

EVANS BANCORP INC
Form 10-Q
August 01, 2018

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, 2018

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

For the transition period from _____ to _____

Commission file number 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, a smaller reporting company, or an emerging growth company. See the definitions of "large accelerated filer," "accelerated filer," "smaller reporting company," and "emerging growth company" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer

Accelerated filer

Non-accelerated filer (Do not check if smaller reporting company)

Smaller reporting company

Emerging growth company

If an emerging growth company, indicate by checkmark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

Edgar Filing: EVANS BANCORP INC - Form 10-Q

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, 4,821,381 shares as of August 1, 2018.

Table of Contents

INDEX

EVANS BANCORP, INC. AND SUBSIDIARIES

| PART 1. FINANCIAL INFORMATION | PAGE |
|---|------|
| <u>Financial Statements</u> | |
| 1. | |
| <u>Unaudited Consolidated Balance Sheets – June 30, 2018 and December 31, 2017</u> | 1 |
| <u>Unaudited Consolidated Statements of Income – Three months ended June 30, 2018 and 2017</u> | 2 |
| <u>Unaudited Consolidated Statements of Income – Six months ended June 30, 2018 and 2017</u> | 3 |
| <u>Unaudited Consolidated Statements of Comprehensive Income – Three months ended June 30, 2018 and 2017</u> | 4 |
| <u>Unaudited Consolidated Statements of Comprehensive Income – Six months ended June 30, 2018 and 2017</u> | 4 |
| <u>Unaudited Consolidated Statements of Changes in Stockholders' Equity – Six months ended June 30, 2018 and 2017</u> | |
| <u>Unaudited Consolidated Statements of Cash Flows - Six months ended June 30, 2018 and 2017</u> | 6 |
| <u>Notes to Unaudited Consolidated Financial Statements</u> | 8 |
| <u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u> | 39 |
| 2. | |
| <u>Quantitative and Qualitative Disclosures About Market Risk</u> | 48 |
| 3. | |
| <u>Controls and Procedures</u> | 49 |
| 4. | |
| PART II. OTHER INFORMATION | |

| | |
|--|----|
| <u>Legal Proceedings</u> | 49 |
| 1. | |
| <u>Unregistered Sales of Equity Securities and Use of Proceeds</u> | 49 |
| 2. | |
| <u>Exhibits</u> | 50 |
| 6. | |
| <u>Signatures</u> | 51 |

Table of Contents

PART I - FINANCIAL INFORMATION
ITEM 1 - FINANCIAL STATEMENTS
EVANS BANCORP, INC. AND SUBSIDIARIES
UNAUDITED CONSOLIDATED BALANCE SHEETS
JUNE 30, 2018 AND DECEMBER 31, 2017
(in thousands, except share and per share amounts)

| | June 30, 2018 | December 31, 2017 |
|---|---------------------|-------------------------|
| ASSETS | | |
| Cash and due from banks | \$ 13,324 | \$ 13,751 |
| Interest-bearing deposits at banks | 3,441 | 7,579 |
| Securities: | | |
| Available for sale, at fair value (amortized cost: \$146,106 at June 30, 2018; \$145,232 at December 31, 2017) | 141,933 | 143,818 |
| Held to maturity, at amortized cost (fair value: \$4,609 at June 30, 2018; \$5,261 at December 31, 2017) | 4,637 | 5,334 |
| Equity securities, at fair value at June 30, 2018; at cost at December 31, 2017 | 2,058 | 580 |
| Federal Home Loan Bank common stock, at cost | 1,475 | 4,863 |
| Federal Reserve Bank common stock, at cost | 1,924 | 1,916 |
| Loans, net of allowance for loan losses of \$15,235 at June 30, 2018 and \$14,019 at December 31, 2017 | 1,110,660 | 1,051,296 |
| Properties and equipment, net of accumulated depreciation of \$18,800 at June 30, 2018 and \$18,255 at December 31, 2017 | 10,331 | 10,564 |
| Goodwill and intangible assets | 8,496 | 8,553 |
| Bank-owned life insurance | 28,072 | 27,729 |
| Other assets | 19,740 | 19,650 |
| TOTAL ASSETS | \$ 1,346,091 | \$ 1,295,633 |
| LIABILITIES AND STOCKHOLDERS' EQUITY | | |
| LIABILITIES | | |
| Deposits: | | |
| Demand | \$ 224,373 | \$ 219,664 |
| NOW | 121,170 | 109,378 |
| Savings | 595,500 | 535,730 |

| | | |
|---|-----------|-----------|
| Time | 241,425 | 186,457 |
| Total deposits | 1,182,468 | 1,051,229 |
| Securities sold under agreement to repurchase | 4,018 | 9,289 |
| Other borrowings | 10,000 | 88,250 |
| Other liabilities | 14,700 | 17,193 |
| Junior subordinated debentures | 11,330 | 11,330 |
| Total liabilities | 1,222,516 | 1,177,291 |

CONTINGENT LIABILITIES AND COMMITMENTS

STOCKHOLDERS' EQUITY:

| | | |
|---|---------------------|---------------------|
| Common stock, \$.50 par value, 10,000,000 shares authorized; 4,821,381 and 4,783,562 shares issued at June 30, 2018 and December 31, 2017, respectively, and 4,821,381 and 4,782,505 outstanding at June 30, 2018 and December 31, 2017, respectively | 2,413 | 2,394 |
| Capital surplus | 60,220 | 59,444 |
| Treasury stock, at cost, 0 and 1,057 shares at June 30, 2018 and December 31, 2017, respectively | - | - |
| Retained earnings | 66,325 | 59,921 |
| Accumulated other comprehensive loss, net of tax | (5,383) | (3,417) |
| Total stockholders' equity | 123,575 | 118,342 |
| TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY | \$ 1,346,091 | \$ 1,295,633 |

See Notes to Unaudited Consolidated Financial Statements

Table of Contents

PART I - FINANCIAL INFORMATION
ITEM 1 - FINANCIAL STATEMENTS
EVANS BANCORP, INC. AND SUBSIDIARIES
UNAUDITED CONSOLIDATED STATEMENTS OF INCOME
THREE MONTHS ENDED JUNE 30, 2018 AND 2017
(in thousands, except share and per share amounts)

| | Three Months Ended June 30, | |
|--|--------------------------------|-----------|
| | 2018 | 2017 |
| INTEREST INCOME | | |
| Loans | \$ 13,199 | \$ 10,646 |
| Interest-bearing deposits at banks | 15 | 43 |
| Securities: | | |
| Taxable | 863 | 563 |
| Non-taxable | 170 | 210 |
| Total interest income | 14,247 | 11,462 |
| INTEREST EXPENSE | | |
| Deposits | 1,759 | 1,190 |
| Other borrowings | 160 | 50 |
| Junior subordinated debentures | 132 | 104 |
| Total interest expense | 2,051 | 1,344 |
| NET INTEREST INCOME | 12,196 | 10,118 |
| PROVISION FOR LOAN LOSSES | 659 | 410 |
| NET INTEREST INCOME AFTER PROVISION FOR LOAN LOSSES | 11,537 | 9,708 |
| NON-INTEREST INCOME | | |
| Deposit service charges | 525 | 428 |
| Insurance service and fees | 1,952 | 1,912 |
| Gain on loans sold | - | 52 |
| Bank-owned life insurance | 178 | 142 |
| Loss on tax credit investment | - | (919) |
| Refundable state historic tax credit | - | 647 |
| Interchange fee income | 420 | 379 |
| Other | 564 | 448 |
| Total non-interest income | 3,639 | 3,089 |
| NON-INTEREST EXPENSE | | |
| Salaries and employee benefits | 6,475 | 5,959 |
| Occupancy | 727 | 775 |
| Advertising and public relations | 326 | 216 |
| Professional services | 626 | 550 |
| Technology and communications | 847 | 804 |
| Amortization of intangibles | 28 | 28 |
| FDIC insurance | 246 | 129 |
| Other | 958 | 856 |

Edgar Filing: EVANS BANCORP INC - Form 10-Q

| | | |
|---|-----------|-----------|
| Total non-interest expense | 10,233 | 9,317 |
| INCOME BEFORE INCOME TAXES | 4,943 | 3,480 |
| INCOME TAX PROVISION | 1,152 | 862 |
| NET INCOME | \$ 3,791 | \$ 2,618 |
| | | |
| Net income per common share-basic | \$ 0.79 | \$ 0.55 |
| Net income per common share-diluted | \$ 0.77 | \$ 0.54 |
| Cash dividends per common share | \$ - | \$ - |
| Weighted average number of common shares outstanding | 4,810,487 | 4,764,080 |
| Weighted average number of diluted shares outstanding | 4,933,522 | 4,880,454 |

See Notes to Unaudited Consolidated Financial Statements

2

Table of Contents

PART I - FINANCIAL INFORMATION
ITEM 1 - FINANCIAL STATEMENTS
EVANS BANCORP, INC. AND SUBSIDIARIES
UNAUDITED CONSOLIDATED STATEMENTS OF INCOME
SIX MONTHS ENDED JUNE 30, 2018 AND 2017
(in thousands, except share and per share amounts)

| | Six Months Ended June 30, | |
|--|---------------------------|-----------|
| | 2018 | 2017 |
| INTEREST INCOME | | |
| Loans | \$ 25,562 | \$ 20,892 |
| Interest-bearing deposits at banks | 25 | 55 |
| Securities: | | |
| Taxable | 1,660 | 999 |
| Non-taxable | 366 | 434 |
| Total interest income | 27,613 | 22,380 |
| INTEREST EXPENSE | | |
| Deposits | 3,257 | 2,306 |
| Other borrowings | 458 | 108 |
| Junior subordinated debentures | 250 | 204 |
| Total interest expense | 3,965 | 2,618 |
| NET INTEREST INCOME | 23,648 | 19,762 |
| PROVISION (CREDIT) FOR LOAN LOSSES | 1,426 | (25) |
| NET INTEREST INCOME AFTER PROVISION FOR LOAN LOSSES | 22,222 | 19,787 |
| NON-INTEREST INCOME | | |
| Deposit service charges | 1,034 | 818 |
| Insurance service and fees | 3,917 | 4,080 |
| Gain on loans sold | - | 70 |
| Bank-owned life insurance | 349 | 272 |
| Loss on tax credit investment | - | (919) |
| Refundable state historic tax credit | - | 647 |
| Interchange fee income | 912 | 723 |
| Other | 1,213 | 920 |
| Total non-interest income | 7,425 | 6,611 |
| NON-INTEREST EXPENSE | | |
| Salaries and employee benefits | 13,102 | 11,605 |
| Occupancy | 1,485 | 1,550 |
| Advertising and public relations | 450 | 406 |
| Professional services | 1,279 | 1,152 |
| Technology and communications | 1,611 | 1,411 |
| Amortization of intangibles | 56 | 56 |
| FDIC insurance | 478 | 356 |
| Other | 1,943 | 1,836 |
| Total non-interest expense | 20,404 | 18,372 |

Edgar Filing: EVANS BANCORP INC - Form 10-Q

| | | |
|---|-----------|-----------|
| INCOME BEFORE INCOME TAXES | 9,243 | 8,026 |
| INCOME TAX PROVISION | 2,133 | 2,262 |
| NET INCOME | \$ 7,110 | \$ 5,764 |
| | | |
| Net income per common share-basic | \$ 1.48 | \$ 1.23 |
| Net income per common share-diluted | \$ 1.44 | \$ 1.20 |
| Cash dividends per common share | \$ 0.46 | \$ 0.40 |
| Weighted average number of common shares outstanding | 4,799,229 | 4,699,447 |
| Weighted average number of diluted shares outstanding | 4,926,385 | 4,819,375 |

See Notes to Unaudited Consolidated Financial Statements

Table of Contents

PART I - FINANCIAL INFORMATION

ITEM 1 - FINANCIAL STATEMENTS

EVANS BANCORP, INC. AND SUBSIDIARIES

UNAUDITED STATEMENTS OF CONSOLIDATED COMPREHENSIVE INCOME

THREE MONTHS ENDED JUNE 30, 2018 AND 2017

(in thousands)

| | Three Months Ended June 30, | |
|---|-----------------------------|----------|
| | 2018 | 2017 |
| NET INCOME | \$ 3,791 | \$ 2,618 |
| OTHER COMPREHENSIVE (LOSS) INCOME, NET OF TAX: | | |
| Unrealized (loss) gain on available-for-sale securities | (684) | 3 |
| Defined benefit pension plans: | | |
| Amortization of prior service cost | 5 | 5 |
| Amortization of actuarial loss | 31 | 26 |
| Total | 36 | 31 |
| OTHER COMPREHENSIVE (LOSS) INCOME, NET OF TAX | (648) | 34 |
| COMPREHENSIVE INCOME | \$ 3,143 | \$ 2,652 |

See Notes to Unaudited Consolidated Financial Statements

PART I - FINANCIAL INFORMATION

ITEM 1 - FINANCIAL STATEMENTS

EVANS BANCORP, INC. AND SUBSIDIARIES

UNAUDITED STATEMENTS OF CONSOLIDATED COMPREHENSIVE INCOME

SIX MONTHS ENDED JUNE 30, 2018 AND 2017

(in thousands)

| | Six Months Ended June 30, | |
|--|---------------------------|------|
| | 2018 | 2017 |

Edgar Filing: EVANS BANCORP INC - Form 10-Q

| | | |
|---|----------|----------|
| NET INCOME | \$ 7,110 | \$ 5,764 |
| OTHER COMPREHENSIVE (LOSS) INCOME, NET OF TAX: | | |
| Unrealized (loss) gain on available-for-sale securities | (2,044) | 190 |
| Defined benefit pension plans: | | |
| Amortization of prior service cost | 11 | 15 |
| Amortization of actuarial loss | 67 | 79 |
| Total | 78 | 94 |
| OTHER COMPREHENSIVE (LOSS) INCOME, NET OF TAX | (1,966) | 284 |
| COMPREHENSIVE INCOME | \$ 5,144 | \$ 6,048 |

See Notes to Unaudited Consolidated Financial Statements

Table of Contents

PART I - FINANCIAL INFORMATION

ITEM 1 - FINANCIAL STATEMENTS

EVANS BANCORP, INC. AND
SUBSIDIARIESUNAUDITED CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS'
EQUITY

SIX MONTHS ENDED JUNE 30, 2018 AND 2017

(in thousands, except share and per share
amounts)

| | Common Stock | Capital Surplus | Retained Earnings | Accumulated Other Comprehensive Loss | Treasury Stock | Total |
|---|-----------------|--------------------|----------------------|---|-------------------|------------|
| Balance, December 31, 2016 | \$ 2,153 | \$ 44,389 | \$ 52,630 | \$ (2,424) | \$ - | \$ 96,748 |
| Net Income | | | 5,764 | | | 5,764 |
| Other comprehensive income | | | | 284 | | 284 |
| Cash dividends (\$0.40 per common share) | | | (1,902) | | | (1,902) |
| Stock compensation expense | | 295 | | | | 295 |
| Issued 440,000 shares in stock offering | 220 | 13,922 | | | | 14,142 |
| Issued 16,283 restricted shares | 8 | (8) | | | | - |
| Issued 3,253 shares under Dividend Reinvestment Plan | 2 | 124 | | | | 126 |
| Issued 3,713 shares in Employee Stock Purchase Plan | 2 | 124 | | | | 126 |
| Issued 7,743 shares in stock option exercises | 4 | 111 | | | | 115 |
| Repurchased 9,218 shares in treasury stock | | | | | (342) | (342) |
| Reissued 10,597 shares in stock option exercises, net of forfeitures | | (135) | | | 342 | 207 |
| Balance, June 30, 2017 | \$ 2,389 | \$ 58,822 | \$ 56,492 | \$ (2,140) | \$ - | \$ 115,563 |
| Balance, December 31, 2017 | \$ 2,394 | \$ 59,444 | \$ 59,921 | \$ (3,417) | \$ - | \$ 118,342 |
| Cumulative-effect adjustment due to change in accounting principle (See Note 1) | | | 1,496 | | | 1,496 |
| Net Income | | | 7,110 | | | 7,110 |
| Other comprehensive income | | | | (1,966) | | (1,966) |
| Cash dividends (\$0.46 per common share) | | | (2,202) | | | (2,202) |
| Stock compensation expense | | 399 | | | | 399 |
| Reissued 1,057 restricted shares | | | | | | - |
| Issued 16,816 restricted shares | 8 | (8) | | | | - |
| Issued 3,205 shares under Dividend Reinvestment Plan | 2 | 142 | | | | 144 |

