, and commercial leases are not individually risk rated or reviewed in the Company’s loan review process. Consumers are not required to provide the Company with updated financial information as is a commercial customer. Consumer loans also carry smaller balances. Given the lack of updated information since the initial underwriting of the loan and small size of individual loans, the Company uses delinquency status as the credit quality indicator for consumer loans.

The following tables provide data, at the class level, of credit quality indicators of certain loans and leases for the dates specified:

March 31, 2014
(in thousands)

Corporate Credit Exposure – By Credit Rating	Commercial Real Estate Construction	Commercial and Multi-Family Mortgages	Total Commercial Real Estate	Commercial and Industrial
3	$ 21,053	$ 304,058	$ 325,111	$ 78,869
4	5,443	42,162	47,605	18,988
5	-	13,649	13,649	9,046
6	1,265	3,911	5,176	3,858
7	-	232	232	183
Total	$ 27,761	$ 364,012	$ 391,773	$ 110,944

December 31, 2013
(in thousands)

Corporate Credit Exposure – By Credit Rating	Commercial Real Estate Construction	Commercial and Multi-Family Mortgages	Total Commercial Real Estate	Commercial and Industrial
3	$ 19,086	$ 297,819	$ 316,905	$ 78,294
4	3,283	47,584	50,867	15,194
5	-	4,028	4,028	9,468
6	1,533	11,479	13,012	3,744
7	-	337	337	252
Total	$ 23,902	$ 361,247	$ 385,149	$ 106,952

Table of Contents

Past Due Loans and Leases

The following tables provide an analysis of the age of the recorded investment in loans and leases that are past due as of the dates indicated:

March 31, 2014
(in thousands)

	30-59 days	60-89 days	90+ days	Total Past Due	Current Balance	Total Balance	90+ Days Accruing	Non-accruing Loans and Leases
Commercial and industrial	$ 4,108	$ -	$ 69	$ 4,177	$ 106,767	$ 110,944	$ -	$ 2,808
Residential real estate:								
Residential	633	22	886	1,541	94,894	96,435	-	943
Construction	-	-	-	-	1,933	1,933	-	-
Commercial real estate:								
Commercial	4,515	-	75	4,590	359,422	364,012	-	977
Construction	-	-	-	-	27,761	27,761	-	-
Home equities	881	249	129	1,259	56,105	57,364	-	445
Direct financing leases	-	-	29	29	-	-	-	29
Consumer	1	1	-	2	1,052	1,054	-	18
Other	-	-	-	-	541	541	-	-
Total Loans	$ 10,138	$ 272	$ 1,188	$ 11,598	$ 648,475	$ 660,044	$ -	$ 5,220

NOTE: Loan and lease balances do not include $651 thousand in net deferred loan and lease origination costs as of March 31, 2014.

Table of Contents

December 31, 2013
(in thousands)

	30-59 days	60-89 days	90+ days	Total Past Due	Current Balance	Total Balance	90+ Days Accruing	Non-accruing Loans and Leases
Commercial and industrial	$ 197	$ 447	$ 358	$ 1,002	$ 105,950	$ 106,952	$ -	$ 2,970
Residential real estate:								
Residential	392	72	915	1,379	92,648	94,027	-	1,376
Construction	-	-	-	-	1,509	1,509	-	-
Commercial real estate:								
Commercial	6,976	1,050	75	8,101	353,146	361,247	-	8,873
Construction	-	-	-	-	23,902	23,902	-	-
Home equities	100	267	76	443	56,785	57,228	-	447
Direct financing leases	1	2	47	50	-	-	-	47
Consumer	1	21	-	22	916	938	-	20
Other	-	-	-	-	323	323	-	-
Total Loans	$ 7,667	$ 1,859	$ 1,471	$ 10,997	$ 635,179	$ 646,126	$ -	$ 13,733

NOTE: Loan and lease balances do not include $870 thousand in net deferred loan and lease origination costs as of December 31, 2013.

Table of Contents

Allowance for loan and lease losses

The following tables present the activity in the allowance for loan and lease losses according to portfolio segment, for the three month periods ended March 31, 2014 and 2013:

March 31, 2014

(in thousands)	Commercial and Industrial	Commercial Real Estate Mortgages*	Consumer **	Residential Mortgages*	HELOC	Direct Financing Leases	Unallocated	Total
Allowance for loan and lease losses:								
Beginning balance	$ 4,489	$ 4,912	$ 37	$ 1,038	$ 878	$ -	$ 149	$ 11,503
Charge-offs	(57)	-	(6)	-	(1)	-	-	(64)
Recoveries	28	29	2	-	-	83	-	142
Provision	63	167	3	(1)	4	(83)	-	153
Ending balance	$ 4,523	$ 5,108	$ 36	$ 1,037	$ 881	$ -	$ 149	$ 11,734
Allowance for loan and lease losses:								
Ending balance:								
Individually evaluated for impairment	$ 1,182	$ 210	$ 19	$ -	$ -	$ -	$ -	$ 1,411
Collectively evaluated for impairment	3,341	4,898	17	1,037	881	-	149	10,323
Total	$ 4,523	$ 5,108	$ 36	$ 1,037	$ 881	$ -	$ 149	$ 11,734
Loans and leases:								
Ending balance:								
Individually evaluated for impairment	$ 4,291	$ 11,579	$ 19	$ 2,100	$ 284	$ -	$ -	$ 18,273
Collectively evaluated								

for impairment	106,653	380,194	1,576	96,268	57,080	-	-	641,771
Total	$ 110,944	$ 391,773	$ 1,595	$ 98,368	$ 57,364	$ -	$ -	$ 660,044

* Includes construction loans

** Includes other loans

NOTE: Loan and lease balances do not include $651 thousand in net deferred loan and lease origination costs as of March 31, 2014.

20

Table of Contents

March 31, 2013

(in thousands)	Commercial and Industrial	Commercial Real Estate Mortgages*	Consumer **	Residential Mortgages*	HELOC	Direct Financing Leases	Unallocated	Total
Allowance for loan and lease losses:								
Beginning balance	$ 3,617	$ 4,493	$ 18	$ 662	$ 746	$ 47	$ 149	$ 9,732
Charge-offs	(10)	(13)	(10)	(6)	(91)	-	-	(130)
Recoveries	97	1	3	1	-	-	-	102
Provision	51	266	4	91	85	(47)	-	450
Ending balance	$ 3,755	$ 4,747	$ 15	$ 748	$ 740	$ -	$ 149	$ 10,154
Allowance for loan and lease losses:								
Ending balance:								
Individually evaluated for impairment	$ 387	$ 412	$ 4	$ 5	$ 7	$ -	$ -	$ 815
Collectively evaluated for impairment	3,368	4,335	11	743	733	-	149	9,339
Total	$ 3,755	$ 4,747	$ 15	$ 748	$ 740	$ -	$ 149	$ 10,154
Loans and leases:								
Ending balance:								
Individually evaluated for impairment	$ 1,417	$ 7,867	$ 20	$ 1,441	$ 573	$ 115	$ -	$ 11,433
Collectively evaluated for impairment	104,565	340,699	1,367	74,263	54,214	814	-	575,922
Total	$ 105,982	$ 348,566	$ 1,387	$ 75,704	$ 54,787	$ 929	$ -	$ 587,355

* Includes construction loans

** Includes other loans

NOTE: Loan and lease balances do not include $731 thousand in net deferred loan and lease origination costs as of March 31, 2013.

