

EVANS BANCORP INC
Form 10-Q
May 02, 2019
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United States

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

For quarterly period ended March 31, 2019

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 every Interactive Data File required to be submitted 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 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.

| | |
|-------------------------|---------------------------|
| Large accelerated filer | Accelerated filer |
| Non-accelerated filer | 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.

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

Yes No

Securities registered pursuant to Section 12(b) of the Act:

| Title of each class | Trading Symbol(s) | Name of each exchange on which registered |
|--------------------------------|-------------------|---|
| Common Stock, \$0.50 par value | EVBN | NYSE American |

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, 4,883,467 shares as of April 30, 2019.

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UNAUDITED CONSOLIDATED BALANCE SHEETS
MARCH 31, 2019 AND DECEMBER 31, 2018
(in thousands, except share and per share amounts)

| | March 31, 2019 | December 31, 2018 |
|--|---------------------|-------------------------|
| ASSETS | | |
| Cash and due from banks | \$ 12,434 | \$ 13,997 |
| Interest-bearing deposits at banks | 56,082 | 25,918 |
| Securities: | | |
| Available for sale, at fair value (amortized cost: \$140,240 at March 31, 2019; \$135,274 at December 31, 2018) | 138,831 | 132,104 |
| Held to maturity, at amortized cost (fair value: \$1,903 at March 31, 2019; \$1,674 at December 31, 2018) | 1,900 | 1,685 |
| Federal Home Loan Bank common stock, at cost | 1,474 | 1,474 |
| Federal Reserve Bank common stock, at cost | 1,939 | 1,929 |
| Loans, net of allowance for loan losses of \$15,207 at March 31, 2019 and \$14,784 at December 31, 2018 | 1,170,222 | 1,141,146 |
| Properties and equipment, net of accumulated depreciation of \$19,713 at March 31, 2019 and \$19,416 at December 31, 2018 | 10,583 | 10,485 |
| Goodwill and intangible assets | 12,880 | 12,992 |
| Bank-owned life insurance | 28,922 | 28,403 |
| Operating lease right-of-use asset (see Note 1) | 4,142 | - |
| Other assets | 16,772 | 18,074 |
| TOTAL ASSETS | \$ 1,456,181 | \$ 1,388,207 |
| LIABILITIES AND STOCKHOLDERS' EQUITY | | |
| LIABILITIES | | |
| Deposits: | | |
| Demand | \$ 242,156 | \$ 231,902 |
| NOW | 122,204 | 110,450 |
| Savings | 618,471 | 571,479 |
| Time | 292,892 | 301,227 |

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| | | |
|---|-----------|-----------|
| Total deposits | 1,275,723 | 1,215,058 |
| Securities sold under agreement to repurchase | 2,482 | 3,142 |
| Other borrowings | 10,000 | 10,000 |
| Operating lease liability (see Note 1) | 4,594 | - |
| Other liabilities | 17,617 | 17,031 |
| Junior subordinated debentures | 11,330 | 11,330 |
| Total liabilities | 1,321,746 | 1,256,561 |

STOCKHOLDERS' EQUITY:

| | | |
|---|---------------------|---------------------|
| Common stock, \$.50 par value, 10,000,000 shares authorized; 4,860,316 and 4,852,868 shares issued at March 31, 2019 and December 31, 2018, respectively, and 4,860,316 and 4,852,868 outstanding at March 31, 2019 and December 31, 2018, respectively | 2,432 | 2,429 |
| Capital surplus | 61,448 | 61,225 |
| Retained earnings | 74,538 | 73,345 |
| Accumulated other comprehensive loss, net of tax | (3,983) | (5,353) |
| Total stockholders' equity | 134,435 | 131,646 |
| TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY | \$ 1,456,181 | \$ 1,388,207 |

See Notes to Unaudited Consolidated Financial Statements

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EVANS BANCORP, INC. AND SUBSIDIARIES
 UNAUDITED CONSOLIDATED STATEMENTS OF INCOME
 THREE MONTHS ENDED MARCH 31, 2019 AND 2018
 (in thousands, except share and per share amounts)

| | Three Months Ended March 31, | |
|--|---------------------------------|-----------|
| | 2019 | 2018 |
| INTEREST INCOME | | |
| Loans | \$ 14,362 | \$ 12,363 |
| Interest-bearing deposits at banks | 249 | 10 |
| Securities: | | |
| Taxable | 801 | 797 |
| Non-taxable | 130 | 196 |
| Total interest income | 15,542 | 13,366 |
| INTEREST EXPENSE | | |
| Deposits | 2,843 | 1,498 |
| Other borrowings | 45 | 298 |
| Junior subordinated debentures | 146 | 118 |
| Total interest expense | 3,034 | 1,914 |
| NET INTEREST INCOME | 12,508 | 11,452 |
| PROVISION FOR LOAN LOSSES | 538 | 767 |
| NET INTEREST INCOME AFTER PROVISION FOR LOAN LOSSES | 11,970 | 10,685 |
| NON-INTEREST INCOME | | |
| Deposit service charges | 533 | 509 |
| Insurance service and fees | 2,442 | 1,965 |
| Gain on loans sold | 26 | - |
| Bank-owned life insurance | 159 | 171 |
| Interchange fee income | 421 | 492 |
| Other | 614 | 649 |
| Total non-interest income | 4,195 | 3,786 |
| NON-INTEREST EXPENSE | | |
| Salaries and employee benefits | 7,160 | 6,627 |
| Occupancy | 836 | 758 |
| Advertising and public relations | 167 | 124 |
| Professional services | 745 | 653 |
| Technology and communications | 893 | 764 |
| Amortization of intangibles | 112 | 28 |
| FDIC insurance | 207 | 232 |
| Other | 1,104 | 985 |
| Total non-interest expense | 11,224 | 10,171 |
| INCOME BEFORE INCOME TAXES | 4,941 | 4,300 |

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| | | |
|---|-----------|-----------|
| INCOME TAX PROVISION | 1,221 | 981 |
| NET INCOME | \$ 3,720 | \$ 3,319 |
| Net income per common share-basic | \$ 0.77 | \$ 0.69 |
| Net income per common share-diluted | \$ 0.75 | \$ 0.68 |
| Cash dividends per common share | \$ 0.52 | \$ 0.46 |
| Weighted average number of common shares outstanding | 4,855,815 | 4,787,846 |
| Weighted average number of diluted shares outstanding | 4,932,451 | 4,912,289 |

See Notes to Unaudited Consolidated Financial Statements

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EVANS BANCORP, INC. AND SUBSIDIARIES
 UNAUDITED STATEMENTS OF CONSOLIDATED COMPREHENSIVE INCOME
 THREE MONTHS ENDED MARCH 31, 2019 AND 2018
 (in thousands)

| | Three Months Ended March 31, | |
|---|---------------------------------|----------|
| | 2019 | 2018 |
| NET INCOME | \$ 3,720 | \$ 3,319 |
| OTHER COMPREHENSIVE INCOME (LOSS), NET OF TAX: | | |
| Unrealized gain/(loss) on available-for-sale securities | 1,303 | (1,360) |
| Defined benefit pension plans: | | |
| Amortization of prior service cost | 6 | 6 |
| Amortization of actuarial loss | 61 | 36 |
| Total | 67 | 42 |
| OTHER COMPREHENSIVE INCOME (LOSS), NET OF TAX | 1,370 | (1,318) |
| COMPREHENSIVE INCOME | \$ 5,090 | \$ 2,001 |

See Notes to Unaudited Consolidated Financial Statements

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EVANS BANCORP, INC. AND SUBSIDIARIES
 UNAUDITED CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY
 THREE MONTHS ENDED MARCH 31, 2019 AND 2018
 (in thousands, except share and per share amounts)

| | Common Stock | Capital Surplus | Retained Earnings | Accumulated Other Comprehensive Loss | Total |
|---|-----------------|--------------------|----------------------|---|------------|
| Balance, December 31, 2017 | \$ 2,394 | \$ 59,444 | \$ 59,921 | \$ (3,417) | \$ 118,342 |
| Cumulative-effect adjustment due to change in accounting principle | | | 1,496 | | 1,496 |
| Net Income | | | 3,319 | | 3,319 |
| Other comprehensive income | | | | (1,318) | (1,318) |
| Cash dividends (\$0.46 per common share) | | | (2,202) | | (2,202) |
| Stock compensation expense | | 186 | | | 186 |
| Reissued 1,057 restricted shares | | - | | | - |
| Issued 16,368 restricted shares | 8 | (8) | | | - |
| Issued 3,404 shares in stock option exercises | 2 | 48 | | | 50 |
| Balance, March 31, 2018 | \$ 2,404 | \$ 59,670 | \$ 62,534 | \$ (4,735) | \$ 119,873 |
| Balance, December 31, 2018 | \$ 2,429 | \$ 61,225 | \$ 73,345 | \$ (5,353) | \$ 131,646 |
| Net Income | | | 3,720 | | 3,720 |
| Other comprehensive income | | | | 1,370 | 1,370 |
| Cash dividends (\$0.52 per common share) | | | (2,527) | | (2,527) |
| Stock compensation expense | | 201 | | | 201 |
| Reissued 500 restricted shares | | - | | | - |
| Issued 4,934 restricted shares, net of forfeitures | 2 | (2) | | | - |
| Issued 2,514 shares in stock option exercises | 1 | 24 | | | 25 |
| Balance, March 31, 2019 | \$ 2,432 | \$ 61,448 | \$ 74,538 | \$ (3,983) | \$ 134,435 |

