EVANS BANCORP INC
Form 10-Q
November 05, 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 September 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 4,255,301 shares as of November 5, 2015

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

	September 30, 2015	December 31, 2014
ASSETS		
Cash and due from banks	$ 11,623	$ 8,784
Interest-bearing deposits at banks	28,796	2,114
Securities:		
Available for sale, at fair value (amortized cost: $103,463 at September 30, 2015; $94,048 at December 31, 2014)	105,122	95,533
Held to maturity, at amortized cost (fair value: $1,509 at September 30, 2015; $1,574 at December 31, 2014)	1,529	1,599
Federal Home Loan Bank common stock, at amortized cost	1,296	1,439
Federal Reserve Bank common stock, at amortized cost	1,487	1,486
Loans, net of allowance for loan losses of $13,456 at September 30, 2015 and $12,533 at December 31, 2014	717,783	683,131
Properties and equipment, net of accumulated depreciation of $15,534 at September 30, 2015 and $15,129 at December 31, 2014	10,683	10,224
Goodwill	8,101	8,101
Bank-owned life insurance	20,838	20,415
Other assets	13,633	13,983
TOTAL ASSETS	$ 920,891	$ 846,809
LIABILITIES AND STOCKHOLDERS' EQUITY		
LIABILITIES		
Deposits:		
Demand	$ 170,022	$ 158,631
NOW	79,983	72,670
Regular savings	436,331	363,542
Time	95,967	112,792
Total deposits	782,303	707,635
Securities sold under agreement to repurchase	11,310	13,778
Other short term borrowings	10,000	13,700
Other liabilities	16,275	14,578
Junior subordinated debentures	11,330	11,330
Total liabilities	831,218	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 September 30, 2015 and December 31, 2014, respectively, and 4,238,448 and 4,203,684 outstanding at September 30, 2015 and December 31, 2014, respectively	2,126	2,123
Capital surplus	43,086	43,102
Treasury stock, at cost, 9,021 shares and 38,113 at September 30, 2015 and December 31, 2014, respectively	(112)	(751)
Retained earnings	45,868	42,822
Accumulated other comprehensive loss, net of tax	(1,295)	(1,508)
Total stockholders' equity	89,673	85,788
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	$ 920,891	$ 846,809

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

	Three Months Ended September 30,	
	2015	2014
INTEREST INCOME		
Loans	$ 8,403	$ 7,865
Interest bearing deposits at banks	16	1
Securities:		
Taxable	407	469
Non-taxable	273	241
Total interest income	9,099	8,576
INTEREST EXPENSE		
Deposits	828	752
Other borrowings	49	64
Junior subordinated debentures	83	82
Total interest expense	960	898
NET INTEREST INCOME	8,139	7,678
PROVISION FOR LOAN LOSSES	396	327
NET INTEREST INCOME AFTER PROVISION FOR LOAN LOSSES	7,743	7,351
NON-INTEREST INCOME		
Bank charges	455	482
Insurance service and fees	1,972	1,888
Data center income	25	85
Gain on loans sold	34	87
Gain on insurance settlement	734	-
Bank-owned life insurance	134	137
Other	903	831
Total non-interest income	4,257	3,510
NON-INTEREST EXPENSE		
Salaries and employee benefits	5,253	4,792
Litigation expense	(175)	-
Occupancy	675	720
Repairs and maintenance	230	190
Advertising and public relations	188	146
Professional services	673	438
Technology and communications	354	247
Amortization of intangibles	-	27
FDIC insurance	151	137
Other	931	788
Total non-interest expense	8,280	7,485
INCOME BEFORE INCOME TAXES	3,720	3,376
INCOME TAX PROVISION	1,211	1,086
NET INCOME	$ 2,509	$ 2,290

Net income per common share-basic	$ 0.59	$ 0.55
Net income per common share-diluted	$ 0.58	$ 0.54
Cash dividends per common share	$ 0.36	$ 0.34
Weighted average number of common shares outstanding	4,241,156	4,184,491
Weighted average number of diluted shares outstanding	4,312,275	4,260,759

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(in thousands, except share and per share amounts)

