EVANS BANCORP INC
Form 10-Q
August 03, 2015

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 June 30, 2015

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)

Not Applicable

(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 4,243,149 shares as of July 31, 2015

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UNAUDITED CONSOLIDATED BALANCE SHEETS
JUNE 30, 2015 AND DECEMBER 31, 2014
(in thousands, except share and per share amounts)

	June 30, 2015	December 31, 2014
ASSETS		
Cash and due from banks	$ 14,407	$ 8,784
Interest-bearing deposits at banks	34,158	2,114
Securities:		
Available for sale, at fair value (amortized cost: $104,284 at June 30, 2015; $94,048 at December 31, 2014)	105,269	95,533
Held to maturity, at amortized cost (fair value: $1,440 at June 30, 2015; $1,574 at December 31, 2014)	1,465	1,599
Federal Home Loan Bank common stock, at amortized cost	1,296	1,439
Federal Reserve Bank common stock, at amortized cost	1,478	1,486
Loans, net of allowance for loan losses of $13,110 at June 30, 2015 and $12,533 at December 31, 2014	697,722	683,131
Properties and equipment, net of accumulated depreciation of $15,651 at June 30, 2015 and $15,129 at December 31, 2014	10,200	10,224
Goodwill	8,101	8,101
Bank-owned life insurance	20,704	20,415
Other assets	13,747	13,983
TOTAL ASSETS	$ 908,547	$ 846,809
LIABILITIES AND STOCKHOLDERS' EQUITY		
LIABILITIES		
Deposits:		
Demand	$ 163,862	$ 158,631
NOW	79,266	72,670
Regular savings	431,555	363,542
Time	99,482	112,792
Total deposits	774,165	707,635
Securities sold under agreement to repurchase	11,009	13,778
Other short term borrowings	10,000	13,700
Other liabilities	13,848	14,578
Junior subordinated debentures	11,330	11,330
Total liabilities	820,352	761,021
CONTINGENT LIABILITIES AND COMMITMENTS		

STOCKHOLDERS' EQUITY:		
Common stock, $.50 par value, 10,000,000 shares authorized; 4,247,469 and 4,241,797 shares issued at June 30, 2015 and December 31, 2014, respectively, and 4,239,929 and 4,203,684 outstanding at June 30, 2015 and December 31, 2014, respectively	2,126	2,123
Capital surplus	42,969	43,102
Treasury stock, at cost, 7,540 shares and 38,113 at June 30, 2015 and December 31, 2014, respectively	(42)	(751)
Retained earnings	44,885	42,822
Accumulated other comprehensive loss, net of tax	(1,743)	(1,508)
Total stockholders' equity	88,195	85,788
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	$ 908,547	$ 846,809

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THREE MONTHS ENDED JUNE 30, 2015 AND 2014
(in thousands, except share and per share amounts)

	Three Months Ended June 30,	
	2015	2014
INTEREST INCOME		
Loans	$ 7,934	$ 7,879
Interest bearing deposits at banks	33	15
Securities:		
Taxable	429	455
Non-taxable	240	243
Total interest income	8,636	8,592
INTEREST EXPENSE		
Deposits	860	756
Other borrowings	46	75
Junior subordinated debentures	82	79
Total interest expense	988	910
NET INTEREST INCOME	7,648	7,682
PROVISION (CREDIT) FOR LOAN LOSSES	415	176
NET INTEREST INCOME AFTER PROVISION FOR LOAN LOSSES	7,233	7,506
NON-INTEREST INCOME		
Bank charges	411	464
Insurance service and fees	1,821	1,586
Data center income	69	101
Gain on loans sold	58	40
Bank-owned life insurance	152	151
Other	965	713
Total non-interest income	3,476	3,055
NON-INTEREST EXPENSE		
Salaries and employee benefits	5,066	4,564
Litigation expense	-	1,000
Occupancy	697	685
Repairs and maintenance	215	180
Advertising and public relations	231	281
Professional services	670	418
Technology and communications	262	278
Amortization of intangibles	-	40
FDIC insurance	148	112
Other	952	774
Total non-interest expense	8,241	8,332
INCOME BEFORE INCOME TAXES	2,468	2,229
INCOME TAX PROVISION	793	650
NET INCOME	$ 1,675	$ 1,579