21

Table of Contents

Impaired Loans and Leases

The following tables provide data, at the class level, of impaired loans and leases as of the dates indicated:

	At March 31, 2014					
	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Interest Income Foregone	Interest Income Recognized
With no related allowance recorded:	(in thousands)					
Commercial and industrial	$ 1,162	$ 1,361	$ -	$ 1,337	$ 33	$ 9
Residential real estate:						
Residential	2,100	2,334	-	2,009	-	13
Construction	-	-	-	-	-	-
Commercial real estate:						
Commercial	9,747	10,147	-	9,711	-	69
Construction	330	330	-	631	-	3
Home equities	284	312	-	414	-	-
Direct financing leases	-	-	-	-	-	-
Consumer	-	-	-	-	-	-
Other	-	-	-	-	-	-
Total impaired loans and leases	$ 13,623	$ 14,484	$ -	$ 14,102	$ 33	$ 94

	At March 31, 2014					
	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Interest Income Foregone	Interest Income Recognized
With a related allowance recorded:	(in thousands)					
Commercial and industrial	$ 3,129	$ 3,197	$ 1,182	$ 3,467	$ 79	$ 12
Residential real estate:						
Residential	-	-	-	-	-	-
Construction	-	-	-	-	-	-
Commercial real estate:						
Commercial	568	643	73	595	-	-
Construction	934	934	137	934	-	8
Home equities	-	-	-	-	-	-
Direct financing leases	-	-	-	-	-	-
Consumer	19	29	19	14	3	-
Other	-	-	-	-	-	-
Total impaired loans and leases	$ 4,650	$ 4,803	$ 1,411	$ 5,010	$ 82	$ 20

Table of Contents

	At March 31, 2014					
	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Interest Income Foregone	Interest Income Recognized
Total:	(in thousands)					
Commercial and industrial	$ 4,291	$ 4,558	$ 1,182	$ 4,804	$ 112	$ 21
	-	-	-	-	-	-
Residential real estate:						
Residential	2,100	2,334	-	2,009	-	13
Construction	-	-	-	-	-	-
	-	-	-	-	-	-
Commercial real estate:						
Commercial	10,315	10,790	73	10,306	-	69
Construction	1,264	1,264	137	1,565	-	11
	-	-	-	-	-	-
Home equities	284	312	-	414	-	-
	-	-	-	-	-	-
Direct financing leases	-	-	-	-	-	-
	-	-	-	-	-	-
Consumer	19	29	19	14	3	-
	-	-	-	-	-	-
Other	-	-	-	-	-	-
Total impaired loans and leases	$ 18,273	$ 19,287	$ 1,411	$ 19,112	$ 115	$ 114

	At December 31, 2013					
	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Interest Income Foregone	Interest Income Recognized
With no related allowance recorded:	(in thousands)					
Commercial and industrial	$ 1,247	$ 1,352	$ -	$ 1,405	$ 100	$ 59
Residential real estate:						
Residential	1,331	1,460	-	1,388	61	9
Construction	-	-	-	-	-	-
Commercial real estate:						
Commercial	9,937	10,288	-	9,832	302	109
Construction	599	599	-	707	-	26
Home equities	408	438	-	402	19	4
Direct financing leases	26	27	-	29	-	-
Consumer	-	-	-	-	-	-
Other	-	-	-	-	-	-
Total impaired loans and leases	$ 13,548	$ 14,164	$ -	$ 13,763	$ 482	$ 207

Table of Contents

	At December 31, 2013 Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Interest Income Foregone	Interest Income Recognized
With a related allowance recorded:	(in thousands)					
Commercial and industrial	$ 3,141	$ 3,191	$ 1,187	$ 3,577	$ 60	$ 108
Residential real estate:						
Residential	621	624	47	622	10	27
Construction	-	-	-	-	-	-
Commercial real estate:						
Commercial	584	650	70	604	6	26
Construction	934	934	146	934	-	33
Home equities	39	39	39	39	-	2
Direct financing leases	-	-	-	-	-	-
Consumer	20	29	20	11	3	2
Other	-	-	-	-	-	-
Total impaired loans and leases	$ 5,339	$ 5,467	$ 1,509	$ 5,787	$ 79	$ 198

	At December 31, 2013 Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Interest Income Foregone	Interest Income Recognized
Total:	(in thousands)					

Commercial and industrial	$ 4,388	$ 4,543	$ 1,187	$ 4,982	$ 160	$ 167
	-	-	-	-	-	-
Residential real estate:						
Residential	1,952	2,084	47	2,010	71	36
Construction	-	-	-	-	-	-
	-	-	-	-	-	-
Commercial real estate:						
Commercial	10,521	10,938	70	10,436	308	135
Construction	1,533	1,533	146	1,641	-	59
	-	-	-	-	-	-
Home equities	447	477	39	441	19	6
	-	-	-	-	-	-
Direct financing leases	26	27	-	29	-	-
	-	-	-	-	-	-
Consumer	20	29	20	11	3	2
	-	-	-	-	-	-
Other	-	-	-	-	-	-
Total impaired loans and leases	$ 18,887	$ 19,631	$ 1,509	$ 19,550	$ 561	$ 405

Table of Contents

Non-performing loans and leases

The following table sets forth information regarding non-performing loans and leases as of the dates specified:

	March 31, 2014	December 31, 2013
	(in thousands)	
Non-accruing loans and leases:		
Commercial and industrial loans	$ 2,808	$ 2,970
Residential real estate:		
Residential	943	1,376
Construction	-	-
Commercial real estate:		
Commercial and multi-family	977	8,873
Construction	-	-
Home equities	445	447
Direct financing leases	29	47
Consumer loans	18	20
Other	-	-
Total non-accruing loans and leases	$ 5,220	$ 13,733
Accruing loans 90+ days past due	-	-
Total non-performing loans and leases	$ 5,220	$ 13,733
Total non-performing loans and leases to total assets	0.62 %	1.65 %
Total non-performing loans and leases to total loans and leases	0.79 %	2.12 %

Table of Contents

Troubled debt restructurings

The Company had $16.5 million in loans and leases that were restructured in a troubled debt restructuring (“TDR”) at March 31, 2014, compared with $17.1 million at December 31, 2013. $3.5 million and $12.0 million of those balances were in non-accrual status at March 31, 2014 and December 31, 2013, respectively. Any TDR that is placed on non-accrual is not reverted back to accruing status until the borrower makes timely payments as contracted for at least six months and future collection under the revised terms is probable. All of the Company’s restructurings were allowed in an effort to maximize its ability to collect on loans and leases where borrowers were experiencing financial difficulty. The Company did not engage in any re-modifications during the three month periods ended March 31, 2014 and 2013.

The reserve for a TDR is based upon the present value of the future expected cash flows discounted at the loan’s original effective rate or upon the fair value of the collateral less costs to sell, if the loan is deemed collateral dependent. This reserve methodology is used because all TDR loans are considered impaired. As of March 31, 2014, there were no commitments to lend additional funds to debtors owing on loans or leases whose terms have been modified in TDRs.