	Nine Months Ended September 30,	
	2015	2014
INTEREST INCOME		
Loans	$ 24,149	$ 23,253
Interest bearing deposits at banks	50	32
Securities:		
Taxable	1,242	1,374
Non-taxable	750	729
Total interest income	26,191	25,388
INTEREST EXPENSE		
Deposits	2,471	2,264
Other borrowings	109	225
Junior subordinated debentures	243	241
Total interest expense	2,823	2,730
NET INTEREST INCOME	23,368	22,658
PROVISION FOR LOAN LOSSES	1,012	655
NET INTEREST INCOME AFTER PROVISION FOR LOAN LOSSES	22,356	22,003
NON-INTEREST INCOME		
Bank charges	1,275	1,406
Insurance service and fees	5,623	5,606
Data center income	117	292
Gain on loans sold	115	127
Gain on insurance settlement	734	-
Bank-owned life insurance	423	434
Other	2,513	2,094
Total non-interest income	10,800	9,959
NON-INTEREST EXPENSE		
Salaries and employee benefits	15,114	14,052
Litigation expense	(175)	1,000

Occupancy	2,066	2,148
Repairs and maintenance	618	547
Advertising and public relations	630	648
Professional services	1,855	1,374
Technology and communications	876	826
Amortization of intangibles	-	108
FDIC insurance	446	410
Other	2,604	2,322
Total non-interest expense	24,034	23,435
INCOME BEFORE INCOME TAXES	9,122	8,527
INCOME TAX PROVISION	3,033	2,646
NET INCOME	$ 6,089	$ 5,881
Net income per common share-basic	$ 1.44	$ 1.41
Net income per common share-diluted	$ 1.41	$ 1.38
Cash dividends per common share	$ 0.72	$ 0.65
Weighted average number of common shares outstanding	4,232,201	4,183,777
Weighted average number of diluted shares outstanding	4,306,532	4,266,341

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

	Three Months Ended September 30, 2015		2014	
NET INCOME		$ 2,509		$ 2,290
OTHER COMPREHENSIVE INCOME (LOSS), NET OF TAX:				
Unrealized gain (loss) on available-for-sale securities:				
Unrealized gain (loss) on available-for-sale securities	412		(171)	
Less: Reclassification of gain on sale of securities	-		-	
		412		(171)
Defined benefit pension plans:				
Amortization of prior service cost	23		4	
Amortization of actuarial assumptions	13		14	
Total		36		18
OTHER COMPREHENSIVE INCOME (LOSS), NET OF TAX		448		(153)
COMPREHENSIVE INCOME		$ 2,957		$ 2,137

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

	Nine Months Ended September 30,			
	2015		2014	
NET INCOME		$ 6,089		$ 5,881
OTHER COMPREHENSIVE INCOME, NET OF TAX:				
Unrealized gain on available-for-sale securities:				
Unrealized gain on available-for-sale securities	106		618	
Less: Reclassification of gain on sale of securities	-		-	
		106		618
Defined benefit pension plans:				
Amortization of prior service cost	33		12	
Amortization of actuarial assumptions	74		46	
Total		107		58
OTHER COMPREHENSIVE INCOME, NET OF TAX		213		676
COMPREHENSIVE INCOME		$ 6,302		$ 6,557

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NINE MONTHS ENDED SEPTEMBER 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			5,881			5,881
Other comprehensive income				676		676
Cash dividends ($0.65 per common share)			(2,730)			(2,730)
Stock options and restricted stock expense		352				352
Excess tax expense from stock-based compensation		72				72
Issued 16,694 restricted shares, net of forfeitures	11	(11)				-
Repurchased 59,800 shares					(1,436)	(1,436)
Reissued 19,351 shares in stock option exercises		(253)			449	196
Reissued 5,400 shares through Dividend Reinvestment Program		9			115	124
Issued 7,186 shares through Employee Stock Purchase Plan	3	124				127
Balance, September 30, 2014	$ 2,120	$ 42,912	$ 40,521	$ (587)	$ (992)	$ 83,974
Balance, December 31, 2014	$ 2,123	$ 43,102	$ 42,822	$ (1,508)	$ (751)	$ 85,788
Net Income			6,089			6,089
Other comprehensive income				213		213
Cash dividends ($0.72 per common share)			(3,043)			(3,043)
Stock options and restricted stock expense		384				384
Excess tax expense from stock-based compensation		31				31
Reissued 20,592 restricted shares, net of 588 forfeitures		(503)			503	-