Edgar Filing: EVANS BANCORP INC - Form 10-Q

| | | | | | | |
|---|----------|-----------|-----------|------------|------|------------|
| Issued 3,898 shares in Employee Stock Purchase Plan | 2 | 151 | | | | 153 |
| Issued 13,900 shares in stock option exercises | 7 | 92 | | | | 99 |
| Balance, June 30, 2018 | \$ 2,413 | \$ 60,220 | \$ 66,325 | \$ (5,383) | \$ - | \$ 123,575 |

See Notes to Unaudited Consolidated Financial Statements

Table of Contents

PART I - FINANCIAL INFORMATION
ITEM 1 - FINANCIAL STATEMENTS
EVANS BANCORP, INC. AND SUBSIDIARIES
UNAUDITED CONSOLIDATED STATEMENTS OF CASH FLOWS
SIX MONTHS ENDED JUNE 30, 2018 AND 2017
(in thousands)

| | Six Months Ended June 30, | |
|--|------------------------------|-----------|
| | 2018 | 2017 |
| OPERATING ACTIVITIES: | | |
| Interest received | \$ 27,645 | \$ 22,329 |
| Fees received | 6,931 | 6,538 |
| Interest paid | (3,828) | (2,587) |
| Cash paid to employees and vendors | (21,009) | (18,748) |
| Cash contributed to pension plan | - | (1,000) |
| Income taxes paid | (576) | (1,635) |
| Proceeds from sale of loans held for resale | - | 5,376 |
| Originations of loans held for resale | - | (5,532) |
| Net cash provided by operating activities | 9,163 | 4,741 |
| INVESTING ACTIVITIES: | | |
| Available for sales securities: | | |
| Purchases | (47,863) | (52,697) |
| Proceeds from maturities, calls, and payments | 50,169 | 6,905 |
| Held to maturity securities: | | |
| Purchases | - | (35) |
| Proceeds from maturities, calls, and payments | 697 | 646 |
| Proceeds from bank owned life insurance claims | 675 | - |
| Additions to properties and equipment | (367) | (264) |
| Purchase of tax credit investment | (676) | (811) |
| Insurance agency acquisitions | - | (275) |
| Net increase in loans | (62,275) | (32,925) |
| Net cash used in investing activities | (59,640) | (79,456) |
| FINANCING ACTIVITIES: | | |
| Repayments of short-term borrowings, net | (83,521) | (14,278) |
| Net increase in deposits | 131,239 | 79,082 |
| Dividends paid | (2,202) | (1,902) |
| Repurchase of treasury stock | - | (342) |
| Issuance of common stock | 396 | 14,509 |
| Reissuance of treasury stock | - | 207 |
| Net cash provided by financing activities | 45,912 | 77,276 |

| | | |
|--|-----------|-----------|
| Net (decrease) increase in cash and cash equivalents | (4,565) | 2,561 |
| CASH AND CASH EQUIVALENTS: | | |
| Beginning of period | 21,330 | 13,084 |
| End of period | \$ 16,765 | \$ 15,645 |

See Notes to Unaudited Consolidated Financial Statements

(continued)

6

Table of Contents

PART I - FINANCIAL INFORMATION
 ITEM 1 - FINANCIAL STATEMENTS
 EVANS BANCORP, INC. AND SUBSIDIARIES
 UNAUDITED CONSOLIDATED STATEMENTS OF CASH FLOWS
 SIX MONTHS ENDED JUNE 30, 2018 AND 2017
 (in thousands)

| | Six Months Ended June 30, | |
|---|------------------------------|-----------------|
| | 2018 | 2017 |
| RECONCILIATION OF NET INCOME TO NET CASH PROVIDED BY OPERATING ACTIVITIES: | | |
| Net income | \$ 7,110 | \$ 5,764 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| Depreciation and amortization | 857 | 875 |
| Deferred tax expense | 280 | 589 |
| Provision (credit) for loan losses | 1,426 | (25) |
| Loss on tax credit investment | - | 919 |
| Refundable state historic tax credit | - | (647) |
| Gain on loans sold | - | (70) |
| Change in fair value of equity securities | (245) | - |
| Stock compensation expense | 399 | 295 |
| Proceeds from sale of loans held for resale | - | 5,376 |
| Originations of loans held for resale | - | (5,532) |
| Changes in assets and liabilities affecting cash flow: | | |
| Other assets | (1,442) | (1,145) |
| Other liabilities | 778 | (1,658) |
| NET CASH PROVIDED BY OPERATING ACTIVITIES | \$ 9,163 | \$ 4,741 |

See Notes to Unaudited Consolidated Financial Statements

Table of Contents

PART 1 – FINANCIAL INFORMATION

ITEM 1 – FINANCIAL STATEMENTS

EVANS BANCORP, INC. AND SUBSIDIARIES

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

THREE AND SIX MONTH PERIODS ENDED JUNE 30, 2018 AND 2017

1. ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

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

The results of operations for the three and six month periods ended June 30, 2018 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, 2017. The Company’s significant accounting policies are disclosed in Note 1 to the Form 10-K.

The Company adopted multiple accounting standards as of January 1, 2018 that impacted its consolidated financial statements. The impact on the Company’s equity as depicted in the Statement of Changes in Stockholders’ Equity is as follows:

As of January 1, 2018

| | | |
|---|-------|-------|
| Impact of adoption of ASU 2014-09: | | |
| Increase in accounts receivable | 551 | |
| Tax effect | (142) | |
| Total | | 409 |
| Impact of adoption of ASU 2016-01 | | |
| Increase in fair value of equity securities | 1,234 | |
| Tax effect | (147) | |
| Total | | 1,087 |
| Total cumulative-effect adjustment due to change in accounting principles | | 1,496 |

On January 1, 2018, the Company adopted Accounting Standards Update (“ASU”) 2014-09 Revenue from Contracts with Customers and all subsequent amendments to the ASU (collectively, “ASC 606”), which creates a single framework for recognizing revenue from contracts with customers that fall within its scope. The Company used the modified retrospective method with a cumulative-effect adjustment to retained earnings. The Company’s implementation efforts included the identification of revenue within the scope of the guidance, as well as the evaluation of revenue contracts. The majority of the Company’s revenues come from interest income on loans and securities that are outside the scope of ASC 606. The Company’s services that fall within the scope of ASC 606 are presented within Non-Interest Income and are recognized as revenue as the Company satisfies its obligation to the customer. Services within the scope of ASC 606 include insurance services fees, deposit service charges, and interchange income. Further detail on the Company’s performance obligations and revenue recognition for these revenue streams is provided in Note 11 to these Unaudited Consolidated Financial Statements.

The Company did identify one revenue source, variable profit-sharing revenue for TEA, which will be accounted for differently in 2018 and beyond. Profit-sharing revenue is variable consideration that TEA earns based on the loss ratio of its customers at insurance companies. TEA typically receives payment in the year following the year in which the profit-sharing revenue is earned, with most payments received in the first quarter. Prior to January 1, 2018, the Company recognized profit-sharing revenue when the payment was received. Beginning with the results reported for periods in 2018 included in these financial statements, the Company will estimate this variable consideration based on past performance and loss experience known during the year and make subsequent adjustments to revenue when the uncertainty associated with the variable revenue is resolved. As of January 1, 2018, the Company recorded accounts

Table of Contents

receivable of \$551 thousand and the tax effect of \$142 thousand through a cumulative-effect adjustment to beginning retained earnings, representing the profit sharing revenue earned in 2017 and expected to be received in 2018.

The Company adopted ASU 2016-01, Recognition and Measurement of Financial Assets and Financial Liabilities and ASU 2018-03 Technical Corrections and Improvements to Financial Instruments—Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities on January 1, 2018 with a cumulative-effect adjustment to retained earnings. This ASU requires equity securities to be measured at fair value with changes in the fair value recognized through net income. As of December 31, 2017, the Company had an investment in the equity securities of another financial institution valued at the historical cost of \$0.6 million. The Company used the cost method of accounting because its ownership of the financial institution was less than 5% of the outstanding shares. With the adoption of ASU 2016-01, the cost method is no longer an acceptable accounting principle. On January 1, 2018 the Company recorded an increase in the value of the investment of \$1.2 million based on observable prices obtained from orderly transactions between market participants through opening retained earnings. While the financial institution is not publicly traded on a major stock exchange and is fairly illiquid, there is transaction activity that can be used by the Company to determine the fair value. The Company recognized an increase in fair value of \$0.1 million and \$0.2 million for the three and six month periods ended June 30, 2018, respectively, from the value at January 1, 2018 based on observable prices obtained from the latest orderly transactions in the respective periods, with the increase being recorded in earnings. Given the nature of equity investments and the requirement to record changes in the fair value of the investment through earnings, the adoption of this standard could lead to increased volatility to earnings.

ASU 2016-01 also contained other provisions impacting the Company's disclosures, including using the exit price notion when measuring the fair value of financial instruments for disclosure purposes and eliminating the requirement for public business entities to disclose the methods and significant assumptions to estimate the fair value that is required to be disclosed for financial instruments measured at amortized cost on the balance sheet. Further details regarding the Company's fair value measurements and corresponding disclosures are provided in Note 3 to these Unaudited Consolidated Financial Statements.

As of December 31, 2017, the Company had a \$171 thousand valuation allowance on the deferred tax asset for the Company's investments in historic tax credits. The valuation allowance was due to the nature of the loss to be recognized when the investment is ultimately sold (which for tax purposes will give rise to a capital loss) as the Company did not have any known capital gains in the future to be able to utilize the capital losses from these investments. With the increase in the value of the equity securities discussed in the preceding paragraph and the corresponding projected capital gains the increased value represents, the Company was able to release the valuation allowance on the deferred tax assets related to the historic tax credits in conjunction with the adoption of ASU 2016-01.

The Company adopted ASU 2017-07 Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost effective January 1, 2018. The update requires that an employer report the service cost

component of net periodic pension cost in the same line item as other compensation costs arising from services rendered by the pertinent employees during the period. The other components of net periodic pension cost such as interest cost, expected return on plan assets, gain or loss, and amortization of prior service cost are required to be presented in the income statement separately from the service cost component. If a separate line item is used to present the other components of net benefit cost, that line item must be appropriately described. Prior to adoption of this update, the Company presented all components of net periodic pension cost in its “salaries and benefits expense” on its income statement. The Company is presenting its income statement for the three and six month periods ended June 30, 2018 and 2017 with service cost as part of the “salaries and benefits expense” and the other components in “other expense.” Further details regarding the Company’s net periodic pension cost are provided in Note 9 to these Unaudited Consolidated Financial Statements.

ASU 2016-15 Classification of Certain Cash Receipts and Cash Payments: This update addresses eight specific cash flow issues with the objective of reducing the existing diversity in practice in how certain cash receipts and cash payments are presented and classified in the statement of cash flows under Topic 230, Statement of Cash Flows. The update had no impact on how the Company was already reporting or presenting its statement of cash flows.

ASU 2016-18 Restricted Cash: This update requires that a statement of cash flows explains the change during the period in the total cash, cash equivalents, and amounts generally described as restricted cash or restricted cash equivalents. Therefore, amounts generally described as restricted cash and restricted cash equivalents should be included with cash and cash equivalents when reconciling the beginning of period and end of period total amounts shown on the statement of cash flows. Previous to the update, there had been some diversity in practice. Given that the Company had already classified restricted cash such as cash reserves at the Federal Reserve as part of cash and cash equivalents on the cash flow statement, the update had no impact on how the Company was already reporting and presenting its statement of cash flows.

ASU 2017-01 Clarifying the Definition of a Business: This update clarifies the definition of a business with the objective of adding guidance to assist entities with evaluating whether transactions should be accounted for as acquisitions (or disposals) of assets or businesses. The definition of a business affects many areas of accounting including acquisitions, disposals, goodwill, and consolidation.

Table of Contents

2. SECURITIES

The amortized cost of securities and their approximate fair value at June 30, 2018 and December 31, 2017 were as follows:

| | June 30, 2018 (in thousands) | | | |
|---|---------------------------------|---------------------|------------|---------------|
| | Amortized Cost | Unrealized Gains | Losses | Fair Value |
| Available for Sale: | | | | |
| Debt securities: | | | | |
| U.S. government agencies | \$ 36,906 | \$ - | \$ (1,007) | \$ 35,899 |
| States and political subdivisions | 23,780 | 95 | (66) | 23,809 |
| Total debt securities | \$ 60,686 | \$ 95 | \$ (1,073) | \$ 59,708 |
| Mortgage-backed securities: | | | | |
| FNMA | \$ 31,268 | \$ 26 | \$ (1,049) | \$ 30,245 |
| FHLMC | 15,718 | 14 | (546) | 15,186 |
| GNMA | 1,866 | 9 | (43) | 1,832 |
| SBA | 9,903 | - | (365) | 9,538 |
| CMO | 26,665 | - | (1,241) | 25,424 |
| Total mortgage-backed securities | \$ 85,420 | \$ 49 | \$ (3,244) | \$ 82,225 |
| Total securities designated as available for sale | \$ 146,106 | \$ 144 | \$ (4,317) | \$ 141,933 |
| Held to Maturity: | | | | |
| Debt securities | | | | |
| States and political subdivisions | \$ 4,637 | \$ 8 | \$ (36) | \$ 4,609 |
| Total securities designated as held to maturity | \$ 4,637 | \$ 8 | \$ (36) | \$ 4,609 |

December 31, 2017

Edgar Filing: EVANS BANCORP INC - Form 10-Q

(in thousands)

| | Amortized Cost | Unrealized Gains | Losses | Fair Value |
|---|-------------------|---------------------|------------|---------------|
| Available for Sale: | | | | |
| Debt securities: | | | | |
| U.S. government agencies | \$ 28,407 | \$ 22 | \$ (376) | \$ 28,053 |
| States and political subdivisions | 29,169 | 246 | (42) | 29,373 |
| Total debt securities | \$ 57,576 | \$ 268 | \$ (418) | \$ 57,426 |
| Mortgage-backed securities: | | | | |
| FNMA | \$ 31,835 | \$ 69 | \$ (350) | \$ 31,554 |
| FHLMC | 14,708 | 22 | (190) | 14,540 |
| GNMA | 2,105 | 18 | (21) | 2,102 |
| SBA | 10,309 | 9 | (103) | 10,215 |
| CMO | 28,699 | 26 | (744) | 27,981 |
| Total mortgage-backed securities | \$ 87,656 | \$ 144 | \$ (1,408) | \$ 86,392 |
| Total securities designated as available for sale | \$ 145,232 | \$ 412 | \$ (1,826) | \$ 143,818 |
| Held to Maturity: | | | | |
| Debt securities | | | | |
| States and political subdivisions | \$ 5,334 | \$ 1 | \$ (74) | \$ 5,261 |
| Total securities designated as held to maturity | \$ 5,334 | \$ 1 | \$ (74) | \$ 5,261 |

Available for sale securities with a total fair value of \$142 million and \$138 million at June 30, 2018 and December 31, 2017, respectively, were pledged as collateral to secure public deposits and for other purposes required or permitted by law.

Table of Contents

The scheduled maturities of debt and mortgage-backed securities at June 30, 2018 and December 31, 2017 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, 2018 | | December 31, 2017 | |
|--|-------------------------------------|-------------------------|-------------------------------------|-------------------------|
| | Amortized cost (in thousands) | Estimated fair value | Amortized cost (in thousands) | Estimated fair value |
| Debt securities available for sale: | | | | |
| Due in one year or less | \$ 7,736 | \$ 7,746 | \$ 5,974 | \$ 5,990 |
| Due after one year through five years | 22,959 | 22,732 | 24,063 | 24,068 |
| Due after five years through ten years | 29,667 | 28,899 | 25,584 | 25,385 |
| Due after ten years | 324 | 331 | 1,955 | 1,983 |
| | 60,686 | 59,708 | 57,576 | 57,426 |
| Mortgage-backed securities available for sale | 85,420 | 82,225 | 87,656 | 86,392 |
| Total available for sale securities | \$ 146,106 | \$ 141,933 | \$ 145,232 | \$ 143,818 |
| Debt securities held to maturity: | | | | |
| Due in one year or less | \$ 3,432 | \$ 3,430 | \$ 4,077 | \$ 4,053 |
| Due after one year through five years | 883 | 870 | 690 | 661 |
| Due after five years through ten years | 228 | 223 | 473 | 464 |
| Due after ten years | 94 | 86 | 94 | 83 |
| | 4,637 | 4,609 | 5,334 | 5,261 |
| Total held to maturity securities | \$ 4,637 | \$ 4,609 | \$ 5,334 | \$ 5,261 |

Contractual maturities of the Company's mortgage-backed securities generally exceed ten years; however, the effective lives may be significantly shorter due to prepayments of the underlying loans and due to the nature of these securities.