The following tables summarize the loans and leases that were classified as troubled debt restructurings as of the dates indicated:

	March 31, 2014 ($ in thousands)			
	Total	Nonaccruing	Accruing	Related Allowance
Commercial and industrial	$ 4,199	$ 2,775	$ 1,424	$ 1,160
Residential real estate:				
Residential	1,027	32	995	-
Construction	-	-	-	-
Commercial real estate:				
Commercial and multi family	10,319	650	9,669	170
Construction	934	-	934	-
Home equities	55	55	-	-
Direct financing leases	-	-	-	-

Consumer loans	-	-	-	-
Other	-	-	-	-
Total troubled restructured loans and leases	$ 16,534	$ 3,512	$ 13,022	$ 1,330

Table of Contents

	December 31, 2013 ($ in thousands)			
	Total	Nonaccruing	Accruing	Related Allowance
Commercial and industrial	$ 4,262	$ 2,903	$ 1,359	$ 983
Residential real estate:				
Residential	1,031	454	577	-
Construction	-	-	-	-
Commercial real estate:				
Commercial and multi family	10,211	8,563	1,648	33
Construction	1,533	-	1,533	-
				-
Home equities	56	56	-	-
Direct financing leases	26	12	14	-
Consumer loans	-	-	-	-
Other	-	-	-	-
Total troubled restructured loans and leases	$ 17,119	$ 11,988	$ 5,131	$ 1,016

The Company's TDRs have various agreements that involve deferral of principal payments, or interest-only payments, for a period (usually 12 months or less) to allow the customer time to improve cash flow or sell the property. Other common types of concessions leading to the designation of a TDR are lines of credit that are termed out and extensions of maturities at rates that are less than market given the risk profile of the borrower.

The following table shows the data for TDR activity by type of concession granted to the borrower for the three month periods ended March 31, 2014 and 2013:

Table of Contents

Troubled Debt Restructurings by Type of Concession	Three Months Ended March 31, 2014 ($ in thousands) Number of Contracts	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment	Three Months Ended March 31, 2013 ($ in thousands) Number of Contracts	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment
Commercial and Industrial:						
Deferral of principal	-	$ -	$ -	-	$ -	$ -
Combination of concessions	-	-	-	2	330	330
Residential Real Estate & Construction:						
Extension of maturity & interest rate reduction	-	-	-	1	28	28
Commercial Real Estate & Construction:						
Deferral of principal	-	-	-	-	-	-
Extension of maturity	-	-	-	2	739	739
Home Equities:						
Extension of maturity and rate reduction	-	-	-	-	-	-
Term out line of credit	-	-	-	-	-	-
Direct financing leases	-	-	-	-	-	-
Consumer loans	-	-	-	-	-	-
Other	-	-	-	-	-	-

The general practice of the Bank is to work with borrowers so that they are able to pay back their loan or lease in full. If a borrower continues to be delinquent or cannot meet the terms of a TDR and the loan or lease is determined to be uncollectible, the loan or lease will be charged off. The following table presents loans and leases which were classified as TDRs during the previous 12 months which defaulted during the three month periods ended March 31, 2014 and 2013:

	Three months ended March 31, 2014 ($ in thousands)		Three months ended March 31, 2013 ($ in thousands)	
Troubled Debt Restructurings That Subsequently Defaulted	Number of Contracts	Recorded Investment	Number of Contracts	Recorded Investment
Commercial and Industrial	-	$ -	-	$ -
Residential Real Estate:				
Residential	-	-	-	-
Construction	-	-	-	-
Commercial Real Estate:				
Commercial and Multi-Family	-	-	-	-
Construction	-	-	-	-
Home Equities	-	-	-	-
Direct financing leases	-	-	-	-
Consumer loans	-	-	-	-
Other	-	-	-	-

Table of Contents

5. PER SHARE DATA

The common stock per share information is based upon the weighted average number of shares outstanding during each period. For the three month periods ended March 31, 2014 and 2013, the Company had an average of 83,497 and 36,617 dilutive shares, respectively.

Potential common shares that would have the effect of increasing diluted earnings per share are considered to be anti-dilutive and not included in calculating diluted earnings per share. For the three month periods ended March 31, 2014 and 2013, there was an average of 9,000 and 90,071 anti-dilutive shares, respectively, that were not included in calculating diluted earnings per share because their effect was anti-dilutive.

6. OTHER COMPREHENSIVE INCOME

The following tables summarize the changes in the components of accumulated other comprehensive income (loss) during the three month periods ended March 31, 2014 and 2013:

	Balance at December 31, 2013	Net Change	Balance at March 31, 2014
	(in thousands)		
Net unrealized gain (loss) on investment securities	$ 191	$ 361	$ 552
Net defined benefit pension plans adjustments	(1,454)	21	(1,433)
Total	$ (1,263)	$ 382	$ (881)

	Balance at December 31, 2012	Net Change	Balance at March 31, 2013
	(in thousands)		
Net unrealized gain (loss) on investment securities	$ 2,457	$ (261)	$ 2,196
Net defined benefit pension plans adjustments	(2,356)	37	(2,319)
Total	$ 101	$ (224)	$ (123)

Table of Contents

	March 31, 2014 (in thousands)			March 31, 2013 (in thousands)		
	Before-Tax Amount	Income Tax (Provision) Benefit	Net-of-Tax Amount	Before-Tax Amount	Income Tax (Provision) Benefit	Net-of-Tax Amount
Unrealized loss on investment securities:						
Unrealized gain (loss) on investment securities	$ 588	$ (227)	$ 361	$ (426)	$ 165	$ (261)
Reclassification from accumulated other comprehensive income for gains (losses)	-	-	-	-	-	-
Net change	588	(227)	361	(426)	165	(261)
Defined benefit pension plans adjustments:						
Net actuarial (loss) gain	$ -	$ -	$ -	$ -	$ -	$ -
Reclassifications from accumulated other comprehensive income for gains (losses)						
Amortization of prior service cost (a)	8	(3)	5	17	(7)	10
Amortization of actuarial loss (a)	26	(10)	16	44	(17)	27
Net change	34	(13)	21	61	(24)	37
Other Comprehensive Income (Loss)	$ 622	$ (240)	$ 382	$ (365)	$ 141	$ (224)

(a) Included in net periodic pension cost, as described in Note 9 – "Net Periodic Benefit Costs"

Table of Contents

7. SEGMENT INFORMATION

The Company is comprised of two primary business segments, banking and insurance agency activities. The following tables set forth information regarding these segments for the three and nine month periods ended March 31, 2014 and 2013.