Repurchased 8,676 shares					(210)	(210)
Reissued 11,832 shares in stock option exercises		(46)			212	166
Reissued 5,582 shares through Dividend Reinvestment Program		4			134	138
Issued 5,672 shares in Employee Stock Purchase Plan	3	114				117
Balance, September 30, 2015	$ 2,126	$ 43,086	$ 45,868	$ (1,295)	$ (112)	$ 89,673

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

	Nine Months Ended September 30,	
	2015	2014
OPERATING ACTIVITIES:		
Interest received	$ 25,623	$ 25,293
Fees received	9,424	9,481
Interest paid	(2,901)	(2,738)
Cash paid to employees and vendors	(23,860)	(21,937)
Cash contributed to pension plan	(165)	(110)
Income taxes paid	(601)	(3,141)
Proceeds from sale of loans held for resale	13,063	9,978
Originations of loans held for resale	(12,800)	(10,600)
Net cash provided by operating activities	7,783	6,226
INVESTING ACTIVITIES:		
Available for sales securities:		
Purchases	(28,457)	(11,446)
Proceeds from maturities, calls, and payments	19,148	12,212
Held to maturity securities:		
Purchases	(346)	(498)
Proceeds from maturities, calls, and payments	416	1,122
Proceeds from property insurance	1,183	-
Additions to properties and equipment	(1,255)	(433)
Purchase of tax credit investment	(832)	(1,577)
Net increase in loans	(35,312)	(37,528)
Net cash used in investing activities	(45,455)	(38,148)
FINANCING ACTIVITIES:		
(Repayments of) proceeds from borrowings, net	(6,168)	1,295
Net increase in deposits	74,668	3,184
Dividends paid	(1,517)	(1,304)

Repurchase of treasury stock	(210)	(1,436)
Issuance of common stock	117	127
Reissuance of treasury stock	303	320
Net cash provided by financing activities	67,193	2,186
Net increase (decrease) in cash and equivalents	29,521	(29,736)
CASH AND CASH EQUIVALENTS:		
Beginning of period	10,898	41,954
End of period	$ 40,419	$ 12,218

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NINE MONTHS ENDED SEPTEMBER 30, 2015 AND 2014
(in thousands)

	Nine Months Ended September 30,	
	2015	2014
RECONCILIATION OF NET INCOME TO NET CASH PROVIDED BY OPERATING ACTIVITIES:		
Net income	$ 6,089	$ 5,881
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	1,120	1,195
Deferred tax expense	645	18
Provision for loan losses	1,012	655
Gain on loans sold	(115)	(127)
Gain on proceeds from insurance	(734)	-
Stock options and restricted stock expense	384	352
Proceeds from sale of loans held for resale	13,063	9,978
Originations of loans held for resale	(12,800)	(10,600)
Cash contributed to pension plan	(165)	(110)
Changes in assets and liabilities affecting cash flow:		
Other assets	(1,436)	(21)
Other liabilities	720	(995)
NET CASH PROVIDED BY OPERATING ACTIVITIES	$ 7,783	$ 6,226

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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 NINE MONTH PERIODS ENDED SEPTEMBER 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 nine month period ended September 30, 2015, the Company revised the unaudited Consolidated Statement of Cash Flows for the nine month period ended September 30, 2014 to correct errors involving a $631 thousand increase within “Net cash provided by operating activities”, a $631 thousand increase in “Net cash used in investing activities”, a $120 thousand increase within “Depreciation and amortization”, $726 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 nine month periods ended September 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 September 30, 2015 and December 31, 2014 were as follows:

	September 30, 2015 (in thousands)			
	Amortized Cost	Unrealized Gains	Losses	Fair Value
Available for Sale:				
Debt securities:				
U.S. government agencies	$ 22,004	$ 288	$ (89)	$ 22,203
States and political subdivisions	39,897	857	(42)	40,712
Total debt securities	$ 61,901	$ 1,145	$ (131)	$ 62,915
Mortgage-backed securities:				
FNMA	$ 15,369	$ 506	$ -	$ 15,875
FHLMC	4,919	95	(46)	4,968
GNMA	7,503	112	(35)	7,580
CMO	13,771	86	(73)	13,784
Total mortgage-backed securities	$ 41,562	$ 799	$ (154)	$ 42,207
Total securities designated as available for sale	$ 103,463	$ 1,944	$ (285)	$ 105,122
Held to Maturity:				
Debt securities				
States and political subdivisions	$ 1,529	$ 7	$ (27)	$ 1,509
Total securities designated as held to maturity	$ 1,529	$ 7	$ (27)	$ 1,509

	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 $73.7 million and $68.8 million at September 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 $10.0 million in borrowed funds as of September 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 September 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 September 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.

	September 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	$ 2,874	$ 2,888	$ 8,172	$ 8,256
Due after one year through five years	31,177	31,691	22,118	22,597
Due after five years through ten years	19,509	19,875	20,517	20,589
Due after ten years	8,341	8,461	6,062	6,335
	61,901	62,915	56,869	57,777
Mortgage-backed securities available for sale	41,562	42,207	37,179	37,756

Total available for sale securities	$ 103,463	$ 105,122	$ 94,048	$ 95,533
Debt securities held to maturity:				
Due in one year or less	$ 368	$ 368	$ 478	$ 477
Due after one year through five years	214	212	77	78
Due after five years through ten years	841	830	932	914
Due after ten years	106	99	112	105
	1,529	1,509	1,599	1,574
Total held to maturity securities	$ 1,529	$ 1,509	$ 1,599	$ 1,574

Information regarding unrealized losses within the Company’s available for sale securities at September 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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	September 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	$ 4,595	$ (24)	$ 5,935	$ (65)	$ 10,530	$ (89)
States and political subdivisions	5,634	(23)	1,125	(19)	6,759	(42)
Total debt securities	$ 10,229	$ (47)	$ 7,060	$ (84)	$ 17,289	$ (131)
Mortgage-backed securities:						
FNMA	$ -	$ -	$ - -	$ -	$ -	$ -
FHLMC	-	-	1,308	(46)	1,308	(46)
GNMA	3,662	(30)	599	(5)	4,261	(35)
CMO'S	4,974	(24)	3,862	(49)	8,836	(73)
Total mortgage-backed securities	$ 8,636	$ (54)	$ 5,769	$ (100)	$ 14,405	$ (154)
Held To Maturity:						
Debt securities:						
States and political subdivisions	$ -	$ -	$ 1,141	$ (27)	$ 1,141	$ (27)
Total temporarily impaired securities	$ 18,865	$ (101)	$ 13,970	$ (211)	$ 32,835	$ (312)

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 September 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 September 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 September 30, 2015 and December 31, 2014:

(in thousands)	Level 1	Level 2	Level 3	Fair Value
September 30, 2015				
Securities available-for-sale:				
U.S. government agencies	$ -	$ 22,203	$ -	$ 22,203
States and political subdivisions	-	40,712	-	40,712
Mortgage-backed securities	-	42,207	-	42,207
Mortgage servicing rights	-	-	549	549
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, during the Company's review or when 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, second, or third 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 nine month periods ended September 30, 2015 and 2014, respectively:

	Three months ended September 30,	
(in thousands)	2015	2014
Mortgage servicing rights -July 1	$ 565	$ 471
Losses included in earnings	(46)	(12)
Additions from loan sales	30	61
Mortgage servicing rights -September 30	$ 549	$ 520

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(in thousands)	Nine months ended September 30, 2015	2014
Mortgage servicing rights - January 1	$ 518	$ 509
Losses included in earnings	(87)	(81)
Additions from loan sales	118	92
Mortgage servicing rights - September 30	$ 549	$ 520

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

	9/30/2015	12/31/2014
Servicing fees	0.25 %	0.25 %
Discount rate	9.49 %	9.52 %
Prepayment rate (CPR)	9.21 %	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 September 30, 2015 and December 31, 2014:

(in thousands)	Level 1	Level 2	Level 3	Fair Value
September 30, 2015				
Impaired loans	$ -	-	11,191	$ 11,191
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 $12.1 million, with a valuation allowance of $0.9 million, at September 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 September 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:

	September 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	$ 40,419	$ 40,419	$ 10,898	$ 10,898
Level 2:				
Available for sale securities	105,122	105,122	95,533	95,533
FHLB and FRB stock	2,783	2,783	2,925	2,925
Level 3:				
Held to maturity securities	1,529	1,509	1,599	1,574
Loans, net	717,783	728,901	683,131	685,148
Mortgage servicing rights	549	549	518	518
Financial liabilities:				

Level 1:				
Demand deposits	$ 170,022	$ 170,022	$ 158,631	$ 158,631
NOW deposits	79,983	79,983	72,670	72,670
Regular savings deposits	436,331	436,331	363,542	363,542
Commitments to extend credit	249	249	245	245
Securities sold under agreement to repurchase	11,310	11,310	13,778	13,778
Level 2:				
Other borrowed funds	10,000	9,951	13,700	13,700
Junior subordinated debentures	11,330	11,330	11,330	11,330
Level 3:				
Time deposits	95,967	96,709	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 September 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:

	September 30, 2015	December 31, 2014
Mortgage loans on real estate:	($ in thousands)	
Residential mortgages	$ 99,210	$ 98,374
Commercial and multi-family	386,723	363,252
Construction-Residential	746	721
Construction-Commercial	48,191	40,986
Home equities	59,901	59,948
Total real estate loans	594,771	563,281
Commercial and industrial loans	132,780	129,456
Consumer loans	1,623	1,764
Other	1,311	404
Net deferred loan origination costs	754	759
Total gross loans	731,239	695,664
Allowance for loan losses	(13,456)	(12,533)
Loans, net	$ 717,783	$ 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 September 30, 2015, the Bank sold mortgages to FNMA totaling $3.3 million, as compared with $6.6 million in mortgages sold to FNMA in the three month period ended September 30, 2014. During the nine month periods ended September 30, 2015 and 2014, the Bank sold $12.9 million and $9.9 million in mortgages, respectively, to FNMA. At September 30, 2015, the Bank had a loan servicing portfolio principal balance of $77.9 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 $0.5 million at both September 30, 2015 and December 31, 2014. At September 30, 2015, there were $0.3 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 September 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 nine month periods ended September 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 are commercial customers. 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 primary 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:

September 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	$ 38,396	$ 324,311	$ 362,707	$ 75,139
4	4,482	43,321	47,803	41,121
5	5,313	13,292	18,605	8,038
6	-	5,383	5,383	8,482

7	-	416	416	-
Total	$ 48,191	$ 386,723	$ 434,914	$ 132,780

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:

September 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	$ 345	$ -	$ 188	$ 533	$ 132,247	$ 132,780	$ 163	$ 5,152
Residential real estate:								
Residential	8	267	560	835	98,375	99,210	184	1,101
Construction	-	-	-	-	746	746	-	-
Commercial real estate:								
Commercial	-	-	893	893	385,830	386,723	233	760
Construction	-	-	-	-	48,191	48,191	-	-
Home equities	360	741	190	1,291	58,610	59,901	-	553
Consumer	27	1	9	37	1,586	1,623	9	15
Other	-	-	-	-	1,311	1,311	-	-
Total Loans	$ 740	$ 1,009	$ 1,840	$ 3,589	$ 726,896	$ 730,485	$ 589	$ 7,581

NOTE: Loan and lease balances do not include $754 thousand in net deferred loan origination costs as of September 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 nine month periods ended September 30, 2015 and 2014:

September 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	(100)	(35)	(17)	(66)	-	-	(218)
Recoveries	88	32	8	1	-	-	129
Provision (Credit)	(198)	1,143	5	70	(8)	-	1,012
Ending balance	$ 4,686	$ 6,790	$ 74	$ 946	$ 811	$ 149	$ 13,456
Allowance for loan losses:							
Ending balance:							
Individually evaluated for impairment	$ 735	$ 83	$ 44	$ -	$ -	$ -	$ 862
Collectively evaluated for impairment	3,951	6,707	30	946	811	149	12,594
Total	$ 4,686	$ 6,790	$ 74	$ 946	$ 811	$ 149	$ 13,456
Loans:							
Ending balance:							
Individually evaluated for impairment	$ 5,306	$ 3,331	$ 44	$ 2,334	$ 1,038	$ -	$ 12,053
Collectively evaluated for impairment	127,474	431,583	2,890	97,622	58,863	-	718,432
Total	$ 132,780	$ 434,914	$ 2,934	$ 99,956	$ 59,901	$ -	$ 730,485

* Includes construction loans

** Includes all other consumer loans

NOTE: Loan balances do not include $754 thousand in net deferred loan origination costs as of September 30, 2015.

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September 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	(913)	(57)	(25)	-	-	-	-	(995)
Recoveries	526	49	37	18	-	162	-	792
Provision (Credit)	(129)	931	25	7	(17)	(162)	-	655
Ending balance	$ 3,973	$ 5,835	$ 74	$ 1,063	$ 861	$ -	$ 149	$ 11,955

Allowance for loan losses: