

EVANS BANCORP INC  
Form 10-Q  
August 04, 2016

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, 2016

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission file number 001-35021

EVANS BANCORP, INC. .

(Exact name of registrant as specified in its charter)

New York 16-1332767

(State or other jurisdiction of (I.R.S. Employer

incorporation or organization) Identification No.)

One Grimsby Drive, Hamburg, NY 14075

(Address of principal executive offices) (Zip Code)

(716) 926-2000 .

(Registrant's telephone number, including area code)

Not Applicable

(Former name, former address and former fiscal year, if changed since last report)

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer Accelerated filer

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

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes No

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

Common Stock, \$.50 par value 4,286,939 shares as of August 4, 2016

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 EVANS BANCORP, INC. AND SUBSIDIARIES  
 UNAUDITED CONSOLIDATED BALANCE SHEETS  
 JUNE 30, 2016 AND DECEMBER 31, 2015  
 (in thousands, except share and per share amounts)

	June 30, 2016	December 31, 2015
<b>ASSETS</b>		
Cash and due from banks	\$ 10,807	\$ 11,813
Interest-bearing deposits at banks	723	10,808
Securities:		
Available for sale, at fair value (amortized cost: \$106,875 at June 30, 2016; \$96,374 at December 31, 2015)	109,107	97,141
Held to maturity, at amortized cost (fair value: \$1,519 at June 30, 2016; \$1,584 at December 31, 2015)	1,522	1,617
Federal Home Loan Bank common stock, at cost	1,636	1,296
Federal Reserve Bank common stock, at cost	1,501	1,487
Loans, net of allowance for loan losses of \$12,773 at June 30, 2016 and \$12,883 at December 31, 2015	840,533	761,101
Properties and equipment, net of accumulated depreciation of \$16,377 at June 30, 2016 and \$15,799 at December 31, 2015	11,592	11,051
Goodwill	8,101	8,101
Bank-owned life insurance	21,254	20,978
Other assets	14,822	13,714
<b>TOTAL ASSETS</b>	<b>\$ 1,021,598</b>	<b>\$ 939,107</b>
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
<b>LIABILITIES</b>		
Deposits:		
Demand	\$ 187,774	\$ 183,098
NOW	88,993	83,674
Regular savings	480,290	439,993
Time	112,828	96,217
Total deposits	869,885	802,982
Securities sold under agreement to repurchase	14,511	10,821
Other borrowings	16,000	10,000
Other liabilities	15,083	12,718
Junior subordinated debentures	11,330	11,330
Total liabilities	926,809	847,851
<b>CONTINGENT LIABILITIES AND COMMITMENTS</b>		

STOCKHOLDERS' EQUITY:

Common stock, \$.50 par value, 10,000,000 shares authorized; 4,290,222 and 4,260,203 shares issued at June 30, 2016 and December 31, 2015, respectively, and 4,286,939 and 4,257,179 outstanding at June 30, 2016 and December 31, 2015, respectively	2,147	2,132
Capital surplus	43,836	43,318
Treasury stock, at cost, 3,283 and 3,024 shares at June 30, 2016 and December 31, 2015, respectively	(80)	-
Retained earnings	49,707	47,616
Accumulated other comprehensive loss, net of tax	(821)	(1,810)
Total stockholders' equity	94,789	91,256
<b>TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY</b>	<b>\$ 1,021,598</b>	<b>\$ 939,107</b>

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(in thousands, except share and per share amounts)

	Three Months Ended June 30,	
	2016	2015
INTEREST INCOME		
Loans	\$ 8,878	\$ 7,934
Interest bearing deposits at banks	33	33
Securities:		
Taxable	561	429
Non-taxable	222	240
Total interest income	9,694	8,636
INTEREST EXPENSE		
Deposits	1,036	860
Other borrowings	51	46
Junior subordinated debentures	91	82
Total interest expense	1,178	988
NET INTEREST INCOME	8,516	7,648
PROVISION FOR LOAN LOSSES (CREDIT)	(376)	415
NET INTEREST INCOME AFTER PROVISION FOR LOAN LOSSES	8,892	7,233
NON-INTEREST INCOME		
Bank charges	403	411
Insurance service and fees	1,572	1,821
Gain on loans sold	29	58
Bank-owned life insurance	141	152
Loss on tax credit investment	(2,139)	-
Refundable state historic tax credit	1,508	-
Interchange fee income	340	324
Other	426	710
Total non-interest income	2,280	3,476
NON-INTEREST EXPENSE		
Salaries and employee benefits	5,467	5,066
Occupancy	740	697
Repairs and maintenance	212	215
Advertising and public relations	190	231
Professional services	656	670
Technology and communications	339	262
FDIC insurance	182	148



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Other	933	952
Total non-interest expense	8,719	8,241
INCOME BEFORE INCOME TAXES	2,453	2,468
INCOME TAX PROVISION	450	793
NET INCOME	\$ 2,003	\$ 1,675
Net income per common share-basic	\$ 0.47	\$ 0.40
Net income per common share-diluted	\$ 0.46	\$ 0.39
Cash dividends per common share	\$ -	\$ -
Weighted average number of common shares outstanding	4,284,180	4,234,334
Weighted average number of diluted shares outstanding	4,346,599	4,309,688

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 (in thousands, except share and per share amounts)

	Six Months Ended June 30,	
	2016	2015
INTEREST INCOME		
Loans	\$ 17,608	\$ 15,746
Interest bearing deposits at banks	44	34
Securities:		
Taxable	938	835
Non-taxable	460	477
Total interest income	19,050	17,092
INTEREST EXPENSE		
Deposits	1,995	1,643
Other borrowings	101	60
Junior subordinated debentures	178	160
Total interest expense	2,274	1,863
NET INTEREST INCOME	16,776	15,229

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PROVISION FOR LOAN LOSSES (CREDIT)	(168)	616
NET INTEREST INCOME AFTER PROVISION FOR LOAN LOSSES	16,944	14,613
NON-INTEREST INCOME		
Bank charges	846	820
Insurance service and fees	3,320	3,650
Gain on loans sold	44	81
Bank-owned life insurance	277	289
Loss on tax credit investment	(2,139)	-
Refundable state historic tax credit	1,508	-
Interchange fee income	658	618
Other	760	1,084
Total non-interest income	5,274	6,542
NON-INTEREST EXPENSE		
Salaries and employee benefits	10,981	9,860
Occupancy	1,439	1,392
Repairs and maintenance	388	388
Advertising and public relations	475	442
Professional services	1,236	1,180
Technology and communications	761	522
FDIC insurance	341	295
Other	1,626	1,674
Total non-interest expense	17,247	15,753
INCOME BEFORE INCOME TAXES	4,971	5,402
INCOME TAX PROVISION	1,254	1,822
NET INCOME	\$ 3,717	\$ 3,580
Net income per common share-basic	\$ 0.87	\$ 0.85
Net income per common share-diluted	\$ 0.86	\$ 0.83
Cash dividends per common share	\$ 0.38	\$ 0.36
Weighted average number of common shares outstanding	4,273,645	4,233,196
Weighted average number of diluted shares outstanding	4,337,299	4,309,423