	Three Months Ended March 31, 2014		
	Banking Activities (in thousands)	Insurance Agency Activities	Total
Net interest income (expense)	$ 7,326	$ (28)	$ 7,298
Provision for loan and lease losses	153	-	153
Net interest income (expense) after provision for loan and lease losses	7,173	(28)	7,145
Non-interest income	1,263	-	1,263
Insurance service and fees	152	1,980	2,132
Amortization expense	-	41	41
Non-interest expense	6,477	1,100	7,577
Income before income taxes	2,111	811	2,922
Income tax provision	596	313	909
Net income	$ 1,515	$ 498	$ 2,013

Table of Contents

	Three Months Ended March 31, 2013		
	Banking Activities	Insurance Agency Activities	Total
	(in thousands)		
Net interest income (expense)	$ 6,854	$ (28)	$ 6,826
Provision for loan and lease losses	450	-	450
Net interest income (expense) after provision for loan and lease losses	6,404	(28)	6,376
Non-interest income	1,311	-	1,311
Insurance service and fees	91	1,908	1,999
Amortization expense	-	63	63
Non-interest expense	5,906	1,107	7,013
Income before income taxes	1,900	710	2,610
Income tax provision	529	265	794
Net income	$ 1,371	$ 445	$ 1,816

8. CONTINGENT LIABILITIES AND COMMITMENTS

The unaudited consolidated financial statements do not reflect various commitments and contingent liabilities, which arise in the normal course of business, and which involve elements of credit risk, interest rate risk and liquidity risk. These commitments and contingent liabilities consist of commitments to extend credit and standby letters of credit. A summary of the Bank’s commitments and contingent liabilities is as follows:

	March 31, 2014	December 31, 2013
	(in thousands)	
Commitments to extend credit	$ 198,993	$ 176,964
Standby letters of credit	2,173	2,664
Total	$ 201,166	$ 179,628

Table of Contents

Commitments to extend credit and standby letters of credit include some exposure to credit loss in the event of nonperformance by the customer. The Bank's credit policies and procedures for credit commitments and financial guarantees are the same as those for extensions of credit that are recorded on the Company's unaudited consolidated balance sheets. Because these instruments have fixed maturity dates, and because they may expire without being drawn upon, they do not necessarily represent cash requirements of the Bank. The Bank has not incurred any losses on its commitments and did not record a reserve for its commitments during the first three months of 2014 or during 2013.

Certain lending commitments for construction residential mortgage loans are considered derivative instruments under the guidelines of GAAP. The changes in the fair value of these commitments, due to interest rate risk, are not recorded on the consolidated balance sheets as the fair value of these derivatives is not considered material.

The Company is subject to possible litigation proceedings in the normal course of business. As of March 31, 2014 and December 31, 2013, there were no claims pending against the Company that management considered material. As noted in the Item 3 of Part II of the Company's Annual Report on Form 10-K for the year ended December 31, 2013 and in the Notes to the audited financial statements contained in that report, the Company was engaged by the Office of the Attorney General for the State of New York ("NYAG") regarding a nonpublic investigation it is conducting. The Company has not accrued any amounts with respect to the NYAG investigation, as the Company does not believe a loss is probable, however, it is reasonably possible that a loss may be incurred. As of March 31, 2014 and December 31, 2013, an estimate of the range of loss cannot reasonably be made.

9. NET PERIODIC BENEFIT COSTS

On January 31, 2008, the Bank froze its defined benefit pension plan. The plan covered substantially all Company employees. The plan provides benefits that are based on the employees' compensation and years of service. Under the freeze, eligible employees will receive, at retirement, the benefits already earned through January 31, 2008, but have not accrued any additional benefits since then. As a result, service cost is no longer incurred.

The Bank uses an actuarial method of amortizing prior service cost and unrecognized net gains or losses which result from actual expense and assumptions being different than those that are projected. The amortization method the Bank used recognized the prior service cost and net gains or losses over the average remaining service period of active employees.

The Bank also maintains a nonqualified supplemental executive retirement plan covering certain members of the Company’s senior management. The Bank uses an actuarial method of amortizing unrecognized net gains or losses which result from actual expense and assumptions being different than those that are projected. The amortization method the Bank uses recognizes the net gains or losses over the average remaining service period of active employees.

The Bank did not contribute to the defined benefit pension plan in the first three months of 2014 but plans to contribute $90 thousand before the end of the year.

The following table presents the net periodic cost for the Bank’s defined benefit pension plan and supplemental executive retirement plan for the three month periods ended March 31, 2014 and 2013:

Table of Contents

	Three months ended March 31, (in thousands)			
	Pension Benefits		Supplemental Executive Retirement Plan	
	2014	2013	2014	2013
Service cost	$ -	$ -	$ 42	$ 41
Interest cost	51	48	40	31
Expected return on plan assets	(76)	(65)	-	-
Amortization of prior service cost	-	-	8	17
Amortization of the net loss	5	17	21	27
Net periodic cost (benefit)	$ (20)	$ -	$ 111	$ 116

10. RECENT ACCOUNTING PRONOUNCEMENTS

Accounting Standards Update ("ASU") 2014-04, Reclassification of Collateralized Mortgage Loans upon a Troubled Debt Restructuring. The objective of this proposed ASU is to clarify when an in substance repossession or foreclosure occurs, that is, when a creditor should be considered to have received physical possession of residential real estate property collateralizing a consumer mortgage loan, such that all or a portion of the loan should be derecognized and the real estate property recognized. The main provisions would also require additional disclosures regarding the amount of foreclosed residential real estate property held by the creditor and the recorded investments of consumer mortgage loans that are in the process of foreclosure at each interim and annual reporting period. This ASU becomes effective for the Company in fiscal years and interim periods within those years, beginning after December 15, 2014. The Company has not early adopted this guidance and does not expect this guidance to have a significant impact on its financial statements.

ITEM 2 - MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

This Quarterly Report on Form 10-Q may contain certain forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended (the “Securities Act”), and Section 21E of the Securities Exchange Act of 1934, as amended (the “Exchange Act”), that involve substantial risks and uncertainties. When used in this report, or in the documents incorporated by reference herein, the words “anticipate,” “believe,” “estimate,” “expect,” “intend,” “may,” “pla “seek,” and similar expressions identify such forward-looking statements. These forward-looking statements include statements regarding the Company’s business plans, prospects, growth and operating strategies, statements regarding the asset quality of the Company’s loan and investment portfolios, and estimates of the Company’s risks and future costs and benefits.

These forward-looking statements are based largely on the expectations of the Company’s management and are subject to a number of risks and uncertainties, including but not limited to: general economic conditions, either nationally or in the Company’s market areas, that are worse than expected; increased competition among depository or other financial institutions; inflation and changes in the interest rate environment that reduce the Company’s margins or reduce the fair value of financial instruments; changes in laws or government regulations affecting financial institutions, including changes in regulatory fees, monetary policy, and capital requirements; the Company’s ability to enter new markets successfully and capitalize on growth opportunities; the Company’s ability to successfully integrate acquired entities; changes in accounting pronouncements and practices, as adopted by financial institution regulatory agencies, the Financial Accounting Standards Board and the Public Company Accounting Oversight Board; changes in consumer spending, borrowing and saving habits; changes in the Company’s organization, compensation and benefit plans; and other factors discussed elsewhere in this Quarterly Report on Form 10-Q, as well as in the Company’s periodic reports filed with the SEC, in particular the “Risk Factors” discussed in Item 1A of the Company’s Annual Report on Form 10-K for the fiscal year ended December 31, 2013. Many of these factors are beyond the Company’s control and are difficult to predict.

Because of these and other uncertainties, the Company’s actual results, performance or achievements could differ materially from those contemplated, expressed or implied by the forward-looking statements contained herein. Forward-looking statements speak only as of the date they are made. The Company undertakes no obligation to publicly update or revise forward-looking information, whether as a result of new, updated information, future events or otherwise.