See Notes to Unaudited Consolidated Financial
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EVANS BANCORP, INC. AND SUBSIDIARIES
 UNAUDITED CONSOLIDATED STATEMENTS OF CASH FLOWS
 THREE MONTHS ENDED MARCH 31, 2019 AND 2018
 (in thousands)

| | Three Months Ended | |
|--|--------------------|-----------|
| | March 31, | |
| | 2019 | 2018 |
| OPERATING ACTIVITIES: | | |
| Interest received | \$ 15,323 | \$ 13,392 |
| Fees received | 4,424 | 3,395 |
| Interest paid | (2,999) | (1,871) |
| Cash paid to employees and vendors | (12,685) | (11,122) |
| Income taxes paid | - | (8) |
| Proceeds from sale of loans held for resale | 2,071 | - |
| Originations of loans held for resale | (2,045) | - |
| Net cash provided by operating activities | 4,089 | 3,786 |
| INVESTING ACTIVITIES: | | |
| Available for sales securities: | | |
| Purchases | (10,568) | (47,853) |
| Proceeds from maturities, calls, and payments | 5,523 | 33,127 |
| Held to maturity securities: | | |
| Purchases | (224) | - |
| Proceeds from maturities, calls, and payments | 10 | 610 |
| Cash paid for bank-owned life insurance | (360) | - |
| Proceeds from bank-owned life insurance claims | - | 675 |
| Additions to properties and equipment | (426) | (162) |
| Purchase of tax credit investment | (19) | (129) |
| Net increase in loans | (29,454) | (48,445) |
| Net cash used in investing activities | (35,518) | (62,177) |
| FINANCING ACTIVITIES: | | |
| Repayments of short-term borrowings, net | (660) | (25,755) |
| Net increase in deposits | 60,665 | 83,204 |
| Issuance of common stock | 25 | 50 |
| Net cash provided by financing activities | 60,030 | 57,499 |
| Net increase (decrease) in cash and cash equivalents | 28,601 | (892) |
| CASH AND CASH EQUIVALENTS: | | |
| Beginning of period | 39,915 | 21,330 |

End of period

\$ 68,516 \$ 20,438

See Notes to Unaudited Consolidated Financial Statements

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EVANS BANCORP, INC. AND SUBSIDIARIES
 UNAUDITED CONSOLIDATED STATEMENTS OF CASH FLOWS
 THREE MONTHS ENDED MARCH 31, 2019 AND 2018
 (in thousands)

| | Three Months Ended March 31, | |
|--|---------------------------------|-----------------|
| | 2019 | 2018 |
| RECONCILIATION OF NET INCOME TO NET CASH PROVIDED BY OPERATING ACTIVITIES: | | |
| Net income | \$ 3,720 | \$ 3,319 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| Depreciation and amortization | 505 | 446 |
| Deferred tax expense | 12 | 144 |
| Provision for loan losses | 538 | 767 |
| Loss on tax credit investment | 148 | - |
| Refundable state historic tax credit received (accrued) | 17 | - |
| Gain on loans sold | (26) | - |
| Change in fair value of equity securities | - | (147) |
| Stock compensation expense | 201 | 186 |
| Proceeds from sale of loans held for resale | 2,071 | - |
| Originations of loans held for resale | (2,045) | - |
| Changes in assets and liabilities affecting cash flow: | | |
| Other assets | (4,528) | (1,060) |
| Other liabilities | 3,476 | 131 |
| NET CASH PROVIDED BY OPERATING ACTIVITIES | \$ 4,089 | \$ 3,786 |

See Notes to Unaudited Consolidated Financial Statements

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EVANS BANCORP, INC. AND SUBSIDIARIES

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

THREE MONTHS ENDED MARCH 31, 2019 AND 2018

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”), and Evans National Holding Corp. (“ENHC”); and (ii) Evans National Financial Services, LLC (“ENFS”), and ENFS’s subsidiary, The Evans Agency, LLC (“TEA”), and TEA’s subsidiaries, Frontier Claims Services, Inc. (“FCS”) and ENB Associates Inc. (“ENBA”), in the preparation of the accompanying interim unaudited consolidated financial statements conform with U.S. generally accepted accounting principles (“GAAP”) and with general practice within the industries in which it operates. Except as the context otherwise requires, the Company and its direct and indirect subsidiaries are collectively referred to in this report as the “Company.”

The results of operations for the three month period ended March 31, 2019 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, 2018 (“10-K”). The Company’s significant accounting policies are disclosed in Note 1 to the 10-K.

The Financial Accounting Standards Board (“FASB”) establishes changes to U.S. GAAP in the form of accounting standards updates (“ASUs”) to the FASB Accounting Standards Codification. The Company considers the applicability and impact of all ASUs when they are issued by FASB. ASUs listed below were adopted by the Company during its current fiscal year. ASUs not listed below did not have a material impact on the Company’s consolidated financial position, results of operations, cash flows or disclosures.

On January 1, 2019, the Company adopted ASU 2016-02 Leases and all subsequent amendments (collectively, “ASU 2016-02”). 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 (“ROU”) 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.

ASU 2016-02 required a modified retrospective transition approach, applying the new standard to all leases existing at the date of initial application. The Company elected to use the effective date, January 1, 2019, as our date of initial application. Consequently, financial information will not be updated and the disclosures required under the new standard will not be provided for dates and periods before January 1, 2019. In addition, the Company elected the package of practical expedients permitted under the transition guidance within the new standard, which among other things, allowed us to carry forward the historical lease classification.

Under ASU 2016-02, leases are classified as finance or operating, with the classification affecting the pattern and classification of expense recognition in the income statement. The Company's leases, consisting of property leases for certain of our bank branches and insurance agency offices, are classified as operating leases. Operating lease ROU assets and liabilities are recognized at commencement date based on the present value of lease payments over the lease term. As these leases do not provide an implicit rate, we use our incremental borrowing rate in determining the present value of lease payments. Our lease terms include options to extend or terminate the lease when it is reasonably certain that we will exercise that option. Leases with an initial term of 12 months or less are not recorded on the balance sheet. Lease expense for lease payments is recognized on a straight-line basis over the lease term.

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ASU 2016-02 had a material impact on the Company's consolidated balance sheets, but did not have an impact on the consolidated statements of income or the consolidated statements of cash flows. The most significant impacts upon adoption on January 1, 2019 were the recognition of \$4.3 million of ROU assets and \$4.7 million of lease liabilities, including \$0.4 million of liabilities that were reported in other liabilities in the Company's December 31, 2018 consolidated balance sheet. ROU assets and lease liability were \$4.1 million and \$4.6 million, respectively, at March 31, 2019. Operating lease expenses during the three months ended March 31, 2019 were \$178 thousand and are included in other non-interest expense on the consolidated statement of income. Cash paid for amounts included in the measurement of lease liabilities during the three months ended March 31, 2019 was \$184 thousand and is included in cash flows from operating activities on the consolidated statement of cash flows. The weighted average discount rate related to the Company's leases was 3.5% as of March 31, 2019. The weighted average remaining lease term related to the Company's leases was 9.0 years as of March 31, 2019. Future minimum lease payments under non-cancellable leases as of March 31, 2019 were as follows:

| | Year Ending December 31, |
|--|--------------------------|
| 2019 (excluding the three months ended March 31, 2019) | 552 |
| 2020 | 749 |
| 2021 | 682 |
| 2022 | 694 |
| 2023 | 589 |
| Thereafter | 2,092 |
| Total future minimum lease payments | 5,358 |
| Less imputed interest | 764 |
| Total | 4,594 |

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2. SECURITIES

The amortized cost of securities and their approximate fair value at March 31, 2019 and December 31, 2018 were as follows:

| | March 31, 2019 (in thousands) | | | |
|---|----------------------------------|---------------------|------------|---------------|
| | Amortized Cost | Unrealized Gains | Losses | Fair Value |
| Available for Sale: | | | | |
| Debt securities: | | | | |
| U.S. government agencies | \$ 39,160 | \$ 139 | \$ (309) | \$ 38,990 |
| States and political subdivisions | 20,212 | 143 | (14) | 20,341 |
| Total debt securities | \$ 59,372 | \$ 282 | \$ (323) | \$ 59,331 |
| Mortgage-backed securities: | | | | |
| FNMA | \$ 27,135 | \$ 29 | \$ (332) | \$ 26,832 |
| FHLMC | 16,181 | 20 | (192) | 16,009 |
| GNMA | 1,608 | 9 | (23) | 1,594 |
| SBA | 8,991 | 3 | (146) | 8,848 |
| CMO | 26,953 | 15 | (751) | 26,217 |
| Total mortgage-backed securities | \$ 80,868 | \$ 76 | \$ (1,444) | \$ 79,500 |
| Total securities designated as available for sale | \$ 140,240 | \$ 358 | \$ (1,767) | \$ 138,831 |
| Held to Maturity: | | | | |
| Debt securities | | | | |
| States and political subdivisions | \$ 1,900 | \$ 16 | \$ (13) | \$ 1,903 |
| Total securities designated as held to maturity | \$ 1,900 | \$ 16 | \$ (13) | \$ 1,903 |

December 31, 2018
(in thousands)

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| | Amortized Cost | Unrealized Gains | Losses | Fair Value |
|---|-------------------|---------------------|------------|---------------|
| Available for Sale: | | | | |
| Debt securities: | | | | |
| U.S. government agencies | \$ 34,597 | \$ 2 | \$ (671) | \$ 33,928 |
| States and political subdivisions | 22,168 | 69 | (64) | 22,173 |
| Total debt securities | \$ 56,765 | \$ 71 | \$ (735) | \$ 56,101 |
| Mortgage-backed securities: | | | | |
| FNMA | \$ 27,747 | \$ 21 | \$ (729) | \$ 27,039 |
| FHLMC | 14,645 | 11 | (431) | 14,225 |
| GNMA | 1,660 | 6 | (36) | 1,630 |
| SBA | 9,432 | - | (299) | 9,133 |
| CMO | 25,025 | 6 | (1,055) | 23,976 |
| Total mortgage-backed securities | \$ 78,509 | \$ 44 | \$ (2,550) | \$ 76,003 |
| Total securities designated as available for sale | \$ 135,274 | \$ 115 | \$ (3,285) | \$ 132,104 |
| Held to Maturity: | | | | |
| Debt securities | | | | |
| States and political subdivisions | \$ 1,685 | \$ 11 | \$ (22) | \$ 1,674 |
| Total securities designated as held to maturity | \$ 1,685 | \$ 11 | \$ (22) | \$ 1,674 |

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Available for sale securities with a total fair value of \$117 million and \$94 million at March 31, 2019 and December 31, 2018, respectively, were pledged as collateral to secure public deposits and for other purposes required or permitted by law.