See Notes to Unaudited Consolidated Financial Statements

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## PART I - FINANCIAL INFORMATION

## ITEM 1 - FINANCIAL STATEMENTS

## EVANS BANCORP, INC. AND SUBSIDIARIES

## UNAUDITED STATEMENTS OF CONSOLIDATED COMPREHENSIVE INCOME

## THREE MONTHS ENDED JUNE 30, 2016 AND 2015

(in thousands, except share and per share amounts)

	Three Months Ended June 30,	
	2016	2015
NET INCOME	\$ 2,003	\$ 1,675
OTHER COMPREHENSIVE INCOME (LOSS), NET OF TAX:		
Unrealized gain (loss) on available-for-sale securities	260	(637)
Defined benefit pension plans:		
Amortization of prior service cost	5	5
Amortization of actuarial assumptions	35	37
Total	40	42
OTHER COMPREHENSIVE INCOME (LOSS), NET OF TAX	300	(595)
COMPREHENSIVE INCOME	\$ 2,303	\$ 1,080

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## EVANS BANCORP, INC. AND SUBSIDIARIES

## UNAUDITED STATEMENTS OF CONSOLIDATED COMPREHENSIVE INCOME

## SIX MONTHS ENDED JUNE 30, 2016 AND 2015

(in thousands, except share and per share amounts)

	Six Months Ended June 30,	
	2016	2015
NET INCOME	\$ 3,717	\$ 3,580
OTHER COMPREHENSIVE INCOME (LOSS), NET OF TAX:		
Unrealized gain (loss) on available-for-sale securities	909	(306)
Defined benefit pension plans:		
Amortization of prior service cost	10	10
Amortization of actuarial assumptions	70	61
Total	80	71
OTHER COMPREHENSIVE INCOME (LOSS), NET OF TAX	989	(235)
COMPREHENSIVE INCOME	\$ 4,706	\$ 3,345

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EQUITY  
SIX MONTHS ENDED JUNE 30, 2016 AND 2015  
(in thousands, except share and per share  
amounts)

	Common Stock	Capital Surplus	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Treasury Stock	Total
Balance, December 31, 2014	\$ 2,123	\$ 43,102	\$ 42,822	\$ (1,508)	\$ (751)	\$ 85,788
Net Income			3,580			3,580
Other comprehensive loss				(235)		(235)
Cash dividends (\$0.36 per common share)			(1,517)			(1,517)
Stock options and restricted stock expense		263				263
Excess tax expense from stock-based compensation		44				44
Reissued 20,592 restricted shares, net of 588 forfeitures		(503)			503	-
Repurchased 3,397 shares in treasury stock					(83)	(83)
Reissued 8,034 shares in stock option exercise		(55)			155	100
Reissued 5,582 shares under Dividend Reinvestment Plan		4			134	138
Issued 5,672 shares in Employee Stock Purchase Plan	3	114				117
Balance, June 30, 2015	\$ 2,126	\$ 42,969	\$ 44,885	\$ (1,743)	\$ (42)	\$ 88,195
Balance, December 31, 2015	\$ 2,132	\$ 43,318	\$ 47,616	\$ (1,810)	\$ -	\$ 91,256
Net Income			3,717			3,717
Other comprehensive income				989		989
Cash dividends (\$0.38 per common share)			(1,626)			(1,626)
Stock compensation expense		270				270
Excess tax benefit from stock-based compensation		15				15
Repurchased 3,280 shares in treasury stock					(80)	(80)
Issued 19,093 restricted shares	10	(10)				-
Issued 5,270 shares under Dividend Reinvestment Plan	3	129				132
	2	106				108

Issued 5,166 shares in Employee Stock Purchase Plan							
Issued 490 shares in stock option exercises		8					8
Reissued 3,021 restricted shares, net of forfeitures							-
Balance, June 30, 2016	\$ 2,147	\$ 43,836	\$ 49,707	\$ (821)	\$ (80)		\$ 94,789

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SIX MONTHS ENDED JUNE 30, 2016 AND 2015  
(in thousands)

	Six Months Ended June 30,	
	2016	2015
<b>OPERATING ACTIVITIES:</b>		
Interest received	\$ 18,778	\$ 16,916
Fees received	5,554	5,795
Interest paid	(2,249)	(1,939)
Cash paid to employees and vendors	(16,429)	(15,932)
Cash contributed to pension plan	(140)	(165)
Income taxes paid	(279)	(601)
Proceeds from sale of loans held for resale	3,514	9,772
Originations of loans held for resale	(3,477)	(10,295)
Net cash provided by operating activities	5,272	3,551
<b>INVESTING ACTIVITIES:</b>		
Available for sales securities:		
Purchases	(25,953)	(24,370)
Proceeds from maturities, calls, and payments	15,005	14,299
Held to maturity securities:		
Purchases	-	(50)
Proceeds from maturities, calls, and payments	95	184
Proceeds from property insurance	-	927
Additions to properties and equipment	(1,119)	(499)
Purchase of tax credit investment	(703)	(831)
Net increase in loans	(78,823)	(14,360)
Net cash used in investing activities	(91,498)	(24,700)
<b>FINANCING ACTIVITIES:</b>		
Proceeds from (repayments of) borrowings, net	9,690	(6,469)
Net increase in deposits	66,903	66,531
Dividends paid	(1,626)	(1,517)
Repurchase of treasury stock	(80)	(83)
Issuance of common stock	248	117
Reissuance of treasury stock	-	237



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Net cash provided by financing activities	75,135	58,816
Net (decrease) increase in cash and cash equivalents	(11,091)	37,667
CASH AND CASH EQUIVALENTS:		
Beginning of period	22,621	10,898
End of period	\$ 11,530	\$ 48,565

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 SIX MONTHS ENDED JUNE 30, 2016 AND 2015  
 (in thousands)

	Six Months Ended June 30,	
	2016	2015
<b>RECONCILIATION OF NET INCOME TO NET CASH PROVIDED BY OPERATING ACTIVITIES:</b>		
Net income	\$ 3,717	\$ 3,580
Adjustments to reconcile net income to net cash provided by (used in) operating activities:		
Depreciation and amortization	647	745
Deferred tax expense	125	191
Provision for loan losses (credit)	(168)	616
Loss on tax credit investment	2,139	-
Refundable state historic tax credit	(1,508)	-
Gain on loans sold	(44)	(81)
Stock options and restricted stock expense	270	263
Proceeds from sale of loans held for resale	3,514	9,772
Originations of loans held for resale	(3,477)	(10,295)
Changes in assets and liabilities affecting cash flow:		
Other assets	(1,001)	(1,112)
Other liabilities	1,058	(128)
<b>NET CASH PROVIDED BY OPERATING ACTIVITIES</b>	<b>\$ 5,272</b>	<b>\$ 3,551</b>

See Notes to Unaudited Consolidated Financial Statements



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PART 1 – FINANCIAL INFORMATION

ITEM 1 – FINANCIAL STATEMENTS

EVANS BANCORP, INC. AND SUBSIDIARIES

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

THREE AND SIX MONTH PERIODS ENDED JUNE 30, 2016 AND 2015

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, 2016 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, 2015 (“10-K”). The Company’s significant accounting policies are disclosed in Note 1 to the 10-K.

An accounting policy not discussed in Note 1 to the 10-K is the accounting for rehabilitation of historic properties tax credit investments. In the typical structure of these transactions, the Bank will invest in a partnership that is incurring expenses related to the rehabilitation of a certified historic structure located in New York State. At the time the historic structure is placed in service, the Bank is eligible for a federal and New York State tax credit. At the same time, the Bank evaluates its investment, which is valued at the present value of the expected cash flows from its partnership interest. If the investment is determined to be impaired, the Bank will record that impairment loss on its income statement in non-interest income. The federal tax credit impact is included in the Company’s estimated effective tax rate calculation and recorded in income tax expense. For New York State, any new credit earned from rehabilitated historic properties placed in service on or after January 1, 2015, not used in the current tax year will be

treated as a refund or overpayment of tax to be credited to the next year's tax. Since the realization of the tax credit does not depend on the Bank's generation of future taxable income or the Bank's ongoing tax status or tax position, the credit is not considered an element of income tax accounting under ASC 740. In such cases, the Bank would not record the credit as a reduction of income tax expense; rather, the Bank includes the refundable New York State tax credit in non-interest income.

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## 2. SECURITIES

The amortized cost of securities and their approximate fair value at June 30, 2016 and December 31, 2015 were as follows:

	June 30, 2016 (in thousands)			
	Amortized Cost	Unrealized Gains	Losses	Fair Value
Available for Sale:				
Debt securities:				
U.S. government agencies	\$ 17,185	\$ 285	\$ (2)	\$ 17,468
States and political subdivisions	36,389	1,204	(10)	37,583
Total debt securities	\$ 53,574	\$ 1,489	\$ (12)	\$ 55,051
Mortgage-backed securities:				
FNMA	\$ 16,369	\$ 347	\$ -	\$ 16,716
FHLMC	4,136	96	(19)	4,213
GNMA	2,862	52	(4)	2,910
CMO	29,934	330	(47)	30,217
Total mortgage-backed securities	\$ 53,301	\$ 825	\$ (70)	\$ 54,056
Total securities designated as available for sale	\$ 106,875	\$ 2,314	\$ (82)	\$ 109,107
Held to Maturity:				
Debt securities				
States and political subdivisions	\$ 1,522	\$ 14	\$ (17)	\$ 1,519
Total securities designated as held to maturity	\$ 1,522	\$ 14	\$ (17)	\$ 1,519

December 31, 2015  
(in thousands)

Amortized Unrealized Fair

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	Cost	Gains	Losses	Value
Available for Sale:				
Debt securities:				
U.S. government agencies	\$ 21,914	\$ 166	\$ (234)	\$ 21,846
States and political subdivisions	36,838	874	(29)	37,683
Total debt securities	\$ 58,752	\$ 1,040	\$ (263)	\$ 59,529
Mortgage-backed securities:				
FNMA	\$ 10,314	\$ 160	\$ (25)	\$ 10,449
FHLMC	4,629	61	(56)	4,634
GNMA	3,215	48	(27)	3,236
CMO	19,464	66	(237)	19,293
Total mortgage-backed securities	\$ 37,622	\$ 335	\$ (345)	\$ 37,612
Total securities designated as available for sale	\$ 96,374	\$ 1,375	\$ (608)	\$ 97,141
Held to Maturity:				
Debt securities				
States and political subdivisions	\$ 1,617	\$ 6	\$ (39)	\$ 1,584
Total securities designated as held to maturity	\$ 1,617	\$ 6	\$ (39)	\$ 1,584

Available for sale securities with a total fair value of \$94 million and \$86 million at June 30, 2016 and December 31, 2015, respectively, were pledged as collateral to secure public deposits and for other purposes required or permitted by law.

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The Company uses the Federal Home Loan Bank of New York (“FHLBNY”) as its primary source of overnight funds and also has several long-term advances with FHLBNY. The Company had \$16 million and \$10 million in borrowed funds at FHLBNY at June 30, 2016 and December 31, 2015, respectively. The Company has pledged sufficient collateral in the form of residential and commercial real estate loans at FHLBNY that meets FHLB collateral requirements. As a member of the Federal Home Loan Bank (“FHLB”) System, the Bank is required to hold stock in FHLBNY. The Bank held \$2 million and \$1 million in FHLBNY stock at June 30, 2016 and December 31, 2015, respectively. The Company regularly evaluates investments in FHLBNY for impairment, considering liquidity, operating performance, capital position, stock repurchase and dividend history. As of June 30, 2016, the Bank’s investment in FHLBNY stock was not impaired.

The Bank, as a member of the Federal Reserve Bank (“FRB”) system, is currently required to purchase and hold shares of capital stock in the FRB in an amount equal to 6% of its capital and surplus. The Bank’s investment in FRB capital stock totaled \$1.5 million at each of June 30, 2016 and December 31, 2015. Based on the current capital adequacy and liquidity position of the FRB, management believes there is no impairment in the Company’s investment at June 30, 2016 and the cost of the investment approximates fair value.

The scheduled maturities of debt and mortgage-backed securities at June 30, 2016 and December 31, 2015 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, 2016		December 31, 2015	
	Amortized cost (in thousands)	Estimated fair value (in thousands)	Amortized cost (in thousands)	Estimated fair value (in thousands)
Debt securities available for sale:				
Due in one year or less	\$ 5,115	\$ 5,149	\$ 4,082	\$ 4,142
Due after one year through five years	31,980	32,736	29,113	29,448
Due after five years through ten years	13,511	14,003	19,356	19,615
Due after ten years	2,968	3,163	6,201	6,324
	53,574	55,051	58,752	59,529

Mortgage-backed securities



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available for sale	53,301	54,056	37,622	37,612
Total available for sale securities	\$ 106,875	\$ 109,107	\$ 96,374	\$ 97,141
Debt securities held to maturity:				
Due in one year or less	\$ 265	\$ 264	\$ 309	\$ 308
Due after one year through five years	358	354	374	365
Due after five years through ten years	793	798	828	815
Due after ten years	106	103	106	96
	1,522	1,519	1,617	1,584
Total held to maturity securities	\$ 1,522	\$ 1,519	\$ 1,617	\$ 1,584

While the contractual maturities of our mortgage-backed securities generally exceed ten years, the Company expects the effective lives to be significantly shorter due to prepayments of the underlying loans and the nature of these securities. The duration of the investment securities portfolio decreased from 4.0 years at December 31, 2015 to 3.7 years at June 30, 2016.

Information regarding unrealized losses within the Company's available for sale securities at June 30, 2016 and December 31, 2015 is summarized below. The securities are primarily U.S. government-guaranteed agency securities or municipal securities. All unrealized losses are considered temporary and related to market interest rate fluctuations.

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June 30, 2016

	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	\$ -	\$ -	\$ 1,998	\$ (2)	\$ 1,998	\$ (2)
States and political subdivisions	-	-	744	(10)	744	(10)
Total debt securities	\$ -	\$ -	\$ 2,742	\$ (12)	\$ 2,742	\$ (12)
Mortgage-backed securities:						
FNMA	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
FHLMC	-	-	1,175	(19)	1,175	(19)
GNMA	-	-	347	(4)	347	(4)
CMO	3,270	(43)	1,400	(4)	4,670	(47)
Total mortgage-backed securities	\$ 3,270	\$ (43)	\$ 2,922	\$ (27)	\$ 6,192	\$ (70)
Held To Maturity:						
Debt securities:						
States and political subdivisions	\$ 582	\$ (5)	\$ 430	\$ (12)	\$ 1,012	\$ (17)
Total temporarily impaired securities	\$ 3,852	\$ (48)	\$ 6,094	\$ (51)	\$ 9,946	\$ (99)

December 31, 2015

	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:						

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Debt securities:

U.S. government agencies	\$ 4,531	\$ (89)	\$ 5,855	\$ (145)	\$ 10,386	\$ (234)
States and political subdivisions	3,133	(6)	1,117	(23)	4,250	(29)
Total debt securities	\$ 7,664	\$ (95)	\$ 6,972	\$ (168)	\$ 14,636	\$ (263)

Mortgage-backed securities:

FNMA	\$ 3,856	\$ (25)	\$ -	\$ -	\$ 3,856	\$ (25)
FHLMC	-	-	1,234	(56)	1,234	(56)
GNMA	1,161	(21)	471	(6)	1,632	(27)
CMO	8,996	(123)	3,661	(114)	12,657	(237)
Total mortgage-backed securities	\$ 14,013	\$ (169)	\$ 5,366	\$ (176)	\$ 19,379	\$ (345)

Held To Maturity:

Debt securities:

States and political subdivisions	\$ 626	\$ (11)	\$ 495	\$ (28)	\$ 1,121	\$ (39)
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Total temporarily impaired securities

	\$ 22,303	\$ (275)	\$ 12,833	\$ (372)	\$ 35,136	\$ (647)
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Management has assessed the securities available for sale in an unrealized loss position at June 30, 2016 and December 31, 2015 and determined the decline in fair value below amortized cost to be temporary. In making this determination, management considered the period of time the securities were in a loss position, the percentage decline in comparison to the securities' amortized cost, and the financial condition of the issuer (primarily government or government-sponsored enterprises). In addition, management does not intend to sell these securities and it is not more likely than not that the Company will be required to sell these securities before recovery of their amortized cost. Management believes the decline in fair value is primarily related to market interest rate fluctuations and not to the credit deterioration of the individual issuers.

The Company had not recorded any other-than-temporary impairment ("OTTI") charges as of June 30, 2016 and did not record any OTTI charges during 2015. Nevertheless, it remains possible that there could be deterioration in the asset quality of the securities portfolio in the future. The credit worthiness of the Company's portfolio is largely reliant on the ability of U.S. government sponsored agencies such as FHLB, Federal National Mortgage Association ("FNMA"), Government National Mortgage Association ("GNMA"), and Federal Home Loan Mortgage Corporation ("FHLMC"), and municipalities throughout New York State to meet their obligations. In addition, dysfunctional markets could materially alter the liquidity, interest rate, and pricing risk of the portfolio. The relatively stable past performance is not a guarantee for similar performance of the Company's securities portfolio going forward.

### 3. FAIR VALUE MEASUREMENTS

The Company follows the provisions of ASC Topic 820, "Fair Value Measurements." Those provisions relate to financial assets and liabilities carried at fair value and fair value disclosures related to financial assets and liabilities. ASC Topic 820 defines fair value and specifies a hierarchy of valuation techniques based on the nature of the inputs used to develop the fair value measures. Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date.

There are three levels of inputs to fair value measurements:

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

Observable market data should be used when available.

## FINANCIAL INSTRUMENTS MEASURED AT FAIR VALUE ON A RECURRING BASIS

The following table presents, for each of the fair-value hierarchy levels as defined in this footnote, those financial instruments which are measured at fair value on a recurring basis as of June 30, 2016 and December 31, 2015, respectively:

(in thousands)	Level 1	Level 2	Level 3	Fair Value
June 30, 2016				
Securities available-for-sale:				
U.S. government agencies	\$ -	\$ 17,468	\$ -	\$ 17,468
States and political subdivisions	-	37,583	-	37,583
Mortgage-backed securities	-	54,056	-	54,056
Mortgage servicing rights	-	-	466	466
December 31, 2015				
Securities available-for-sale:				
U.S. government agencies	\$ -	\$ 21,846	\$ -	\$ 21,846
States and political subdivisions	-	37,683	-	37,683
Mortgage-backed securities	-	37,612	-	37,612
Mortgage servicing rights	-	-	557	557

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### Securities available for sale

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

### 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 MSR's 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, 2016 and 2015, respectively:

(in thousands)	Three months ended June 30,	
	2016	2015
Mortgage servicing rights - April 1	\$ 496	\$ 497
Gains (losses) included in earnings	(56)	4
Additions from loan sales	26	64
Mortgage servicing rights - June 30	\$ 466	\$ 565

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(in thousands)	Six months ended June 30,	
	2016	2015
Mortgage servicing rights - January 1	\$ 557	\$ 518
Losses included in earnings	(125)	(41)
Additions from loan sales	34	88
Mortgage servicing rights - June 30	\$ 466	\$ 565

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

	June 30, 2016	December 31, 2015
Servicing fees	0.25 %	0.25 %
Discount rate	9.52 %	9.52 %
Prepayment rate (CPR)	10.24 %	8.55 %

#### 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, 2016 and December 31, 2015:



(in thousands)	Level 1	Level 2	Level 3	Fair Value
June 30, 2016				
Collateral dependent impaired loans	\$ -	-	16,848	\$ 16,848
December 31, 2015				
Collateral dependent impaired loans	\$ -	-	17,758	\$ 17,758

#### 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, which ranges from 10%-50%. Collateral may consist of real estate and/or business assets including equipment, inventory and/or accounts receivable and the value of these assets is determined based on appraisals by qualified licensed appraisers hired by the Company. Appraised and reported values may be discounted based on management's historical knowledge, changes in market conditions from the time of valuation, estimated costs to sell, and/or management's expertise and knowledge of the client and the client's business.

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The Company has an appraisal policy in which appraisals are obtained upon a commercial loan being downgraded on the Company internal loan rating scale to a 5 (special mention) or a 6 (substandard) depending on the amount of the loan, the type of loan and the type of collateral. All impaired commercial loans are either graded a 6 or 7 on the internal loan rating scale. For consumer loans, the Company obtains appraisals when a loan becomes 90 days past due or is determined to be impaired, whichever occurs first. Subsequent to the downgrade or reaching 90 days past due, if the loan remains outstanding and impaired for at least one year more, management may require another follow-up appraisal. Between receipts of updated appraisals, if necessary, management may perform an internal valuation based on any known changing conditions in the marketplace such as sales of similar properties, a change in the condition of the collateral, or feedback from local appraisers. Impaired loans had a gross value of \$18.4 million, with a allowance for loan loss of \$1.5 million, at June 30, 2016 compared with \$19.5 million and \$1.7 million, respectively, at December 31, 2015.

## FAIR VALUE OF FINANCIAL INSTRUMENTS

At each of June 30, 2016 and December 31, 2015, the estimated fair values of the Company's financial instruments, including those that are not measured and reported at fair value on a recurring basis or nonrecurring basis, were as follows:

	June 30, 2016		December 31, 2015	
	Carrying Amount (in thousands)	Fair Value	Carrying Amount (in thousands)	Fair Value
Financial assets:				
Level 1:				
Cash and cash equivalents	\$ 11,530	\$ 11,530	\$ 22,621	\$ 22,621
Level 2:				
Available for sale securities	109,107	109,107	97,141	97,141
FHLB and FRB stock	3,137	3,137	2,783	2,783
Level 3:				
Held to maturity securities	1,522	1,519	1,617	1,584
Loans, net	840,533	859,300	761,101	772,472
Mortgage servicing rights	466	466	557	557

Financial liabilities:

Level 1:				
Demand deposits	\$ 187,774	\$ 187,774	\$ 183,098	\$ 183,098
NOW deposits	88,993	88,993	83,674	83,674
Regular savings deposits	480,290	480,290	439,993	439,993
Level 2:				
Securities sold under agreement to repurchase	14,511	14,511	10,821	10,821
Other borrowed funds	16,000	16,120	10,000	9,874
Junior subordinated debentures	11,330	11,330	11,330	11,330
Level 3:				
Time deposits	112,828	114,117	96,217	96,975

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

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

**FHLB and FRB stock.** The carrying value of FHLB and FRB stock, which are non-marketable equity investments, approximate fair value.

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

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

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

**Junior Subordinated Debentures.** There is no active market for the Company’s debentures and there have been no issuances of similar instruments in recent years. The Company looked at a market bond index to estimate a discount margin to value the debentures. The discount margin was very similar to the spread to LIBOR established at the issuance of the debentures. As a result, the Company determined that the fair value of the adjustable-rate debentures approximates their face amount.

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

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

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## 4. LOANS AND THE ALLOWANCE FOR LOAN LOSSES

## Loan Portfolio Composition

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

	June 30, 2016	December 31, 2015
Mortgage loans on real estate:	(in thousands)	
Residential mortgages	\$ 108,405	\$ 103,941
Commercial and multi-family	426,418	399,819
Construction-Residential	532	1,546
Construction-Commercial	72,981	60,892
Home equities	63,542	61,042
Total real estate loans	671,878	627,240
Commercial and industrial loans	179,210	144,330
Consumer and other loans	1,447	1,735
Net deferred loan origination costs	771	679
Total gross loans	853,306	773,984
Allowance for loan losses	(12,773)	(12,883)
Loans, net	\$ 840,533	\$ 761,101

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, 2016, the Bank sold mortgages to FNMA totaling \$2.6 million, as compared with \$7.1 million in mortgages sold to FNMA in the three month period ended June 30, 2015. During the six month periods ended June 30, 2016 and 2015, the Bank sold \$3.5 million and \$9.7 million, respectively, to FNMA. At June 30, 2016, the Bank had a loan servicing portfolio principal balance of \$76 million upon which it earns servicing fees, as compared with \$77 million at December 31, 2015. The value of the mortgage servicing rights for that portfolio was \$0.5 million at June 30, 2016 and \$0.6 million at December 31, 2015. At each of June 30, 2016

and December 31, 2015, there were \$0.5 million in residential mortgage loans held-for-sale. The Company had no commercial loans held-for-sale at June 30, 2016 or December 31, 2015. The Company has never been contacted by FNMA to repurchase any loans due to improper documentation or fraud.

As noted in Note 1, these financial statements should be read in conjunction with the Audited Consolidated Financial Statements and the Notes thereto included in our Annual Report on Form 10-K for the year ended December 31, 2015. 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, 2015. Unless otherwise noted in this Form 10-Q, the policies and methodology described in the Annual Report for the year ended December 31, 2015 are consistent with those utilized by the Company in the three and six month periods ended June 30, 2016.

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## Credit Quality Indicators

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

- 1-3.2-Pass
- 4-Watch
- 5-O.A.E.M. (Other Assets Especially Mentioned) or Special Mention
- 6-Substandard
- 7-Doubtful
- 8-Loss

The Company’s consumer loans, including residential mortgages and home equities, are not individually risk rated or reviewed in the Company’s loan review process. Consumers are not required to provide the Company with updated financial information as are commercial customers. Consumer loans also carry smaller balances. Given the lack of updated information after the initial underwriting of the loan and small size of individual loans, the Company uses delinquency status as the primary credit quality indicator for consumer loans. 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, 2016  
(in thousands)

Corporate Credit Exposure – By Credit Rating	Commercial Real Estate Construction	Commercial and Multi-Family Mortgages	Total Commercial Real Estate	Commercial and Industrial
3	\$ 62,822	\$ 342,539	\$ 405,361	\$ 112,730
4	5,640	68,289	73,929	51,658



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5	339	8,802	9,141	7,967
6	4,180	6,788	10,968	6,855
7	-	-	-	-
Total	\$ 72,981	\$ 426,418	\$ 499,399	\$ 179,210

December 31, 2015  
(in thousands)

Corporate Credit Exposure – By Credit Rating	Commercial Real Estate Construction	Commercial and Multi-Family Mortgages	Total Commercial Real Estate	Commercial and Industrial
3	\$ 42,383	\$ 340,837	\$ 383,220	\$ 80,379
4	13,098	40,019	53,117	47,509
5	1,224	11,772	12,996	8,973
6	4,187	7,191	11,378	7,350
7	-	-	-	119
Total	\$ 60,892	\$ 399,819	\$ 460,711	\$ 144,330

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## Past Due Loans

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

June 30, 2016  
(in thousands)

	30-59 days	60-89 days	90+ days	Total Past Due	Current Balance	Total Balance	90+ Days Accruing	Non-accruing Loans
Commercial and industrial	\$ 4,513	\$ 71	\$ 658	\$ 5,242	\$ 173,968	\$ 179,210	\$ 338	\$ 4,936
Residential real estate:								
Residential	-	143	636	779	107,626	108,405	159	725
Construction	-	-	-	-	532	532	-	-
Commercial real estate:								
Commercial	-	2,624	2,644	5,268	421,150	426,418	1,212	3,465
Construction	5,000	239	4,181	9,420	63,561	72,981	-	4,181
Home equities	245	272	780	1,297	62,245	63,542	3	1,037
Consumer and other	18	14	7	39	1,408	1,447	7	13
Total Loans	\$ 9,776	\$ 3,363	\$ 8,906	\$ 22,045	\$ 830,490	\$ 852,535	\$ 1,719	\$ 14,357

NOTE: Loan balances do not include \$771 thousand in net deferred loan origination costs as of June 30, 2016.

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December 31, 2015  
(in thousands)

	30-59 days	60-89 days	90+ days	Total Past Due	Current Balance	Total Balance	90+ Days Accruing	Non-accruing Loans
Commercial and industrial	\$ 160	\$ 224	\$ 66	\$ 450	\$ 143,880	\$ 144,330	\$ 40	\$ 5,312
Residential real estate:								
Residential	822	402	569	1,793	102,148	103,941	-	1,400
Construction	-	-	-	-	1,546	1,546	-	-
Commercial real estate:								
Commercial	1,919	963	457	3,339	396,480	399,819	457	3,574
Construction	-	-	-	-	60,892	60,892	-	4,187
Home equities	253	236	267	756	60,286	61,042	-	1,058
Consumer and other	8	-	-	8	1,727	1,735	-	14
Total Loans	\$ 3,162	\$ 1,825	\$ 1,359	\$ 6,346	\$ 766,959	\$ 773,305	\$ 497	\$ 15,545

NOTE: Loan balances do not include \$679 thousand in net deferred loan origination costs as of December 31, 2015.

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## Allowance for loan losses

The following tables present the activity in the allowance for loan losses according to portfolio segment, for the six month periods ended June 30, 2016 and 2015:

June 30, 2016

(in thousands)	Commercial and Industrial	Commercial Real Estate Mortgages*	Consumer	Residential Mortgages*	HELOC	Unallocated	Total
Allowance for loan losses:							
Beginning balance	\$ 4,383	\$ 7,135	\$ 85	\$ 909	\$ 371	\$ -	\$ 12,883
Charge-offs	(33)	-	(23)	-	-	-	(56)
Recoveries	55	51	7	-	1	-	114
Provision (Credit)	(210)	122	32	(146)	34	-	(168)
Ending balance	\$ 4,195	\$ 7,308	\$ 101	\$ 763	\$ 406	\$ -	\$ 12,773
Allowance for loan losses:							
Ending balance:							
Individually evaluated for impairment	\$ 324	\$ 1,128	\$ 40	\$ 3	\$ 18	\$ -	\$ 1,513
Collectively evaluated for impairment	3,871	6,180	61	760	388	-	11,260
Total	\$ 4,195	\$ 7,308	\$ 101	\$ 763	\$ 406	\$ -	\$ 12,773
Loans:							
Ending balance:							
Individually evaluated for impairment	\$ 4,985	\$ 9,261	\$ 40	\$ 2,461	\$ 1,614	\$ -	\$ 18,361
Collectively evaluated for impairment	174,225	490,138	1,407	106,476	61,928	-	834,174
Total	\$ 179,210	\$ 499,399	\$ 1,447	\$ 108,937	\$ 63,542	\$ -	\$ 852,535

\* Includes construction loans

NOTE: Loan balances do not include \$771 thousand in net deferred loan origination costs as of June 30, 2016.

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June 30, 2015

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

\* Includes construction loans

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



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The following tables present the activity in the allowance for loan losses by portfolio segment for the three month periods ended June 30, 2016 and 2015:

June 30, 2016

(\$ in thousands)	Commercial and Industrial	Commercial Real Estate Mortgages*	Consumer	Residential Mortgages*	HELOC	Unallocated	Total
Allowance for loan losses:							
Beginning balance	\$ 4,580	\$ 7,442	\$ 93	\$ 696	\$ 308	\$ -	\$ 13,119
Charge-offs	(20)	-	(16)	-	-	-	(36)
Recoveries	48	13	4	-	1	-	66
Provision	(413)	(147)	20	67	97	-	(376)
Ending balance	\$ 4,195	\$ 7,308	\$ 101	\$ 763	\$ 406	\$ -	\$ 12,773

June 30, 2015

(\$ in thousands)	Commercial and Industrial	Commercial Real Estate Mortgages*	Consumer	Residential Mortgages*	HELOC	Unallocated	Total
Allowance for loan losses:							
Beginning balance	\$ 4,989	\$ 5,830	\$ 70	\$ 924	\$ 815	\$ 149	\$ 12,777
Charge-offs	(80)	(35)	(5)	-	-	-	(120)
Recoveries	19	13	5	1	-	-	38
Provision	(283)	686	1	23	(12)	-	415
Ending balance	\$ 4,645	\$ 6,494	\$ 71	\$ 948	\$ 803	\$ 149	\$ 13,110





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## Impaired Loans

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

	At June 30, 2016					
	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	\$ 4,266	\$ 4,654	\$ -	\$ 4,664	\$ 119	\$ 3
Residential real estate:						
Residential	2,406	2,610	-	2,440	19	38
Construction	-	-	-	-	-	-
Commercial real estate:						
Commercial	3,754	3,817	-	3,836	50	36
Construction	262	262	-	691	1	21
Home equities	1,398	1,459	-	1,420	22	13
Consumer	-	-	-	-	-	-
Total impaired loans	\$ 12,086	\$ 12,802	\$ -	\$ 13,051	\$ 211	\$ 111

	At June 30, 2016					
	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	\$ 719	\$ 759	\$ 324	\$ 746	\$ 22	\$ 1

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Residential real estate:						
Residential	55	55	3	55	1	-
Construction	-	-	-	-	-	-
Commercial real estate:						
Commercial	1,065	1,083	229	1,074	25	-
Construction	4,180	4,201	899	4,184	96	-
Home equities	216	223	18	218	6	-
Consumer	40	65	40	42	1	1
Total impaired loans	\$ 6,275	\$ 6,386	\$ 1,513	\$ 6,319	\$ 151	\$ 2

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	At June 30, 2016					
	Recorded Investment (in thousands)	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Interest Income Foregone	Interest Income Recognized
Total:						
Commercial and industrial	\$ 4,985	\$ 5,413	\$ 324	\$ 5,410	\$ 141	\$ 4
Residential real estate:						
Residential	2,461	2,665	3	2,495	20	38
Construction	-	-	-	-	-	-
Commercial real estate:						
Commercial	4,819	4,900	229	4,910	75	36
Construction	4,442	4,463	899	4,875	97	21
Home equities	1,614	1,682	18	1,638	28	13
Consumer	40	65	40	42	1	1
Total impaired loans	\$ 18,361	\$ 19,188	\$ 1,513	\$ 19,370	\$ 362	\$ 113

	At December 31, 2015					
	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	\$ 1,750	\$ 1,811	\$ -	\$ 1,945	\$ 58	\$ 47
Residential real estate:						
Residential	2,444	2,555	-	2,474	90	63
Construction	-	-	-	-	-	-

Commercial real estate:						
Commercial	3,888	3,908	-	3,930	27	179
Construction	834	834	-	834	-	31
Home equities	1,644	1,711	-	1,661	40	52
Consumer	-	-	-	-	-	-
Total impaired loans	\$ 10,560	\$ 10,819	\$ -	\$ 10,844	\$ 215	\$ 372

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	At December 31, 2015					
	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Interest Income Foregone	Interest Income Recognized
With a related allowance recorded:	(in thousands)					
Commercial and industrial	\$ 3,572	\$ 3,835	\$ 552	\$ 3,966	\$ 255	\$ 9
Residential real estate:						
Residential	55	55	2	55	1	2
Construction	-	-	-	-	-	-
Commercial real estate:						
Commercial	1,083	1,083	235	1,083	4	42
Construction	4,188	4,201	911	4,188	29	166
Home equities	-	-	-	-	-	-
Consumer	42	57	42	45	2	6
Total impaired loans	\$ 8,940	\$ 9,231	\$ 1,742	\$ 9,337	\$ 291	\$ 225

	At December 31, 2015					
	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Interest Income Foregone	Interest Income Recognized
Total:	(in thousands)					
Commercial and industrial	\$ 5,322	\$ 5,646	\$ 552	\$ 5,911	\$ 313	\$ 56
Residential real estate:						
Residential	2,499	2,610	2	2,529	91	65
Construction	-	-	-	-	-	-
Commercial real estate:						
Commercial	4,971	4,991	235	5,013	31	221
Construction	5,022	5,035	911	5,022	29	197
Home equities	1,644	1,711	-	1,661	40	52
Consumer	42	57	42	45	2	6
	\$ 19,500	\$ 20,050	\$ 1,742	\$ 20,181	\$ 506	\$ 597

Total impaired  
loans

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## Non-performing loans

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

	June 30, 2016	December 31, 2015		
	(in thousands)			
Non-accruing loans:				
Commercial and industrial loans	\$ 4,936	\$ 5,312		
Residential real estate:				
Residential	725	1,400		
Construction	-	-		
Commercial real estate:				
Commercial and multi-family	3,465	3,574		
Construction	4,181	4,187		
Home equities	1,037	1,058		
Consumer loans	13	14		
Total non-accruing loans	\$ 14,357	\$ 15,545		
Accruing loans 90+ days past due	1,719	497		
Total non-performing loans	\$ 16,076	\$ 16,042		
Total non-performing loans to total assets	1.57	%	1.71	%
Total non-performing loans to total loans	1.88	%	2.07	%



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## Troubled debt restructurings

The Company had \$5.1 million and \$5.8 million in loans that were restructured in a troubled debt restructuring (“TDR”) at June 30, 2016 and December 31, 2015, respectively. Of those balances, \$1.1 million and \$1.8 million were in non-accrual status at June 30, 2016 and December 31, 2015, respectively. Any TDR that is placed on non-accrual is not reverted back to accruing status until the borrower makes timely payments as contracted for at least six months and future collection under the revised terms is probable. All of the Company’s restructurings were allowed in an effort to maximize its ability to collect on loans 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 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, 2016, there were no commitments to lend additional funds to debtors owing on loans whose terms have been modified in TDRs.

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

	June 30, 2016 (in thousands)			
	Total	Nonaccruing	Accruing	Related Allowance
Commercial and industrial	\$ 516	\$ 467	\$ 49	\$ 166
Residential real estate:				
Residential	1,860	124	1,736	-
Construction	-	-	-	-
Commercial real estate:				
Commercial and multi-family	1,676	323	1,353	-
Construction	262	-	262	-
Home equities	755	178	577	-
Consumer loans	27	-	27	27
Total troubled restructured loans	\$ 5,096	\$ 1,092	\$ 4,004	\$ 193



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	December 31, 2015			
	(in thousands)			
	Total	Nonaccruing	Accruing	Related Allowance
Commercial and industrial	\$ 517	\$ 508	\$ 9	\$ 165
Residential real estate:				
Residential	1,789	689	1,100	-
Construction	-	-	-	-
Commercial real estate:				
Commercial and multi-family	1,732	334	1,398	-
Construction	834	-	834	-
Home equities	867	281	586	-
Consumer loans	28	-	28	28
Total troubled restructured loans	\$ 5,767	\$ 1,812	\$ 3,955	\$ 193

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

There was no TDR activity for the three-month periods ended June 30, 2016 and 2015.

The following table shows the data for TDR activity by type of concession granted to the borrower for the six month periods ended June 30, 2016 and 2015:

Six months ended June 30, 2016  
(in thousands)

Six months ended June 30, 2015  
(in thousands)

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Troubled Debt Restructurings by Type of Concession	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: Deferral of principal	-	\$ -	\$ -	3	\$ 541	\$ 541
Extension of maturity	1	24	24	-	-	-
Term-out line of credit	1	20	20	-	-	-
Residential Real Estate & Construction: Extension of maturity	1	95	95	-	-	-
Commercial Real Estate & Construction	-	-	-	-	-	-
Home Equities	-	-	-	-	-	-
Consumer loans	-	-	-	-	-	-

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The general practice of the Bank is to work with borrowers so that they are able to pay back 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. The following table presents loans which were classified as TDRs during the previous 12 months which defaulted during the three and six month periods ended June 30, 2016 and 2015:

	Three months ended June 30, 2016 (in thousands)		Three months ended June 30, 2015 (in thousands)	
	Number of Contracts	Recorded Investment	Number of Contracts	Recorded Investment
Troubled Debt Restructurings That Subsequently Defaulted				
Commercial and Industrial	-	\$ -	-	\$ -
Residential Real Estate:				
Residential	-	-	-	-
Construction	-	-	-	-
Commercial Real Estate:				
Commercial and multi-family	-	-	1	245
Construction	-	-	-	-
Home Equities	-	-	-	-
Consumer loans	-	-	-	-

	Six months ended June 30, 2016 (in thousands)		Six months ended June 30, 2015 (in thousands)	
	Number of Contracts	Recorded Investment	Number of Contracts	Recorded Investment
Troubled Debt Restructurings That Subsequently Defaulted				
Commercial and Industrial	-	\$ -	-	\$ -

Residential Real Estate:

Residential	-	-	-	-
Construction	-	-	-	-
Commercial Real Estate:				
Commercial and multi-family	-	-	1	245
Construction	-	-	-	-
Home Equities	-	-	1	19
Consumer loans	-	-	-	-

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## 5. PER SHARE DATA

The common stock per share information is based upon the weighted average number of shares outstanding during each period. For the three and six month periods ended June 30, 2016, the Company had an average of 62,419 and 63,654 dilutive shares outstanding, respectively. The Company had an average of 75,354 and 76,227 dilutive shares outstanding for the three and six months periods ended June 30, 2015, respectively.

Potential common shares that would have the effect of increasing diluted earnings per share are considered to be anti-dilutive and not included in calculating diluted earnings per share. For both the three and six month periods ended June 30, 2016, there was an average of 83,960 anti-dilutive shares outstanding, that were not included in calculating diluted earnings per share because their effect was anti-dilutive. For the three and sixth month periods ended June 30, 2015, there were 37,800 and 38,215 potentially anti-dilutive shares outstanding, respectively.

## 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, 2016 and 2015:

	Balance at March 31, 2016	Net Change	Balance at June 30, 2016
	(in thousands)		
Net unrealized gain on investment securities	\$ 1,124	\$ 260	\$ 1,384
Net defined benefit pension plan adjustments	(2,245)	40	(2,205)
Total	\$ (1,121)	\$ 300	\$ (821)

	Balance at March 31, 2015	Net Change	Balance at June 30, 2015
	(in thousands)		
Net unrealized gain on investment securities	\$ 1,242	\$ (637)	\$ 605
Net defined benefit pension plan adjustments	(2,390)	42	(2,348)
Total	\$ (1,148)	\$ (595)	\$ (1,743)

	Balance at December 31, 2015 (in thousands)	Net Change	Balance at June 30, 2016
Net unrealized gain (loss) on investment securities	\$ 475	\$ 909	\$ 1,384
Net defined benefit pension plan adjustments	(2,285)	80	(2,205)
Total	\$ (1,810)	\$ 989	\$ (821)

	Balance at December 31, 2014 (in thousands)	Net Change	Balance at June 30, 2015
Net unrealized gain on investment securities	\$ 911	\$ (306)	\$ 605
Net defined benefit pension plan adjustments	(2,419)	71	(2,348)
Total	\$ (1,508)	\$ (235)	\$ (1,743)



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	Three months ended June 30, 2016 (in thousands)			Three months ended June 30, 2015 (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 gain on investment securities:						
Unrealized gain on investment securities	\$ 419	\$ (159)	\$ 260	\$ (1,041)	\$ 404	\$ (637)
Reclassification from accumulated other comprehensive income for gains (losses)	-	-	-	-	-	-
Net change	419	(159)	260	(1,041)	404	(637)
Defined benefit pension plan adjustments:						
Net actuarial gain (loss)	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
Reclassifications from accumulated other comprehensive income for gains (losses)						
Amortization of prior service cost (a)	8	(3)	5	9	(4)	5
Amortization of actuarial loss (a)	56	(21)	35	52	(15)	37
Net change	64	(24)	40	61	(19)	42
Other Comprehensive Income (Loss)	\$ 483	\$ (183)	\$ 300	\$ (980)	\$ 385	\$ (595)

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

	Six months ended June 30, 2016 (in thousands)			Six months ended June 30, 2015 (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 gain (loss) on investment securities:						
Unrealized gain (loss) on investment securities	\$ 1,465	\$ (556)	\$ 909	\$ (500)	\$ 194	\$ (306)
Reclassification from accumulated other						

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comprehensive income for gains (losses)	-	-	-	-	-	-
Net change	1,465	(556)	909	(500)	194	(306)
Defined benefit pension plan adjustments:						
Net actuarial gain (loss)	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
Reclassifications from accumulated other comprehensive income for gains (losses)						
Amortization of prior service cost (a)	16	(6)	10	16	(6)	10
Amortization of actuarial loss (a)	112	(42)	70	100	(39)	61
Net change	128	(48)	80	116	(45)	71
Other Comprehensive Income (Loss)	\$ 1,593	\$ (604)	\$ 989	\$ (384)	\$ 149	\$ (235)

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

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## 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, 2016 and 2015.

	Three months ended June 30, 2016		
	Banking Activities (in thousands)	Insurance Agency Activities	Total
Net interest income (expense)	\$ 8,549	\$ (33)	\$ 8,516
Provision for loan losses (credit)	(376)	-	(376)
Net interest income (expense) after provision for loan losses	8,925	(33)	8,892
Non-interest income	708	-	708
Insurance service and fees	116	1,456	1,572
Non-interest expense	7,551	1,168	8,719
Income before income taxes	2,198	255	2,453
Income tax provision	352	98	450
Net income	\$ 1,846	\$ 157	\$ 2,003

	Three months ended June 30, 2015		
	Banking Activities (in thousands)	Insurance Agency Activities	Total
Net interest income (expense)	\$ 7,677	\$ (29)	\$ 7,648

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Provision for loan losses	415	-	415
Net interest income (expense) after provision for loan losses	7,262	(29)	7,233
Non-interest income	1,655	-	1,655
Insurance service and fees	191	1,630	1,821
Non-interest expense	7,089	1,152	8,241
Income before income taxes	2,019	449	2,468
Income tax provision	616	177	793