APPLICATION OF CRITICAL ACCOUNTING ESTIMATES

The Company’s Unaudited Consolidated Financial Statements included in this Quarterly Report on Form 10-Q are prepared in accordance with U.S. GAAP and follow general practices within the industries in which it operates. Application of these principles requires management to make estimates, assumptions and judgments that affect the amounts reported in the Company's Unaudited Consolidated Financial Statements and Notes. These estimates, assumptions and judgments are based on information available as of the date of the Unaudited Consolidated Financial Statements. Accordingly, as this information changes, the Unaudited Consolidated Financial Statements could reflect different estimates, assumptions and judgments. Certain policies inherently have a greater reliance on the use of estimates, assumptions and judgments, and as such, have a greater possibility of producing results that could be materially different than originally reported. Estimates, assumptions and judgments are necessary when assets and liabilities are required to be recorded at fair value, when a decline in the value of an asset not carried on the financial statements at fair value warrants an impairment write-down or valuation reserve to be established, or when an asset or liability needs to be recorded contingent upon a future event. Carrying assets and liabilities at fair value inherently results in more financial statement volatility. The fair values and the information used to record valuation adjustments for certain assets and liabilities are based either on quoted market prices or are provided by other third-party sources, when available. When third-party information is not available, valuation adjustments are estimated in good faith by management primarily through the use of internal cash flow modeling techniques. Refer to Note 3 – "Fair Value Measurements" to the Company's Unaudited Consolidated Financial Statements included in Item 1 of this Quarterly Report on Form 10-Q for further detail on fair value measurement.

Significant accounting policies followed by the Company are presented in Note 1 – "Organization and Summary of Significant Accounting Policies" to the Audited Consolidated Financial Statements included in Item 8 in its Annual Report on Form 10-K for the year ended December 31, 2013. These policies, along with the disclosures presented in the other Notes to the Company's Audited Consolidated Financial Statements contained in its Annual Report on Form 10-K and in this financial review, provide information on how significant assets and liabilities are presented in the Company's Unaudited Consolidated Financial Statements and how those values are determined.

Based on the valuation techniques used and the sensitivity of financial statement amounts to the methods, assumptions and estimates underlying those amounts, management has identified the determination of the allowance for loan and lease losses and valuation of goodwill to be the accounting areas that require the most subjective or complex judgments, and as such, could be most subject to revision as new information becomes available.

Table of Contents

Allowance for Loan and Lease Losses

The allowance for loan and lease losses represents management's estimate of probable losses in the Company's loan and lease portfolio. Determining the amount of the allowance for loan and lease losses is considered a critical accounting estimate because it requires significant judgment on the part of management and the use of estimates related to the amount and timing of expected future cash flows on impaired loans and leases, estimated losses on pools of homogeneous loans and leases based on historical loss experience and consideration of current economic trends and conditions, all of which may be susceptible to significant change. The loan and lease portfolio also represents the largest asset type on the Company's Unaudited Consolidated Balance Sheets. Note 1 to the Audited Consolidated Financial Statements included in Item 8 in the Company's Annual Report on Form 10-K for the year ended December 31, 2013, describes the methodology used to determine the allowance for loan and lease losses.

Goodwill

The amount of goodwill reflected in the Company's Unaudited Consolidated Financial Statements is required to be tested by management for impairment on at least an annual basis. The test for impairment of goodwill on the identified reporting unit is considered a critical accounting estimate because it requires judgment on the part of management and the use of estimates related to the growth assumptions and market multiples used in the valuation model. The goodwill impairment testing is typically performed annually as of December 31st.   No impairment charges were incurred in the most recent test and the fair value of the tested reporting unit substantially exceeded its fair value. There were no triggering events in the three month period ended March 31, 2014 that resulted in an interim impairment test.

ANALYSIS OF FINANCIAL CONDITION

Loan and Lease Activity

Total loans and leases grew to $660.7 million at March 31, 2014, a $13.7 million, or 2.1%, increase from total loans and leases of $647.0 million at December 31, 2013. Total loans and leases grew $72.6 million, or 12.3%, from $588.1 million at March 31, 2013.

Loans secured by real estate were $547.5 million at March 31, 2014, reflecting a $9.6 million, or 1.8%, increase from $537.9 million at December 31, 2013. The Company's commercial real estate portfolio has historically been the fastest growing part of the real estate portfolio, however, the largest growth in the real estate portfolio during the first quarter of 2014 was experienced in the Company's residential mortgages, with the largest percentage increase of 3.0%, or $2.8 million. In the first quarter of 2014, residential mortgages increased $2.4 million, or 2.6%, and residential construction loans increased $0.4 million, or 28.1%, since December 31, 2013. Commercial construction and commercial and multi-family loans increased $6.6 million, or 1.7%, since December 31, 2013.

The Company retained most residential mortgages originated during the first quarter of 2014. During the first quarter of 2013, the Company sold approximately 8.7% of the residential mortgages originated during that quarter to FNMA. Residential mortgages increased to $96.4 million at March 31, 2014. However, residential mortgage originations decreased to $5.7 million in the three month period ended March 31, 2014, compared with $8.6 million in the three month period ended March 31, 2013.

The Bank sells certain fixed rate residential mortgages to FNMA, while maintaining the servicing rights for those mortgages. In the three month period ended March 31, 2014, the Bank did not sell any mortgages to FNMA, as compared with $0.8 million sold during the three month period ended March 31, 2013. At March 31, 2014, the Bank had a loan servicing portfolio principal balance of $62.3 million upon which it earns servicing fees, as compared with $63.5 million at December 31, 2013. The value of the mortgage servicing rights for that portfolio was $0.5 million at March 31, 2014 and December 31, 2013. At March 31, 2014, there were $0.1 million in residential mortgage loans held-for-sale, compared with no residential mortgages held for sale at December 31, 2013. The Company had no commercial loans held-for-sale at March 31, 2014 or December 31, 2013. The Company has never been contacted by FNMA to repurchase any loans due to improper documentation or fraud.

The Company continues to focus on diversified growth with commercial and industrial ("C&I") lending as a way to achieve such diversification in its loan portfolio, which has historically experienced strong growth rates in real estate loans. In the first quarter of 2014, C&I balances increased $4.0 million, or 3.7%, from $107.0 million at December 31, 2013 to $111.0 million at March 31, 2014. C&I loans increased $5.0 million, or 4.7%, from $106.0 million at March 31, 2013.

Table of Contents

Credit Quality of Loan Portfolio

Total non-performing loans and leases, defined as accruing loans and leases greater than 90 days past due and non-accrual loans and leases, totaled $5.2 million, or 0.79% of total loans and leases outstanding, as of March 31, 2014, compared with $13.7 million, or 2.12% of total loans and leases outstanding at December 31, 2013. The $8.5 million, or 62.0%, decrease in non-performing loans and leases is mostly due to a single commercial real estate loan returned to accrual status in the first quarter of 2014. The loan was successfully restructured with a new borrower in the third quarter of 2013 and has since demonstrated repayment performance.

In the first quarter of 2014, commercial credits graded as “special mention” and “substandard” increased $1.4 million from $30.3 million at December 31, 2013 to $31.7 million at March 31, 2014, primarily due to an increase in commercial and multi-family mortgages classified as “special mention” during the first quarter. As noted in Note 4 to these Unaudited Financial Statements, internal risk ratings are the credit quality indicators used by the Company’s management to determine the appropriate allowance for loan and lease losses for commercial credits. “Special mention” and “substandard” loans are weaker credits with a higher risk of loss than “pass” or “watch” credits. As of March 31, 2014, $7.3 million, or 81.3%, of the $9.0 million “substandard” credits were identified as impaired, and thus, individually evaluated for specific reserves.