Information regarding unrealized losses within the Company's available for sale securities at June 30, 2018 and December 31, 2017 is summarized below. The securities are primarily U.S. government-guaranteed agency securities or municipal securities. All unrealized losses are considered temporary and are related to market interest rate fluctuations.

Table of Contents

June 30, 2018

| | Less than 12 months | | 12 months or longer | | Total | |
|---------------------------------------|---------------------|------------|---------------------|------------|------------|------------|
| | Fair | Unrealized | Fair | Unrealized | Fair | Unrealized |
| | Value | Losses | Value | Losses | Value | Losses |
| | (in thousands) | | | | | |
| Available for Sale: | | | | | | |
| Debt securities: | | | | | | |
| U.S. government agencies | \$ 19,509 | \$ (488) | \$ 12,390 | \$ (519) | \$ 31,899 | \$ (1,007) |
| States and political subdivisions | 10,390 | (50) | 891 | (16) | 11,281 | (66) |
| Total debt securities | \$ 29,899 | \$ (538) | \$ 13,281 | \$ (535) | \$ 43,180 | \$ (1,073) |
| Mortgage-backed securities: | | | | | | |
| FNMA | \$ 18,978 | \$ (588) | \$ 10,456 | \$ (461) | \$ 29,434 | \$ (1,049) |
| FHLMC | 12,056 | (417) | 2,627 | (129) | 14,683 | (546) |
| GNMA | - | - | 1,046 | (43) | 1,046 | (43) |
| SBA | 5,467 | (197) | 4,070 | (168) | 9,537 | (365) |
| CMO | 10,217 | (376) | 15,208 | (865) | 25,425 | (1,241) |
| Total mortgage-backed securities | \$ 46,718 | \$ (1,578) | \$ 33,407 | \$ (1,666) | \$ 80,125 | \$ (3,244) |
| Held to Maturity: | | | | | | |
| Debt securities: | | | | | | |
| States and political subdivisions | \$ 3,734 | \$ (6) | \$ 583 | \$ (30) | \$ 4,317 | \$ (36) |
| Total temporarily impaired securities | \$ 80,351 | \$ (2,122) | \$ 47,271 | \$ (2,231) | \$ 127,622 | \$ (4,353) |

December 31, 2017

| | Less than 12 months | | 12 months or longer | | Total | |
|--|---------------------|------------|---------------------|------------|-------|------------|
| | Fair | Unrealized | Fair | Unrealized | Fair | Unrealized |
| | Value | Losses | Value | Losses | Value | Losses |
| | (in thousands) | | | | | |

Edgar Filing: EVANS BANCORP INC - Form 10-Q

Available for Sale:

Debt securities:

| | | | | | | |
|-----------------------------------|-----------|----------|----------|----------|-----------|----------|
| U.S. government agencies | \$ 15,151 | \$ (239) | \$ 6,863 | \$ (137) | \$ 22,014 | \$ (376) |
| States and political subdivisions | 7,288 | (28) | 894 | (14) | 8,182 | (42) |
| Total debt securities | \$ 22,439 | \$ (267) | \$ 7,757 | \$ (151) | \$ 30,196 | \$ (418) |

Mortgage-backed securities:

| | | | | | | |
|----------------------------------|-----------|----------|-----------|----------|-----------|------------|
| FNMA | \$ 20,087 | \$ (207) | \$ 6,517 | \$ (143) | \$ 26,604 | \$ (350) |
| FHLMC | 12,984 | (147) | 960 | (43) | 13,944 | (190) |
| GNMA | - | - | 1,212 | (21) | 1,212 | (21) |
| SBA | 4,516 | (43) | 1,769 | (60) | 6,285 | (103) |
| CMO | 11,023 | (216) | 14,753 | (528) | 25,776 | (744) |
| Total mortgage-backed securities | \$ 48,610 | \$ (613) | \$ 25,211 | \$ (795) | \$ 73,821 | \$ (1,408) |

Held to Maturity:

Debt securities:

| | | | | | | |
|-----------------------------------|----------|---------|--------|---------|----------|---------|
| States and political subdivisions | \$ 4,548 | \$ (37) | \$ 626 | \$ (37) | \$ 5,174 | \$ (74) |
|-----------------------------------|----------|---------|--------|---------|----------|---------|

Total temporarily impaired securities

| | | | | | | |
|--|-----------|----------|-----------|----------|------------|------------|
| | \$ 75,597 | \$ (917) | \$ 33,594 | \$ (983) | \$ 109,191 | \$ (1,900) |
|--|-----------|----------|-----------|----------|------------|------------|

Table of Contents

Management has assessed the securities available for sale in an unrealized loss position at June 30, 2018 and December 31, 2017 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 has not recorded any other-than-temporary impairment ("OTTI") charges as of June 30, 2018 and did not record any OTTI charges during 2017. 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 stable past performance is not a guarantee for similar performance of the Company's securities portfolio in future periods.

3. FAIR VALUE MEASUREMENTS

Fair value is defined in ASC Topic 820 "Fair Value Measurements" 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 inputs are quoted prices for identical instruments in active markets;
- Level 2 inputs are inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly or indirectly; and
- Level 3 inputs are 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 as of June 30, 2018 and December 31, 2017, respectively:

| (in thousands) | Level 1 | Level 2 | Level 3 | Fair Value |
|-----------------------------------|---------|-----------|---------|------------|
| June 30, 2018 | | | | |
| Securities available-for-sale: | | | | |
| US government agencies | \$ - | \$ 35,899 | \$ - | \$ 35,899 |
| States and political subdivisions | - | 23,809 | - | 23,809 |
| Mortgage-backed securities | - | 82,225 | - | 82,225 |
| Equity securities | - | - | 2,058 | 2,058 |
| Mortgage servicing rights | - | - | 635 | 635 |
| December 31, 2017 | | | | |
| Securities available-for-sale: | | | | |
| US government agencies | \$ - | \$ 28,053 | \$ - | \$ 28,053 |
| States and political subdivisions | - | 29,373 | - | 29,373 |
| Mortgage-backed securities | - | 86,392 | - | 86,392 |
| Mortgage servicing rights | - | - | 586 | 586 |

Table of Contents

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 not have 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.

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.

Equity securities

The Company holds equity securities in another financial institution. Since the ownership level is less than 5% of the outstanding shares of the bank, the investment was recorded on the Company's balance sheet at historical cost, under the cost method of accounting, as of December 31, 2017. As noted in Note 1 to the Unaudited Consolidated Financial Statements, on January 1, 2018, the Company adopted ASU 2016-01, which resulted in the Company adopting an accounting policy to mark the investment to its fair value with a cumulative-effect adjustment to retained earnings. As of the end of each reporting period presented after January 1, 2018, equity securities will be presented at fair value,

with changes in fair value during the period being recorded in the income statement.

The equity securities are classified as Level 3 in the fair value hierarchy because the primary inputs in measuring the fair value are unobservable to the public. The shares of the institution are not publicly traded on a major stock exchange, but rather through private sales between shareholders. Trading in the securities is fairly limited as the institution's total trading volume for 2017 was approximately 1% of the outstanding common shares. Trading activity in the first six months of 2018 was at a similar low volume. The institution tracks the sales and the Company obtains the sales information from the institution to calculate the fair value of the equity securities as of the end of the reporting period. The fair value recorded in the financial statements is based on observable prices obtained from the latest orderly transactions in the quarter.

Due to the adoption of ASU 2016-01 and the designation of the equity securities as Level 3 on the fair value hierarchy, there was a transfer into Level 3 for the equity securities during the first quarter of 2018.

| (in thousands) | Three months ended June 30, | |
|--|--------------------------------|--------|
| | 2018 | 2017 |
| Equity securities - April 1 | \$ 1,961 | \$ 580 |
| Fair value change included in earnings | 97 | - |
| Equity securities - June 30 | \$ 2,058 | \$ 580 |

Table of Contents

| (in thousands) | Six months ended June 30, | |
|---|------------------------------|--------|
| | 2018 | 2017 |
| Equity securities - December 31 | \$ 580 | \$ 580 |
| Increase in recorded value due to adoption of ASU 2016-01 through beginning retained earnings | 1,234 | - |
| Fair value change included in earnings | 244 | - |
| Equity securities - June 30 | \$ 2,058 | \$ 580 |

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, 2018 and 2017, respectively:

| (in thousands) | Three months ended June 30, | |
|-------------------------------------|--------------------------------|--------|
| | 2018 | 2017 |
| Mortgage servicing rights - April 1 | \$ 644 | \$ 564 |
| Losses included in earnings | (9) | (32) |
| Additions from loan sales | - | 23 |
| Mortgage servicing rights - June 30 | \$ 635 | \$ 555 |

| (in thousands) | Six months ended June 30, | |
|---------------------------------------|------------------------------|--------|
| | 2018 | 2017 |
| Mortgage servicing rights - January 1 | \$ 586 | \$ 527 |
| Gains/(Losses) included in earnings | 49 | (21) |
| Additions from loan sales | - | 49 |
| Mortgage servicing rights - June 30 | \$ 635 | \$ 555 |

15

Table of Contents

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

| | June 30, 2018 | | December 31, 2017 | |
|-----------------------|---------------|---------|-------------------|---------|
| Servicing fees | 0.25 % | 0.25 % | 0.25 % | 0.25 % |
| Discount rate | 9.50 % | 9.50 % | 9.50 % | 9.50 % |
| Prepayment rate (CPR) | 8.07 % | 10.56 % | 8.07 % | 10.56 % |

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, 2018 and December 31, 2017:

| (in thousands) | Level 1 | Level 2 | Level 3 | Fair Value |
|-------------------------------------|---------|---------|-----------|------------|
| June 30, 2018 | | | | |
| Collateral dependent impaired loans | \$ - | \$ - | \$ 24,125 | \$ 24,125 |
| December 31, 2017 | | | | |
| Collateral dependent impaired loans | \$ - | \$ - | \$ 14,464 | \$ 14,464 |

Collateral dependent 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. 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.

The Company has an appraisal policy in which appraisals are obtained upon a commercial loan being downgraded on the Company's internal loan rating scale to special mention or substandard depending on the amount of the loan, the type of loan and the type of collateral. All impaired commercial loans are either graded as substandard or doubtful 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 \$25.5 million, with an allowance for loan loss of \$1.4 million, at June 30, 2018 compared with \$15.5 million and \$1.1 million, respectively, at December 31, 2017.

Table of Contents

FAIR VALUE OF FINANCIAL INSTRUMENTS

With the adoption of ASU 2016-01, the Company is no longer required to disclose the methods and significant assumptions used in estimating the fair value of financial instruments measured at amortized cost on the balance sheet. The amendments in the ASU also require the Company to measure the fair value of financial instruments using the exit price notion consistent with ASC Topic 820, Fair Value Measurement. Prior to adoption on January 1, 2018, loans were calculated using an entry price notion.

The table below depicts 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.

| | June 30, 2018 | | December 31, 2017 | |
|------------------------------------|--------------------|---------------|--------------------|---------------|
| | Carrying Amount | Fair Value | Carrying Amount | Fair Value |
| | (in thousands) | | (in thousands) | |
| Financial assets: | | | | |
| Level 1: | | | | |
| Cash and cash equivalents | \$ 16,765 | \$ 16,765 | \$ 21,330 | \$ 21,330 |
| Equity securities | 2,058 | 2,058 | 580 | 1,814 |
| Level 2: | | | | |
| Available for sale securities | 141,933 | 141,933 | 143,818 | 143,818 |
| FHLB and FRB stock | 3,399 | 3,399 | 6,779 | 6,779 |
| Level 3: | | | | |
| Held to maturity securities | 4,637 | 4,609 | 5,334 | 5,261 |
| Loans, net | 1,110,660 | 1,098,879 | 1,051,296 | 1,047,967 |
| Mortgage servicing rights | 635 | 635 | 586 | 586 |
| Financial liabilities: | | | | |
| Level 1: | | | | |
| Demand deposits | \$ 224,373 | \$ 224,373 | \$ 219,664 | \$ 219,664 |
| NOW deposits | 121,170 | 121,170 | 109,378 | 109,378 |
| Savings deposits | 595,500 | 595,500 | 535,730 | 535,730 |
| Level 2: | | | | |
| Securities sold under agreement to | | | | |

Edgar Filing: EVANS BANCORP INC - Form 10-Q

| | | | | |
|--------------------------------|---------|---------|---------|---------|
| repurchase | 4,018 | 4,018 | 9,289 | 9,289 |
| Other borrowed funds | 10,000 | 9,806 | 88,250 | 88,132 |
| Junior subordinated debentures | 11,330 | 11,330 | 11,330 | 11,330 |
| Level 3: | | | | |
| Time deposits | 241,425 | 239,448 | 186,457 | 187,782 |

17

Table of Contents

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, 2018 | December 31, 2017 |
|-------------------------------------|------------------|----------------------|
| Mortgage loans on real estate: | (in thousands) | |
| Residential mortgages | \$ 146,076 | \$ 131,208 |
| Commercial and multi-family | 552,023 | 519,902 |
| Construction-Residential | 587 | 2,134 |
| Construction-Commercial | 115,519 | 107,274 |
| Home equities | 69,319 | 69,745 |
| Total real estate loans | 883,524 | 830,263 |
| Commercial and industrial loans | 239,485 | 232,211 |
| Consumer and other loans | 1,447 | 1,654 |
| Net deferred loan origination costs | 1,439 | 1,187 |
| Total gross loans | 1,125,895 | 1,065,315 |
| Allowance for loan losses | (15,235) | (14,019) |
| Loans, net | \$ 1,110,660 | \$ 1,051,296 |

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, 2018, the Bank did not sell any mortgages to FNMA, compared with \$2.5 million in the three month period ended June 30, 2017. The Bank did not sell any mortgages to FNMA during the six month period ended June 30, 2018, compared with \$5.3 million during the six month period ended June 30, 2017. At June 30, 2018, the Bank had a loan servicing portfolio principal balance of \$74 million upon which it earned servicing fees, compared with \$78 million at December 31, 2017. The value of the mortgage servicing rights for that portfolio was \$0.6 million at each of the periods June 30, 2018 and December 31, 2017. No loans were held

for sale at June 30, 2018 or December 31, 2017. The Company has never been contacted by FNMA to repurchase any loans due to improper documentation or fraud.

The Company did not hold any foreclosed residential real estate property at June 30, 2018 or December 31, 2017. There were \$0.7 million and \$0.3 million at June 30, 2018 and December 31, 2017, respectively, in loans secured by residential real estate that were in the process of foreclosure.

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, 2017. 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, 2017. Unless otherwise noted in this Form 10-Q, the policies and methodology described in the Annual Report for the year ended December 31, 2017 are consistent with those utilized by the Company in the three and six month periods ended June 30, 2018.

Table of Contents

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 losses:

- Acceptable or better
- Watch
- Special Mention
- Substandard
- Doubtful
- 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. Unlike commercial customers, consumer loan customers are not required to provide the Company with updated financial information. 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. However, once a consumer loan is identified as impaired, it is individually evaluated for impairment.