Net income per common share-basic	$ 0.40	$ 0.38
Net income per common share-diluted	$ 0.39	$ 0.37
Cash dividends per common share	$ -	$ -
Weighted average number of common shares outstanding	4,234,334	4,166,497
Weighted average number of diluted shares outstanding	4,309,688	4,248,249

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(in thousands, except share and per share amounts)

	Six Months Ended June 30, 2015	2014
INTEREST INCOME		
Loans	$ 15,746	$ 15,389
Interest bearing deposits at banks	34	31
Securities:		
Taxable	835	904
Non-taxable	477	488
Total interest income	17,092	16,812
INTEREST EXPENSE		
Deposits	1,643	1,512
Other borrowings	60	160
Junior subordinated debentures	160	159
Total interest expense	1,863	1,831
NET INTEREST INCOME	15,229	14,981
PROVISION (CREDIT) FOR LOAN LOSSES	616	328
NET INTEREST INCOME AFTER PROVISION FOR LOAN LOSSES	14,613	14,653
NON-INTEREST INCOME		
Bank charges	820	925
Insurance service and fees	3,650	3,718
Data center income	92	207
Gain on loans sold	81	40
Bank-owned life insurance	289	296
Other	1,610	1,263
Total non-interest income	6,542	6,449
NON-INTEREST EXPENSE		
Salaries and employee benefits	9,860	9,260
Litigation expense	-	1,000
Occupancy	1,392	1,428
Repairs and maintenance	388	356

Advertising and public relations	442	503
Professional services	1,180	936
Technology and communications	522	578
Amortization of intangibles	-	81
FDIC insurance	295	274
Other	1,674	1,535
Total non-interest expense	15,753	15,951
INCOME BEFORE INCOME TAXES	5,402	5,151
INCOME TAX PROVISION	1,822	1,559
NET INCOME	$ 3,580	$ 3,592
Net income per common share-basic	$ 0.85	$ 0.86
Net income per common share-diluted	$ 0.83	$ 0.84
Cash dividends per common share	$ 0.36	$ 0.31
Weighted average number of common shares outstanding	4,233,196	4,183,414
Weighted average number of diluted shares outstanding	4,309,423	4,264,889

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UNAUDITED STATEMENTS OF CONSOLIDATED COMPREHENSIVE INCOME
THREE MONTHS ENDED JUNE 30, 2015 AND 2014
(in thousands, except share and per share amounts)

	Three Months Ended June 30,			
	2015		2014	
NET INCOME		$ 1,675		$ 1,579
OTHER COMPREHENSIVE INCOME, NET OF TAX:				
Unrealized (loss) gain on available-for-sale securities:				
Unrealized (loss) gain on available-for-sale securities	(637)		428	
Less: Reclassification of gain on sale of securities	-		-	
		(637)		428
Defined benefit pension plans:				
Amortization of prior service cost	5		4	
Amortization of actuarial assumptions	37		15	
Total		42		19
OTHER COMPREHENSIVE (LOSS) INCOME, NET OF TAX		(595)		447
COMPREHENSIVE INCOME		$ 1,080		$ 2,026

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SIX MONTHS ENDED JUNE 30, 2015 AND 2014
(in thousands, except share and per share amounts)

	Six Months Ended June 30,			
	2015		2014	
NET INCOME		$ 3,580		$ 3,592
OTHER COMPREHENSIVE INCOME, NET OF TAX:				
Unrealized (loss) gain on available-for-sale securities:				
Unrealized (loss) gain on available-for-sale securities	(306)		789	
Less: Reclassification of gain on sale of securities	-		-	
		(306)		789
Defined benefit pension plans:				
Amortization of prior service cost	10		9	
Amortization of actuarial assumptions	61		31	
Total		71		40
OTHER COMPREHENSIVE (LOSS) INCOME, NET OF TAX		(235)		829
COMPREHENSIVE INCOME		$ 3,345		$ 4,421

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SIX MONTHS ENDED JUNE 30, 2015 AND 2014
(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, 2013	$ 2,106	$ 42,619	$ 37,370	$ (1,263)	$ (120)	$ 80,712
Net Income			3,592			3,592
Other comprehensive income				829		829
Cash dividends ($0.31 per common share)			(1,305)			(1,305)
Stock options and restricted stock expense		220				220
Excess tax expense from stock-based compensation		31				31
Issued 20,517 restricted shares	11	(11)				-
Repurchased 59,800 shares					(1,436)	(1,436)
Reissued 5,093 shares in stock option exercise		(51)			106	55
Reissued 5,400 shares under dividend reinvestment plan		9			115	124
Issued 7,186 shares through Employee Stock Purchase Plan	3	124				127
Balance, June 30, 2014	$ 2,120	$ 42,941	$ 39,657	$ (434)	$ (1,335)	$ 82,949
Balance, December 31, 2014	$ 2,123	$ 43,102	$ 42,822	$ (1,508)	$ (751)	$ 85,788
Net Income			3,580			3,580
Other comprehensive loss				(235)		(235)
Cash dividends ($0.36 per common share)			(1,517)			(1,517)
Stock options and restricted stock expense		263				263
Excess tax expense from stock-based compensation		44				44
Reissued 20,592 restricted shares, net of 588 forfeitures		(503)			503	-
Repurchased 3,397 shares in Treasury stock					(83)	(83)

Reissued 8,034 shares in stock option exercise		(55)			155	100
Reissued 5,582 shares under dividend reinvestment plan		4			134	138
Issued 5,672 shares in Employee Stock Purchase Plan	3	114				117
Balance, June 30, 2015	$ 2,126	$ 42,969	$ 44,885	$ (1,743)	$ (42)	$ 88,195

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UNAUDITED CONSOLIDATED STATEMENTS OF CASH FLOWS
SIX MONTHS ENDED JUNE 30, 2015 AND 2014
(in thousands)

	Six Months Ended June 30, 2015	2014
OPERATING ACTIVITIES:		
Interest received	$ 16,916	$ 16,934
Fees received	5,795	6,141
Interest paid	(1,939)	(1,842)
Cash paid to employees and vendors	(15,932)	(15,317)
Cash contributed to pension plan	(165)	-
Income taxes paid	(601)	(2,785)
Proceeds from sale of loans held for resale	9,772	3,439
Originations of loans held for resale	(10,295)	(3,636)
Net cash provided by operating activities	3,551	2,934
INVESTING ACTIVITIES:		
Available for sales securities:		
Purchases	(24,370)	(8,900)
Proceeds from maturities, calls, and payments	14,299	7,144
Held to maturity securities:		
Purchases	(50)	(330)
Proceeds from maturities, calls, and payments	184	781
Proceeds from property insurance	927	-
Additions to properties and equipment	(499)	(275)
Purchase of tax credit investment	(831)	(1,467)
Net increase in loans	(14,360)	(16,304)
Net cash used in investing activities	(24,700)	(19,351)
FINANCING ACTIVITIES:		
Proceeds from (repayments of) borrowings, net	(6,469)	(3,231)
Net increase in deposits	66,531	558
Dividends paid	(1,517)	(1,305)

Repurchase of treasury stock	(83)	(1,501)
Issuance of common stock	117	183
Reissuance of treasury stock	237	188
Net cash provided by (used in) financing activities	58,816	(5,108)
Net increase (decrease) in cash and equivalents	37,667	(21,525)
CASH AND CASH EQUIVALENTS:		
Beginning of period	10,898	41,954
End of period	$ 48,565	$ 20,429

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SIX MONTHS ENDED JUNE 30, 2015 AND 2014
(in thousands)