The allowance for loan and lease losses totaled $11.7 million, or 1.78% of total loans and leases outstanding as of March 31, 2014, consistent with the allowance for loan and lease loss to total loans and leases ratio of 1.78% at December 31, 2013. The $0.2 million increase in the allowance from $11.5 million at December 31, 2013 was driven by the $1.5 million increase in commercial loans classified as criticized assets and general loan growth during the quarter, partially offset by loan and lease recoveries and decreases in specific reserves held on impaired loans. The net charge-off (recovery) ratio in the first quarter of 2014 equated to (0.05)% of average net loans and leases, compared with a ratio of (0.15)% and 0.02% in the fourth quarter of 2013 and first quarter of 2013, respectively.

The first quarter coverage ratio of the allowance for loan and lease losses to non-performing loans and leases increased to 225% compared with the fourth quarter of 2013 of 84%, due to the commercial mortgage credit relationship that was returned to accrual status in the first quarter of 2014, as discussed above.

Investing Activities

Total securities were $97.0 million at March 31, 2014, compared with $102.0 million at December 31, 2013. Interest-bearing deposits at other banks, which consist of overnight funds kept at correspondent banks and the Federal Reserve, increased to $30.1 million at March 31, 2014 from $27.3 million at December 31, 2013. Interest-bearing cash increased in the first quarter due to large seasonal influx from municipal deposits from tax receipts. Securities and interest-bearing deposits at correspondent banks made up 16.8% of the Bank's total average interest earning assets in the first quarter of 2014, compared with 18.7% and 23.5% in the fourth quarter of 2013 and first quarter of 2013, respectively.

The Company's highest concentration in its securities portfolio was in available for sale tax-advantaged debt securities issued by state and political subdivisions with 32.9% at March 31, 2014, compared with 31.2% at December 31, 2013. The concentration in U.S. government-sponsored agency bonds was 28.9% of the total securities portfolio at March 31, 2014, compared with 31.3% at December 31, 2013. U.S. government-sponsored mortgage-backed securities comprised 35.7% of the securities portfolio at March 31, 2014, compared with 35.1% at December 31, 2013.

Management believes that the credit quality of the securities portfolio as a whole is strong as the portfolio has no individual securities in a significant unrealized loss position. While interest rates have been near historic lows and long-term rates decreased in the first quarter of 2014 compared to the fourth quarter of 2013, long-term rates increased from the first quarter of 2013. As a result, the net unrealized gain position of the available-for-sale investment portfolio increased from $0.3 million at December 31, 2013, and decreased from $3.6 million at March 31, 2013.

The Company monitors extension and prepayment risk in the securities portfolio to limit potential exposures. Available-for-sale securities with a total fair value of $93.6 million at March 31, 2014, as compared with $71.1 million at December 31, 2013, were pledged as collateral to secure public deposits and for other purposes required or permitted by law. The Company has no direct exposure to subprime mortgages, nor does the Company hold private mortgage-backed securities, credit default swaps, or FNMA or FHLMC preferred stock investments in its investment portfolio.

Funding Activities

Total deposits at March 31, 2014 were $721.9 million, compared with $706.6 million at December 31, 2013, reflecting an increase of $15.3 million, or 2.2%, from the fourth quarter 2013. The increase in deposit balances during the first quarter of 2014 was driven by growth in municipal NOW products due to seasonality of tax collections received. Total NOW deposits increased $13.6 million, or 20.6%, over December 31, 2013.

Table of Contents

The Company's retail deposit growth vehicle for the last three years has been its complementary Better Checking and Better Savings products, which are included in the NOW and regular savings deposit categories, respectively, on the Company's balance sheet. However, the growth in NOW and savings deposits slowed in 2013 as the Better Checking and Better Savings products begin to mature and the Company continued to lower rates on selected deposit products given the Company's current excess liquidity and declining net interest margin in this extended low rate environment. Demand deposits, totaling $140.0 million and $123.1 at March 31, 2014 and 2013, respectively, drove much of the 3.4% year-over-year increase in total deposits mostly due to commercial demand deposit growth.

In the first quarter of 2014, time deposits decreased slightly to $108.7 million from $110.1 million at December 31, 2013. Time deposit rates remain low, resulting in recent balance declines, as customers have preferred liquid savings deposits.

Other borrowings, which typically include the Bank's overnight line of credit and other advances with the FHLBNY, were $9.0 million at March 31, 2014 and December 31, 2013. The Company remains in an overall liquid position, and therefore has not needed to add to its wholesale borrowings.

Table of Contents

ANALYSIS OF RESULTS OF OPERATIONS

Average Balance Sheet

The following tables present the significant categories of the assets and liabilities of the Company, interest income and interest expense, and the corresponding yields earned and rates paid for the periods indicated. The assets and liabilities are presented as daily averages. The average loan and lease balances include both performing and non-performing loans and leases. Investments are included at amortized cost. Yields are presented on a non-tax-equivalent basis.

	Three Months Ended March 31, 2014			Three Months Ended March 31, 2013		
	Average Outstanding Balance	Interest Earned/ Paid	Yield/ Rate	Average Outstanding Balance	Interest Earned/ Paid	Yield/ Rate
	(dollars in thousands)			(dollars in thousands)		
ASSETS						
Interest-earning assets:						
Loans and leases, net	$ 641,265	$ 7,510	4.68 %	$ 575,953	$ 7,252	5.04 %
Taxable securities	69,992	449	2.57 %	63,974	417	2.61 %
Tax-exempt securities	33,499	245	2.93 %	34,146	269	3.15 %
Interest bearing deposits at banks	26,238	15	0.23 %	78,426	18	0.09 %
Total interest-earning assets	770,994	$ 8,219	4.26 %	752,499	$ 7,956	4.23 %
Non interest-earning assets:						
Cash and due from banks	14,920			14,376		
Premises and equipment, net	11,210			11,219		
Other assets	39,789			35,719		
Total Assets	$ 836,913			$ 813,813		
LIABILITIES & STOCKHOLDERS' EQUITY						
Interest-bearing liabilities:						
NOW	$ 71,190	$ 76	0.43 %	$ 67,836	$ 113	0.67 %
Regular savings	388,890	265	0.27 %	380,783	327	0.34 %
Time deposits	109,549	415	1.52 %	110,209	450	1.63 %

Other borrowed funds	9,000	79	3.51 %	17,989	153	3.40 %
Junior subordinated debentures	11,330	79	2.79 %	11,330	79	2.79 %
Securities sold U/A to repurchase	14,883	7	0.19 %	14,374	8	0.22 %
Total interest-bearing liabilities	604,842	$ 921	0.61 %	602,521	$ 1,130	0.75 %
Noninterest-bearing liabilities:						
Demand deposits	139,503			122,359		
Other	12,090			12,856		
Total liabilities	$ 756,435			$ 737,736		
Stockholders' equity	80,478			76,077		
Total Liabilities and Equity	$ 836,913			$ 813,813		
Net interest earnings		$ 7,298			$ 6,826	
Net interest margin			3.79 %			3.63 %
Interest rate spread			3.65 %			3.48 %

Table of Contents

Net Income

Net income was $2.0 million in the first quarter of 2014, up from $1.8 million in the first quarter of 2013, primarily due to a $0.5 million increase in net interest income driven by growth in loans and non-interest bearing demand deposits. As a result, return on average equity was 10.01% for the first quarter of 2014 compared with 9.55% in the first quarter of 2013.

Other Results of Operations – Quarterly Comparison

Net interest income was $7.3 million for the first quarter, an increase of 6.9% from the prior-year period, and down 0.6% from the trailing fourth quarter of 2013. Growth in loans and non-interest bearing demand deposits drove the increase over the prior-year period.

Net interest margin decreased 6 basis points to 3.79% from 3.85% in the trailing fourth quarter, primarily driven by a decrease in the yield on interest-earning assets. Net interest margin improved over the 2013 first quarter rate of 3.63%. The increase in net interest margin from the prior-year period was due to a 14 basis point decrease in pricing on Evans' interest bearing liabilities, combined with a 3 basis point increase in the yield on interest-earning assets.

The provision for loan and lease losses was $0.2 million in the 2014 first quarter, down from $0.5 million in the prior-year period. The decrease is due mostly to a lower level of criticized assets in the current quarter in comparison to prior year first quarter. When compared with the trailing fourth quarter of 2013, the provision decreased by $0.1 million.

Non-interest income was $3.4 million, or 31.7% of total revenue, in the quarter, up $0.1 million, or 2.6%, from the prior-year period. Insurance agency revenue of $2.1 million was up $0.1 million, or 6.6%, from the 2013 first quarter, due mostly to increases in property and casualty and wealth management revenue. Compared with the trailing fourth quarter of 2013, total non-interest income increased by 12.5%, mostly due to an increase of $0.6 million, or 35.0%, in insurance agency revenue as a result of seasonal profit sharing.

Total non-interest expense was $7.6 million, an increase of 7.7% from the prior-year period. Personnel expenses, the largest expense item for the Company, were up $0.4 million, or 9.5%, from the prior-year period, and reflecting annual merit increases and personnel hires to support the Company's growth strategy.

Income tax expense for the quarter was $1.0 million, representing an effective tax rate of 31.1% compared with an effective tax rate of 30.4% in the first quarter of 2013.

CAPITAL

The Company consistently maintains regulatory capital ratios significantly above the federal “well capitalized” standard, including a Tier 1 leverage ratio of 10.20% and 10.36% at March 31, 2014 and December 31, 2013, respectively. Book value per share of the Company’s common stock was $19.41 at March 31, 2014, compared with $19.18 at December 31, 2013. Tangible book value per share (a non-GAAP measure) at March 31, 2014 was $17.44, compared with $17.26 at December 31, 2013. The increase in both book value and tangible book value per share is a result of the Company’s repurchase of shares in the first quarter.

Tangible book value per share is a non-GAAP financial measure. The Company calculates tangible book value per share by dividing tangible book value by the number of common shares outstanding, as compared to GAAP book value per share, which the Company calculates by dividing GAAP book value by the number of common shares outstanding. Management believes that this information is consistent with treatment by bank regulatory agencies, which exclude intangible assets from the calculation of risk-based capital ratios. Accordingly, management believes that this non-GAAP financial measure provides information that is important to investors and that is useful in understanding the Company’s capital position and ratios. Further, management believes that presentation of this measure, together with the accompanying reconciliation, provides a complete understanding of factors and trends affecting the Company’s business and allows investors to view the Company’s performance in a manner similar to management, the financial services industry, bank stock analysts and regulatory agencies. However, this non-GAAP financial measure is supplemental and is not a substitute for an analysis based on GAAP financial measures. Note that other companies may use different calculations for this measure, and therefore the Company’s presentation of tangible book value per share may not be comparable to similarly titled measures reported by other companies. Investors should review the Company’s consolidated financial statements in their entirety and should not rely on any single financial measure.

Table of Contents

A reconciliation of this non-GAAP financial measure, tangible book value per share, to the most directly comparable GAAP financial measure, book value, is set forth in the following table:

($ in thousands, except per share data)	March 31, 2014	December 31, 2013
Stockholders' equity ("book value")	$ 80,517	$ 80,712
Goodwill (related to insurance agency reporting unit)	(8,101)	(8,101)
Intangible assets (related to insurance agency reporting unit)	(67)	(108)
Tangible book value	$ 72,349	$ 72,503
Number of common shares outstanding	4,147,666	4,201,362
Tangible book value per share	$ 17.44	$ 17.26

On February 18, 2014, the Company declared a cash dividend of $0.31 per share on the Company's outstanding common stock. The dividend was paid on April 8, 2014 to shareholders of record as of March 18, 2014.

LIQUIDITY

The Bank utilizes cash flows from the investment portfolio and federal funds sold balances to manage the liquidity requirements related to loan demand and deposit fluctuations. The Bank also has many borrowing options. As a member of the FHLB the Bank is able to borrow funds at competitive rates. Advances of up to $172.3 million can be drawn on the FHLB via an Overnight Line of Credit Agreement between the Bank and the FHLB. An amount equal to 25% of the Bank's total assets could be borrowed through the advance programs under certain qualifying circumstances. The Bank also has the ability to purchase up to $14.0 million in federal funds from its correspondent banks. By placing sufficient collateral in safekeeping at the Federal Reserve Bank, the Bank could borrow at the discount window. The Bank's liquidity needs also can be met by more aggressively pursuing time deposits, or accessing the brokered time deposit market, including the Certificate of Deposit Account Registry Service ("CDARS") network. The Company's primary source of liquidity is dividends from the Bank. Additionally, the Company has access to capital markets as a funding source.

Cash flows from the Bank's investment portfolio are laddered, so that securities mature at regular intervals, to provide funds from principal and interest payments at various times as liquidity needs may arise. Contractual maturities are also laddered, with consideration as to the volatility of market prices. At March 31, 2014, approximately 1.6% of the

Bank's securities had contractual maturity dates of one year or less and approximately 28.8% had maturity dates of five years or less.

Management, on an ongoing basis, closely monitors the Company's liquidity position for compliance with internal policies, and believes that available sources of liquidity are adequate to meet funding needs in the normal course of business. As part of that monitoring process, management calculates the 90-day liquidity each month by analyzing the cash needs of the Bank. Included in the calculation are liquid assets and potential liabilities. Management stresses the potential liabilities calculation to ensure a strong liquidity position. Included in the calculation are assumptions of some significant deposit run-off as well as funds needed for loan closings and investment purchases. At March 31, 2014, in the Company's internal stress test, the Company had net short-term liquidity of $73.8 million as compared with $121.8 million at December 31, 2013. Available assets of $134.7 million, divided by public and purchased funds of $137.6 million, resulted in a long-term liquidity ratio of 98% at March 31, 2014, compared with 119% at December 31, 2013.

Management does not anticipate engaging in any activities, either currently or in the long term, for which adequate funding would not be available and which would therefore result in significant pressure on liquidity. However, continued economic recession could negatively impact the Company's liquidity.

The Company believes that the Bank maintains a sufficient level of U.S. government and government agency securities and New York State municipal bonds that can be pledged as collateral for municipal deposits.

Table of Contents

ITEM 3 - QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Additional information responsive to this Item is contained in the Liquidity section of Management's Discussion and Analysis of Financial Condition and Results of Operations, which information is incorporated herein by reference.

Market risk is the risk of loss from adverse changes in market prices and/or interest rates of the Bank's financial instruments. The primary market risk the Company is exposed to is interest rate risk. The core banking activities of lending and deposit-taking expose the Bank to interest rate risk, which occurs when assets and liabilities reprice at different times and by different amounts as interest rates change. As a result, net interest income earned by the Bank is subject to the effects of changing interest rates. The Bank measures interest rate risk by calculating the variability of net interest income in future periods under various interest rate scenarios using projected balances for interest-earning assets and interest-bearing liabilities. Management's philosophy toward interest rate risk management is to limit the variability of net interest income to changes in net interest rates. The balances of financial instruments used in the projections are based on expected growth from forecasted business opportunities, anticipated prepayments of loans, and expected maturities of investment securities, loans and deposits. Management supplements the modeling technique described above with analysis of market values of the Bank's financial instruments and changes to such market values given changes in the interest rates.

The Bank's Asset-Liability Committee, which includes members of senior management, monitors the Bank's interest rate sensitivity with the aid of a model that considers the impact of ongoing lending and deposit taking activities, as well as interrelationships in the magnitude and timing of the repricing of financial instruments, including the effect of changing interest rates on expected prepayments and maturities. When deemed prudent, management has taken actions, and intends to do so in the future, to mitigate exposure to interest rate risk through the use of on- or off-balance sheet financial instruments. Possible actions include, but are not limited to, changing the pricing of loan and deposit products, and modifying the composition of interest-earning assets and interest-bearing liabilities, and reliance on other financial instruments used for interest rate risk management purposes.

The following table demonstrates the possible impact of changes in interest rates on the Bank's net interest income over a 12-month period of time:

SENSITIVITY OF NET INTEREST INCOME TO CHANGES IN INTEREST RATES

	Calculated increase in projected annual net interest income (in thousands)	
	March 31, 2014	December 31, 2013
Changes in interest rates		
+200 basis points	$ 1,242	$ 789
+100 basis points	1,559	1,263
-100 basis points	NM	NM
-200 basis points	NM	NM

Many assumptions were utilized by management to calculate the impact that changes in interest rates may have on the Bank's net interest income. The more significant assumptions related to the rate of prepayments of mortgage-related assets, loan and deposit volumes and pricing, and deposit maturities. The Bank assumed immediate changes in rates including 200 basis point rate changes. In the event that the 200 basis point rate changes cannot be achieved, the applicable rate changes are limited to lesser amounts such that interest rates cannot be less than zero. These assumptions are inherently uncertain and, as a result, the Bank cannot precisely predict the impact of changes in interest rates on net interest income. Actual results may differ significantly due to the timing, magnitude, and frequency of interest rate changes in market conditions and interest rate differentials (spreads) between maturity/repricing categories, as well as any actions such as those previously described, which management may take to counter such changes. In light of the uncertainties and assumptions associated with the process, the amounts presented in the table and changes in such amounts are not considered significant to the Bank's projected net interest income.

Table of Contents

ITEM 4 - CONTROLS AND PROCEDURES

DISCLOSURE CONTROLS AND PROCEDURES

The Company’s management, with the participation of the Company’s principal executive officer and principal financial officer, evaluated the effectiveness of the design and operation of the Company’s disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act) as of March 31, 2014 (the end of the period covered by this Report). Based on that evaluation, the Company’s principal executive and principal financial officers concluded that as of March 31, 2014 the Company’s disclosure controls and procedures were effective.

CHANGES IN INTERNAL CONTROL OVER FINANCIAL REPORTING

No changes in the Company’s internal control over financial reporting were identified in connection with the evaluation required by paragraph (d) of Rule 13a-15 or Rule 15d-15 under the Exchange Act that occurred during the fiscal quarter ended March 31, 2014 that have materially affected, or are reasonably likely to materially affect, the Company’s internal control over financial reporting.

PART II - OTHER INFORMATION

ITEM 2 – UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

In March 2013, the Company announced it had been authorized by its Board of Directors to purchase up to 100,000 shares of the Company’s outstanding common stock. In the first quarter of 2014, the Company purchased shares of its common stock as follows:

Issuer Purchases of Equity Securities

Period	Total Number of Shares Purchased (1)	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs (2)	Maximum Number of Shares that may yet be Purchased Under the Plans or Programs
January 2014:				
January 1, 2014 - January 31, 2014	-	$ -	-	-
February 2014:				
February 1, 2014 - February 28, 2014	-	$ -	-	-
March 2014:				
March 1, 2014 - March 31, 2014	65,978	$ 23.95	59,800	27,168
Total:	65,978	$ 23.95	59,800	27,168

(1) 6,178 of the total shares purchased in the period consist of shares constructively tendered to the Company by attestation in satisfaction of the exercise price due upon exercise of options issued pursuant to the Company's 2009 Long-Term Incentive Plan. The "average price paid per share" reported in the table above, with respect to such shares, reflects the fair market value of the Company's common stock on the exercise date, which was the closing sales price of the Company's common stock as reported on the NYSE MKT on that date. The remaining 59,800 shares were purchased under the Company's publicly-announced repurchase program, described in footnote (2) below.

(2) On March 25, 2013, the Board of Directors authorized the Company to repurchase up to 100,000 shares of the Company's common stock. The repurchase program has no fixed expiration date but may be suspended or discontinued at any time. The Company did not make any repurchases during the quarter ended March 31, 2014 except pursuant to this publically announced program.

Table of Contents

ITEM 6 – EXHIBITS

The information called for by this item is incorporated herein by reference to the Exhibit Index included immediately following the signature page to this Quarterly Report on Form 10-Q.

Table of Contents

SIGNATURES

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

Evans Bancorp, Inc.

DATE

May 2, 2014

/s/ David J. Nasca
David J. Nasca
President and CEO
(Principal Executive Officer)

DATE

May 2, 2014

/s/ Gary A. Kajtoch
Gary A. Kajtoch
Treasurer
(Principal Financial Officer)

Table of Contents

EXHIBIT INDEX

Exhibit No.	Name
31.1	Certification of Principal Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2	Certification of the Principal Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1	Certification of Principal Executive Officer pursuant to 18 USC Section 1350 Chapter 63 of Title 18, United States Code, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
32.2	Certification of Principal Financial Officer pursuant to 18 USC Section 1350 Chapter 63 of Title 18, United States Code, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
101	The following materials from Evans Bancorp, Inc.'s Quarterly Report on Form 10-Q for the quarter ended March 31, 2014, formatted in XBRL (eXtensible Business Reporting Language): (i) Unaudited Consolidated Balance Sheets – March 31, 2014 and December 31, 2013; (ii) Unaudited Consolidated Statements of Income – Three months ended March 31, 2014 and 2013; (iii) Unaudited Statements of Consolidated Comprehensive Income – Three months ended March 31, 2014 and 2013; (iv) Unaudited Consolidated Statements of Stockholder's Equity – Three months ended March 31, 2014 and 2013; (v) Unaudited Consolidated Statements of Cash Flows – Three months ended March 31, 2014 and 2013; and (vi) Notes to Unaudited Consolidated Financial Statements.