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

June 30, 2018
(in thousands)

| Corporate Credit Exposure – By Credit Rating | Commercial Real Estate Construction | Commercial and Multi-Family Mortgages | Total Commercial Real Estate | Commercial and Industrial |
|--|-------------------------------------|---------------------------------------|------------------------------|---------------------------|
| Acceptable or better | \$ 65,378 | \$ 439,190 | \$ 504,568 | \$ 174,153 |
| Watch | 41,166 | 92,419 | 133,585 | 54,457 |

Edgar Filing: EVANS BANCORP INC - Form 10-Q

| | | | | |
|-----------------|------------|------------|------------|------------|
| Special Mention | - | 11,395 | 11,395 | 6,845 |
| Substandard | 8,975 | 9,019 | 17,994 | 3,324 |
| Doubtful/Loss | - | - | - | 706 |
| Total | \$ 115,519 | \$ 552,023 | \$ 667,542 | \$ 239,485 |

December 31, 2017
(in thousands)

| Corporate Credit Exposure – By Credit Rating | Commercial Real Estate Construction | Commercial and Multi-Family Mortgages | Total Commercial Real Estate | Commercial and Industrial |
|--|---|--|------------------------------------|---------------------------------|
| Acceptable or better | \$ 83,203 | \$ 418,819 | \$ 502,022 | \$ 158,181 |
| Watch | 24,071 | 87,746 | 111,817 | 57,827 |
| Special Mention | - | 4,106 | 4,106 | 13,247 |
| Substandard | - | 9,231 | 9,231 | 2,134 |
| Doubtful/Loss | - | - | - | 822 |
| Total | \$ 107,274 | \$ 519,902 | \$ 627,176 | \$ 232,211 |

Table of Contents

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, 2018
(in thousands)

| | Current | | | | Non-accruing | Total |
|---------------------------|--------------|---------------|---------------|-------------|--------------|--------------|
| | Balance | 30-59 days | 60-89 days | 90+ days | Loans | Balance |
| Commercial and industrial | \$ 235,827 | \$ 882 | \$ 300 | \$ - | \$ 2,476 | \$ 239,485 |
| Residential real estate: | | | | | | |
| Residential | 144,599 | 320 | - | - | 1,157 | 146,076 |
| Construction | 587 | - | - | - | - | 587 |
| Commercial real estate: | | | | | | |
| Commercial | 535,511 | 6,425 | 967 | 385 | 8,735 | 552,023 |
| Construction | 106,157 | 154 | - | 233 | 8,975 | 115,519 |
| Home equities | 67,786 | 227 | 57 | - | 1,249 | 69,319 |
| Consumer and other | 1,447 | - | - | - | - | 1,447 |
| Total Loans | \$ 1,091,914 | \$ 8,008 | \$ 1,324 | \$ 618 | \$ 22,592 | \$ 1,124,456 |

Note: Loan balances do not include \$1.4 million in net deferred loan origination costs as of June 30, 2018.

Table of Contents

December 31, 2017

(in thousands)

| | Current | | | | Non-accruing | Total |
|---------------------------|--------------|---------------|---------------|-------------|--------------|--------------|
| | Balance | 30-59 days | 60-89 days | 90+ days | Loans | Balance |
| Commercial and industrial | \$ 225,915 | \$ 4,019 | \$ 163 | \$ 365 | \$ 1,749 | \$ 232,211 |
| Residential real estate: | | | | | | |
| Residential | 129,251 | 731 | - | - | 1,226 | 131,208 |
| Construction | 2,134 | - | - | - | - | 2,134 |
| Commercial real estate: | | | | | | |
| Commercial | 508,044 | 2,611 | - | 309 | 8,938 | 519,902 |
| Construction | 102,109 | 3,239 | 1,926 | - | - | 107,274 |
| Home equities | 68,415 | 171 | 40 | - | 1,119 | 69,745 |
| Consumer and other | 1,628 | 11 | 6 | - | 9 | 1,654 |
| Total Loans | \$ 1,037,496 | \$ 10,782 | \$ 2,135 | \$ 674 | \$ 13,041 | \$ 1,064,128 |

Note: Loan balances do not include \$1.2 million in net deferred loan origination costs as of December 31, 2017.

Table of Contents

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 30, 2018 and 2017:

June 30, 2018

| (in thousands) | Commercial and Industrial | Commercial Real Estate Mortgages* | Consumer and Other | Residential Mortgages* | Home Equities | Total |
|---------------------------------------|---------------------------------|---|-----------------------|---------------------------|------------------|--------------|
| Allowance for loan losses: | | | | | | |
| Beginning balance | \$ 5,204 | \$ 7,409 | \$ 109 | \$ 950 | \$ 347 | \$ 14,019 |
| Charge-offs | (67) | - | (64) | (86) | (11) | (228) |
| Recoveries | 13 | - | 4 | - | 1 | 18 |
| Provision (Credit) | (809) | 2,036 | 41 | 161 | (3) | 1,426 |
| Ending balance | \$ 4,341 | \$ 9,445 | \$ 90 | \$ 1,025 | \$ 334 | \$ 15,235 |
| Allowance for loan losses: | | | | | | |
| Ending balance: | | | | | | |
| Individually evaluated for impairment | \$ 94 | \$ 1,245 | \$ 24 | \$ 38 | \$ - | \$ 1,401 |
| Collectively evaluated for impairment | 4,247 | 8,200 | 66 | 987 | 334 | 13,834 |
| Total | \$ 4,341 | \$ 9,445 | \$ 90 | \$ 1,025 | \$ 334 | \$ 15,235 |
| Loans: | | | | | | |
| Ending balance: | | | | | | |
| Individually evaluated for impairment | \$ 2,936 | \$ 18,475 | \$ 24 | \$ 2,522 | \$ 1,904 | \$ 25,861 |
| Collectively evaluated for impairment | 236,549 | 649,067 | 1,423 | 144,141 | 67,415 | 1,098,595 |
| Total | \$ 239,485 | \$ 667,542 | \$ 1,447 | \$ 146,663 | \$ 69,319 | \$ 1,124,456 |

* Includes construction loans

Note: Loan balances do not include \$1.4 million in net deferred loan origination costs as of June 30, 2018.

22

Table of Contents

June 30, 2017

| (in thousands) | Commercial and Industrial | Commercial Real Estate Mortgages* | Consumer and Other | Residential Mortgages* | Home Equities | Total |
|---------------------------------------|---------------------------------|---|-----------------------|---------------------------|------------------|------------|
| Allowance for loan losses: | | | | | | |
| Beginning balance | \$ 4,813 | \$ 7,890 | \$ 96 | \$ 769 | \$ 348 | \$ 13,916 |
| Charge-offs | (33) | - | (33) | - | - | (66) |
| Recoveries | 331 | - | 21 | - | 1 | 353 |
| Provision (Credit) | (141) | 9 | 20 | 63 | 24 | (25) |
| Ending balance | \$ 4,970 | \$ 7,899 | \$ 104 | \$ 832 | \$ 373 | \$ 14,178 |
| Allowance for loan losses: | | | | | | |
| Ending balance: | | | | | | |
| Individually evaluated for impairment | \$ 681 | \$ 1,189 | \$ 42 | \$ 1 | \$ 2 | \$ 1,915 |
| Collectively evaluated for impairment | 4,289 | 6,710 | 62 | 831 | 371 | 12,263 |
| Total | \$ 4,970 | \$ 7,899 | \$ 104 | \$ 832 | \$ 373 | \$ 14,178 |
| Loans: | | | | | | |
| Ending balance: | | | | | | |
| Individually evaluated for impairment | \$ 2,665 | \$ 12,298 | \$ 42 | \$ 2,834 | \$ 1,651 | \$ 19,490 |
| Collectively evaluated for impairment | 205,104 | 561,558 | 1,460 | 123,333 | 64,493 | 955,948 |
| Total | \$ 207,769 | \$ 573,856 | \$ 1,502 | \$ 126,167 | \$ 66,144 | \$ 975,438 |

* Includes construction loans

Note: Loan balances do not include \$1.1 million in net deferred loan origination costs as of June 30, 2017.

Table of Contents

The following tables present the activity in the allowance for loan losses according to portfolio segment for the three month periods ended June 30, 2018 and 2017:

June 30, 2018

| (\$ in thousands) | Commercial and Industrial | Commercial Real Estate Mortgages* | Consumer and Other | Residential Mortgages* | Home Equities | Total |
|----------------------------|---------------------------|-----------------------------------|--------------------|------------------------|---------------|-----------|
| Allowance for loan losses: | | | | | | |
| Beginning balance | \$ 5,115 | \$ 8,145 | \$ 96 | \$ 1,007 | \$ 330 | \$ 14,693 |
| Charge-offs | - | - | (30) | (86) | (11) | (127) |
| Recoveries | 7 | - | 3 | - | - | 10 |
| Provision (Credit) | (781) | 1,300 | 21 | 104 | 15 | 659 |
| Ending balance | \$ 4,341 | \$ 9,445 | \$ 90 | \$ 1,025 | \$ 334 | \$ 15,235 |

June 30, 2017

| (\$ in thousands) | Commercial and Industrial | Commercial Real Estate Mortgages* | Consumer and Other | Residential Mortgages* | Home Equities | Total |
|----------------------------|---------------------------|-----------------------------------|--------------------|------------------------|---------------|-----------|
| Allowance for loan losses: | | | | | | |
| Beginning balance | \$ 3,963 | \$ 8,198 | \$ 135 | \$ 919 | \$ 364 | \$ 13,579 |
| Charge-offs | - | - | (5) | - | - | (5) |
| Recoveries | 184 | - | 9 | - | 1 | 194 |
| Provision (Credit) | 823 | (299) | (35) | (87) | 8 | 410 |
| Ending balance | \$ 4,970 | \$ 7,899 | \$ 104 | \$ 832 | \$ 373 | \$ 14,178 |

*Includes construction loans

Table of Contents

Impaired Loans

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

| | At June 30, 2018 | | | | | |
|-------------------------------------|------------------------|--------------------------------|----------------------|-----------------------------------|--------------------------------|----------------------------------|
| | Recorded Investment | Unpaid Principal Balance | Related Allowance | Average Recorded Investment | Interest Income Foregone | Interest Income Recognized |
| With no related allowance recorded: | (in thousands) | | | | | |
| Commercial and industrial | \$ 2,625 | \$ 3,772 | \$ - | \$ 2,716 | \$ 72 | \$ 50 |
| Residential real estate: | | | | | | |
| Residential | 2,062 | 2,321 | - | 2,136 | 21 | 32 |
| Construction | - | - | - | - | - | - |
| Commercial real estate: | | | | | | |
| Commercial | 2,778 | 2,903 | - | 2,818 | 46 | 58 |
| Construction | 154 | 154 | - | 169 | - | 7 |
| Home equities | 1,904 | 2,045 | - | 1,946 | 39 | 16 |
| Consumer and other | - | - | - | - | - | - |
| Total impaired loans | \$ 9,523 | \$ 11,195 | \$ - | \$ 9,785 | \$ 178 | \$ 163 |

| | At June 30, 2018 | | | | | |
|------------------------------------|------------------------|--------------------------------|----------------------|-----------------------------------|--------------------------------|----------------------------------|
| | Recorded Investment | Unpaid Principal Balance | Related Allowance | Average Recorded Investment | Interest Income Foregone | Interest Income Recognized |
| With a related allowance recorded: | (in thousands) | | | | | |
| | \$ 311 | \$ 339 | \$ 94 | \$ 326 | \$ 11 | \$ 1 |

| | | | | | | |
|---|-----------|-----------|----------|-----------|--------|--------|
| Commercial and industrial Residential real estate: | | | | | | |
| Residential | 460 | 484 | 38 | 463 | 12 | - |
| Construction | - | - | - | - | - | - |
| Commercial real estate: | | | | | | |
| Commercial | 6,568 | 6,769 | 511 | 6,624 | 148 | - |
| Construction | 8,975 | 8,975 | 734 | 8,975 | 120 | 113 |
| Home equities | - | - | - | - | - | - |
| Consumer and other | 24 | 28 | 24 | 24 | - | 1 |
| Total impaired loans | \$ 16,338 | \$ 16,595 | \$ 1,401 | \$ 16,412 | \$ 291 | \$ 115 |

Table of Contents

| | At June 30, 2018 | | | | | |
|------------------------------|--|--------------------------------|----------------------|-----------------------------------|--------------------------------|----------------------------------|
| | Recorded Investment (in thousands) | Unpaid Principal Balance | Related Allowance | Average Recorded Investment | Interest Income Foregone | Interest Income Recognized |
| Total: | | | | | | |
| Commercial and industrial | \$ 2,936 | \$ 4,111 | \$ 94 | \$ 3,042 | \$ 83 | \$ 51 |
| Residential real estate: | | | | | | |
| Residential | 2,522 | 2,805 | 38 | 2,599 | 33 | 32 |
| Construction | - | - | - | - | - | - |
| Commercial real estate: | | | | | | |
| Commercial | 9,346 | 9,672 | 511 | 9,442 | 194 | 58 |
| Construction | 9,129 | 9,129 | 734 | 9,144 | 120 | 120 |
| Home equities | 1,904 | 2,045 | - | 1,946 | 39 | 16 |
| Consumer and other | 24 | 28 | 24 | 24 | - | 1 |
| Total impaired loans | \$ 25,861 | \$ 27,790 | \$ 1,401 | \$ 26,197 | \$ 469 | \$ 278 |

| | At December 31, 2017 | | | | | |
|---|--|--------------------------------|----------------------|-----------------------------------|--------------------------------|----------------------------------|
| | Recorded Investment (in thousands) | Unpaid Principal Balance | Related Allowance | Average Recorded Investment | Interest Income Foregone | Interest Income Recognized |
| With no related allowance recorded: | | | | | | |
| Commercial and industrial | \$ 1,023 | \$ 1,917 | \$ - | \$ 1,704 | \$ 92 | \$ 28 |
| Residential real estate: | | | | | | |
| Residential | 2,415 | 2,594 | - | 2,456 | 46 | 83 |
| Construction | - | - | - | - | - | - |
| Commercial real estate: | | | | | | |
| Commercial | 2,336 | 2,469 | - | 2,449 | 134 | 32 |

Edgar Filing: EVANS BANCORP INC - Form 10-Q

| | | | | | | |
|----------------------|----------|----------|------|----------|--------|--------|
| Construction | 187 | 187 | - | 218 | - | 13 |
| Home equities | 1,785 | 1,892 | - | 1,828 | 62 | 33 |
| Consumer and other | - | - | - | - | - | - |
| Total impaired loans | \$ 7,746 | \$ 9,059 | \$ - | \$ 8,655 | \$ 334 | \$ 189 |

Table of Contents

| | At December 31, 2017 | | | | | |
|------------------------------------|----------------------|--------------------------|-------------------|-----------------------------|--------------------------|----------------------------|
| | Recorded Investment | Unpaid Principal Balance | Related Allowance | Average Recorded Investment | Interest Income Foregone | Interest Income Recognized |
| With a related allowance recorded: | (in thousands) | | | | | |
| Commercial and industrial | \$ 1,240 | \$ 1,431 | \$ 372 | \$ 1,279 | \$ 79 | \$ 12 |
| Residential real estate: | | | | | | |
| Residential | 196 | 196 | 28 | 196 | 6 | 3 |
| Construction | - | - | - | - | - | - |
| Commercial real estate: | | | | | | |
| Commercial | 6,689 | 6,819 | 643 | 6,755 | 156 | 129 |
| Construction | - | - | - | - | - | - |
| Home equities | - | - | - | - | - | - |
| Consumer and other | 34 | 59 | 34 | 37 | 3 | 2 |
| Total impaired loans | \$ 8,159 | \$ 8,505 | \$ 1,077 | \$ 8,267 | \$ 244 | \$ 146 |

| | At December 31, 2017 | | | | | |
|---------------------------|----------------------|--------------------------|-------------------|-----------------------------|--------------------------|----------------------------|
| | Recorded Investment | Unpaid Principal Balance | Related Allowance | Average Recorded Investment | Interest Income Foregone | Interest Income Recognized |
| Total: | (in thousands) | | | | | |
| Commercial and industrial | \$ 2,263 | \$ 3,348 | \$ 372 | \$ 2,983 | \$ 171 | \$ 40 |
| Residential real estate: | | | | | | |
| Residential | 2,611 | 2,790 | 28 | 2,652 | 52 | 86 |
| Construction | - | - | - | - | - | - |
| Commercial real estate: | | | | | | |
| Commercial | 9,025 | 9,288 | 643 | 9,204 | 290 | 161 |
| Construction | 187 | 187 | - | 218 | - | 13 |
| Home equities | 1,785 | 1,892 | - | 1,828 | 62 | 33 |
| | 34 | 59 | 34 | 37 | 3 | 2 |

| | | | | | | |
|---|-----------|-----------|----------|-----------|--------|--------|
| Consumer and other Total impaired loans | \$ 15,905 | \$ 17,564 | \$ 1,077 | \$ 16,922 | \$ 578 | \$ 335 |
|---|-----------|-----------|----------|-----------|--------|--------|

27

Table of Contents

Troubled debt restructurings

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

| | June 30, 2018 (in thousands) | | | |
|-----------------------------|---------------------------------|-------------|----------|-------------------|
| | Total | Nonaccruing | Accruing | Related Allowance |
| Commercial and industrial | \$ 749 | \$ 289 | \$ 460 | \$ 56 |
| Residential real estate: | | | | |
| Residential | 1,627 | 262 | 1,365 | 3 |
| Construction | - | - | - | - |
| Commercial real estate: | | | | |
| Commercial and multi-family | 4,330 | 3,719 | 611 | 146 |
| Construction | 154 | - | 154 | - |
| Home equities | 782 | 127 | 655 | - |
| Consumer and other | 24 | - | 24 | 24 |
| Total TDR loans | \$ 7,666 | \$ 4,397 | \$ 3,269 | \$ 229 |

| | December 31, 2017 (in thousands) | | | |
|-----------------------------|-------------------------------------|-------------|----------|-------------------|
| | Total | Nonaccruing | Accruing | Related Allowance |
| Commercial and industrial | \$ 734 | \$ 220 | \$ 514 | \$ 8 |
| Residential real estate: | | | | |
| Residential | 1,656 | 271 | 1,385 | - |
| Construction | - | - | - | - |
| Commercial real estate: | | | | |
| Commercial and multi-family | 3,854 | 3,767 | 87 | 236 |
| Construction | 187 | - | 187 | - |
| Home equities | 794 | 128 | 666 | - |
| Consumer and other | 25 | - | 25 | 24 |
| Total TDR loans | \$ 7,250 | \$ 4,386 | \$ 2,864 | \$ 268 |

Any TDR that is placed on non-accrual is not reverted back to accruing status until the borrower makes timely payments as contracted for at least six months and future collection under the revised terms is probable. All of the Company's restructurings were allowed in an effort to maximize its ability to collect on loans where borrowers were experiencing financial difficulty.

The reserve for a TDR is based upon the present value of the future expected cash flows discounted at the loan's original effective interest rate or upon the fair value of the collateral less costs to sell, if the loan is deemed collateral dependent. This reserve methodology is used because all TDR loans are considered impaired. As of June 30, 2018, there were no commitments to lend additional funds to debtors owing on loans whose terms have been modified in TDRs.

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

Table of Contents

The following tables show the data for TDR activity by the type of concession granted to the borrower for the three month and six month periods ended June 30, 2018 and 2017:

| Troubled Debt Restructurings by Type of Concession | Three months ended June 30, 2018 (Recorded Investment in thousands) | | | Three months ended June 30, 2017 (Recorded Investment in thousands) | | |
|--|--|--|---|--|--|---|
| | Number of Contracts | Pre-Modification Outstanding Recorded Investment | Post-Modification Outstanding Recorded Investment | Number of Contracts | Pre-Modification Outstanding Recorded Investment | Post-Modification Outstanding Recorded Investment |
| Commercial and Industrial: Term-out line of credit | 1 | \$ 29 | \$ 29 | - | \$ - | \$ - |
| Combination of concessions | 1 | 63 | 63 | - | - | - |
| Residential Real Estate & Construction | - | - | - | - | - | - |
| Commercial Real Estate & Construction: Extension of maturity | - | - | - | 1 | 20 | 20 |
| Combination of concessions | 1 | 154 | 154 | - | - | - |
| Home Equities | - | - | - | - | - | - |
| Deferral of principal | 1 | 100 | 100 | - | - | - |
| Consumer and other loans | - | - | - | - | - | - |

Six months ended June 30, 2018

Six months ended June 30, 2017

Edgar Filing: EVANS BANCORP INC - Form 10-Q

| Troubled Debt Restructurings by Type of Concession | (Recorded Investment in thousands) | | | (Recorded Investment in thousands) | | |
|--|------------------------------------|--|---|------------------------------------|--|---|
| | Number of Contracts | Pre-Modification Outstanding Recorded Investment | Post-Modification Outstanding Recorded Investment | Number of Contracts | Pre-Modification Outstanding Recorded Investment | Post-Modification Outstanding Recorded Investment |
| Commercial and Industrial: | | | | | | |
| Term-out line of credit | 1 | \$ 29 | \$ 29 | 1 | \$ 180 | \$ 180 |
| Combination of concessions | 1 | 63 | 63 | - | - | - |
| Residential Real Estate & Construction: | - | - | - | - | - | - |
| Commercial Real Estate & Construction: | | | | | | |
| Extension of maturity | 1 | 181 | 181 | 3 | 5,073 | 5,073 |
| Combination of concessions | 1 | 154 | 154 | - | - | - |
| Home Equities: | | | | | | |
| Deferral of principal | 1 | 100 | 100 | - | - | - |
| Extension of maturity and interest rate reduction | - | - | - | 1 | 20 | 20 |
| Consumer and other loans | - | - | - | - | - | - |

Table of Contents

The general practice of the Bank is to work with borrowers so that they are able to repay their loan in full. If a borrower continues to be delinquent or cannot meet the terms of a TDR and the loan is determined to be uncollectible, the loan will be charged-off. A loan is considered in default when the loan is 90 days past due. There were no loans which were classified as TDRs during the previous 12 months which defaulted during the three or six month periods ended June 30, 2018 and 2017.

5. COMMON EQUITY AND EARNINGS PER SHARE DATA

The common stock per share information is based upon the weighted average number of shares outstanding during each period. For the three and six month periods ended June 30, 2018, the Company had an average of 123,035 and 127,156 dilutive shares outstanding, respectively. The Company had an average of 116,374 and 119,928 dilutive shares outstanding for the three and six months periods ended June 30, 2017, respectively.

Potential common shares that would have the effect of increasing diluted earnings per share are considered to be anti-dilutive and not included in calculating diluted earnings per share. There were no anti-dilutive shares for the three month period ended June 30, 2018. For the six month period ended June 30, 2018, there was an average of 28,660 potentially anti-dilutive shares outstanding, that were not included in calculating diluted earnings per share because their effect was anti-dilutive. For the three and six month periods ended June 30, 2017, there was an average of 23,020 and 24,005 potentially anti-dilutive shares outstanding.

Table of Contents

6. OTHER COMPREHENSIVE INCOME

The following tables summarize the changes in the components of accumulated other comprehensive income (loss) during the three and six month periods ended June 30, 2018 and 2017:

| | Balance at March 31, 2018 (in thousands) | Net Change | Balance at June 30, 2018 |
|--|---|---------------|--------------------------------|
| Net unrealized loss on investment securities | \$ (2,409) | \$ (684) | \$ (3,093) |
| Net defined benefit pension plan adjustments | (2,326) | 36 | (2,290) |
| Total | \$ (4,735) | \$ (648) | \$ (5,383) |

| | Balance at March 31, 2017 (in thousands) | Net Change | Balance at June 30, 2017 |
|---|---|---------------|--------------------------------|
| Net unrealized (loss) gain on investment securities | \$ (178) | \$ 3 | \$ (175) |
| Net defined benefit pension plan adjustments | (1,996) | 31 | (1,965) |
| Total | \$ (2,174) | \$ 34 | \$ (2,140) |

| | Balance at December 31, 2017 (in thousands) | Net Change | Balance at June 30, 2018 |
|--|---|---------------|--------------------------------|
| Net unrealized loss on investment securities | \$ (1,049) | \$ (2,044) | \$ (3,093) |
| Net defined benefit pension plan adjustments | (2,368) | 78 | (2,290) |
| Total | \$ (3,417) | \$ (1,966) | \$ (5,383) |

| | Balance at December 31, 2016 (in thousands) | Net Change | Balance at June 30, 2017 |
|---|---|---------------|--------------------------------|
| Net unrealized (loss) gain on investment securities | \$ (365) | \$ 190 | \$ (175) |
| Net defined benefit pension plan adjustments | (2,059) | 94 | (1,965) |
| Total | \$ (2,424) | \$ 284 | \$ (2,140) |

Table of Contents

| | Three months ended June 30, 2018 (in thousands) | | | Three months ended June 30, 2017 (in thousands) | | |
|---|---|------------------------|----------------------|---|------------------------|----------------------|
| | Income Tax | | Net-of-Tax Amount | Income Tax | | Net-of-Tax Amount |
| | Before-Tax Amount | (Provision) Benefit | | Before-Tax Amount | (Provision) Benefit | |
| Unrealized (loss) gain on investment securities: | | | | | | |
| Unrealized (loss) gain on investment securities | \$ (921) | \$ 237 | \$ (684) | \$ 7 | \$ (4) | \$ 3 |
| Defined benefit pension plan adjustments: | | | | | | |
| Reclassifications from accumulated other comprehensive income for gains | | | | | | |
| Amortization of prior service cost (a) | \$ 8 | \$ (3) | \$ 5 | \$ 8 | \$ (3) | \$ 5 |
| Amortization of actuarial loss (a) | 42 | (11) | 31 | 43 | (17) | 26 |
| Net change | 50 | (14) | 36 | 51 | (20) | 31 |
| Other Comprehensive (Loss) Income | \$ (871) | \$ 223 | \$ (648) | \$ 58 | \$ (24) | \$ 34 |

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

| | Six months ended June 30, 2018 (in thousands) | | | Six months ended June 30, 2017 (in thousands) | | |
|--|--|------------------------|----------------------|--|----------------------------|----------------------|
| | Income Tax | | Net-of-Tax Amount | Income Tax | | Net-of-Tax Amount |
| | Before-Tax Amount | (Provision) Benefit | | Before-Tax Amount | (Provision) Benefit (b) | |
| Unrealized (loss) gain on investment securities: | | | | | | |
| Unrealized (loss) gain on investment securities | \$ (2,759) | \$ 715 | \$ (2,044) | \$ 303 | \$ (113) | \$ 190 |

Defined benefit pension plan

adjustments:

Reclassifications from accumulated other
comprehensive income for gains

| | | | | | | |
|--|------------|--------|------------|--------|----------|--------|
| Amortization of prior service cost (a) | \$ 16 | \$ (5) | \$ 11 | \$ 16 | \$ (1) | \$ 15 |
| Amortization of actuarial loss (a) | 84 | (17) | 67 | 86 | (7) | 79 |
| Net change | 100 | (22) | 78 | 102 | (8) | 94 |
| Other Comprehensive (Loss) Income | \$ (2,659) | \$ 693 | \$ (1,966) | \$ 405 | \$ (121) | \$ 284 |

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

(b) Tax benefit includes impact of re-valuation of deferred tax asset due to increase in marginal federal income tax rate from 34% to 35%.

Table of Contents

7. SEGMENT INFORMATION

The Company is comprised of two primary business segments, banking and insurance agency activities. The following tables set forth information regarding these segments for the three and six month periods ended June 30, 2018 and 2017.

| | Three months ended June 30, 2018 | | |
|--|---|--------------------------------|-----------|
| | Banking Activities (in thousands) | Insurance Agency Activities | Total |
| Net interest income (expense) | \$ 12,225 | \$ (29) | \$ 12,196 |
| Provision for loan losses | 659 | - | 659 |
| Net interest income (expense) after provision for loan losses | 11,566 | (29) | 11,537 |
| Non-interest income | 1,687 | - | 1,687 |
| Insurance service and fees | 164 | 1,788 | 1,952 |
| Amortization expense | - | 28 | 28 |
| Non-interest expense | 8,624 | 1,581 | 10,205 |
| Income before income taxes | 4,793 | 150 | 4,943 |
| Income tax provision | 1,105 | 47 | 1,152 |
| Net income | \$ 3,688 | \$ 103 | \$ 3,791 |

| | Three months ended June 30, 2017 | | |
|--|---|--------------------------------|-------|
| | Banking Activities (in thousands) | Insurance Agency Activities | Total |

Edgar Filing: EVANS BANCORP INC - Form 10-Q

| | | | |
|--|-----------|---------|-----------|
| Net interest income (expense) | \$ 10,144 | \$ (26) | \$ 10,118 |
| Provision for loan losses | 410 | - | 410 |
| Net interest income (expense) after provision for loan losses | 9,734 | (26) | 9,708 |
| Non-interest income | 1,177 | - | 1,177 |
| Insurance service and fees | 96 | 1,816 | 1,912 |
| Amortization expense | - | 28 | 28 |
| Non-interest expense | 7,874 | 1,415 | 9,289 |
| Income before income taxes | 3,133 | 347 | 3,480 |
| Income tax provision | 729 | 133 | 862 |
| Net income | \$ 2,404 | \$ 214 | \$ 2,618 |

Table of Contents

| | Six months ended June 30, 2018 | | |
|--|--------------------------------|--------------------------------|-----------|
| | Banking Activities | Insurance Agency Activities | Total |
| | (in thousands) | | |
| Net interest income (expense) | \$ 23,704 | \$ (56) | \$ 23,648 |
| Provision for loan losses | 1,426 | - | 1,426 |
| Net interest income (expense) after provision for loan losses | 22,278 | (56) | 22,222 |
| Non-interest income | 3,508 | - | 3,508 |
| Insurance service and fees | 301 | 3,616 | 3,917 |
| Amortization expense | - | 56 | 56 |
| Non-interest expense | 17,189 | 3,159 | 20,348 |
| Income before income taxes | 8,898 | 345 | 9,243 |
| Income tax provision | 2,043 | 90 | 2,133 |
| Net income | \$ 6,855 | \$ 255 | \$ 7,110 |

| | Six months ended June 30, 2017 | | |
|--|--------------------------------|--------------------------------|-----------|
| | Banking Activities | Insurance Agency Activities | Total |
| | (in thousands) | | |
| Net interest income (expense) | \$ 19,814 | \$ (52) | \$ 19,762 |
| Provision for loan losses | (25) | - | (25) |
| Net interest income (expense) after provision for loan losses | 19,839 | (52) | 19,787 |
| Non-interest income | 2,531 | - | 2,531 |
| Insurance service and fees | 205 | 3,875 | 4,080 |
| Amortization expense | - | 56 | 56 |
| Non-interest expense | 15,521 | 2,795 | 18,316 |
| Income before income taxes | 7,054 | 972 | 8,026 |
| Income tax provision | 1,888 | 374 | 2,262 |
| Net income | \$ 5,166 | \$ 598 | \$ 5,764 |

8. CONTINGENT LIABILITIES AND COMMITMENTS

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

| | June 30, 2018 | December 31, 2017 |
|------------------------------|------------------|-------------------------|
| | (in thousands) | |
| Commitments to extend credit | \$ 264,802 | \$ 247,540 |
| Standby letters of credit | 3,549 | 3,115 |
| Total | \$ 268,351 | \$ 250,655 |

Table of Contents

Commitments to extend credit and standby letters of credit include some exposure to credit loss in the event of nonperformance by the customer. The Bank's credit policies and procedures for credit commitments and financial guarantees are the same as those for extensions of credit that are recorded on the Company's unaudited consolidated balance sheets. Because these instruments have fixed maturity dates, and because they may expire without being drawn upon, they do not necessarily represent cash requirements of the Bank. The Bank did not incur any losses on its commitments and did not record a reserve for its commitments during the first six months of 2018 or during 2017.

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

9. NET PERIODIC BENEFIT COSTS

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

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

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

The Bank did not make a contribution to the defined benefit pension plan during the first six months of 2018.

The following table presents the net periodic cost for the Bank's defined benefit pension plan and supplemental executive retirement plan for the three and six month periods ended June 30, 2018 and 2017:

| | Three months ended June 30, (in thousands) | | | |
|------------------------------------|---|------|--|--------|
| | Pension Benefits | | Supplemental Executive Retirement Plan | |
| | 2018 | 2017 | 2018 | 2017 |
| Service cost | \$ - | \$ - | \$ 47 | \$ 42 |
| Interest cost | 51 | 54 | 34 | 34 |
| Expected return on plan assets | (78) | (68) | - | - |
| Amortization of prior service cost | - | - | 8 | 8 |
| Amortization of the net loss | 21 | 23 | 21 | 20 |
| Net periodic cost (benefit) | \$ (6) | \$ 9 | \$ 110 | \$ 104 |

Table of Contents

Six months ended June 30,
(in thousands)

| | Pension Benefits | | Supplemental Executive Retirement Plan | |
|------------------------------------|------------------|-------|--|--------|
| | 2018 | 2017 | 2018 | 2017 |
| Service cost | \$ - | \$ - | \$ 94 | \$ 84 |
| Interest cost | 102 | 108 | 68 | 68 |
| Expected return on plan assets | (156) | (137) | - | - |
| Amortization of prior service cost | - | - | 16 | 16 |
| Amortization of the net loss | 42 | 46 | 42 | 40 |
| Net periodic cost (benefit) | \$ (12) | \$ 17 | \$ 220 | \$ 208 |

The components of net periodic benefit cost other than the service cost component are included in the line item “other expense” in the income statement.

10. INCOME TAXES

In the second quarter of 2017, the Company recognized the impact of its investment in a partnership that incurred expenses related to the rehabilitation of a certified historic structure located in New York State after a historic structure was placed in service. At the time a historic structure is placed in service, the Bank is eligible for a federal and New York State tax credit. The Company’s accounting policies related to these investments and the resulting tax

credits is detailed in Note 1 to the audited Consolidated Financial Statements on Form 10-K for the year ended December 31, 2017. There were no historic structures placed in service related to any of the Company's investments in 2018 and thus there was no impact to the financial statements for the three and six month periods ended June 30, 2018. The impact for the three and six month periods ended June 30, 2017 was a loss on the investment of \$0.9 million, the recording of the New York State tax credit of \$0.6 million in non-interest income, and a benefit in income tax expense line of \$0.2 million.

11. REVENUE RECOGNITION OF NON-INTEREST INCOME

A description of the Company's material revenue streams in non-interest income accounted for under ASC 606 follows:

Insurance Service and Fees: Insurance services revenue relates to various revenue streams from services provided by TEA and the Bank:

- TEA earns commission revenue from selling commercial and personal property and casualty ("P&C") insurance as well as employee benefits ("EB") solutions to commercial customers.

TEA has agreements with various insurance companies to sell policies to customers on behalf of the carriers. The performance obligation for TEA is to sell annual P&C policies to commercial customers and consumers. This performance obligation is met when a new policy is sold or when an existing policy renews. The policies are generally one year terms. In the agreements with the respective companies, a commission rate is agreed upon. The commission is recognized at the time of the sale of the policy or when a policy renews.

TEA has signed contracts with insurance carriers that enable TEA to sell benefit plans to commercial customers on behalf of the insurance carriers. The performance obligation for TEA is to sell the plans to commercial customers. After the initial sale when the customer signs an agreement to purchase the offered benefit plan, the performance obligation is met each month when a customer continues utilizing benefit plans from the carrier. The customer does not commit to a specific length of time with the carrier. In the agreements with the respective insurance companies, a commission rate is agreed upon. Revenue is recognized each month when the customer continues with the benefit plan sold by TEA.

Table of Contents

- TEA also earns contingent profit sharing revenue. The insurance companies measure the loss ratio for TEA's customers and will pay TEA according to how profitable TEA customers are.

TEA has signed written agreements with insurance carriers that document payouts to TEA based on the loss ratios of its customers. The performance obligation for TEA is to maintain a customer base with loss ratios below the agreed upon thresholds. In the contracts with the insurance companies, payout rates based on loss ratios are documented. The consideration is variable as loss ratios vary based on customer experience. TEA's performance obligation is over the course of the year as its customers' performance with insurance carriers is measured throughout the year as losses occur. Due to variable nature of contingent profit sharing revenue, TEA will accrue contingent profit sharing revenue throughout the year based on recent historical results. As loss events occur and overall performance becomes known to TEA, accrual adjustments will be made until the cash is ultimately received.

- Financial services commission revenue from the Bank related to wealth management such as life insurance, annuities, and mutual funds sales is also included in the "insurance service and fees" line of the income statement.

The Company earns wealth management fees from its contracts with customers for certain financial services. Fees that are transaction-based are recognized at the point in time that the transaction is executed. Other related services provided include financial planning services and the fees the Bank earns are recognized when the services are rendered.

- Insurance claims services revenue is recorded at FCS.

FCS has signed agreements with insurance companies to perform claims services including investigative and adjustment services related to residential and commercial lines. The performance obligation is for FCS to investigate the insurance claims and inspecting the damage to determine the extent of the insurance company's liability. FCS is paid based on time and materials expended to investigate the claim. The rates paid are determined in the agreement between FCS and the respective insurance companies. Upon completion of its claims inspection work, FCS bills the insurance company for services rendered and recognizes the revenue earned.

A disaggregation of the total insurance service and other fees for the three and six month periods ended June 30, 2018 and 2017 is provided in the tables below:

Three months
ended June

| | 30, | |
|--|-------|-------|
| | 2018 | 2017 |
| Commercial property and casualty insurance commissions | 613 | 572 |
| Personal property and casualty insurance commissions | 735 | 771 |
| Employee benefits sales commissions | 177 | 146 |
| Profit sharing and contingent revenue | 145 | 176 |
| Wealth management and other financial services | 168 | 97 |
| Insurance claims services revenue | 96 | 129 |
| Other insurance-related revenue | 18 | 21 |
| Total insurance service and other fees | 1,952 | 1,912 |

| | Six months ended June | |
|--|--------------------------|-------|
| | 30, | |
| | 2018 | 2017 |
| Commercial property and casualty insurance commissions | 1,335 | 1,244 |
| Personal property and casualty insurance commissions | 1,332 | 1,385 |
| Employee benefits sales commissions | 423 | 198 |
| Profit sharing and contingent revenue | 304 | 749 |
| Wealth management and other financial services | 311 | 211 |
| Insurance claims services revenue | 169 | 249 |
| Other insurance-related revenue | 43 | 44 |
| Total insurance service and other fees | 3,917 | 4,080 |

Table of Contents

12. RECENT ACCOUNTING PRONOUNCEMENTS

Note 1 contains details on the impact of accounting pronouncements adopted in the six-month period ended June 30, 2018. The following proposed standards will be adopted in future periods:

ASU 2016-02, Leases. The objective of this ASU is to increase transparency and comparability among organizations by recognizing lease assets and lease liabilities on the balance sheet and disclosing key information about leasing arrangements to meet that objective. The main difference between previous GAAP and this ASU is the recognition of lease assets and lease liabilities by lessees for those leases classified as operating leases under previous GAAP. Under this new guidance, a lessee should recognize in the statement of financial position a liability to make lease payments and a right-of-use asset representing its right to use the underlying asset for the lease term. The recognition, measurement, and presentation of expenses and cash flows arising from a lease by a lessee have not significantly changed from previous GAAP. Information about the Company's operating lease obligations is disclosed in Note 16 to the Company's Consolidated Financial Statements included in Item 8 of the Annual Report on Form 10-K for the year ended December 31, 2017. The amendments in this ASU are effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. The Company is currently evaluating the impact of the standard on its financial reporting.

ASU 2016-13, Financial Instruments – Credit Losses: Measurement of Credit Losses on Financial Instruments. Current GAAP requires an “incurred loss” methodology for recognizing credit losses that delays recognition until it is probable a loss has been incurred. Both financial institutions and users of their financial statements expressed concern that current GAAP restricts the ability to record credit losses that are expected, but do not yet meet the “probable” threshold. The main objective of this ASU (commonly known as the Current Expected Credit Loss Impairment Model, or CECL, in the industry) is to provide financial statement users with more decision-useful information about the expected credit losses on financial instruments and other commitments to extend credit held by a reporting entity at each reporting date. To achieve this objective, the amendments in CECL replace the incurred loss impairment methodology in current GAAP with a methodology that reflects expected credit losses and requires consideration of a broader range of reasonable and supportable information to inform credit loss estimates. The amendments in CECL are effective for the Company for fiscal years beginning after December 15, 2019, including interim periods within those fiscal years. The FASB expects that an entity will be able to leverage its current systems and methods for recording the allowance for credit losses. However, many financial institutions, particularly community banks similar in size to the Company and industry groups like the American Bankers Association, have expressed concern about the impact of CECL. The life of loan loss concept presents complexities that can decrease capital, and add both volatility to the allowance for loan losses (“ALLL”) estimates and additional costs. CECL may increase the ALLL, though many factors will determine the impact for each bank. Changes in expectations of future economic conditions play a large role in CECL and can significantly affect the credit loss estimate. A challenge for the Company could be the operational impact. Significant procedural challenges may be faced both in implementation and on an ongoing basis. The total impact of CECL to the Company's financial statements is unknown but may be material. Implementation of CECL will be a significant project for the Company through the projected implementation date of January 1, 2020.

ASU 2017-04, Simplifying the Test for Goodwill Impairment. The objective of this ASU is to simplify how an entity is required to test goodwill impairment by eliminating Step 2 from the goodwill impairment test. Step 2 measures a goodwill impairment loss by comparing the implied fair value of a reporting unit's goodwill with the carrying amount of that goodwill. Under the amendments in this ASU, an entity will perform its annual goodwill impairment test by comparing the fair value of a reporting unit with its carrying amount. An entity would recognize an impairment charge for the amount by which the carrying amount exceeds the reporting unit's fair value. The amendments in this ASU are effective for annual reporting periods beginning after December 15, 2019, including interim periods within those fiscal years. The Company does not expect the standard to have a material impact on the Company's financial reporting.

ASU 2017-08, Premium Amortization on Purchased Callable Debt Securities. The objective of this ASU is to amend the amortization period for certain purchased callable debt securities held at a premium. The FASB is shortening the amortization period for the premium to the earliest call date. Under current GAAP, entities generally amortize the premium as an adjustment of yield over the contractual life of the investment. Current GAAP excludes certain callable debt securities from consideration of early repayment of principal even if the holder is certain that the call will be exercised. As a result, upon the exercise of a call on a callable debt security held at a premium, the unamortized premium is recorded as a loss in earnings. The amendments do not require an accounting change for securities held at a discount; the discount continues to be amortized to maturity. The amendments in this ASU are effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2018. The Company does hold callable debt securities that were purchased at a premium and is currently evaluating the impact of the standard on its financial reporting.

Table of Contents

13. SUBSEQUENT EVENTS

TEA purchased the business of Richardson and Stout Insurance (“R&S”) on July 1, 2018 in what will be accounted for as a business combination for \$5 million. R&S was an insurance agency in Wellsville, NY that offered personal and commercial property and casualty insurance agency services. The purchase agreement included an additional \$1.5 million in cash and stock compensation to be paid by TEA should the former R&S owners remain employees of TEA through July 1, 2021. The \$0.6 million in stock compensation will be made through an issuance of the Company’s stock based on the share price as of the close of business on June 29, 2018 of \$46.10. The impact of the purchase on the Company’s financial statements will be included on the Consolidated Balance Sheet as of September 30, 2018 and in the results reported in the Consolidated Statement of Income for the three-month period ended September 30, 2018 in next quarter’s Form 10-Q.

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

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

These forward-looking statements are based largely on the expectations of the Company’s management and are subject to a number of risks and uncertainties, including but not limited to: general economic conditions, either nationally or in the Company’s market areas, that are worse than expected; increased competition among depository or other financial institutions; inflation and changes in the interest rate environment that reduce the Company’s margins or reduce the fair value of financial instruments; changes in laws or government regulations affecting financial institutions, including changes in regulatory fees, monetary policy, and capital requirements; the Company’s ability to enter new markets successfully and capitalize on growth opportunities; the Company’s ability to successfully integrate acquired entities; loan losses in excess of the Company’s allowance for loan losses; changes in accounting pronouncements and practices, as adopted by financial institution regulatory agencies, the Financial Accounting Standards Board and the Public Company Accounting Oversight Board; the impact of such changes in accounting pronouncements and practices being greater than anticipated; the ability to realize the benefit of deferred tax assets; changes in tax policies, rates and regulations of federal, state and local tax authorities; changes in consumer spending, borrowing and saving habits; changes in the Company’s organization, compensation and benefit plans; and other

factors discussed elsewhere in this Quarterly Report on Form 10-Q, as well as in the Company's periodic reports filed with the SEC, in particular the "Risk Factors" discussed in Item 1A of the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2017. Many of these factors are beyond the Company's control and are difficult to predict.

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

APPLICATION OF CRITICAL ACCOUNTING ESTIMATES

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

Table of Contents

Company's Unaudited Consolidated Financial Statements included in Item 1 of this Quarterly Report on Form 10-Q for further detail on fair value measurement.

Significant accounting policies followed by the Company are presented in Note 1 – “Organization and Summary of Significant Accounting Policies” to the Audited Consolidated Financial Statements included in Item 8 in its Annual Report on Form 10-K for the year ended December 31, 2017. These policies, along with the disclosures presented in the other Notes to the Company's Audited Consolidated Financial Statements contained in its Annual Report on Form 10-K and in this financial review, provide information on how significant assets and liabilities are presented in the Company's Unaudited Consolidated Financial Statements and how those values are determined.

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

Allowance for Loan Losses

The allowance for loan losses represents management's estimate of probable losses in the Company's loan portfolio. Determining the amount of the allowance for loan losses is considered a critical accounting estimate because it requires significant judgment on the part of management and the use of estimates related to the amount and timing of expected future cash flows on impaired loans, estimated losses on pools of homogeneous loans based on historical loss experience, and consideration of current economic trends and conditions, all of which may be susceptible to significant change. The loan portfolio also represents the largest asset type on the Company's Unaudited Consolidated Balance Sheets. Note 1 to the Audited Consolidated Financial Statements included in Item 8 in the Company's Annual Report on Form 10-K for the year ended December 31, 2017 describes the methodology used to determine the allowance for loan losses.

Goodwill

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

value. There were no triggering events in the six month period ended June 30, 2018 that resulted in an interim impairment test.

ANALYSIS OF FINANCIAL CONDITION

Loan Activity

Total loans grew to \$1.13 billion at June 30, 2018, a \$16 million or 1% increase from total loans of \$1.11 billion at March 31, 2018 and a \$61 million or 6% increase from \$1.07 billion at December 31, 2017.

Loans secured by real estate were \$884 million at June 30, 2018, reflecting a \$22 million or 3% increase from \$862 million at March 31, 2018 and a \$54 million or 6% increase from \$830 million at December 31, 2017. Commercial real estate loans, including construction loans, were \$668 million at June 30, 2018, \$16 million higher than the \$652 million balance at the end of the first quarter of 2018 and \$41 million higher than the balance of \$627 million at the end of 2017. Commercial real estate is the largest part of the Company's loan portfolio and has historically been the highest growth segment of the portfolio. The market for commercial real estate in the Company's footprint in Western New York has been strong over the past two years. The demand, along with the Company's proven track record in commercial real estate lending, led to strong growth at an annualized rate of 10% in the second quarter of 2018.

In the second quarter of 2018, residential mortgage originations were \$9 million compared with the previous quarter's originations of \$12 million and \$6 million in the 2017 second quarter. The Company originated \$21 million in residential mortgages in the first six months of 2018, compared with \$17 million in the first six months of 2017. There were no loans sold in the first two quarters of 2018, compared with 39% of originated residential mortgage loans sold in the second quarter of 2017 and 31% of originated residential mortgage loans sold in the first six months of 2017. Management decides to keep or sell residential mortgage loans at the time of origination based on interest rate risk management and the risk-adjusted return of alternative investment sources such as mortgage-backed securities.

Table of Contents

The Company has also focused on growth opportunities in commercial and industrial (“C&I”) lending as a way to diversify its overall loan portfolio. The C&I portfolio was \$239 million at June 30, 2018, representing a \$6 million or 2% decrease from \$245 million at March 31, 2018, but \$7 million or 3% higher than the \$232 million balance at December 31, 2017. C&I loan growth was impacted by the Company’s concerted effort to exit leveraged syndicated national credits (“SNC”). As these loans come up for renewal the Company has chosen not to participate. Leveraged SNC balances were \$2 million at June 30, 2018, compared with \$9 million at March 31, 2018 and \$12 million at December 31, 2017. The Company does not plan to originate any new loans in the leveraged SNC portfolio in the foreseeable future.

Credit Quality of Loan Portfolio

Total non-performing loans, defined as accruing loans greater than 90 days past due and nonaccrual loans, totaled \$23 million, or 2.06% of total loans outstanding at June 30, 2018, compared with \$15 million, or 1.33% of total loans outstanding, as of March 31, 2018 and \$14 million, or 1.29% of total loans outstanding, as of December 31, 2017. The \$8 million increase in non-performing loans in the second quarter of 2018 is due to a single commercial construction loan of \$9 million that was downgraded to nonaccrual status after it exceeded its original maturity date and the Bank did not agree to an extension. Based on management’s analysis and a current valuation of the loan’s collateral, management considers the loan to be adequately reserved.

Commercial credits graded as “special mention” and “substandard,” or the criticized loan portfolio, were \$40 million at June 30, 2018, a \$2 million increase from \$38 million at March 31, 2018 and \$10 million higher than the \$30 million in criticized loans at December 31, 2017. The increase in criticized loans in the second quarter of 2018 reflected the aforementioned downgrade of a \$9 million commercial construction loan to substandard, partially offset by a \$5 million decrease in criticized C&I loans and a \$1 million decrease in criticized commercial real estate loans. There were several upgrades in the C&I portfolio in the second quarter of 2018 after the Company received updated financial information from several borrowers that demonstrated improved operating performance that justified upgrades to watch or pass status. The level of criticized loans can fluctuate as new information is constantly received on the Company’s borrowers and their financial circumstances change over time. As noted in Note 4 to the Company’s Unaudited Financial Statements included in Part I of this Quarterly Report on Form 10-Q, internal risk ratings are the credit quality indicators used by the Company’s management to determine the appropriate allowance for loan losses for commercial credits. “Special mention” and “substandard” loans are weaker credits with a higher risk of loss categorized as “criticized” credits rather than “pass” or “watch” credits.

The Company maintains an allowance for loan losses that in management’s judgment appropriately reflects losses inherent in the loan portfolio. The allowance for loan losses totaled \$15.2 million or 1.35% of total loans outstanding at June 30, 2018, compared with \$14.7 million or 1.32% of total loans outstanding as of March 31, 2018 and \$14.0 million or 1.32% of total loans outstanding at December 31, 2017. The Company recorded \$0.7 million in provision for loan losses in the second quarter of 2018, reflecting the specific reserve for the \$9 million non-performing loan downgraded in the quarter. Net charge-offs were \$0.1 million in the second quarter of 2018, or 0.04% of average net loans, compared with a net charge-off ratio of 0.03% and (0.08)% in the first quarter of 2018 and second quarter of 2017, respectively.

Investing Activities

Total securities decreased to \$149 million at June 30, 2018 from \$164 million at March 31, 2018 and \$150 million at December 31, 2017. Interest-bearing deposits at other banks, which consist of overnight funds kept at correspondent banks and the Federal Reserve, were \$3 million at June 30, 2018, compared with \$9 million at March 31, 2018 and \$8 million at December 31, 2017. Seasonal municipal deposit inflows in the first quarter of 2018 required collateralization, resulting in the increased investment securities and interest-bearing deposits at other banks at the end of the first quarter. Average investment securities and interest-bearing cash were 13% of average interest-earning assets in the second quarter of 2018, unchanged from the first three months of 2018.

The Company's highest concentration in its debt securities portfolio was in available for sale U.S. government sponsored mortgage-backed securities at 56% of total debt securities at June 30, 2018, compared with 53% at March 31, 2018 and 58% at December 31, 2017. The concentration in tax-advantaged debt securities issued by state and political subdivisions and U.S. government-sponsored agency bonds was 19% and 25%, respectively, of the total debt securities portfolio at June 30, 2018, compared with 19% and 22% at March 31, 2018 and 23% and 19% at December 31, 2017. The Company also held a short-term U.S. Treasury bond for \$10 million, or 6% of total outstanding debt securities, as of March 31, 2018 for purposes of collateralizing seasonal municipal deposits.

The total net unrealized loss position of the available-for-sale investment portfolio was \$4.2 million at June 30, 2018, compared with \$3.3 million at March 31, 2018 and \$1.4 million at December 31, 2017. The securities in an unrealized loss position at the end of the second quarter of 2018 reflect an increase in market interest rates rather than any credit concerns. Management believes that the credit quality of the securities portfolio as a whole is strong.

The Company monitors extension and prepayment risk in the securities portfolio to limit potential exposures. The Company has no exposure to subprime mortgages, nor does the Company hold private mortgage-backed securities, credit default swaps, or FNMA or FHLMC preferred stock investments in its investment portfolio.

Table of Contents

Funding Activities

Total deposits at June 30, 2018 were \$1.18 billion, a \$48 million or 4% increase from \$1.13 billion at March 31, 2018 and a \$131 million or 12% increase from \$1.05 billion at December 31, 2017. The growth in the first six months of 2018 reflected growth in savings deposits of \$60 million, time deposits of \$55 million, NOW deposits (interest-bearing checking accounts) of \$12 million, and demand deposits (non-interest-bearing checking accounts) of \$5 million. Due to the transactional nature of demand deposits, average balances are a useful metric to meaningfully measure sustained growth rates. Average demand deposits were \$240 million in the second quarter of 2018, a 7% increase from \$223 million in the first quarter of 2018 and 17% higher than the \$205 million average balance in the second quarter of 2017. Most of the Company's demand deposit growth over the past twelve months has been with commercial customers.

The Company's core deposit strategy centers on targeting business customers. Commercial savings deposits increased \$42 million during the first six months of 2018 while commercial demand deposits increased \$2 million over the same time period. The Company's government banking initiative that began in 2017 in an effort to support the Bank's funding needs continued to be successful in the first half of 2018. Municipal deposits grew \$64 million, including \$51 million in savings deposits, \$11 million in NOW deposits, and \$2 million in demand deposits.

Consumer savings deposit growth has been challenging as consumer preferences move toward term products with higher rates and local market competition has stiffened. Consumer savings deposits declined \$34 million in the first six months of 2018, including \$14 million during the second quarter of 2018. The growth product for consumer deposits continues to be time deposits, which grew \$36 million during the first half of 2018. The Company supplemented its core deposit portfolio with \$19 million of brokered time deposits growth in the second quarter of 2018. The Company previously did not have any brokered time deposits and has now expanded its funding strategy to include brokered time deposits as the Bank seeks to manage core funding pricing along with interest rate risk.

The Company had \$10 million in other borrowings at June 30, 2018. This represents a single \$10 million long-term advance with the Federal Home Loan Bank of New York ("FHLBNY") scheduled to mature in 2020. Other borrowings were \$62 million at March 31, 2018 and \$88 million at December 31, 2017. The Company's use of its overnight line of credit with FHLBNY varies depending on its ability to fund investment and loan growth with core deposits along with the line usage's impact on interest rate risk.

Table of Contents

ANALYSIS OF RESULTS OF OPERATIONS

Average Balance Sheet

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

| | Three months ended June 30, 2018 | | | Three months ended June 30, 2017 | | |
|---|---|-----------------------------|----------------|---|-----------------------------|----------------|
| | Average Outstanding Balance (dollars in thousands) | Interest Earned/ Paid | Yield/ Rate | Average Outstanding Balance (dollars in thousands) | Interest Earned/ Paid | Yield/ Rate |
| ASSETS | | | | | | |
| Interest-earning assets: | | | | | | |
| Loans, net | \$ 1,098,391 | \$ 13,199 | 4.82 % | \$ 941,446 | \$ 10,646 | 4.54 % |
| Taxable securities | 124,947 | 863 | 2.77 % | 92,606 | 563 | 2.44 % |
| Tax-exempt securities | 30,142 | 170 | 2.26 % | 35,086 | 210 | 2.40 % |
| Interest bearing deposits at banks | 4,013 | 15 | 1.50 % | 16,840 | 43 | 1.02 % |
| Total interest-earning assets | 1,257,493 | \$ 14,247 | 4.54 % | 1,085,978 | \$ 11,462 | 4.23 % |
| Non interest-earning assets: | | | | | | |
| Cash and due from banks | 13,643 | | | 13,545 | | |
| Premises and equipment, net | 10,420 | | | 11,021 | | |
| Other assets | 57,050 | | | 46,744 | | |
| Total Assets | \$ 1,338,606 | | | \$ 1,157,288 | | |
| LIABILITIES & STOCKHOLDERS' EQUITY | | | | | | |
| Interest-bearing liabilities: | | | | | | |
| NOW | \$ 120,510 | \$ 78 | 0.26 % | \$ 97,422 | \$ 54 | 0.22 % |
| Savings | 576,197 | 850 | 0.59 % | 540,995 | 650 | 0.48 % |
| Time deposits | 214,410 | 831 | 1.55 % | 152,112 | 486 | 1.28 % |
| Other borrowed funds | 32,546 | 157 | 1.93 % | 10,329 | 44 | 1.71 % |
| Junior subordinated debentures | 11,330 | 132 | 4.67 % | 11,330 | 104 | 3.68 % |

Edgar Filing: EVANS BANCORP INC - Form 10-Q

| | | | | | | |
|------------------------------------|--------------|-----------|--------|--------------|-----------|--------|
| Securities sold U/A to repurchase | 7,041 | 3 | 0.17 % | 11,154 | 6 | 0.22 % |
| Total interest-bearing liabilities | 962,034 | \$ 2,051 | 0.86 % | 823,342 | \$ 1,344 | 0.65 % |
| Noninterest-bearing liabilities: | | | | | | |
| Demand deposits | 239,546 | | | 205,361 | | |
| Other | 14,614 | | | 13,860 | | |
| Total liabilities | \$ 1,216,194 | | | \$ 1,042,563 | | |
| Stockholders' equity | 122,412 | | | 114,725 | | |
| Total Liabilities and Equity | \$ 1,338,606 | | | \$ 1,157,288 | | |
| Net interest earnings | | \$ 12,196 | | | \$ 10,118 | |
| Net interest margin | | | 3.89 % | | | 3.74 % |
| Interest rate spread | | | 3.68 % | | | 3.58 % |

43

Table of Contents

| | Six months ended June 30, 2018 | | | Six months ended June 30, 2017 | | |
|---|---|-----------------------------|----------------|---|-----------------------------|----------------|
| | Average Outstanding Balance (dollars in thousands) | Interest Earned/ Paid | Yield/ Rate | Average Outstanding Balance (dollars in thousands) | Interest Earned/ Paid | Yield/ Rate |
| ASSETS | | | | | | |
| Interest-earning assets: | | | | | | |
| Loans, net | \$ 1,082,922 | \$ 25,562 | 4.76 % | \$ 933,067 | \$ 20,892 | 4.52 % |
| Taxable securities | 126,765 | 1,660 | 2.64 % | 81,650 | 999 | 2.47 % |
| Tax-exempt securities | 31,134 | 366 | 2.37 % | 35,760 | 434 | 2.45 % |
| Interest bearing deposits at banks | 3,366 | 25 | 1.50 % | 11,425 | 55 | 0.97 % |
| Total interest-earning assets | 1,244,187 | \$ 27,613 | 4.48 % | 1,061,902 | \$ 22,380 | 4.25 % |
| Non interest-earning assets: | | | | | | |
| Cash and due from banks | 13,904 | | | 13,143 | | |
| Premises and equipment, net | 10,490 | | | 11,126 | | |
| Other assets | 56,486 | | | 46,743 | | |
| Total Assets | \$ 1,325,067 | | | \$ 1,132,914 | | |
| LIABILITIES & STOCKHOLDERS' EQUITY | | | | | | |
| Interest-bearing liabilities: | | | | | | |
| NOW | \$ 117,406 | \$ 154 | 0.26 % | \$ 95,761 | \$ 105 | 0.22 % |
| Regular savings | 564,437 | 1,594 | 0.57 % | 525,874 | 1,260 | 0.48 % |
| Time deposits | 204,372 | 1,509 | 1.49 % | 148,512 | 941 | 1.28 % |
| Other borrowed funds | 51,785 | 450 | 1.75 % | 12,910 | 97 | 1.52 % |
| Junior subordinated debentures | 11,330 | 250 | 4.45 % | 11,330 | 204 | 3.63 % |
| Securities sold U/A to repurchase | 8,675 | 8 | 0.19 % | 11,524 | 11 | 0.19 % |
| Total interest-bearing liabilities | 958,005 | \$ 3,965 | 0.83 % | 805,911 | \$ 2,618 | 0.66 % |
| Noninterest-bearing liabilities: | | | | | | |
| Demand deposits | 231,406 | | | 200,890 | | |
| Other | 14,886 | | | 14,453 | | |
| Total liabilities | \$ 1,204,297 | | | \$ 1,021,254 | | |
| Stockholders' equity | 120,770 | | | 111,660 | | |
| Total Liabilities and Equity | \$ 1,325,067 | | | \$ 1,132,914 | | |

| | | |
|-----------------------|-----------|-----------|
| Net interest earnings | \$ 23,648 | \$ 19,762 |
| Net interest margin | 3.83 % | 3.75 % |
| Interest rate spread | 3.65 % | 3.59 % |

44

Table of Contents

Net Income

Net income was \$3.8 million, or \$0.77 per diluted share, in the second quarter of 2018, compared with \$3.3 million, or \$0.68 per diluted share, in the first quarter of 2018 and \$2.6 million, or \$0.54 per diluted share, in the prior year's second quarter. The increase over both comparative periods primarily reflects higher net interest income due to loan growth and a wider net interest margin, and a lower effective tax rate related to federal income tax reform. Return on average equity was 12.39% for the second quarter of 2018 compared with 11.15% in the first quarter of 2018 and 9.13% in the second quarter of 2017.

The Company had net income of \$7.1 million, or \$1.44 per diluted share, in the first six months of 2018, a 23% increase from \$5.8 million, or \$1.20 per diluted share, in the comparable period of 2017. Return on average equity improved from 10.32% in the first half of 2017 to 11.77% in the six month period ended June 30, 2018.

Other Results of Operations – Quarterly Comparison

Net interest income increased \$0.7 million, or 7%, from the first quarter of 2018 and \$2.1 million, or 21%, from the prior-year second quarter to \$12.2 million in the second quarter of 2018. The strong growth of average commercial loans and a higher net interest margin were the primary drivers of the improvement in net interest income in the second quarter of 2018 when compared with both comparative periods. Average commercial loans, including both commercial real estate and C&I loans, were \$898 million in the 2018 second quarter, 3% higher than \$872 million in the trailing first quarter, and 18% higher than \$763 million in the 2017 second quarter.

The 2018 second quarter net interest margin of 3.89% increased 12 basis points from 3.77% in the 2018 first quarter, and 15 basis points from 3.74% in the second quarter of 2017. The margin improvement from the prior year quarter stems from increased yields on interest-earning assets, somewhat offset by higher funding cost. Loan yields benefited from variable loan re-pricing as the Federal Reserve increased its target rate by 125 basis points from March 2017 through June 2018. The increase in short-term interest rates, along with a very competitive deposit market resulted in increased funding cost during the quarter. The cost of interest-bearing liabilities was 0.86% in the second quarter of 2018, compared with 0.81% in the first quarter of 2018 and 0.65% in the second quarter of 2017. Funding costs have been impacted by a shift in deposit mix as consumers in low-cost legacy savings deposit products have migrated to higher-cost time deposits or to competitor financial institutions with higher rates.

The \$0.7 million provision for loan loss for the second quarter of 2018 reflects the increase in non-performing loans in the quarter. The decrease compared with the first quarter of 2018 provision for loan loss of \$0.8 million is due to lower loan growth, including the \$7 million payoff of a leveraged SNC loan. The increase over the prior year second quarter provision for loan loss of \$0.4 million reflects higher net charge-offs. Net charge-offs were \$0.1 million in the second quarter of 2018, compared with net recoveries of \$0.2 million in last year's second quarter.

Non-interest income was \$3.6 million in the second quarter of 2018, a decrease from \$3.8 million in the first quarter of 2018, but an increase from \$3.1 million in the prior year second quarter. The decrease in non-interest income in the second quarter of 2018 compared with the first quarter of 2018 is mostly due to lower fair value adjustments to the Company's mortgage servicing rights asset and equity securities. The increase in non-interest income in the second quarter of 2018 compared with the prior-year period is due to an increase in the fair value of the Company's equity

securities and the impact of a net reduction of noninterest income of \$0.3 million during the second quarter of 2017 related to an investment in an historic rehabilitation tax credit. There were no historic rehabilitation tax credit transactions during 2018.

Insurance revenue increased 2% during the second quarter of 2018 when compared with the prior year period due to higher commercial lines, employee benefits, and financial services revenues, offset by a reduction in personal lines and claims services revenue.

Non-interest expenses in the second quarter of 2018 increased 10% from the prior-year period, but less than 1% when compared with the first quarter of 2018, to \$10.2 million. Salaries and benefits costs were \$6.5 million in the second quarter of 2018, a decrease of 2% from the first quarter of 2018 but 9% higher than last year's second quarter. The first quarter of 2018 included a one-time bonus paid to non-senior associates in recognition of their superior efforts. The total cost of the bonus was \$0.3 million. The increase in salaries and benefits costs when compared with the prior year period reflects strategic personnel hires to support the Company's continued growth.

Advertising expenses increased to \$0.3 million in the second quarter of 2018, compared with \$0.1 million in the first quarter of 2018, and \$0.2 million in the prior-year period. The increase in advertising expense is due to promotional campaigns for the Company's deposit products.

FDIC insurance expense increased to \$0.2 million in the second quarter of 2018, which was relatively flat compared with the first quarter of 2018, but represented an increase of \$0.1 million when compared with the prior-year period. The increase in FDIC insurance expense is a result of higher average assets from prior year as the Company continues to grow its loan portfolio.

Table of Contents

The Company's efficiency ratio in the second quarter of 2018 improved to 64.5% from 66.6% in the first quarter of 2018 and 68.9% in the prior year's second quarter. The improvement in the efficiency ratio reflects the Company's significant net interest income growth and a strategic focus on expense management.

Income tax expense was \$1.2 million, or an effective tax rate of 23.3%, for the second quarter of 2018, compared with \$1.0 million, or 22.8%, in the first quarter of 2018 and \$0.9 million, or 24.8%, in last year's second quarter. The effective tax rate for the second quarter of 2017 reflects the benefit of the previously noted tax credit investment transactions. Excluding the impact of the historic tax credits, the effective tax rate for the second quarter of 2017 was 29.3%. The lower effective rate in the second quarter of 2018 when compared with the prior year period reflects the benefit of federal tax reform, which decreased the Company's marginal federal income tax rate from 35% to 21%.

Other Results of Operations – Year-to-Date Comparison

Net interest income was \$23.6 million for the first six months of 2018, a \$3.9 million or 20% increase from the first six months of 2017. The increase in net interest income is attributable to a \$182 million or 17% increase in average interest-earning assets and an 8 basis point increase in net interest margin. The increase in average interest-earning assets reflects average loan growth of \$150 million or 16% to \$1.1 billion during the first half of 2018. Most of the growth was in commercial loans, including \$85 million in average commercial real estate loans and \$52 million in average C&I loans.

The Company's net interest margin increased 8 basis points from 3.75% in the first six months of 2017 to 3.83% in the first six months of 2018. The yield on average interest-earning assets increased 23 basis points from 4.25% to 4.48%. Average loan yields increased 24 basis points from 4.52% to 4.76%, reflecting the benefit of variable loan re-pricing as short-term interest rates rise. The cost of interest-bearing liabilities was 0.83%, or 17 basis points higher in the first six months of 2018 when compared with the first six months of 2017. In reaction to the competitive deposit market the Company has increased promotional pricing on certain deposit products, primarily time deposits. The rate paid on average time deposits increased from 1.28% in the first half of 2017 to 1.49% during the first six months of 2018. The higher overall cost of interest-bearing liabilities also reflects a shift in the Company's funding mix. Low-cost consumer savings deposits declined as the average balance of higher cost time deposits and other wholesale borrowings increased. Average time deposits and other borrowings were 21% and 5%, respectively, of total interest-bearing liabilities in the six-month period ended June 30, 2018, compared with 18% and 2%, respectively, in the first six months of 2017.

The Company recorded \$1.4 million in provision for loan losses in the six month period ended June 30, 2018, compared with a release of under \$0.1 million in allowance for loan losses in the six-month period ended June 30, 2017. The increase in provision for loan losses during the first six months of 2018 compared with the prior year period reflects strong loan growth, higher qualitative loss factors to account for credit trends such as a higher ratio of non-performing loans to total loans and an increase in specific reserves for impaired loans. The release in the first six months of 2017 was attributable to a sustained period of low charge-offs impacting historical loss rates in the reserve calculation and net recoveries of \$0.3 million.

Non-interest income for the first six months of 2018 increased \$0.8 million from the prior year period to \$7.4 million. The increase was a result of higher deposit service charges of \$0.2 million, a \$0.2 million increase in the Company's investment in the equity securities of another financial institution, an increase in interchange fee income of \$0.2 million, and a lower reduction of income related to historic tax credit transactions. The net impact of historic tax credit investments on non-interest income in the first half of 2017 was a reduction in income of \$0.3 million while there was no reduction in 2018. Those increases in non-interest income were partially offset by a \$0.2 million decrease in insurance service and fee revenue. The decrease in insurance service and fee revenue during the first six months of 2018 when compared with prior year period was primarily due to a reduction in profit sharing revenue somewhat offset by higher employee benefits revenue.

Total non-interest expense increased to \$20.4 million in the first six months of 2018, 11% higher than the six-month period ended June 30, 2017. The increase was mostly attributable to an increase in salaries and employee benefits costs. Salaries and employee benefits costs were \$13.1 million for the first six months of 2018, a \$1.5 million or 13% increase from \$11.6 million in the prior year period. The year-over-year increase in salary and benefits expense reflects strategic personnel hires to support the Company's growth. Technology and communications expenses increased \$0.2 million to \$1.6 million, reflecting additional expense related to the full year impact of the Company's new online banking platform which converted in the second quarter of 2017.

The Company's efficiency ratio for the first six months of 2018 was 65.5%, compared with 68.7% during the prior-year period. The improvement in the ratio reflects the increase in net interest income and non-interest income, partially offset by the increase in non-interest expenses.

Table of Contents

The Company recorded income tax expense of \$2.1 million for the six-month period ended June 30, 2018, compared with \$2.3 million in the first six months of 2017. The effective tax rate for the first six months of 2018 was 23.1%, compared with 28.1% in the comparable 2017 period. The effective tax rate for the first six months of 2017 reflects the benefit of historic tax credit investment transactions. Excluding the impact of the historic tax credit transactions, the effective tax rate was 30.1% for the six-month period ended June 30, 2017. The lower effective rate for the first six months of 2018 reflects the benefit of federal tax reform.

CAPITAL

The Company consistently maintains regulatory capital ratios significantly above the federal “well capitalized” standard, including a Tier 1 leverage ratio of 9.94% at June 30, 2018, compared with 9.81% at March 31, 2018 and 10.11% at December 31, 2017. Book value per share increased to \$25.63 at June 30, 2018, compared with \$24.96 at March 31, 2018, and \$24.74 at December 31, 2017.

On February 20, 2018, the Company declared a cash dividend of \$0.46 per share on the Company’s outstanding common stock. The dividend was paid on April 3, 2018. This semi-annual dividend represented a \$0.06, or 15%, increase from the previous semi-annual dividend paid in October 2017.

LIQUIDITY

The Bank utilizes cash flows from the investment portfolio and federal funds sold balances to manage the liquidity requirements related to loan demand and deposit fluctuations. The Bank also has many borrowing options. The Company uses the Federal Home Loan Bank of New York as its primary source of overnight funds and also has one long-term advance with FHLB NY. The Company had \$10 million in borrowed funds at FHLB NY at June 30, 2018, compared with \$62 million and \$88 million at March 31, 2018 and December 31, 2017, respectively. The Company has pledged sufficient collateral in the form of residential and commercial real estate loans at FHLB NY that meets FHLB collateral requirements. As a member of the FHLB, the Bank is able to borrow funds at competitive rates. Advances of up to \$313 million can be drawn on the FHLB via an Overnight Line of Credit Agreement between the Bank and the FHLB. An amount equal to 25% of the Bank’s total assets could be borrowed through the advance programs under certain qualifying circumstances. The Bank also has the ability to purchase up to \$18 million in federal funds from its correspondent banks. By placing sufficient collateral in safekeeping at the Federal Reserve Bank, the Bank could borrow at the discount window. The Bank’s liquidity needs also can be met by more aggressively pursuing time deposits, or accessing the brokered time deposit market, including the Certificate of

Deposit Account Registry Service (“CDARS”) network.

Cash flows from the Bank’s investment portfolio are laddered, so that securities mature at regular intervals, to provide funds from principal and interest payments at various times as liquidity needs may arise. Contractual maturities are also laddered, with consideration as to the volatility of market prices. At June 30, 2018, approximately 8% of the Bank’s securities had contractual maturity dates of one year or less and approximately 24% had maturity dates of five years or less. Additionally, mortgage-backed securities, which comprised 56% of the investment portfolio at June 30, 2018, provide consistent cash flows for the Bank.

The Company’s primary source of liquidity is dividends from the Bank. Additionally, the Company has access to capital markets as a funding source.

Management, on an ongoing basis, closely monitors the Company’s liquidity position for compliance with internal policies and believes that available sources of liquidity are adequate to meet funding needs in the normal course of business. As part of that monitoring process, management calculates the 90-day liquidity each month by analyzing the cash needs of the Bank. Included in the calculation are liquid assets and potential liabilities. Management stresses the potential liabilities calculation to ensure a strong liquidity position. Included in the calculation are assumptions of some significant deposit run-off as well as funds needed for loan closings and investment purchases. In the Company’s internal stress test at June 30, 2018, the Company had net short-term liquidity of \$257 million as compared with \$237 million at December 31, 2017. Available assets of \$149 million, divided by public and purchased funds of \$261 million, resulted in a long-term liquidity ratio of 57% at June 30, 2018, compared with 49% at December 31, 2017.

Management does not anticipate engaging in any activities, either currently or in the long term, for which adequate funding would not be available and which would therefore result in significant pressure on liquidity.

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

Table of Contents

ITEM 3 - QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

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

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

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

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

SENSITIVITY OF NET INTEREST INCOME TO CHANGES IN INTEREST RATES

Calculated increase
in projected annual net interest income
(in thousands)

| | June 30, 2018 | December 31, 2017 |
|---------------------------|---------------|-------------------|
| Changes in interest rates | | |
| +200 basis points | \$ 1,232 | \$ 1,907 |
| +100 basis points | 2,723 | 2,927 |
| -100 basis points | (3,017) | (3,268) |
| -200 basis points | NM | NM |

Many assumptions were utilized by management to calculate the impact that changes in interest rates may have on the Bank's net interest income. The more significant assumptions related to the rate of prepayments of mortgage-related assets, loan and deposit volumes and pricing, and deposit maturities. The Bank assumed immediate changes in rates including 200 basis point rate changes.

In each of the 100 and 200 basis point rate reduction scenarios, the applicable rate changes may be limited to lesser amounts such that interest rates are not less than zero. The assumptions in the Company's projections are inherently uncertain and, as a result, the Bank cannot precisely predict the impact of changes in interest rates on net interest income. Actual results may differ significantly due to the timing, magnitude, and frequency of interest rate changes in market conditions and interest rate differentials (spreads) between maturity/repricing categories, as well as any actions such as those previously described, which management may take to counter such changes. In light of the uncertainties and assumptions associated with the process, the amounts presented in the table and changes in such amounts are not considered significant to the Bank's projected net interest income.

Table of Contents

ITEM 4 - CONTROLS AND PROCEDURES

DISCLOSURE CONTROLS AND PROCEDURES

The Company's management, with the participation of the Company's principal executive officer and principal financial officer, evaluated the effectiveness of the design and operation of the Company's disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act) as of June 30, 2018 (the end of the period covered by this Report). Based on that evaluation, the Company's principal executive and principal financial officers concluded that as of June 30, 2018 the Company's disclosure controls and procedures were effective.

CHANGES IN INTERNAL CONTROL OVER FINANCIAL REPORTING

No changes in the Company's internal control over financial reporting were identified in connection with the evaluation required by paragraph (d) of Rule 13a-15 or Rule 15d-15 under the Exchange Act that occurred during the fiscal quarter ended June 30, 2018 that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

PART II - OTHER INFORMATION

ITEM 1 – LEGAL PROCEEDINGS

The nature of the Company's business generates a certain amount of litigation involving matters arising in the ordinary course of business.

In the opinion of management, there are no proceedings pending to which the Company is a party or to which its property is subject, which, if determined adversely, would have a material effect on the Company's results of operations or financial condition.

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

In the second quarter of 2018, the Company purchased shares of its common stock as follows:

Issuer Purchases of Equity Securities

| Period | Total Number of Shares Purchased (1) | Average Price Paid per Share | Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs | Maximum Number of Shares that may yet be Purchased Under the Plans or Programs (2) |
|--------------------------------|--------------------------------------|------------------------------|--|--|
| April 2018: | | | | |
| April 1, 2018 - April 30, 2018 | - | \$ - | - | 100,000 |
| May 2018: | | | | |
| May 1, 2018 - May 31, 2018 | 2,648 | \$ 46.98 | - | 100,000 |
| June 2018: | | | | |
| June 1, 2018 - June 30, 2018 | 636 | \$ 45.90 | - | 100,000 |
| Total: | 3,284 | \$ 46.77 | - | 100,000 |

(1) The total shares purchased in the period consist of shares constructively tendered to the Company by attestation in satisfaction of the exercise price due upon exercise of options issued pursuant to the Company's 2009 Long-Term Incentive Plan. The "average price paid per share" reported in the table above, with respect to such shares, reflects the fair market value of the Company's common stock on the exercise date, which was the closing sales price of the Company's common stock as reported on the NYSE American on that date.

(2) On October 17, 2017, the Board of Directors authorized the Company to repurchase up to 100,000 shares of the Company's common stock (the "2017 Repurchases Program"). The 2017 Repurchase Program expires 24 months after its adoption and may be suspended or discontinued by the Board of Directors at any time. The maximum number of shares that may be purchased under the 2017 Repurchase Program as of June 30, 2018 was 100,000.

Table of Contents

ITEM 6 – EXHIBITS

The following exhibits are filed as a part of this report:

EXHIBIT INDEX

Exhibit

| No. | Name |
|-------------|--|
| <u>31.1</u> | <u>Certification of Principal Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.</u> |
| <u>31.2</u> | <u>Certification of the Principal Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.</u> |
| <u>32.1</u> | <u>Certification of Principal Executive Officer pursuant to 18 USC Section 1350 Chapter 63 of Title 18, United States Code, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.</u> |
| <u>32.2</u> | <u>Certification of Principal Financial Officer pursuant to 18 USC Section 1350 Chapter 63 of Title 18, United States Code, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.</u> |
| 101 | The following materials from Evans Bancorp, Inc.'s Quarterly Report on Form 10-Q for the quarter ended June 30, 2018, formatted in XBRL (eXtensible Business Reporting Language): (i) Unaudited Consolidated Balance Sheets – June 30, 2018 and December 31, 2017; (ii) Unaudited Consolidated Statements of Income – Three months ended June 30, 2018 and 2017; (iii) Unaudited Consolidated Statements of Income – Six months ended June 30, 2018 and 2017; (iv) Unaudited Statements of Consolidated Comprehensive Income – Three months ended June 30, 2018 and 2017; (v) Unaudited Statements of Consolidated Comprehensive Income – Six months ended June 30, 2018 and 2017; (vi) Unaudited Consolidated Statements of Stockholders' Equity – Six months ended June 30, 2018 and 2017; (vii) Unaudited Consolidated Statements of Cash Flows – Six months ended June 30, 2018 and 2017; and (vii) Notes to Unaudited Consolidated Financial Statements |

50

Table of Contents

SIGNATURES

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

Evans Bancorp, Inc.

DATE

August 1, 2018

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

DATE

August 1, 2018

/s/ John B. Connerton
John B. Connerton

Treasurer
(Principal Financial Officer)

51