The scheduled maturities of debt and mortgage-backed securities at March 31, 2019 and December 31, 2018 are summarized below. All maturity amounts are contractual maturities. Actual maturities may differ from contractual maturities because certain issuers have the right to call or prepay obligations with or without call premiums.

| | March 31, 2019 | | December 31, 2018 | |
|--|-------------------------------------|---|-------------------------------------|---|
| | 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 | \$ 3,344 | \$ 3,347 | \$ 5,074 | \$ 5,075 |
| Due after one year through five years | 21,794 | 21,782 | 22,637 | 22,448 |
| Due after five years through ten years | 34,050 | 34,016 | 28,870 | 28,391 |
| Due after ten years | 184 | 186 | 184 | 187 |
| | 59,372 | 59,331 | 56,765 | 56,101 |
| Mortgage-backed securities available for sale | | | | |
| | 80,868 | 79,500 | 78,509 | 76,003 |
| Total | \$ 140,240 | \$ 138,831 | \$ 135,274 | \$ 132,104 |
| Debt securities held to maturity: | | | | |
| Due in one year or less | \$ 733 | \$ 734 | \$ 693 | \$ 693 |
| Due after one year through five years | 991 | 999 | 811 | 811 |
| Due after five years through ten years | 88 | 85 | 93 | 89 |
| Due after ten years | 88 | 85 | 88 | 81 |
| Total | \$ 1,900 | \$ 1,903 | \$ 1,685 | \$ 1,674 |

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 March 31, 2019 and December 31, 2018 is summarized below. The securities are primarily U.S. government-guaranteed agency securities or municipal securities.

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March 31, 2019

| | Less than 12 months | | 12 months or longer | | Total | |
|---------------------------------------|---------------------|-------------------|---------------------|-------------------|------------|-------------------|
| | Fair Value | Unrealized Losses | Fair Value | Unrealized Losses | Fair Value | Unrealized Losses |
| | (in thousands) | | | | | |
| Available for Sale: | | | | | | |
| Debt securities: | | | | | | |
| U.S. government agencies | \$ - | \$ - | \$ 24,697 | \$ (309) | \$ 24,697 | \$ (309) |
| States and political subdivisions | 402 | (1) | 3,545 | (13) | 3,947 | (14) |
| Total debt securities | \$ 402 | \$ (1) | \$ 28,242 | \$ (322) | \$ 28,644 | \$ (323) |
| Mortgage-backed securities: | | | | | | |
| FNMA | \$ - | \$ - | \$ 22,217 | \$ (332) | \$ 22,217 | \$ (332) |
| FHLMC | - | - | 13,558 | (192) | 13,558 | (192) |
| GNMA | 201 | (1) | 769 | (22) | 970 | (23) |
| SBA | - | - | 7,113 | (146) | 7,113 | (146) |
| CMO | - | - | 22,795 | (751) | 22,795 | (751) |
| Total mortgage-backed securities | \$ 201 | \$ (1) | \$ 66,452 | \$ (1,443) | \$ 66,653 | \$ (1,444) |
| Held to Maturity: | | | | | | |
| Debt securities: | | | | | | |
| States and political subdivisions | \$ - | \$ - | \$ 558 | \$ (13) | \$ 558 | \$ (13) |
| Total temporarily impaired securities | \$ 603 | \$ (2) | \$ 95,252 | \$ (1,778) | \$ 95,855 | \$ (1,780) |

December 31, 2018

| | Less than 12 months | | 12 months or longer | | Total | |
|-----------------------------------|---------------------|-------------------|---------------------|-------------------|------------|-------------------|
| | Fair Value | Unrealized Losses | Fair Value | Unrealized Losses | Fair Value | Unrealized Losses |
| | (in thousands) | | | | | |
| Available for Sale: | | | | | | |
| Debt securities: | | | | | | |
| U.S. government agencies | \$ 9,931 | \$ (49) | \$ 21,144 | \$ (622) | \$ 31,075 | \$ (671) |
| States and political subdivisions | 5,218 | (15) | 6,893 | (49) | 12,111 | (64) |
| Total debt securities | \$ 15,149 | \$ (64) | \$ 28,037 | \$ (671) | \$ 43,186 | \$ (735) |
| Mortgage-backed securities: | | | | | | |

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| | | | | | | |
|---------------------------------------|-----------|----------|-----------|------------|------------|------------|
| FNMA | \$ 2,637 | \$ (21) | \$ 23,667 | \$ (708) | \$ 26,304 | \$ (729) |
| FHLMC | 1,895 | (25) | 11,899 | (406) | 13,794 | (431) |
| GNMA | - | - | 926 | (36) | 926 | (36) |
| SBA | - | - | 9,133 | (299) | 9,133 | (299) |
| CMO | - | - | 23,127 | (1,055) | 23,127 | (1,055) |
| Total mortgage-backed securities | \$ 4,532 | \$ (46) | \$ 68,752 | \$ (2,504) | \$ 73,284 | \$ (2,550) |
| Held to Maturity: | | | | | | |
| Debt securities: | | | | | | |
| States and political subdivisions | \$ 156 | \$ - | \$ 722 | \$ (22) | \$ 878 | \$ (22) |
| Total temporarily impaired securities | \$ 19,837 | \$ (110) | \$ 97,511 | \$ (3,197) | \$ 117,348 | \$ (3,307) |

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Management has assessed the securities available for sale in an unrealized loss position at March 31, 2019 and December 31, 2018 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 March 31, 2019 and did not record any OTTI charges during 2018. The credit worthiness of the Company's securities portfolio is largely reliant on the ability of U.S. government sponsored agencies such as Federal Home Loan Bank ("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 MEASUREMENT

Fair value is defined in ASC Topic 820 "Fair Value Measurement" 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 measurement:

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 March 31, 2019 and December 31, 2018, respectively:

| (in thousands) | Level 1 | Level 2 | Level 3 | Fair Value |
|-----------------------------------|---------|-----------|---------|------------|
| March 31, 2019 | | | | |
| Securities available-for-sale: | | | | |
| US government agencies | \$ - | \$ 38,990 | \$ - | \$ 38,990 |
| States and political subdivisions | - | 20,341 | - | 20,341 |
| Mortgage-backed securities | - | 79,500 | - | 79,500 |
| Mortgage servicing rights | - | - | 587 | 587 |
| December 31, 2018 | | | | |
| Securities available-for-sale: | | | | |
| US government agencies | \$ - | \$ 33,928 | \$ - | \$ 33,928 |
| States and political subdivisions | - | 22,173 | - | 22,173 |
| Mortgage-backed securities | - | 76,003 | - | 76,003 |
| Mortgage servicing rights | - | - | 609 | 609 |

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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.

Equity securities

At December 31, 2017 and through the first three months of 2018, the Company held equity securities in another financial institution. Since the ownership level was less than 5% of the outstanding shares of that financial institution, the investment was recorded on the Company's balance sheet at historical cost, under the cost method of accounting. On January 1, 2018, the Company adopted ASU 2016-01, requiring the Company to mark the investment to its fair value with a cumulative-effect adjustment to retained earnings.

The equity securities of the financial institution 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 the first three months of 2018 was approximately 1% of the outstanding common shares. The Company obtained 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 Company's 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 financial institution's equity securities as Level 3 on the fair value hierarchy, there was a transfer into Level 3 for the institution's equity securities during the first quarter of 2018. The Company sold its entire equity interest in this financial institution during the third quarter of 2018. The following table summarizes the changes in fair value for equity securities:

| (in thousands) | Three months ended March 31, 2018 |
|---|---|
| Equity securities - January 1 | \$ 580 |
| Increase in recorded value due to adoption of ASU 2016-01 through beginning retained earnings | 1,234 |
| Fair value change included in earnings | 147 |
| Equity securities - March 31 | \$ 1,961 |

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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. MSRs 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 MSRs:

| (in thousands) | Three months ended March 31, | |
|---------------------------------------|------------------------------------|--------|
| | 2019 | 2018 |
| Mortgage servicing rights - January 1 | \$ 609 | \$ 586 |
| Losses/(gains) included in earnings | (40) | 58 |
| Additions from loan sales | 18 | - |
| Mortgage servicing rights - March 31 | \$ 587 | \$ 644 |

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

| | March | |
|-----------------------|--------|----------|
| | 31, | December |
| | 2019 | 31, 2018 |
| Servicing fees | 0.25 % | 0.25 % |
| Discount rate | 9.00 % | 9.00 % |
| Prepayment rate (CPR) | 7.31 % | 6.52 % |

FINANCIAL INSTRUMENTS MEASURED AT FAIR VALUE ON A NONRECURRING BASIS

The Company is required, on a nonrecurring basis, to adjust the carrying value of certain assets or provide valuation allowances related to certain assets using fair value measurements. The following table presents for each of the fair-value hierarchy levels as defined in this footnote, those financial instruments which are measured at fair value on a nonrecurring basis at March 31, 2019 and December 31, 2018:

| (in thousands) | Level 1 | Level 2 | Level 3 | Fair Value |
|-------------------------------------|---------|---------|-----------|------------|
| March 31, 2019 | | | | |
| Collateral dependent impaired loans | \$ - | \$ - | \$ 21,221 | \$ 21,221 |
| December 31, 2018 | | | | |
| Collateral dependent impaired loans | \$ - | \$ - | \$ 20,590 | \$ 20,590 |

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.

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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 a special mention or a substandard depending on the amount of the loan, the type of loan and the type of collateral. All impaired commercial loans are graded substandard or worse 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. Collateral dependent impaired loans had a gross value of \$22.2 million, with an allowance for loan loss of \$1.0 million, at March 31, 2019 compared with \$21.7 million and \$1.1 million, respectively, at December 31, 2018.

FAIR VALUE OF FINANCIAL INSTRUMENTS

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.

| | March 31, 2019 | | December 31, 2018 | |
|-------------------------------|--------------------|---------------|--------------------|---------------|
| | Carrying Amount | Fair Value | Carrying Amount | Fair Value |
| | (in thousands) | | (in thousands) | |
| Financial assets: | | | | |
| Level 1: | | | | |
| Cash and cash equivalents | \$ 68,516 | \$ 68,516 | \$ 39,915 | \$ 39,915 |
| Level 2: | | | | |
| Available for sale securities | 138,831 | 138,831 | 132,104 | 132,104 |
| FHLB and FRB stock | 3,413 | 3,413 | 3,403 | 3,403 |
| Level 3: | | | | |
| Held to maturity securities | 1,900 | 1,903 | 1,685 | 1,674 |
| Loans, net | 1,170,222 | 1,165,888 | 1,141,146 | 1,131,891 |

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| | | | | |
|---|------------|------------|------------|------------|
| Mortgage servicing rights | 587 | 587 | 609 | 609 |
| Financial liabilities: | | | | |
| Level 1: | | | | |
| Demand deposits | \$ 242,156 | \$ 242,156 | \$ 231,902 | \$ 231,902 |
| NOW deposits | 122,204 | 122,204 | 110,450 | 110,450 |
| Savings deposits | 618,471 | 618,471 | 571,479 | 571,479 |
| Level 2: | | | | |
| Securities sold under agreement to repurchase | 2,482 | 2,482 | 3,142 | 3,142 |
| Other borrowed funds | 10,000 | 9,904 | 10,000 | 9,854 |
| Junior subordinated debentures | 11,330 | 11,330 | 11,330 | 11,330 |
| Level 3: | | | | |
| Time deposits | 292,892 | 291,744 | 301,227 | 298,999 |

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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:

| | March 31, 2019 | December 31, 2018 |
|-------------------------------------|-------------------|----------------------|
| Mortgage loans on real estate: | (in thousands) | |
| Residential mortgages | \$ 160,999 | \$ 158,404 |
| Commercial and multi-family | 608,384 | 592,507 |
| Construction-Residential | 194 | 113 |
| Construction-Commercial | 101,468 | 105,196 |
| Home equities | 69,777 | 70,546 |
| Total real estate loans | 940,822 | 926,766 |
| Commercial and industrial loans | 241,509 | 226,057 |
| Consumer and other loans | 1,438 | 1,520 |
| Net deferred loan origination costs | 1,660 | 1,587 |
| Total gross loans | 1,185,429 | 1,155,930 |
| Allowance for loan losses | (15,207) | (14,784) |
| Loans, net | \$ 1,170,222 | \$ 1,141,146 |

The Bank sells certain fixed rate residential mortgages to FNMA while maintaining the servicing rights for those mortgages. In the three month period ended March 31, 2019, the Bank sold mortgages to FNMA totaling \$2.0 million. The Bank did not sell any mortgages to FNMA in the three month period ended March 31, 2018. At March 31, 2019 and December 31, 2018, the Bank had a loan servicing portfolio principal balance of \$73 million upon which it earned servicing fees. The value of the mortgage servicing rights for that portfolio was \$0.6 million at March 31, 2019 and December 31, 2018. No loans were held for sale at March 31, 2019. At December 31, 2018 there were \$0.4 million in residential mortgages held for sale. 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, 2018. 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, 2018. Unless otherwise noted in this Form 10-Q, the policies and methodology described in the Annual Report for the year ended December 31, 2018 are consistent with those utilized by the Company in the three month period ended March 31, 2019.

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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:

- 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:

March 31, 2019
(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 | \$ 58,782 | \$ 459,925 | \$ 518,707 | \$ 153,604 |

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| | | | | |
|-----------------|------------|------------|------------|------------|
| Watch | 29,529 | 126,592 | 156,121 | 74,762 |
| Special Mention | 4,330 | 15,778 | 20,108 | 4,830 |
| Substandard | 8,827 | 6,089 | 14,916 | 8,313 |
| Doubtful/Loss | - | - | - | - |
| Total | \$ 101,468 | \$ 608,384 | \$ 709,852 | \$ 241,509 |

December 31, 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 | \$ 65,932 | \$ 466,294 | \$ 532,226 | \$ 155,687 |
| Watch | 30,628 | 109,409 | 140,037 | 57,366 |
| Special Mention | - | 10,583 | 10,583 | 4,105 |
| Substandard | 8,636 | 6,221 | 14,857 | 8,870 |
| Doubtful/Loss | - | - | - | 29 |
| Total | \$ 105,196 | \$ 592,507 | \$ 697,703 | \$ 226,057 |

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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:

March 31, 2019
(in thousands)

| | Current | | | | Non-accruing | Total |
|---------------------------|--------------|---------------|---------------|-------------|--------------|--------------|
| | Balance | 30-59 days | 60-89 days | 90+ days | Loans | Balance |
| Commercial and industrial | \$ 237,850 | \$ 1,316 | \$ - | \$ - | \$ 2,343 | \$ 241,509 |
| Residential real estate: | | | | | | |
| Residential | 158,734 | 609 | - | - | 1,656 | 160,999 |
| Construction | 194 | - | - | - | - | 194 |
| Commercial real estate: | | | | | | |
| Commercial | 600,585 | 1,710 | - | - | 6,089 | 608,384 |
| Construction | 83,095 | 9,546 | - | - | 8,827 | 101,468 |
| Home equities | 68,219 | 461 | 25 | - | 1,072 | 69,777 |
| Consumer and other | 1,425 | 13 | - | - | - | 1,438 |
| Total Loans | \$ 1,150,102 | \$ 13,655 | \$ 25 | \$ - | \$ 19,987 | \$ 1,183,769 |

Note: Loan balances do not include \$1.7 million in net deferred loan origination costs as of March 31, 2019.

December 31, 2018
(in thousands)

| | Current | | | | Non-accruing | Total |
|---------------------------|------------|---------------|---------------|-------------|--------------|------------|
| | Balance | 30-59 days | 60-89 days | 90+ days | Loans | Balance |
| Commercial and industrial | \$ 217,625 | \$ 6,173 | \$ 565 | \$ - | \$ 1,694 | \$ 226,057 |
| Residential real estate: | | | | | | |

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| | | | | | | |
|-------------------------|--------------|-----------|----------|------|-----------|--------------|
| Residential | 154,063 | 2,546 | 332 | - | 1,463 | 158,404 |
| Construction | 113 | - | - | - | - | 113 |
| Commercial real estate: | | | | | | |
| Commercial | 582,016 | 4,546 | - | - | 5,945 | 592,507 |
| Construction | 95,204 | 1,027 | 329 | - | 8,636 | 105,196 |
| Home equities | 69,094 | 123 | 76 | - | 1,253 | 70,546 |
| Consumer and other | 1,514 | 5 | 1 | - | - | 1,520 |
| Total Loans | \$ 1,119,629 | \$ 14,420 | \$ 1,303 | \$ - | \$ 18,991 | \$ 1,154,343 |

Note: Loan balances do not include \$1.6 million in net deferred loan origination costs as of December 31, 2018.

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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 three month periods ended March 31, 2019 and 2018:

March 31, 2019

| (in thousands) | Commercial and Industrial | Commercial Real Estate Mortgages* | Consumer and Other | Residential Mortgages* | Home Equities | Total |
|----------------------------|---------------------------|-----------------------------------|--------------------|------------------------|---------------|-----------|
| Allowance for loan losses: | | | | | | |
| Beginning balance | \$ 4,368 | \$ 8,844 | \$ 106 | \$ 1,121 | \$ 345 | \$ 14,784 |
| Charge-offs | (121) | - | (23) | - | - | (144) |
| Recoveries | 22 | - | 7 | - | - | 29 |
| Provision (Credit) | 485 | 205 | 21 | (168) | (5) | 538 |
| Ending balance | \$ 4,754 | \$ 9,049 | \$ 111 | \$ 953 | \$ 340 | \$ 15,207 |

Allowance for loan losses:

Ending balance:

| | | | | | | |
|---------------------------------------|----------|----------|--------|--------|--------|-----------|
| Individually evaluated for impairment | \$ 499 | \$ 579 | \$ 22 | \$ 70 | \$ - | \$ 1,170 |
| Collectively evaluated for impairment | 4,255 | 8,470 | 89 | 883 | 340 | 14,037 |
| Total | \$ 4,754 | \$ 9,049 | \$ 111 | \$ 953 | \$ 340 | \$ 15,207 |

Loans:

Ending balance:

| | | | | | | |
|---------------------------------------|----------|-----------|-------|----------|----------|-----------|
| Individually evaluated for impairment | \$ 4,293 | \$ 15,536 | \$ 22 | \$ 2,963 | \$ 1,661 | \$ 24,475 |
| Collectively evaluated | | | | | | |

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| | | | | | | |
|----------------|------------|------------|----------|------------|-----------|--------------|
| for impairment | 237,216 | 694,316 | 1,416 | 158,230 | 68,116 | 1,159,294 |
| Total | \$ 241,509 | \$ 709,852 | \$ 1,438 | \$ 161,193 | \$ 69,777 | \$ 1,183,769 |

* Includes construction loans

Note: Loan balances do not include \$1.7 million in net deferred loan origination costs as of March 31, 2019.

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March 31, 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) | - | (34) | - | - | (101) |
| Recoveries | 6 | - | 1 | - | 1 | 8 |
| Provision (Credit) | (28) | 736 | 20 | 57 | (18) | 767 |
| Ending balance | \$ 5,115 | \$ 8,145 | \$ 96 | \$ 1,007 | \$ 330 | \$ 14,693 |
| Allowance for loan losses: | | | | | | |
| Ending balance: | | | | | | |
| Individually evaluated for impairment | \$ 292 | \$ 567 | \$ 24 | \$ 36 | \$ - | \$ 919 |
| Collectively evaluated for impairment | 4,823 | 7,578 | 72 | 971 | 330 | 13,774 |
| Total | \$ 5,115 | \$ 8,145 | \$ 96 | \$ 1,007 | \$ 330 | \$ 14,693 |
| Loans: | | | | | | |
| Ending balance: | | | | | | |
| Individually evaluated for impairment | \$ 2,485 | \$ 10,282 | \$ 24 | \$ 2,765 | \$ 1,960 | \$ 17,516 |
| Collectively evaluated for impairment | 242,773 | 641,284 | 1,541 | 138,146 | 67,422 | 1,091,166 |
| Total | \$ 245,258 | \$ 651,566 | \$ 1,565 | \$ 140,911 | \$ 69,382 | \$ 1,108,682 |

* Includes construction loans

Note: Loan balances do not include \$1.3 million in net deferred loan origination costs as of March 31, 2018.

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Impaired Loans

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

| | At March 31, 2019 | | | | | |
|-------------------------------------|------------------------|--------------------------------|----------------------|-----------------------------------|--------------------------------|----------------------------------|
| | 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 | \$ 3,372 | \$ 3,581 | \$ - | \$ 3,545 | \$ 17 | \$ 36 |
| Residential real estate: | | | | | | |
| Residential | 2,419 | 2,649 | - | 2,485 | 15 | 16 |
| Construction | - | - | - | - | - | - |
| Commercial real estate: | | | | | | |
| Commercial | 6,614 | 7,043 | - | 6,858 | 67 | 11 |
| Construction | 424 | 424 | - | 462 | 9 | 3 |
| Home equities | 1,661 | 1,832 | - | 1,739 | 18 | 9 |
| Consumer and other | - | - | - | - | - | - |
| Total impaired loans | \$ 14,490 | \$ 15,529 | \$ - | \$ 15,089 | \$ 126 | \$ 75 |

| | At March 31, 2019 | | | | | |
|------------------------------------|------------------------|--------------------------------|----------------------|-----------------------------------|--------------------------------|----------------------------------|
| | Recorded Investment | Unpaid Principal Balance | Related Allowance | Average Recorded Investment | Interest Income Foregone | Interest Income Recognized |
| With a related allowance recorded: | (in thousands) | | | | | |
| | \$ 921 | \$ 962 | \$ 499 | \$ 982 | \$ 16 | \$ 3 |

| | | | | | | |
|---|----------|-----------|----------|-----------|--------|------|
| Commercial and industrial Residential real estate: | | | | | | |
| Residential | 544 | 548 | 70 | 547 | 7 | - |
| Construction | - | - | - | - | - | - |
| Commercial real estate: | | | | | | |
| Commercial | - | - | - | - | - | - |
| Construction | 8,498 | 8,975 | 579 | 8,720 | 133 | - |
| Home equities | - | - | - | - | - | - |
| Consumer and other | 22 | 26 | 22 | 23 | - | - |
| Total impaired loans | \$ 9,985 | \$ 10,511 | \$ 1,170 | \$ 10,272 | \$ 156 | \$ 3 |

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| | At March 31, 2019 | | | | | |
|------------------------------|--|--------------------------------|----------------------|-----------------------------------|--------------------------------|----------------------------------|
| | Recorded Investment (in thousands) | Unpaid Principal Balance | Related Allowance | Average Recorded Investment | Interest Income Foregone | Interest Income Recognized |
| Total: | | | | | | |
| Commercial and industrial | \$ 4,293 | \$ 4,543 | \$ 499 | \$ 4,527 | \$ 33 | \$ 39 |
| Residential real estate: | | | | | | |
| Residential | 2,963 | 3,197 | 70 | 3,032 | 22 | 16 |
| Construction | - | - | - | - | - | - |
| Commercial real estate: | | | | | | |
| Commercial | 6,614 | 7,043 | - | 6,858 | 67 | 11 |
| Construction | 8,922 | 9,399 | 579 | 9,182 | 142 | 3 |
| Home equities | 1,661 | 1,832 | - | 1,739 | 18 | 9 |
| Consumer and other | 22 | 26 | 22 | 23 | - | - |
| Total impaired loans | \$ 24,475 | \$ 26,040 | \$ 1,170 | \$ 25,361 | \$ 282 | \$ 78 |

| | At December 31, 2018 | | | | | |
|---|--|--------------------------------|----------------------|-----------------------------------|--------------------------------|----------------------------------|
| | 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 | \$ 1,633 | \$ 2,611 | \$ - | \$ 1,785 | \$ 116 | \$ 65 |
| Residential real estate: | | | | | | |
| Residential | 2,289 | 2,483 | - | 2,337 | 45 | 69 |
| Construction | - | - | - | - | - | - |
| Commercial real estate: | | | | | | |
| Commercial | 6,538 | 6,914 | - | 6,733 | 220 | 115 |

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| | | | | | | |
|-------------------------|-----------|-----------|------|-----------|--------|--------|
| Construction | 116 | 116 | - | 143 | - | 12 |
| Home equities | 1,887 | 2,058 | - | 1,952 | 71 | 43 |
| Consumer and other | - | - | - | - | - | - |
| Total impaired loans | \$ 12,463 | \$ 14,182 | \$ - | \$ 12,950 | \$ 452 | \$ 304 |

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| | At December 31, 2018 | | | | | |
|------------------------------------|----------------------|-----------|-----------|------------|----------|------------|
| | Recorded | Unpaid | Related | Average | Interest | Interest |
| | Investment | Principal | Allowance | Recorded | Income | Income |
| | (in thousands) | Balance | | Investment | Foregone | Recognized |
| With a related allowance recorded: | | | | | | |
| Commercial and industrial | \$ 2,068 | \$ 2,095 | \$ 249 | \$ 2,098 | \$ 17 | \$ 125 |
| Residential real estate: | | | | | | |
| Residential | 525 | 556 | 85 | 520 | 22 | 3 |
| Construction | - | - | - | - | - | - |
| Commercial real estate: | | | | | | |
| Commercial | - | - | - | - | - | - |
| Construction | 8,636 | 8,975 | 716 | 8,793 | 379 | 113 |
| Home equities | - | - | - | - | - | - |
| Consumer and other | 23 | 27 | 23 | 23 | - | 2 |
| Total impaired loans | \$ 11,252 | \$ 11,653 | \$ 1,073 | \$ 11,434 | \$ 418 | \$ 243 |

| | At December 31, 2018 | | | | | |
|---------------------------|----------------------|-----------|-----------|------------|----------|------------|
| | Recorded | Unpaid | Related | Average | Interest | Interest |
| | Investment | Principal | Allowance | Recorded | Income | Income |
| | (in thousands) | Balance | | Investment | Foregone | Recognized |
| Total: | | | | | | |
| Commercial and industrial | \$ 3,701 | \$ 4,706 | \$ 249 | \$ 3,883 | \$ 133 | \$ 190 |
| Residential real estate: | | | | | | |
| Residential | 2,814 | 3,039 | 85 | 2,857 | 67 | 72 |
| Construction | - | - | - | - | - | - |
| Commercial real estate: | | | | | | |
| Commercial | 6,538 | 6,914 | - | 6,733 | 220 | 115 |
| Construction | 8,752 | 9,091 | 716 | 8,936 | 379 | 125 |
| Home equities | 1,887 | 2,058 | - | 1,952 | 71 | 43 |
| | 23 | 27 | 23 | 23 | - | 2 |

Consumer and
other
Total impaired
loans

\$ 23,715

\$ 25,835

\$ 1,073

\$ 24,384

\$ 870

\$ 547

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Troubled debt restructurings

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

| | March 31, 2019 | | | |
|-----------------------------|----------------|-------------|----------|-------------------|
| | (in thousands) | | | |
| | Total | Nonaccruing | Accruing | Related Allowance |
| Commercial and industrial | \$ 2,181 | \$ 231 | \$ 1,950 | \$ 81 |
| Residential real estate: | | | | |
| Residential | 1,585 | 278 | 1,307 | - |
| Construction | - | - | - | - |
| Commercial real estate: | | | | |
| Commercial and multi-family | 4,045 | 3,520 | 525 | - |
| Construction | 8,593 | 8,498 | 95 | 578 |
| Home equities | 817 | 228 | 589 | - |
| Consumer and other | 22 | - | 22 | 22 |
| Total TDR loans | \$ 17,243 | \$ 12,755 | \$ 4,488 | \$ 681 |

| | December 31, 2018 | | | |
|-----------------------------|-------------------|-------------|----------|-------------------|
| | (in thousands) | | | |
| | Total | Nonaccruing | Accruing | Related Allowance |
| Commercial and industrial | \$ 2,282 | \$ 275 | \$ 2,007 | \$ 154 |
| Residential real estate: | | | | |
| Residential | 1,617 | 266 | 1,351 | 14 |
| Construction | - | - | - | - |
| Commercial real estate: | | | | |
| Commercial and multi-family | 4,164 | 3,571 | 593 | - |
| Construction | 8,753 | 8,637 | 116 | 716 |
| Home equities | 756 | 122 | 634 | - |
| Consumer and other | 23 | - | 23 | 23 |
| Total TDR loans | \$ 17,595 | \$ 12,871 | \$ 4,724 | \$ 907 |

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 March 31, 2019, 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 borrower 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.

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The following tables show the data for TDR activity by the type of concession granted to the borrower for the three month periods ended March 31, 2019 and 2018:

| Troubled Debt Restructurings by Type of Concession | Three months ended March 31, 2019 (Recorded Investment in thousands) | | | Three months ended March 31, 2018 (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 | - | \$ - | \$ - | - | \$ - | \$ - |
| Residential Real Estate & Construction | - | - | - | - | - | - |
| Commercial Real Estate & Construction: | | | | | | |
| Extension of maturity | - | - | - | 1 | 181 | 181 |
| Home Equities: | | | | | | |
| Extension of maturity and interest rate reduction | 1 | 109 | 109 | - | - | - |
| Consumer and other loans | - | - | - | - | - | - |

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 to its collateral value. A loan is considered in default when the loan is 90 days past due. Loans which were classified as TDRs during the previous 12 months which defaulted during the three month periods ended March 31, 2019 and 2018 were not material.

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 month periods ended March 31, 2019 and 2018, the Company had an average of 76,636 and 124,443 dilutive shares outstanding, respectively.

Potential common shares that would have the effect of increasing diluted earnings per share are considered to be anti-dilutive and not included in calculating diluted earnings per share. For the three month period ended March 31, 2019 and 2018, there was an average of 46,220 and 28,660 potentially anti-dilutive shares outstanding, respectively, that were not included in calculating diluted earnings per share because their effect was anti-dilutive.

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6. OTHER COMPREHENSIVE INCOME

The following tables summarize the changes in the components of accumulated other comprehensive income (loss) during the three months ended March 31, 2019 and 2018:

| | Balance at December 31, 2018 (in thousands) | Net Change | Balance at March 31, 2019 |
|--|---|---------------|---------------------------------|
| Net unrealized loss on investment securities | \$ (2,348) | \$ 1,303 | \$ (1,045) |
| Net defined benefit pension plan adjustments | (3,005) | 67 | (2,938) |
| Total | \$ (5,353) | \$ 1,370 | \$ (3,983) |

| | Balance at December 31, 2017 (in thousands) | Net Change | Balance at March 31, 2018 |
|--|---|---------------|---------------------------------|
| Net unrealized loss on investment securities | \$ (1,049) | \$ (1,360) | \$ (2,409) |
| Net defined benefit pension plan adjustments | (2,368) | 42 | (2,326) |
| Total | \$ (3,417) | \$ (1,318) | \$ (4,735) |

| | Three months ended March 31, 2019 (in thousands) | | Three months ended March 31, 2018 (in thousands) | |
|--|--|--|--|--|
| | Income Tax Before-Tax Amount | (Provision) Net-of-Tax Benefit Amount | Income Tax Before-Tax Amount | (Provision) Net-of-Tax Benefit Amount |
| Unrealized gain (loss) on investment securities: | | | | |

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| | | | | | | |
|---|----------|----------|----------|------------|--------|------------|
| Unrealized gain (loss) on investment securities | \$ 1,761 | \$ (458) | \$ 1,303 | \$ (1,838) | \$ 478 | \$ (1,360) |
| Defined benefit pension plan adjustments: | | | | | | |
| Reclassifications from accumulated other comprehensive income for gains | | | | | | |
| Amortization of prior service cost (a) | \$ 8 | \$ (2) | \$ 6 | \$ 8 | \$ (2) | \$ 6 |
| Amortization of actuarial loss (a) | 83 | (22) | 61 | 42 | (6) | 36 |
| Net change | 91 | (24) | 67 | 50 | (8) | 42 |
| Other comprehensive (loss) income | \$ 1,852 | \$ (482) | \$ 1,370 | \$ (1,788) | \$ 470 | \$ (1,318) |

(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 comprises two primary business segments, banking and insurance agency activities. The following tables set forth information regarding these segments for the three month periods ended March 31, 2019 and 2018.

| | March 31, 2019 | | |
|--|-----------------------|--------------------------------|-----------|
| | Banking Activities | Insurance Agency Activities | Total |
| | (in thousands) | | |
| Net interest income (expense) | \$ 12,541 | \$ (33) | \$ 12,508 |
| Provision for loan losses | 538 | - | 538 |
| Net interest income (expense) after provision for loan losses | 12,003 | (33) | 11,970 |
| Non-interest income | 1,753 | - | 1,753 |
| Insurance service and fees | 119 | 2,323 | 2,442 |
| Amortization expense | - | 112 | 112 |
| Non-interest expense | 9,086 | 2,026 | 11,112 |
| Income before income taxes | 4,789 | 152 | 4,941 |
| Income tax provision | 1,181 | 40 | 1,221 |
| Net income | \$ 3,608 | \$ 112 | \$ 3,720 |

| | March 31, 2018 | | |
|-------------------------------|-----------------------|--------------------------------|-----------|
| | Banking Activities | Insurance Agency Activities | Total |
| | (in thousands) | | |
| Net interest income (expense) | \$ 11,479 | \$ (27) | \$ 11,452 |

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| | | | |
|---|----------|--------|----------|
| Provision for loan losses | 767 | - | 767 |
| Net interest income (expense) after provision for loan losses | 10,712 | (27) | 10,685 |
| Non-interest income | 1,821 | - | 1,821 |
| Insurance service and fees | 137 | 1,828 | 1,965 |
| Amortization expense | - | 28 | 28 |
| Non-interest expense | 8,565 | 1,578 | 10,143 |
| Income before income taxes | 4,105 | 195 | 4,300 |
| Income tax provision | 938 | 43 | 981 |
| Net income | \$ 3,167 | \$ 152 | \$ 3,319 |

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8. CONTINGENT LIABILITIES AND COMMITMENTS

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

| | March 31, 2019 | December 31, 2018 |
|------------------------------|-------------------|-------------------------|
| | (in thousands) | |
| Commitments to extend credit | \$ 281,042 | \$ 290,785 |
| Standby letters of credit | 3,543 | 3,379 |
| Total | \$ 284,585 | \$ 294,164 |

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 three months of 2019 or during 2018.

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 following table presents the net periodic cost for the Bank's defined benefit pension plan and supplemental executive retirement plan for the three months ended March 31, 2019 and 2018:

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Three months ended March 31,
(in thousands)

| | Pension Benefits | | Supplemental Executive Retirement Plan | |
|------------------------------------|------------------|--------|--|--------|
| | 2019 | 2018 | 2019 | 2018 |
| Service cost | \$ - | \$ - | \$ 36 | \$ 47 |
| Interest cost | 55 | 51 | 50 | 34 |
| Expected return on plan assets | (69) | (78) | - | - |
| Amortization of prior service cost | - | - | 8 | 8 |
| Amortization of the net loss | 24 | 21 | 59 | 21 |
| Net periodic cost (benefit) | \$ 10 | \$ (6) | \$ 153 | \$ 110 |

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. 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 insurance 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.

- TEA also earns contingent profit sharing revenue. The insurance companies measure the loss ratio for TEA’s customers and 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 the 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.

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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 months ended March 31, 2019 and 2018 is provided in the tables below:

| | Three months ended March 31, | |
|--|------------------------------------|----------|
| | 2019 | 2018 |
| | (in thousands) | |
| Commercial property and casualty insurance commissions | \$ 842 | \$ 722 |
| Personal property and casualty insurance commissions | 750 | 597 |
| Employee benefits sales commissions | 293 | 246 |
| Profit sharing and contingent revenue | 257 | 159 |
| Wealth management and other financial services | 124 | 143 |
| Insurance claims services revenue | 146 | 73 |
| Other insurance-related revenue | 30 | 25 |
| Total insurance service and other fees | \$ 2,442 | \$ 1,965 |

11. RECENT ACCOUNTING PRONOUNCEMENTS

Note 1 contains details on the impact of accounting pronouncements adopted during the three months ended March 31, 2019. The following standards will be adopted in future periods. ASUs not listed below are not expected to have a material impact on the Company's consolidated financial position, results of operations, cash flows or disclosures.

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 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. Changes in expectations of future economic conditions will play a large role in CECL and can significantly affect the credit loss estimate. The Company is developing its approach for determining expected credit losses under the new guidance, including the licensing of new software and the development of processes to track loan performance. 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 2018-13, Disclosure Framework – Changes to the Disclosure Requirements for Fair Value Measurement – The amendments in this ASU modify the disclosure requirements on fair value measurements. The amendments on changes in unrealized gains and losses, the range and weighted average of significant unobservable inputs used to develop Level 3 fair value measurements, and the narrative description of measurement uncertainty should be applied prospectively for only the most recent interim or annual period

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presented in the initial fiscal year of adoption. All other amendments should be applied retrospectively to all periods presented upon their effective date. The amendments in this ASU are effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2019. Adoption of this ASU will impact the Company's disclosures but will not impact the Company's financial condition, results of operations or cash flows.

ASU 2018-14, Disclosure Framework – Changes to the Disclosure Requirements for Defined Benefit Plans – The amendments in this ASU remove disclosures that no longer are considered cost beneficial, clarify the specific requirements of disclosures, and add disclosure requirements identified as relevant. The amendments in this ASU are effective for fiscal years ending after December 15, 2020. Adoption of this ASU will impact the Company's disclosures but will not impact the Company's financial condition, results of operations or cash flows.

12. ACQUISITIONS

TEA purchased the business of Richardson and Stout Insurance (“R&S”) on July 1, 2018 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 cash and stock compensation expense will be accrued evenly over the three-year period from the acquisition date to the payment date. The accrual of both the cash and stock compensation is included in salaries and benefits expense in the Unaudited Consolidated Income Statement.

The purchase included \$0.3 million in tangible assets and resulted in \$2.4 million in goodwill and \$2.3 million in identifiable intangible assets. The tangible assets included accounts receivable and fixed assets. \$2.2 million of the identifiable intangible assets is related to customer relationships and will be amortized over a seven-year period and \$0.1 million is attributable to the R&S trade name and will be amortized over a five-year period. The Company recorded \$0.1 million in amortization expense related to the R&S purchase during the three months ended March 31, 2019.

R&S contributed \$0.5 million of revenue during the three months ended March 31, 2019. R&S did not have a material impact on net income for the three months ended March 31, 2019.

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, 2018. 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.

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APPLICATION OF CRITICAL ACCOUNTING ESTIMATES

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

Significant accounting policies followed by the Company are presented in Note 1 – "Organization and Summary of Significant Accounting Policies" to the Audited Consolidated Financial Statements included in Item 8 in its Annual Report on Form 10-K for the year ended December 31, 2018. 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, 2018 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 31. 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 three month period ended March 31, 2019 that resulted in an interim impairment test.

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ANALYSIS OF FINANCIAL CONDITION

Loan Activity

Total gross loans were \$1.2 billion at March 31, 2019, a \$29 million or 3% increase from December 31, 2018 and a \$75 million or 7% increase from March 31, 2018.

Loans secured by real estate were \$941 million at March 31, 2019, reflecting a \$14 million or 2% increase from \$927 million at December 31, 2018 and a \$79 million or 9% increase from \$862 million at March 31, 2018. Commercial real estate loans, including construction loans, were \$710 million at March 31, 2019, \$12 million or 2% higher than the \$698 million balance at the end of the fourth quarter of 2018 and \$58 million or 9% higher than the balance at March 31, 2018. 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 dedicated resources to commercial real estate lending, led to strong growth at an annualized rate of 7% in the first quarter of 2019.

In the first quarter of 2019, residential mortgage originations were \$7 million compared with the previous quarter's originations of \$10 million and \$12 million in the first quarter of 2018. Residential mortgages sold in the first quarter of 2019 equated to approximately 31% of the residential mortgages originated by the Company during the quarter, as compared with 37% in the fourth quarter of 2018. There were no loans sold in the first quarter of 2018. 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.

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 \$242 million at March 31, 2019, representing a \$16 million or 7% increase from \$226 million at December 31, 2018, but \$4 million or 2% lower than the \$245 million balance at March 31, 2018. The increase in C&I balances during the quarter equates to a 27% annualized growth rate. C&I lending is a critical component of the Company's strategy as C&I relationships can often include core deposits, which are especially valuable in a rising rate environment.

Credit Quality of Loan Portfolio

Total non-performing loans, defined as accruing loans greater than 90 days past due and nonaccrual loans, totaled \$20 million, or 1.69% of total loans outstanding at March 31, 2019, compared with \$19 million, or 1.64% of total loans outstanding, as of December 31, 2018 and \$15 million, or 1.33% of total loans outstanding, as of March 31, 2018. In the first quarter of 2019, the increase in non-performing loans reflected higher C&I and commercial real estate

nonaccrual loans.

Commercial credits graded as “special mention” and “substandard,” or the criticized loan portfolio, were \$48 million at March 31, 2019, a \$10 million increase from \$38 million at each respective period ending December 31, 2018 and March 31, 2018. The increase in criticized loans in the first quarter of 2019 primarily reflected \$10 million in commercial real estate loans that were downgraded to special mention status during the quarter. 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 1.28% of total loans outstanding at March 31, 2019, compared with \$14.8 million or 1.28% of total loans outstanding as of December 31, 2018 and \$14.7 million or 1.32% at March 31, 2018. The Company recorded \$0.5 million in provision for loan losses in the first quarter of 2019, compared with \$0.3 million release of allowance for loan losses during the fourth quarter of 2018 and \$0.8 million provision for loan losses in last year’s first quarter. The provision for loan losses in the first quarter of 2019 and 2018 reflects strong loan growth and an increase in criticized loans in both quarters. The \$0.3 million release of allowance for loan losses in the fourth quarter of 2018 reflected a decrease in non-performing loans and marginal loan growth in the quarter.

Investing Activities

Total investment securities were \$141 million at March 31, 2019, compared with \$134 million at December 31, 2018 and \$164 million at March 31, 2018. Interest-bearing deposits at other banks, which consist of overnight funds kept at correspondent banks and the Federal Reserve, increased to \$56 million at March 31, 2019 from \$26 million at December 31, 2018, and \$9 million at March 31, 2018. The primary objectives of the Company’s investment portfolio are to provide liquidity, provide collateral to secure municipal deposits, and maximize income while preserving safety of principal. With the yield curve continuing to flatten, there is a reduced advantage to purchasing longer-term investment securities. Average investment securities and interest-bearing cash were 14% of average interest-earning assets in the first quarter of 2019, compared with 15% in the fourth quarter of 2018 and 13% in last year’s first quarter.

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The Company's highest concentration in its securities portfolio was in available for sale U.S. government sponsored mortgage-backed securities at 56%, 57% and 53% of total investment securities at March 31, 2019, December 31, 2018 and March 31, 2018, respectively. The concentration in tax-advantaged debt securities issued by state and political subdivisions and U.S. government-sponsored agency bonds was 16% and 28%, respectively, of the total securities portfolio at March 31, 2019, compared with 17% and 25% at December 31, 2018 and 19% and 22% at March 31, 2018.

The total net unrealized loss position of the available-for-sale investment portfolio was \$1.4 million at March 31, 2019, compared with \$3.2 million at December 31, 2018 and \$3.3 million at March 31, 2018. The securities in an unrealized loss position at the end of the first quarter of 2019 reflect an increase in market interest rates rather than a reduction in 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 direct exposure to subprime mortgages, nor does the Company hold private mortgage-backed securities, credit default swaps, or FNMA or FHLMC preferred stock investments in its investment portfolio.

Funding Activities

Total deposits at March 31, 2019 were \$1.28 billion, a \$61 million or 5% increase from \$1.22 billion at December 31, 2018 and a \$141 million or 12% increase from \$1.13 billion at March 31, 2018. The growth in the first three months of 2019 reflects growth in municipal savings and commercial savings deposits of \$28 million and \$26 million, respectively. Year-over-year, time deposits increased \$89 million, of which \$41 million were brokered. Savings deposits were \$618 million at March 31, 2019 an increase of \$52 million from prior year period. The increase in savings deposits from prior year includes \$50 million in commercial deposits, and \$42 million in municipal deposits partially offset by a decrease in consumer deposits. Further discussion of deposit growth and changes in deposit mix are in the "Analysis of Results of Operations." Due to the transactional nature of demand deposits, average balances are a useful metric to meaningfully measure sustained growth rates. Average demand deposits were \$242 million in the first quarter of 2019, a 2% decrease from \$248 million in the fourth quarter of 2018, but 8% higher than the \$223 million average balance in the first quarter of 2018. Of the Company's \$19 million in average demand deposit growth over the prior year's first quarter, \$18 million was in commercial accounts.

The Company had \$10 million in other borrowings at March 31, 2019 and December 31, 2018. This represents a single \$10 million long-term advance with the FHLB NY scheduled to mature in 2020. Other borrowings were \$62 million at March 31, 2018, including \$52 million in overnight borrowings with the FHLB NY. The Company's use of its overnight line of credit with FHLB NY varies depending on its ability to fund investment and loan growth with deposits along with the line usage's impact on interest rate risk.

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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 March 31, 2019 | | | Three months ended March 31, 2018 | | |
|---|---|-----------------------------|----------------|---|-----------------------------|----------------|
| | 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 | \$ 1,153,067 | \$ 14,362 | 5.05 % | \$ 1,067,282 | \$ 12,363 | 4.70 % |
| Taxable securities | 120,099 | 801 | 2.70 % | 128,603 | 797 | 2.51 % |
| Tax-exempt securities | 21,150 | 130 | 2.49 % | 32,136 | 196 | 2.47 % |
| Interest bearing deposits at banks | 44,024 | 249 | 2.29 % | 2,712 | 10 | 1.50 % |
| Total interest-earning assets | 1,338,340 | \$ 15,542 | 4.71 % | 1,230,733 | \$ 13,366 | 4.40 % |
| Non interest-earning assets: | | | | | | |
| Cash and due from banks | 13,515 | | | 14,169 | | |
| Premises and equipment, net | 10,501 | | | 10,560 | | |
| Other assets | 62,370 | | | 55,915 | | |
| Total Assets | \$ 1,424,726 | | | \$ 1,311,377 | | |
| LIABILITIES & STOCKHOLDERS' EQUITY | | | | | | |
| Interest-bearing liabilities: | | | | | | |
| NOW | \$ 112,571 | \$ 82 | 0.30 % | \$ 114,268 | \$ 75 | 0.27 % |
| Savings | 591,641 | 1,174 | 0.80 % | 552,546 | 744 | 0.55 % |
| Time deposits | 298,586 | 1,587 | 2.16 % | 194,223 | 679 | 1.42 % |
| Other borrowed funds | 10,000 | 43 | 1.74 % | 71,237 | 293 | 1.67 % |

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| | | | | | | |
|------------------------------------|--------------|-----------|--------|--------------|-----------|--------|
| Junior subordinated debentures | 11,330 | 146 | 5.23 % | 11,330 | 118 | 4.22 % |
| Securities sold U/A to repurchase | 4,416 | 2 | 0.18 % | 10,326 | 5 | 0.20 % |
| Total interest-bearing liabilities | 1,028,544 | \$ 3,034 | 1.20 % | 953,930 | \$ 1,914 | 0.81 % |
| Noninterest-bearing liabilities: | | | | | | |
| Demand deposits | 242,030 | | | 223,176 | | |
| Other | 21,219 | | | 15,161 | | |
| Total liabilities | \$ 1,291,793 | | | \$ 1,192,267 | | |
| Stockholders' equity | 132,933 | | | 119,110 | | |
| Total Liabilities and Equity | \$ 1,424,726 | | | \$ 1,311,377 | | |
| Net interest income | | \$ 12,508 | | | \$ 11,452 | |
| Net interest margin | | | 3.79 % | | | 3.77 % |
| Interest rate spread | | | 3.51 % | | | 3.59 % |

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Net Income

Net income was \$3.7 million, or \$0.75 per diluted share, in the first quarter of 2019, compared with \$4.5 million, or \$0.90 per diluted share, in the fourth quarter of 2018 and \$3.3 million, or \$0.68 per diluted share, in last year's first quarter. The decrease from the linked quarter reflects higher loan loss provision and income tax provision, partially offset by higher non-interest income. The fourth quarter of 2018 included a historic rehabilitation tax credit transaction that reduced non interest income by \$0.9 million and reduced income tax expense by \$1.4 million. The increase over prior-year period reflects higher net interest income due to loan growth and higher insurance service and fee revenue primarily resulting from the acquisition of R&S, partially offset by an increase in non-interest expense. Return on average equity was 11.19% for the first quarter of 2019 compared with 13.86% in the fourth quarter of 2018 and 11.15% in the first quarter of 2018.

Other Results of Operations – Quarterly Comparison

Net interest income increased \$0.1 million, or 1%, from the fourth quarter of 2018, and \$1.1 million, or 9%, from the prior-year first quarter to \$12.5 million in the first quarter of 2019. The increase from the prior periods was driven by average interest-earning asset growth, particularly loans, partially offset by an increase in interest expense. The increase in interest income reflects growth in the commercial loan portfolio as well as the benefit from the re-pricing of variable rate loans tied to the Company's prime rate. Average commercial loans, including commercial real estate and commercial and industrial loans, were \$935 million in the first quarter of 2019, \$22 million higher than \$913 million in the fourth quarter of 2018 and \$63 million higher than \$872 million in the first quarter of 2018.

First quarter net interest margin of 3.79% improved 9 basis points from the 2018 fourth quarter and 2 basis points from the first quarter of 2018. The margin improvement stems from increased yields on loans, partially offset by higher funding costs. The higher yield on loans when compared with the fourth quarter of 2018 and the first quarter of 2018 reflects an increase of 11 and 35 basis points, respectively. The margin has been impacted by rising funding costs due to increases in short-term interest rates, along with competitive deposit market pricing. The cost of interest-bearing liabilities was 1.20% in the first quarter of 2019, compared with 1.14% in the fourth quarter of 2018 and 0.81% in the first quarter of 2018. The Company has experienced a shift in deposit mix as consumers in low-cost legacy savings deposit products have migrated to higher-rate time deposits. The average cost of time deposits was 2.16% in the first quarter of 2019, compared with 2.07% in the fourth quarter of 2018 and 1.42% in the first quarter of 2018. Average time deposits comprised 24% of average total deposits during the first quarter of 2019 and the fourth quarter of 2018, compared with 18% in and the first quarter of 2018. The Company has also increased its brokered time deposit activity as part of its funding strategy. Average brokered time deposits were \$41 million during the first quarter of 2019 and \$40 million in the fourth quarter of 2018. The Company did not have brokered time deposits during the first quarter of 2018.

The \$0.5 million and \$0.8 million provision for loan losses for the first quarter of 2019 and 2018, respectively, reflects strong loan growth and an increase in criticized loans in both of the quarters. The \$0.3 million release of allowance for loan losses for the fourth quarter of 2018 reflected a decrease in non-performing loans and marginal loan growth in the quarter.

Non-interest income was \$4.2 million in the first quarter of 2019, compared with \$3.0 million in the fourth quarter of 2018 and \$3.8 million in the prior year first quarter. The fourth quarter of 2018 included a \$0.9 million net reduction of non-interest income related to an investment in an historic rehabilitation tax credit. There were no significant historic tax credit transactions in the first quarter of 2019 and 2018.

The Company is actively engaged in the community by financing historic rehabilitation projects in the City of Buffalo and enhances its yield by investing in the related tax credits. When a project is completed, the Company begins to recognize tax benefits with an associated reduction in the investment. In the fourth quarter of 2018, the positive net impact to net income was \$0.5 million as a \$1.8 million refundable New York State tax credit was recorded in non-interest income and a corresponding \$1.4 million tax benefit was realized in income tax expense, offset by a \$2.7 million write-off on the investment. The write-off was contemplated when management priced the initial investment in the tax credit project.

Insurance revenue increased \$0.2 million from the fourth quarter of 2018 and \$0.5 million from last year's first quarter to \$2.4 million in the first quarter of 2019. The increase in insurance revenue from the fourth quarter of 2018 was due to seasonally lower policy renewals for institutional clients, including businesses and municipalities, during the fourth quarter. The R&S acquisition, which was effective July 1, 2018, contributed to the increase in revenue when compared to prior year's first quarter.

Non-interest expenses of \$11.2 million in the first quarter of 2019 increased 10% from the prior-year period but decreased 2% from the fourth quarter of 2018. Salaries and benefits costs were \$7.2 million in the first quarter of 2019, an increase of 8% from last year's first quarter, and relatively flat from the fourth quarter of 2018. Salaries and benefits expense in the first quarter of 2018 included approximately \$0.3 million of costs related to one-time bonuses paid to non-senior associates. Excluding the impact of these bonuses, first quarter salaries and benefits costs increased 12% from the prior-year period, reflecting the R&S acquisition and the addition of strategic personnel hires to support the Company's continued growth.

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Technology and communications expenses were \$0.9 million in the first quarter of 2019 and the fourth quarter of 2018, an increase of \$0.1 million from last year's first quarter, Technology expenses increased from the prior year period due to higher ATM card fees, online banking activity and software costs.

The Company's efficiency ratio in the first quarter of 2019 was 66.5%, a decrease from 69.5% in the fourth quarter of 2018 and 66.6% in last year's first quarter. The decrease in the efficiency ratio compared with the fourth quarter of 2018 reflects higher seasonal insurance agency revenue.

Income tax expense was \$1.2 million, or an effective tax rate of 24.7%, for the first quarter of 2019 compared with an income tax benefit of \$0.2 million in the fourth quarter of 2018 and income tax expense of \$1.0 million, or an effective tax rate of 22.8%, in last year's first quarter. Excluding the impact of historic tax credit transactions, the fourth quarter of 2018 effective tax rate was 23.1%.

CAPITAL

The Company consistently maintains regulatory capital ratios significantly above the federal "well capitalized" standard, including a Tier 1 leverage ratio of 9.74% at March 31, 2019, compared with 9.73% at December 31, 2018 and 9.81% at March 31, 2018. Book value per share increased to \$27.66 at March 31, 2019, compared with \$27.13 at December 31, 2018, and \$24.96 at March 31, 2018.

On February 19, 2019, the Company declared a semi-annual cash dividend of \$0.52 per share on the Company's outstanding common stock. The dividend was paid on April 3, 2019 to shareholders of record as of March 13, 2019. This semi-annual dividend represents a \$0.06, or 13% increase from its previous semi-annual dividend paid in October 2018.

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 March 31, 2019 and December 31, 2018. The Company's use of its overnight line of credit with FHLB NY 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. The Company's funding strategy has resulted in significant time deposit growth, resulting in less usage of the FHLB NY overnight line of credit. 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 \$301 million can be drawn on the FHLB via an

Overnight Line of Credit Agreement between the Bank and the FHLB. 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 March 31, 2019, approximately 3% of the Bank's securities had contractual maturity dates of one year or less and approximately 19% had maturity dates of five years or less. Additionally, mortgage-backed securities, which comprise 56% of the investment portfolio at March 31, 2019, 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 March 31, 2019, the Company had net short-term liquidity of \$295 million as compared with \$249 million at December 31, 2018. Available assets of \$200 million, divided by public and purchased funds of \$303 million, resulted in a long-term liquidity ratio of 66% at March 31, 2019, compared with 63% at December 31, 2018.

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.

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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.

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.

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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

| Changes in interest rates | Calculated increase in projected annual net interest income (in thousands) | |
|---------------------------|--|-------------------|
| | March 31, 2019 | December 31, 2018 |
| +200 basis points | \$ 754 | \$ 1,598 |
| +100 basis points | 2,471 | 2,825 |
| -100 basis points | (2,645) | (3,026) |
| -200 basis points | NM | NM |

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

ITEM 4 - CONTROLS AND PROCEDURES

DISCLOSURE CONTROLS AND PROCEDURES

The Company's management, with the participation of the Company's principal executive officer and principal financial officer, evaluated the effectiveness of the design and operation of the Company's disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act) as of March 31, 2019 (the end of the period covered by this Report). Based on that evaluation, the Company's principal executive and principal financial officers concluded that as of March 31, 2019 the Company's disclosure controls and procedures were effective.

CHANGES IN INTERNAL CONTROL OVER FINANCIAL REPORTING

No changes in the Company's internal control over financial reporting were identified in connection with the evaluation required by paragraph (d) of Rule 13a-15 or Rule 15d-15 under the Exchange Act that occurred during the fiscal quarter ended March 31, 2019 that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

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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 1A – RISK FACTORS

There have been no material changes in risk factors relating to the Company to those disclosed in response to Item 1A. Part I of Form 10-K for the year ended December 31, 2018.

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

In the first quarter of 2019, 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) |
|--------|--------------------------------------|------------------------------|--|--|
| | | | | |

| | | | |
|--------------------|-------|----------|---------|
| January 2019: | | | |
| January 1, 2019 - | | \$ | |
| January 31, 2019 | - | - | - |
| | | | 100,000 |
| February 2019: | | | |
| February 1, 2019 - | | \$ | |
| February 28, 2019 | 1,468 | 35.50 | - |
| | | | 100,000 |
| March 2019: | | | |
| March 1, 2019 - | | \$ | |
| March 31, 2019 | - | - | - |
| | | | 100,000 |
| Total: | 1,468 | \$ 35.50 | - |
| | | | 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 Repurchase 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 March 31, 2019 was 100,000.

ITEM 3 – DEFAULTS UPON SENIOR SECURITIES

(Not Applicable.)

ITEM 4 – MINE SAFETY DISCLOSURE

(Not Applicable.)

ITEM 5 – OTHER INFORMATION

(Not Applicable.)

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ITEM 6 – EXHIBITS

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

EXHIBIT INDEX

Exhibit

| Exhibit No. | Name |
|-------------|--|
| 10.1 | <u>Evans Bancorp, Inc. Amended and Restated 2019 Long Term Equity Incentive Plan (incorporated by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K, filed on April 26, 2019).</u> |
| 31.1 | <u>Certification of Principal Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.</u> |
| 31.2 | <u>Certification of the Principal Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.</u> |
| 32.1 | <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> |
| 32.2 | <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 March 31, 2019, formatted in XBRL (eXtensible Business Reporting Language): (i) Unaudited Consolidated Balance Sheets – March 31, 2019 and December 31, 2018; (ii) Unaudited Consolidated Statements of Income – Three months ended March 31, 2019 and 2018; (iii) Unaudited Statements of Consolidated Comprehensive Income – Three months ended March 31, 2019 and 2018; (iv) Unaudited |

Consolidated Statements of Stockholders' Equity – Three months ended March 31, 2019 and 2018; (v)
Unaudited Consolidated Statements of Cash Flows – Three months ended March 31, 2019 and 2018; and
(vi) Notes to Unaudited Consolidated Financial Statements.

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SIGNATURES

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

Evans Bancorp, Inc.

DATE

May 2, 2019

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

DATE

May 2, 2019

/s/ John B. Connerton
John B. Connerton
Treasurer
(Principal Financial Officer and Principal Accounting Officer)

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