	Six Months Ended June 30,	
	2015	2014
RECONCILIATION OF NET INCOME TO NET CASH PROVIDED BY OPERATING ACTIVITIES:		
Net income	$ 3,580	$ 3,592
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	745	827
Deferred tax expense (benefit)	191	(241)
Provision for loan losses	616	328
Gain on loans sold	(81)	(40)
Stock options and restricted stock expense	263	221
Proceeds from sale of loans held for resale	9,772	3,439
Originations of loans held for resale	(10,295)	(3,636)
Cash contributed to pension plan	(165)	-
Changes in assets and liabilities affecting cash flow:		
Other assets	(1,112)	344
Other liabilities	37	(1,900)
NET CASH PROVIDED BY OPERATING ACTIVITIES	$ 3,551	$ 2,934

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PART 1 – FINANCIAL INFORMATION

ITEM 1 – FINANCIAL STATEMENTS

EVANS BANCORP, INC. AND SUBSIDIARIES

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

THREE AND SIX MONTH PERIODS ENDED JUNE 30, 2015 AND 2014

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 accompanying consolidated financial statements are unaudited. In the opinion of management, all adjustments necessary for a fair presentation of the Company’s financial position and results of operations for the interim periods have been made. During the six month period ended June 30, 2015, the Company revised the unaudited Consolidated Statement of Cash Flows for the six month period ended June 30, 2014 to correct errors involving a $347 thousand increase within “Net cash provided by operating activities”, a $347 thousand increase in “Net cash used in investing activities”, a $80 thousand increase within “Depreciation and amortization”, $483 thousand increase within “Change in other assets affecting cash flow”, and a $216 thousand increase within “Change in other liabilities affecting cash flow” line items. The Company has assessed the materiality of this correction and concluded, based on qualitative and quantitative considerations, in accordance with Staff Accounting Bulletin No. 99, that the adjustments were not material to our previously reported financial statements.

The results of operations for the three and six month periods ended June 30, 2015 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, 2014.

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2. SECURITIES

The amortized cost of securities and their approximate fair value at June 30, 2015 and December 31, 2014 were as follows:

	June 30, 2015 (in thousands)			
	Amortized Cost	Unrealized Gains	Losses	Fair Value
Available for Sale:				
Debt securities:				
U.S. government agencies	$ 24,120	$ 261	$ (301)	$ 24,080
States and political subdivisions	38,621	801	(118)	39,304
Total debt securities	$ 62,741	$ 1,062	$ (419)	$ 63,384
Mortgage-backed securities:				
FNMA	$ 13,957	$ 434	$ (19)	$ 14,372
FHLMC	5,275	94	(66)	5,303
GNMA	7,867	98	(67)	7,898
CMO	14,444	58	(190)	14,312
Total mortgage-backed securities	$ 41,543	$ 684	$ (342)	$ 41,885
Total securities designated as available for sale	$ 104,284	$ 1,746	$ (761)	$ 105,269
Held to Maturity:				
Debt securities				
States and political subdivisions	$ 1,465	$ 6	$ (31)	$ 1,440
Total securities designated as held to maturity	$ 1,465	$ 6	$ (31)	$ 1,440

	December 31, 2014 (in thousands)			
	Amortized Cost	Unrealized Gains	Losses	Fair Value

Available for Sale:				
Debt securities:				
U.S. government agencies	$ 26,687	$ 305	$ (275)	$ 26,717
States and political subdivisions	30,182	927	(49)	31,060
Total debt securities	$ 56,869	$ 1,232	$ (324)	$ 57,777
Mortgage-backed securities:				
FNMA	$ 14,653	$ 516	$ (15)	$ 15,154
FHLMC	5,901	121	(64)	5,958
GNMA	6,014	143	(27)	6,130
CMO	10,611	42	(139)	10,514
Total mortgage-backed securities	$ 37,179	$ 822	$ (245)	$ 37,756
Total securities designated as available for sale	$ 94,048	$ 2,054	$ (569)	$ 95,533
Held to Maturity:				
Debt securities				
States and political subdivisions	$ 1,599	$ 7	$ (32)	$ 1,574
Total securities designated as held to maturity	$ 1,599	$ 7	$ (32)	$ 1,574

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Available for sale securities with a total fair value of $68.6 million and $68.8 million at June 30, 2015 and December 31, 2014, 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 no borrowed funds as of June 30, 2015, and had a total of $13.7 million in borrowed funds with FHLBNY at December 31, 2014. 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 $1.3 million and $1.4 million in FHLBNY stock as of June 30, 2015 and December 31, 2014, respectively, 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 June 30, 2015 and December 31, 2014 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.

	June 30, 2015		December 31, 2014	
	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	$ 2,641	$ 2,659	$ 8,172	$ 8,256
Due after one year through five years	28,639	29,150	22,118	22,597
Due after five years through ten years	22,094	22,172	20,517	20,589
Due after ten years	9,367	9,403	6,062	6,335
	62,741	63,384	56,869	57,777
Mortgage-backed securities available for sale	41,543	41,885	37,179	37,756

Total available for sale securities	$ 104,284	$ 105,269	$ 94,048	$ 95,533
Debt securities held to maturity:				
Due in one year or less	$ 388	$ 388	$ 478	$ 477
Due after one year through five years	66	67	77	78
Due after five years through ten years	898	881	932	914
Due after ten years	113	104	112	105
	1,465	1,440	1,599	1,574
Total held to maturity securities	$ 1,465	$ 1,440	$ 1,599	$ 1,574

Information regarding unrealized losses within the Company's available for sale securities at June 30, 2015 and December 31, 2014 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.

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June 30, 2015

	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	$ 8,411	$ (155)	$ 5,854	$ (146)	$ 14,265	$ (301)
States and political subdivisions	9,083	(94)	1,187	(24)	10,270	(118)
Total debt securities	$ 17,494	$ (249)	$ 7,041	$ (170)	$ 24,535	$ (419)
Mortgage-backed securities:						
FNMA	$ 4,155	$ (19)	$ - -	$ -	$ 4,155	$ (19)
FHLMC	-	-	1,362	(66)	1,362	(66)
GNMA	3,684	(60)	674	(7)	4,358	(67)
CMO'S	5,153	(92)	4,012	(98)	9,165	(190)
Total mortgage-backed securities	$ 12,992	$ (171)	$ 6,048	$ (171)	$ 19,040	$ (342)
Held To Maturity:						
Debt securities:						
States and political subdivisions	$ 799	$ (30)	$ 89	$ (1)	$ 888	$ (31)
Total temporarily impaired securities	$ 31,285	$ (450)	$ 13,178	$ (342)	$ 44,463	$ (792)

December 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	$ 3,906	$ (26)	$ 7,751	$ (249)	$ 11,657	$ (275)
States and political subdivisions	4,752	(9)	1,902	(40)	6,654	(49)
Total debt securities	$ 8,658	$ (35)	$ 9,653	$ (289)	$ 18,311	$ (324)
Mortgage-backed securities:						
FNMA	$ 1,498	$ (10)	$ 1,731	$ (5)	$ 3,229	$ (15)
FHLMC	-	-	1,482	(64)	1,482	(64)
GNMA	-	-	2,079	(27)	2,079	(27)
CMO'S	1,722	(11)	4,290	(128)	6,012	(139)
Total mortgage-backed securities	$ 3,220	$ (21)	$ 9,582	$ (224)	$ 12,802	$ (245)
Held To Maturity:						
Debt securities:						
States and political subdivisions	$ 371	$ (1)	$ 556	$ (31)	$ 927	$ (32)
Total temporarily impaired securities	$ 12,249	$ (57)	$ 19,791	$ (544)	$ 32,040	$ (601)

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Management has assessed the securities available for sale in an unrealized loss position at June 30, 2015 and December 31, 2014 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 June 30, 2015 and did not record any OTTI charges during 2014. 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

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 June 30, 2015 and December 31, 2014:

(in thousands)	Level 1	Level 2	Level 3	Fair Value
June 30, 2015				
Securities available-for-sale:				
U.S. government agencies	$ -	$ 24,080	$ -	$ 24,080
States and political subdivisions	-	39,304	-	39,304
Mortgage-backed securities	-	41,885	-	41,885
Mortgage servicing rights	-	-	565	565
December 31, 2014				
Securities available-for-sale:				
U.S. government agencies	$ -	$ 26,717	$ -	$ 26,717
States and political subdivisions	-	31,060	-	31,060
Mortgage-backed securities	-	37,756	-	37,756
Mortgage servicing rights	-	-	518	518

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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 would 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 and second quarters of 2015 or during fiscal year 2014.

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. 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.

The following table summarizes the changes in fair value for mortgage servicing rights during the three and six month periods ended June 30, 2015 and 2014, respectively:

	Three months ended June 30,	
(in thousands)	2015	2014
Mortgage servicing rights - April 1	$ 497	$ 471
Gains (losses) included in earnings	4	(31)
Additions from loan sales	64	31
Mortgage servicing rights - June 30	$ 565	$ 471

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(in thousands)	Six months ended June 30, 2015	2014
Mortgage servicing rights - January 1	$ 518	$ 509
Gains (losses) included in earnings	(41)	(69)
Additions from loan sales	88	31
Mortgage servicing rights - June 30	$ 565	$ 471

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

	6/30/2015	12/31/2014
Servicing fees	0.25 %	0.25 %
Discount rate	9.52 %	9.52 %
Prepayment rate (CPR)	8.10 %	9.28 %

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 June 30, 2015 and December 31, 2014:

(in thousands)	Level 1	Level 2	Level 3	Fair Value
June 30, 2015				
Impaired loans	$ -	-	13,882	$ 13,882
December 31, 2014				
Impaired loans	$ -	-	13,716	$ 13,716

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.

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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 $14.8 million, with a valuation allowance of $0.9 million, at June 30, 2015, compared to a gross value for impaired loans of $15.0 million, with a valuation allowance of $1.3 million, at December 31, 2014.

FAIR VALUE OF FINANCIAL INSTRUMENTS

At June 30, 2015 and December 31, 2014, 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:

	June 30, 2015		December 31, 2014	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
	(in thousands)		(in thousands)	
Financial assets:				
Level 1:				
Cash and cash equivalents	$ 48,565	$ 48,565	$ 10,898	$ 10,898
Level 2:				
Available for sale securities	105,269	105,269	95,533	95,533
FHLB and FRB stock	2,774	2,774	2,925	2,925
Level 3:				
Held to maturity securities	1,465	1,440	1,599	1,574
Loans and leases, net	697,722	709,025	683,131	685,148
Mortgage servicing rights	565	565	518	518
Financial liabilities:				
Level 1:				

Demand deposits	$ 163,862	$ 163,862	$ 158,631	$ 158,631
NOW deposits	79,266	79,266	72,670	72,670
Regular savings deposits	431,555	431,555	363,542	363,542
Commitments to extend credit	249	249	245	245
Securities sold under agreement to repurchase	11,009	11,009	13,778	13,778
Level 2:				
Other borrowed funds	10,000	10,000	13,700	13,700
Junior subordinated debentures	11,330	11,330	11,330	11,330
Level 3:				
Time deposits	99,482	100,370	112,792	113,854

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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.

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. There is no active market for the Company’s debentures. The fair value of the junior subordinated debentures is determined using an expected prevent value technique. The fair value of the adjustable-rate debentures approximates their face amount.

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 June 30, 2015 and December 31, 2014. 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.

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4. LOANS AND THE ALLOWANCE FOR LOAN LOSSES

Loan Portfolio Composition

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

	June 30, 2015	December 31, 2014
Mortgage loans on real estate:	(in thousands)	
Residential Mortgages	$ 98,269	$ 98,374
Commercial and multi-family	373,891	363,252
Construction-Residential	709	721
Construction-Commercial	45,232	40,986
Home equities	59,381	59,948
Total real estate loans	577,482	563,281
Commercial and industrial loans	129,812	129,456
Consumer loans	1,699	1,764
Other	1,165	404
Net deferred loan origination costs	674	759
Total gross loans	710,832	695,664
Allowance for loan losses	(13,110)	(12,533)
Loans, net	$ 697,722	$ 683,131

The Bank sells certain fixed rate residential mortgages to FNMA while maintaining the servicing rights for those mortgages. In the three month period ended June 30, 2015, the Bank sold mortgages to FNMA totaling $7.1 million, as compared with $3.4 million in mortgages sold to FNMA in the three month period ended June 30, 2014. During the six month period ended June 30, 2015 and 2014, the Bank sold $9.7 million and $3.4 million in mortgages, respectively, to FNMA. At June 30, 2015, the Bank had a loan servicing portfolio principal balance of $77.3 million upon which it earns servicing fees, as compared with $71.6 million at December 31, 2014. The value of the mortgage servicing rights for that portfolio was $0.6 and $0.5 million at June 30, 2015 and December 31, 2014, respectively. At June 30, 2015, there were $1.0 million in residential mortgage loans held-for-sale, compared with $0.4 million in residential mortgages held-for-sale at December 31, 2014. The Company had no commercial loans held-for-sale at June 30, 2015 or December 31, 2014. 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, 2014. Disclosures related to the basis for accounting for loans, the method for recognizing interest income on loans, the policy for placing loans 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 losses, the policy for charging off loans, 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, 2014. Unless otherwise noted in this Form 10-Q, the policies and methodology described in the Annual Report for the year ended December 31, 2014 are consistent with those utilized by the Company in the three and six months ended June 30, 2015.

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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:

- 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, 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 after 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:

June 30, 2015
(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	$ 37,357	$ 311,618	$ 348,975	$ 77,168
4	2,669	40,588	43,257	33,611
5	5,206	15,720	20,926	11,464
6	-	5,965	5,965	7,465

7	-	-	-	104
Total	$ 45,232	$ 373,891	$ 419,123	$ 129,812

December 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	$ 29,421	$ 299,798	$ 329,219	$ 83,789
4	10,492	50,691	61,183	30,223
5	1,073	7,853	8,926	8,662
6	-	4,757	4,757	6,613
7	-	153	153	169
Total	$ 40,986	$ 363,252	$ 404,238	$ 129,456

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Past Due Loans

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

June 30, 2015
(in thousands)

	30-59 days	60-89 days	90+ days	Total Past Due	Current Balance	Total Balance	90+ Days Accruing	Non-accruing Loans
Commercial and industrial	$ 463	$ 223	$ 148	$ 834	$ 128,978	$ 129,812	$ 103	$ 5,620
Residential real estate:								
Residential	237	243	650	1,130	97,139	98,269	125	1,265
Construction	-	-	-	-	709	709	-	-
Commercial real estate:								
Commercial	-	-	2,525	2,525	371,366	373,891	238	2,812
Construction	-	-	267	267	44,965	45,232	267	-
Home equities	254	518	326	1,098	58,283	59,381	72	475
Consumer	23	1	17	41	1,658	1,699	-	17
Other	-	-	-	-	1,165	1,165	-	-
Total Loans	$ 977	$ 985	$ 3,933	$ 5,895	$ 704,263	$ 710,158	$ 805	$ 10,189

NOTE: Loan and lease balances do not include $674 thousand in net deferred loan origination costs as of June 30, 2015.

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December 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
Commercial and industrial	$ 153	$ 60	$ 274	$ 487	$ 128,969	$ 129,456	$ -	$ 5,500
Residential real estate:								
Residential	848	158	682	1,688	96,686	98,374	-	1,296
Construction	-	-	-	-	721	721	-	-
Commercial real estate:								
Commercial	4,201	3,115	513	7,829	355,423	363,252	-	3,162
Construction	8	-	201	209	40,777	40,986	201	-
Home equities	594	120	192	906	59,042	59,948	-	415
Consumer	13	1	-	14	1,750	1,764	-	17
Other	-	-	-	-	404	404	-	-
Total Loans	$ 5,817	$ 3,454	$ 1,862	$ 11,133	$ 683,772	$ 694,905	$ 201	$ 10,390

NOTE: Loan and lease balances do not include $759 thousand in net deferred loan origination costs as of December 31, 2014.

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Allowance for loan losses

The following tables present the activity in the allowance for loan losses according to portfolio segment, for the six month periods ended June, 2015 and 2014:

June 30, 2015

(in thousands)	Commercial and Industrial	Commercial Real Estate Mortgages*	Consumer **	Residential Mortgages*	HELOC	Unallocated	Total
Allowance for loan losses:							
Beginning balance	$ 4,896	$ 5,650	$ 78	$ 941	$ 819	$ 149	$ 12,533
Charge-offs	(80)	(35)	(11)	-	-	-	(126)
Recoveries	57	23	6	1	-	-	87
Provision	(228)	856	(2)	6	(16)	-	616
Ending balance	$ 4,645	$ 6,494	$ 71	$ 948	$ 803	$ 149	$ 13,110
Allowance for loan losses:							
Ending balance:							
Individually evaluated for impairment	$ 730	$ 59	$ 46	$ 40	$ -	$ -	$ 875
Collectively evaluated for impairment	3,915	6,435	25	908	803	149	12,235
Total	$ 4,645	$ 6,494	$ 71	$ 948	$ 803	$ 149	$ 13,110
Loans:							
Ending balance:							
Individually evaluated for impairment	$ 5,795	$ 5,455	$ 46	$ 2,500	$ 961	$ -	$ 14,757
Collectively evaluated for impairment	124,017	413,668	2,818	96,478	58,420	-	695,401
Total	$ 129,812	$ 419,123	$ 2,864	$ 98,978	$ 59,381	$ -	$ 710,158

* Includes construction loans

** Includes all other consumer loans

NOTE: Loan balances do not include $674 thousand in net deferred loan origination costs as of June 30, 2015.

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June 30, 2014

(in thousands)	Commercial and Industrial	Commercial Real Estate Mortgages*	Consumer **	Residential Mortgages*	HELOC	Direct Financing Leases	Unallocated	Total
Allowance for loan losses:								
Beginning balance	$ 4,489	$ 4,912	$ 37	$ 1,038	$ 878	$ -	$ 149	$ 11,503
Charge-offs	(474)	(57)	(12)	-	(1)	-	-	(544)
Recoveries	59	39	4	2	-	131	-	235
Provision	(171)	651	17	6	(44)	(131)	-	328
Ending balance	$ 3,903	$ 5,545	$ 46	$ 1,046	$ 833	$ -	$ 149	$ 11,522
Allowance for loan losses:								
Ending balance:								
Individually evaluated for impairment	$ 191	$ 358	$ 18	$ -	$ -	$ -	$ -	$ 567
Collectively evaluated for impairment	3,712	5,187	28	1,046	833	-	149	10,955
Total	$ 3,903	$ 5,545	$ 46	$ 1,046	$ 833	$ -	$ 149	$ 11,522
Loans:								
Ending balance:								
Individually evaluated for impairment	$ 1,125	$ 13,642	$ 18	$ 1,958	$ 544	$ -	$ -	$ 17,287
Collectively evaluated for impairment	110,358	377,657	3,753	96,736	56,937	-	-	645,441
Total	$ 111,483	$ 391,299	$ 3,771	$ 98,694	$ 57,481	$ -	$ -	$ 662,728

* Includes construction loans

** Includes all other consumer loans

NOTE: Loan balances do not include $671 thousand in net deferred loan origination costs as of June 30, 2014.

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The following tables present the activity in the allowance for loan losses by portfolio segment for the three month periods ended June 30, 2015 and 2014: