EVANS BANCORP INC
Form 10-Q
August 02, 2013

United States

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

For quarterly period ended June 30, 2013

¨ 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)

.

(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 x No ¨

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

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

Large accelerated filer ¨ Accelerated filer ¨

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

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes ¨ No x

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: 4,198,596 shares as of July 31, 2013

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UNAUDITED CONSOLIDATED BALANCE SHEETS
JUNE 30, 2013 AND DECEMBER 31, 2012
(in thousands, except share and per share amounts)

	June 30, 2013	December 31, 2012
ASSETS		
Cash and due from banks	$ 12,757	$ 12,409
Interest-bearing deposits at banks	59,820	78,068
Securities:		
Available for sale, at fair value (amortized cost: $91,510 at June 30, 2013; $88,054 at December 31, 2012)	92,800	92,063
Held to maturity, at amortized cost (fair value: $3,639 at June 30, 2013; $3,721 at December 31, 2012)	3,706	3,744
Federal Home Loan Bank common stock, at amortized cost	1,364	1,804
Federal Reserve Bank common stock, at amortized cost	1,458	1,445
Loans and leases, net of allowance for loan and lease losses of $10,259 at June 30, 2013 and $9,732 at December 31, 2012	597,520	573,163
Properties and equipment, net of depreciation of $14,831 at June 30, 2013 and $14,256 at December 31, 2012	11,379	11,368
Goodwill	8,101	8,101
Intangible assets	204	329
Bank-owned life insurance	15,575	15,333
Other assets	11,590	11,849
TOTAL ASSETS	$ 816,274	$ 809,676
LIABILITIES AND STOCKHOLDERS' EQUITY		
LIABILITIES		
Deposits:		
Demand	$ 132,820	$ 123,405
NOW	67,736	65,753
Regular savings	379,782	380,924
Time	112,076	108,910
Total deposits	692,414	678,992
Securities sold under agreement to repurchase	14,542	12,111
Other short term borrowings	3,000	10,000
Other liabilities	11,703	13,415

Junior subordinated debentures	11,330	11,330
Long term borrowings	6,000	9,000
Total liabilities	738,989	734,848
CONTINGENT LIABILITIES AND COMMITMENTS		
STOCKHOLDERS' EQUITY:		
Common stock, $.50 par value, 10,000,000 shares authorized; 4,199,724 and 4,171,473 shares issued at June 30, 2013 and December 31, 2012, respectively, and 4,198,596 and 4,171,473 outstanding at June 30, 2013 and December 31, 2012, respectively	2,101	2,087
Capital surplus	42,324	42,029
Retained earnings	34,350	30,611
Accumulated other comprehensive (loss) gain, net of tax	(1,490)	101
Total stockholders' equity	77,285	74,828
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	$ 816,274	$ 809,676

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UNAUDITED CONSOLIDATED STATEMENTS OF INCOME
THREE MONTHS ENDED JUNE 30, 2013 AND 2012
(in thousands, except share and per share amounts)

	Three Months Ended June 30,	
	2013	2012
INTEREST INCOME		
Loans and leases	$ 7,277	$ 7,521
Interest bearing deposits at banks	45	15
Securities:		
Taxable	404	457
Non-taxable	267	296
Total interest income	7,993	8,289
INTEREST EXPENSE		
Deposits	810	1,146
Other borrowings	100	177
Junior subordinated debentures	81	85
Total interest expense	991	1,408
NET INTEREST INCOME	7,002	6,881
PROVISION FOR LOAN AND LEASE LOSSES	80	301
NET INTEREST INCOME AFTER PROVISION FOR LOAN AND LEASE LOSSES	6,922	6,580
NON-INTEREST INCOME		
Bank charges	506	437
Insurance service and fees	1,726	1,643
Data center income	110	119
Gain on loans sold	-	75
Bank-owned life insurance	129	134
Other	743	630
Total non-interest income	3,214	3,038
NON-INTEREST EXPENSE		
Salaries and employee benefits	4,225	4,229
Occupancy	738	645
Repairs and maintenance	187	177
Advertising and public relations	236	336
Professional services	480	567
Technology and communications	340	269
Amortization of intangibles	62	106

FDIC insurance	165	139
Other	824	855
Total non-interest expense	7,257	7,323
INCOME BEFORE INCOME TAXES	2,879	2,295
INCOME TAX PROVISION	956	800
NET INCOME	$ 1,923	$ 1,495
Net income per common share-basic	$ 0.46	$ 0.36
Net income per common share-diluted	$ 0.46	$ 0.36
Cash dividends per common share	$ -	$ -
Weighted average number of common shares outstanding	4,179,419	4,139,805
Weighted average number of diluted shares outstanding	4,219,428	4,156,868

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(in thousands, except share and per share amounts)

	Six Months Ended June 30,	
	2013	2012
INTEREST INCOME		
Loans and leases	$ 14,529	$ 15,029
Interest bearing deposits at banks	64	24
Securities:		
Taxable	821	1,002
Non-taxable	536	603
Total interest income	15,950	16,658
INTEREST EXPENSE		
Deposits	1,700	2,388
Other borrowings	260	364
Junior subordinated debentures	161	173
Total interest expense	2,121	2,925
NET INTEREST INCOME	13,829	13,733
PROVISION FOR LOAN AND LEASE LOSSES	530	52
NET INTEREST INCOME AFTER		
PROVISION FOR LOAN AND LEASE LOSSES	13,299	13,681
NON-INTEREST INCOME		
Bank charges	988	873
Insurance service and fees	3,726	3,589
Data center income	224	244
Gain on loans sold	25	128
Bank-owned life insurance	242	252
Other	1,320	1,241
Total non-interest income	6,525	6,327
NON-INTEREST EXPENSE		
Salaries and employee benefits	8,514	8,443
Occupancy	1,554	1,330
Repairs and maintenance	365	346
Advertising and public relations	360	481
Professional services	934	1,106
Technology and communications	631	517
Amortization of intangibles	125	210
FDIC insurance	303	274
Other	1,548	1,525
Total non-interest expense	14,334	14,232
INCOME BEFORE INCOME TAXES	5,490	5,776
INCOME TAX PROVISION	1,751	1,902

NET INCOME	$ 3,739	$ 3,874
Net income per common share-basic	$ 0.90	$ 0.94
Net income per common share-diluted	$ 0.89	$ 0.94
Cash dividends per common share	$ -	$ 0.22
Weighted average number of common shares outstanding	4,176,817	4,133,230
Weighted average number of diluted shares outstanding	4,214,513	4,142,209

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UNAUDITED STATEMENTS OF CONSOLIDATED COMPREHENSIVE INCOME
THREE MONTHS ENDED JUNE 30, 2013 AND 2012
(in thousands, except share and per share amounts)

	Three Months Ended June 30,	
	2013	2012
NET INCOME	$ 1,923	$ 1,495
OTHER COMPREHENSIVE INCOME (LOSS), NET OF TAX:		
Unrealized loss on available-for-sale securities:		
Unrealized loss on available-for-sale securities	(1,405)	14
Reclassification of gain on sale of securities	-	-
	(1,405)	14
Defined benefit pension plans:		
Amortization of prior service cost	11	13
Amortization of actuarial loss	27	26
Total	38	39
OTHER COMPREHENSIVE LOSS, NET OF TAX	(1,367)	53
COMPREHENSIVE INCOME	$ 556	$ 1,548

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SIX MONTHS ENDED JUNE 30, 2013 AND 2012
(in thousands, except share and per share amounts)

	Six Months Ended June 30,	
	2013	2012
NET INCOME	$ 3,739	$ 3,874
OTHER COMPREHENSIVE INCOME (LOSS), NET OF TAX:		
Unrealized loss on available-for-sale securities:		
Unrealized loss on available-for-sale securities	(1,666)	(101)
Reclassification of gain on sale of securities	-	-
	(1,666)	(101)
Defined benefit pension plans:		
Amortization of prior service cost	21	27
Amortization of actuarial loss	54	52
Total	75	79
OTHER COMPREHENSIVE LOSS, NET OF TAX	(1,591)	(22)
COMPREHENSIVE INCOME	$ 2,148	$ 3,852

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UNAUDITED CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY
SIX MONTHS ENDED JUNE 30, 2013 AND 2012
(in thousands, except share and per share amounts)

	Common Stock	Capital Surplus	Retained Earnings	Accumulated Other Comprehensive (Loss) Income	Total
Balance, December 31, 2011	$ 2,063	$ 41,275	$ 25,304	$ 346	$ 68,988
Net Income			3,874		3,874
Other comprehensive loss				(22)	(22)
Cash dividends ($0.22 per common share)			(909)		(909)
Stock options and restricted stock expense		151			151
Issued 6,680 shares under dividend reinvestment plan	3	92			95
Issued 11,493 restricted shares	6	(6)			-
Issued 10,267 shares under Employee Stock Purchase Plan	5	99			104
Balance, June 30, 2012	$ 2,077	$ 41,611	$ 28,269	$ 324	$ 72,281
Balance, December 31, 2012	$ 2,087	$ 42,029	$ 30,611	$ 101	$ 74,828
Net Income			3,739		3,739
Other comprehensive loss				(1,591)	(1,591)
Stock options and restricted stock expense		176			176
Issued 18,784 restricted shares	9	(9)			-

Issued 2,400 shares though stock option exercise	1	37			38
Issued 7,067 shares in ESPP	4	91			95
Balance, June 30, 2013	$ 2,101	$ 42,324	$ 34,350	$ (1,490)	$ 77,285

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UNAUDITED CONSOLIDATED STATEMENTS OF CASH FLOWS
SIX MONTHS ENDED JUNE 30, 2013 AND 2012
(in thousands)

	Six Months Ended June 30, 2013	2012
OPERATING ACTIVITIES:		
Interest received	$ 15,992	$ 16,526
Fees received	6,595	5,802
Interest paid	(2,132)	(2,968)
Cash paid to employees and vendors	(12,666)	(13,137)
Cash contributed to pension plan	(140)	(310)
Income taxes paid	(2,315)	(2,274)
Proceeds from sale of loans held for resale	776	11,268
Originations of loans held for resale	(229)	(8,575)
Net cash provided by operating activities	5,881	6,332
INVESTING ACTIVITIES:		
Available for sales securities:		
Purchases	(10,926)	(23,936)
Proceeds from maturities, calls, and payments	7,674	30,741
Held to maturity securities:		
Purchases	(220)	(638)
Proceeds from maturities, calls, and payments	258	732
Additions to properties and equipment	(699)	(563)
Net (increase) decrease in loans	(25,854)	(18,214)
Net cash used in investing activities	(29,767)	(11,878)
FINANCING ACTIVITIES:		
Repayments of borrowings	(7,569)	(2,155)
Net increase in deposits	13,422	37,718
Dividends paid	-	(909)
Issuance of common stock	133	199
Net cash provided by financing activities	5,986	34,853

Net increase (decrease) in cash and equivalents	(17,900)	29,307
CASH AND CASH EQUIVALENTS:		
Beginning of period	90,477	14,678
End of period	$ 72,577	$ 43,985

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EVANS BANCORP, INC. AND SUBSIDIARIES
UNAUDITED CONSOLIDATED STATEMENTS OF CASH FLOWS
SIX MONTHS ENDED JUNE 30, 2013 AND 2012
(in thousands)

	Six Months Ended June 30, 2013	2012
RECONCILIATION OF NET INCOME TO NET CASH PROVIDED BY OPERATING ACTIVITIES:		
Net income	$ 3,739	$ 3,874
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	1,016	1,024
Deferred tax expense	116	398
Provision for loan and lease losses	530	52
Premium on loans sold	(25)	(128)
Stock options and restricted stock expense	176	151
Proceeds from sale of loans held for resale	776	11,268
Originations of loans held for resale	(229)	(8,575)
Cash contributed to pension plan	(140)	(310)
Changes in assets and liabilities affecting cash flow:		
Other assets	885	(175)
Other liabilities	(963)	(1,247)
NET CASH PROVIDED BY OPERATING ACTIVITIES	$ 5,881	$ 6,332

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PART 1 – FINANCIAL INFORMATION

ITEM 1 – FINANCIAL STATEMENTS

EVANS BANCORP, INC. AND SUBSIDIARIES

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

THREE AND SIX MONTHS ENDED JUNE 30, 2013 AND 2012

1. ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

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

The accompanying consolidated financial statements are unaudited. In the opinion of management, all adjustments necessary for a fair presentation of the Company’s financial position and results of operations for the interim periods have been made. Certain reclassifications have been made to the 2012 unaudited consolidated financial statements to conform to the presentation used in 2013. During the six-month period ended June 30, 2013, the Company revised the Consolidated Statement of Cash Flows for the six month period ended June 30, 2012 to correct a $388 thousand error within “Depreciation and Amortization” and “Changes in Other Assets Affecting Cash Flow.” The Company has assessed the materiality of this correction and concluded, based on qualitative and quantitative considerations, that the adjustments are not material to the Consolidated Statements of Cash Flows as a whole.

The results of operations for the three and six month periods ended June 30, 2013 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, 2012. The Company has evaluated subsequent events for potential recognition and/or disclosure through the date of filing. Refer to Note 10 – “Subsequent Events” herein the Company’s Notes to Unaudited Consolidated Financial Statements for the three and six month periods ended June 30, 2013.

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2. SECURITIES

The amortized cost of securities and their approximate fair value at June 30, 2013 and December 31, 2012 were as follows:

	June 30, 2013 (in thousands)			
	Amortized Cost	Unrealized Gains	Losses	Fair Value
Available for Sale:				
Debt securities:				
U.S. government agencies	$ 29,193	$ 608	$ (429)	$ 29,372
States and political subdivisions	31,783	922	(198)	32,507
Total debt securities	$ 60,976	$ 1,530	$ (627)	$ 61,879
Mortgage-backed securities:				
FNMA	$ 12,422	$ 433	$ (9)	$ 12,846
FHLMC	5,192	109	(50)	5,251
GNMA	6,529	106	(55)	6,580
CMO	6,391	20	(167)	6,244
Total mortgage-backed securities	$ 30,534	$ 668	$ (281)	$ 30,921
Total securities designated as available for sale	$ 91,510	$ 2,198	$ (908)	$ 92,800
Held to Maturity:				
Debt securities				
States and political subdivisions	3,706	10	(77)	3,639
Total securities designated as held to maturity	$ 3,706	$ 10	$ (77)	$ 3,639
Total securities	$ 95,216	$ 2,208	$ (985)	$ 96,439

December 31, 2012
(in thousands)

	Amortized Cost	Unrealized Gains	Losses	Fair Value
Available for Sale:				
Debt securities:				
U.S. government agencies	$ 27,227	$ 1,137	$ (32)	$ 28,332
States and political subdivisions	29,912	1,567	(10)	31,469
Total debt securities	$ 57,139	$ 2,704	$ (42)	$ 59,801
Mortgage-backed securities:				
FNMA	$ 15,210	$ 867	$ -	$ 16,077
FHLMC	6,292	189	-	6,481
GNMA	7,750	263	-	8,013
CMO	1,663	28	-	1,691
Total mortgage-backed securities	$ 30,915	$ 1,347	$ -	$ 32,262
Total securities designated as available for sale	$ 88,054	$ 4,051	$ (42)	$ 92,063
Held to Maturity:				
Debt securities				
States and political subdivisions	3,744	23	(46)	3,721
Total securities designated as held to maturity	$ 3,744	$ 23	$ (46)	$ 3,721
Total securities	$ 91,798	$ 4,074	$ (88)	$ 95,784

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Available for sale securities with a total fair value of $77.0 million and $68.0 million at June 30, 2013 and December 31, 2012, respectively, were pledged as collateral to secure public deposits and for other purposes required or permitted by law.

The Company uses the Federal Home Loan Bank of New York ("FHLBNY") as its primary source of overnight funds and also has several long-term advances with FHLBNY. The Company had a total of $9.0 million and $19.0 million in borrowed funds with FHLBNY at June 30, 2013 and December 31, 2012, respectively. The Company has placed sufficient collateral in the form of residential and commercial real estate loans at FHLBNY that meet FHLB collateral requirements. As a member of the Federal Home Loan Bank ("FHLB") System, the Bank is required to hold stock in FHLBNY. The Bank held $1.4 million in FHLBNY stock as of June 30, 2013 and $1.8 million as of December 31, 2012 at amortized cost. The Company regularly evaluates investments in FHLBNY for impairment, considering liquidity, operating performance, capital position, stock repurchase and dividend history. At this time, the Company does not believe any impairment in FHLBNY stock is warranted.

The scheduled maturities of debt and mortgage-backed securities at June 30, 2013 and December 31, 2012 are summarized below. All maturity amounts are contractual maturities. Actual maturities may differ from contractual maturities because certain issuers have the right to call or prepay obligations with or without call premiums.

	June 30, 2013		December 31, 2012	
	Amortized cost	Estimated fair value	Amortized cost	Estimated fair value
	(in thousands)		(in thousands)	
Debt securities available for sale:				
Due in one year or less	$ 1,321	$ 1,331	$ 2,766	$ 2,797
Due after one year through five years	20,602	21,190	16,797	17,561
Due after five years through ten years	31,141	31,117	29,280	30,344
Due after ten years	7,912	8,241	8,296	9,099
	60,976	61,879	57,139	59,801
Mortgage-backed securities available for sale	30,534	30,921	30,915	32,262

Total available for sale securities	$ 91,510	$ 92,800	$ 88,054	$ 92,063
Debt securities held to maturity:				
Due in one year or less	$ 2,244	$ 2,235	$ 2,241	$ 2,228
Due after one year through five years	312	315	317	322
Due after five years through ten years	886	832	516	490
Due after ten years	264	257	670	681
	3,706	3,639	3,744	3,721
Total held to maturity securities	$ 3,706	$ 3,639	$ 3,744	$ 3,721

Information regarding unrealized losses within the Company's available for sale securities at June 30, 2013 and December 31, 2012, is summarized below. The securities are primarily U.S. government-guaranteed agency securities or municipal securities. All unrealized losses are considered temporary and related to market interest rate fluctuations.

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June 30, 2013

	Less than 12 months		12 months or longer		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
	(in thousands)					
Available for Sale:						
Debt securities:						
U.S. government agencies	$ 8,572	$ (429)	$ -	$ -	$ 8,572	$ (429)
States and political subdivisions	8,473	(193)	102	(5)	8,575	(198)
Total debt securities	$ 17,045	$ (622)	$ 102	$ (5)	$ 17,147	$ (627)
Mortgage-backed securities:						
FNMA	$ 4,604	$ (9)	$ -	$ -	$ 4,604	$ (9)
FHLMC	1,892	(50)	-	-	1,892	(50)
GNMA	1,541	(55)	-	-	1,541	(55)
CMO'S	4,824	(167)	-	-	4,824	(167)
Total mortgage-backed securities	$ 12,861	$ (281)	$ -	$ -	$ 12,861	$ (281)
Held To Maturity:						
Debt securities:						
States and political subdivisions	$ 2,928	$ (77)	$ -	$ -	$ 2,928	$ (77)
Total temporarily impaired securities	$ 32,834	$ (980)	$ 102	$ (5)	$ 32,936	$ (985)

December 31, 2012

	Less than 12 months		12 months or longer		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
	(in thousands)					
Available for Sale:						
Debt securities:						
U.S. government agencies	$ 3,968	$ (32)	$ -	$ -	$ 3,968	$ (32)
States and political subdivisions	1,192	(10)	-	-	1,192	(10)
Total debt securities	$ 5,160	$ (42)	$ -	$ -	$ 5,160	$ (42)
Mortgage-backed securities:						
FNMA	$ 34	$ -	$ -	$ -	$ 34	$ -
FHLMC	-	-	-	-	-	-
GNMA	-	-	-	-	-	-
CMO'S	-	-	-	-	-	-
Total mortgage-backed securities	$ 34	$ -	$ -	$ -	$ 34	$ -
Held To Maturity:						
Debt securities:						
States and political subdivisions	$ 2,660	$ (46)	$ -	$ -	$ 2,660	$ (46)
Total temporarily impaired securities	$ 7,854	$ (88)	$ -	$ -	$ 7,854	$ (88)

In regard to municipal securities, the Company's general investment policy is that in-state securities must be rated at least Moody's Baa (or equivalent) at the time of purchase. The Company reviews the ratings report and municipality financial statements

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and prepares a pre-purchase analysis report before the purchase of any municipal securities. Out-of-state issues must be rated by Moody's at least Aa (or equivalent) at the time of purchase. The Company did not own any out-of-state municipal bonds at June 30, 2013 or December 31, 2012. Bonds rated below A are reviewed periodically to ensure their continued credit worthiness. While purchase of non-rated municipal securities is permitted under the Company's investment policy, such purchases are limited to bonds issued by municipalities in the Company's general market area. Those municipalities are typically customers of the Bank whose financial situation is familiar to management. The financial statements of the issuers of non-rated securities are reviewed by the Bank and a credit file of the issuers is kept on each non-rated municipal security with relevant financial information.

Although concerns have been raised in the marketplace recently about the health of municipal bonds, the Company has not experienced any significant credit troubles in this portfolio and does not believe any credit troubles are imminent with respect to its portfolio. Aside from the non-rated municipal securities to local municipalities discussed above that are considered held-to-maturity, all of the Company's available-for-sale municipal bonds are investment-grade government obligation ("G.O.") bonds. G.O. bonds are generally considered safer than revenue bonds because they are backed by the full faith and credit of the government while revenue bonds rely on the revenue produced by a particular project. All of the Company's municipal bonds are issued by municipalities in New York State. To the Company's knowledge, there has never been a default of a NY G.O. in the history of the state. The Company believes that its risk of loss on default of a G.O. municipal bond for the Company is relatively low. However, historical performance does not guarantee future performance.

Management has assessed the securities available for sale in an unrealized loss position at June 30, 2013 and December 31, 2012 and determined the decline in fair value below amortized cost to be temporary. In making this determination, management considered the period of time the securities were in a loss position, the percentage decline in comparison to the securities' amortized cost, and the financial condition of the issuer (primarily government or government-sponsored enterprises). In addition, management does not intend to sell these securities and it is not more likely than not that the Company will be required to sell these securities before recovery of their amortized cost. Management believes the decline in fair value is primarily related to market interest rate fluctuations and not to the credit deterioration of the individual issuers.

The Company had not recorded any other-than-temporary impairment ("OTTI") charges as of June 30, 2013 and did not record any OTTI charges during 2012. The gross unrealized losses in the Company's securities portfolio were at an immaterial level during each of those periods, amounting to less than 1.0% of the total fair value of the securities portfolio at June 30, 2013 and December 31, 2012. Nevertheless, it remains possible that there could be deterioration in the asset quality of the securities portfolio in the future. The credit worthiness of the Company's portfolio is largely reliant on the ability of U.S. government sponsored agencies such as FHLB, Federal National Mortgage Association ("FNMA"), Government National Mortgage Association ("GNMA"), and Federal Home Loan Mortgage Corporation ("FHLMC"), and municipalities throughout New York State to meet their obligations. In addition, dysfunctional markets could materially alter the liquidity, interest rate, and pricing risk of the portfolio. The relatively stable past performance is not a guarantee for similar performance of the Company's securities portfolio going forward.

3. FAIR VALUE MEASUREMENTS

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

There are three levels of inputs to fair value measurements:

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

Observable market data should be used when available.

FINANCIAL INSTRUMENTS MEASURED AT FAIR VALUE ON A RECURRING BASIS

The following table presents for each of the fair-value hierarchy levels as defined in this footnote, those financial instruments which are measured at fair value on a recurring basis at June 30, 2013 and December 31, 2012:

(in thousands)	Level 1	Level 2	Level 3	Fair Value
June 30, 2013				
Securities available-for-sale:				
U.S. government agencies	$ -	$ 29,372	$ -	$ 29,372
States and political subdivisions	-	32,507	-	32,507
Mortgage-backed securities	-	30,921	-	30,921
Mortgage servicing rights	-	-	503	503
December 31, 2012				
Securities available-for-sale:				

U.S. Treasury and other U.S. government agencies	$ -	$ 28,332	$ -	$ 28,332
States and political subdivisions	-	31,469	-	31,469
Mortgage-backed securities	-	32,262	-	32,262
Mortgage servicing rights	-	-	467	467

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Securities available for sale

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

Management believes that it has a sufficient understanding of the third party service's valuation models, assumptions and inputs used in determining the fair value of securities to enable management to maintain an appropriate system of internal control. On a quarterly basis, the Company reviews changes in the market value of its security portfolio. Individual changes in valuations are reviewed for consistency with general interest rate movements and any known credit concerns for specific securities. Additionally, on an annual basis, the Company has its entire security portfolio priced by a second pricing service to determine consistency with another market evaluator. If, on the Company's review or in comparing with another servicer, a material difference between pricing evaluations were to exist, the Company may submit an inquiry to the service provider regarding the data used to value a particular security. If the Company determines it has market information that would support a different valuation than the initial evaluation it can submit a challenge for a change to that security's valuation. There were no material differences in valuations noted in the first and second quarters of 2013 or during fiscal year 2012.

Securities available for sale are classified as Level 2 in the fair value hierarchy as the valuation provided by the third-party provider uses observable market data.

Mortgage servicing rights

Mortgage servicing rights ("MSRs") do not trade in an active, open market with readily observable prices. Accordingly, the Company obtains the fair value of the MSRs using a third-party pricing provider. The provider determines the fair value by discounting projected net servicing cash flows of the remaining servicing portfolio. The valuation model used by the provider considers market loan prepayment predictions and other economic factors which management considers to be significant unobservable inputs. The fair value of MSRs is mostly affected by changes in mortgage interest rates since rate changes cause the loan prepayment acceleration factors to increase or decrease. All assumptions are market driven. Management has a sufficient understanding of the third party service's valuation models, assumptions and inputs used in determining the fair value of MSRs to enable management to maintain an appropriate system of internal control. Mortgage servicing rights are classified within Level 3 of the fair value hierarchy as the valuation is model driven and primarily based on unobservable inputs.

The following table summarizes the changes in fair value for mortgage servicing rights during the three and six month periods ended June 30, 2013 and 2012, respectively:

	Three months ended June 30, (in thousands)	
	2013	2012
Beginning balance, Mar 31	$ 455	$ 454
Gain (loss) included in earnings	48	(47)
Additions from loan sales	-	41
Ending balance, June 30	$ 503	$ 448

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	Six months ended June 30, (in thousands)	
	2013	2012
Beginning balance, Dec 31	$ 467	$ 407
Gain (loss) included in earnings	28	(54)
Additions from loan sales	8	95
Ending balance, June 30	$ 503	$ 448

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

	6/30/2013	6/30/2012
Servicing fees	0.25 %	0.25 %
Discount rate	10.05 %	10.08 %
Prepayment rate (CPR)	11.12 %	15.82 %

FINANCIAL INSTRUMENTS MEASURED AT FAIR VALUE ON A NONRECURRING BASIS

The Company is required, on a nonrecurring basis, to adjust the carrying value of certain assets or provide valuation allowances related to certain assets using fair value measurements. The following table presents for each of the fair-value hierarchy levels as defined in this footnote, those financial instruments which are measured at fair value on a nonrecurring basis at June 30, 2013 and December 31, 2012:

(in thousands)	Level 1	Level 2	Level 3	Fair Value
June 30, 2013				
Impaired loans	$ -	-	18,239	$ 18,239
December 31, 2012				
Impaired loans	$ -	-	12,303	$ 12,303

Impaired loans

The Company evaluates and values impaired loans at the time the loan is identified as impaired, and the fair values of such loans are estimated using Level 3 inputs in the fair value hierarchy. Each loan's collateral has a unique appraisal and management's discount of the value is based on factors unique to each impaired loan. The significant unobservable input in determining the fair value is management's subjective discount on appraisals of the collateral securing the loan, which ranges from 10%-50%. Collateral may consist of real estate and/or business assets including equipment, inventory and/or accounts receivable and the value of these assets is determined based on appraisals by qualified licensed appraisers hired by the Company. Appraised and reported values may be discounted based on management's historical knowledge, changes in market conditions from the time of valuation, estimated costs to sell, and/or management's expertise and knowledge of the client and the client's business.

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The Company has an appraisal policy in which appraisals are obtained upon a commercial loan being downgraded on the Company internal loan rating scale to a 5 (special mention) or a 6 (substandard) depending on the amount of the loan, the type of loan and the type of collateral. All impaired commercial loans are either graded a 6 or 7 on the internal loan rating scale. For consumer loans, the Company obtains appraisals when a loan becomes 90 days past due or is determined to be impaired, whichever occurs first. Subsequent to the downgrade or reaching 90 days past due, if the loan remains outstanding and impaired for at least one year more, management may require another follow-up appraisal. Between receipts of updated appraisals, if necessary, management may perform an internal valuation based on any known changing conditions in the marketplace such as sales of similar properties, a change in the condition of the collateral, or feedback from local appraisers. Impaired loans had a gross value of $19.4 million, with a valuation allowance of $1.2 million, at June 30, 2013, compared to a gross value for impaired loans of $13.6 million, with a valuation allowance of $1.3 million, at December 31, 2012.

FAIR VALUE OF FINANCIAL INSTRUMENTS

At June 30, 2013 and December 31, 2012, the estimated fair values of the Company's financial instruments, including those that are not measured and reported at fair value on a recurring basis or nonrecurring basis, were as follows:

	June 30, 2013		December 31, 2012	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
	(in thousands)		(in thousands)	
Financial assets:				
Level 1:				
Cash and cash equivalents	$ 72,577	$ 72,577	$ 90,477	$ 90,477
Level 2:				
Available for sale securities	92,800	92,800	92,063	92,063
FHLB and FRB stock	2,822	2,822	3,249	3,249
Level 3:				
Held to maturity securities	3,706	3,639	3,744	3,721
Loans and leases, net	597,520	631,017	573,163	607,916
Mortgage servicing rights	503	503	467	467
Financial liabilities:				
Level 1:				
Demand deposits	$ 132,820	$ 132,820	$ 123,405	$ 123,405
NOW deposits	67,736	67,736	65,753	65,753
Regular savings deposits	379,782	379,782	380,924	380,924

Junior subordinated debentures	11,330	11,330	11,330	11,330
Commitments to extend credit	151	151	49	49
Securities sold under agreement to repurchase	14,542	14,542	12,111	12,111
Level 2:				
Other borrowed funds	9,000	9,299	19,000	19,503
Level 3:				
Time deposits	112,076	114,630	108,910	111,883

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

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

FHLB and FRB stock. The carrying value of FHLB and FRB stock approximate fair value.

Securities held to maturity. The Company holds certain municipal bonds as held-to-maturity. These bonds are generally small in dollar amount and are issued only by certain local municipalities within the Company’s market area. The original terms are negotiated directly and on an individual basis consistent with our loan and credit guidelines. These bonds are not traded on the open market and management intends to hold the bonds to maturity. The fair value of held-to-maturity securities is estimated by discounting the future

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cash flows using the current rates at which similar agreements would be made with municipalities with similar credit ratings and for the same remaining maturities.

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

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

Junior Subordinated Debentures. The carrying amount of Junior Subordinated Debentures is a reasonable estimate of fair value due to the fact that they bear a floating interest rate that adjusts on a quarterly basis.

Commitments to extend credit and standby letters of credit. As described in Note 8 - “Contingent Liabilities and Commitments” to these Unaudited Consolidated Financial Statements, the Company was a party to financial instruments with off-balance sheet risk at June 30, 2013 and December 31, 2012. Such financial instruments consist of commitments to extend permanent financing and letters of credit. If the options are exercised by the prospective borrowers, these financial instruments will become interest-earning assets of the Company. If the options expire, the Company retains any fees paid by the counterparty in order to obtain the commitment or guarantee. The fees collected for these commitments are recorded as “unearned commitment fees” in Other Liabilities. The carrying value approximates the fair value.

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

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

4. LOANS, LEASES, AND THE ALLOWANCE FOR LOAN AND LEASE LOSSES

Loan and Lease Portfolio Composition

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

	June 30, 2013	December 31, 2012
Mortgage loans on real estate:	(in thousands)	
Residential Mortgages	$ 80,303	$ 68,135
Commercial and multi-family	327,908	323,777
Construction-Residential	732	811
Construction-Commercial	26,529	28,941
Home equities	55,891	56,366
Total real estate loans	491,363	478,030
Direct financing leases	337	1,612
Commercial and industrial loans	112,263	99,951
Consumer loans	1,047	1,294
Other	1,930	1,342
Net deferred loan origination costs	839	666
Total gross loans	607,779	582,895
Allowance for loan losses	(10,259)	(9,732)
Loans, net	$ 597,520	$ 573,163

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The Bank sells certain fixed rate residential mortgages to FNMA, while maintaining the servicing rights for those mortgages. During the three and six month periods ended June 30, 2013, the Bank sold mortgages to FNMA totaling $0.8 million, respectively, as compared with $4.9 million and $11.1 million sold during the three and six month periods ended June 30, 2012. At June 30, 2013, the Bank had a loan servicing portfolio principal balance of $68.0 million upon which it earns servicing fees, as compared with $73.7 million at December 31, 2012. The value of the mortgage servicing rights for that portfolio was $0.5 million at June 30, 2013 and December 31, 2012. Residential mortgage loans held-for-sale were $0.4 million at June 30, 2013, compared with $0.9 million at December 31, 2012. The Company had no commercial loans held-for-sale at June 30, 2013 and at December 31, 2012. 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, 2012. Disclosures related to the basis for accounting for loans and leases, the method for recognizing interest income on loans and leases, the policy for placing loans and leases 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 and lease losses, the policy for charging off loans and leases, 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 Company's year ended December 31, 2012. Unless otherwise noted in this Form 10-Q, the policies and methodology described in the Annual Report for the year ended December 31, 2012 are consistent with those utilized by the Company in the six months ended June 30, 2013.

Credit Quality Indicators

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

- 1-3-Pass
- 4-Watch
- 5-O.A.E.M. (Other Assets Especially Mentioned) or Special Mention
- 6-Substandard
- 7-Doubtful
- 8-Loss

The Company's consumer loans, including residential mortgages and home equities, and commercial leases are not individually risk rated or reviewed in the Company's loan review process. Consumers are not required to provide the Company with updated financial information as is a commercial customer. Consumer loans also carry smaller balances. Given the lack of updated information since the initial underwriting of the loan and small size of individual loans, the Company uses delinquency status as the credit quality indicator for consumer loans.

There were no changes in the Company’s allowance for loan and lease loss methodology in the six month period ended June 30, 2013.

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

June 30, 2013
(in thousands)

Corporate Credit Exposure – By Credit Rating	Commercial Real Estate Construction	Commercial and Multi-Family Mortgages	Total Commercial Real Estate	Commercial and Industrial
3	$ 23,568	$ 291,963	$ 315,531	$ 88,949
4	1,279	19,622	20,901	16,163
5	934	2,424	3,358	4,393
6	748	10,287	11,035	2,676
7	-	3,612	3,612	82
Total	$ 26,529	$ 327,908	$ 354,437	$ 112,263

December 31, 2012
(in thousands)

Corporate Credit Exposure – By Credit Rating	Commercial Real Estate Construction	Commercial and Multi-Family Mortgages	Total Commercial Real Estate	Commercial and Industrial
3	$ 24,461	$ 273,843	$ 298,304	$ 77,095
4	2,023	40,346	42,369	14,681

5	1,728	3,081	4,809	5,229
6	729	2,911	3,640	2,308
7	-	3,596	3,596	638
Total	$ 28,941	$ 323,777	$ 352,718	$ 99,951

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Past Due Loans and Leases

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

June 30, 2013
(in thousands)

	30-59 days	60-89 days	90+ days	Total Past Due	Current Balance	Total Balance	90+ Days Accruing	Non-accruing Loans and Leases
Commercial and industrial	$ 641	$ 40	$ 270	$ 951	$ 111,312	$ 112,263	$ 28	$ 834
Residential real estate:								
Residential	90	238	347	675	79,628	80,303	23	1,347
Construction	-	-	-	-	732	732	-	-
Commercial real estate:								
Commercial	-	6,731	1,218	7,949	319,959	327,908	-	10,591
Construction	-	-	-	-	26,529	26,529	-	-
Home equities	93	42	479	614	55,277	55,891	19	502
Direct financing leases	10	-	96	106	231	337	-	101
Consumer	3	6	-	9	1,038	1,047	-	11
Other	-	-	-	-	1,930	1,930	-	-
Total Loans	$ 837	$ 7,057	$ 2,410	$ 10,304	$ 596,636	$ 606,940	$ 70	$ 13,386

NOTE: Loan and lease balances do not include $839 thousand in net deferred loan and lease origination costs as of June 30, 2013.

December 31, 2012
(in thousands)

	30-59 days	60-89 days	90+ days	Total Past Due	Current Balance	Total Balance	90+ Days Accruing	Non-accruing Loans and Leases
Commercial and industrial	$ 564	$ 141	$ 135	$ 840	$ 99,111	$ 99,951	$ -	$ 914

Residential real estate:								
Residential	1,015	62	872	1,949	66,186	68,135	-	1,443
Construction	-	-	-	-	811	811	-	-
Commercial real estate:								
Commercial	12,658	169	3,658	16,485	307,292	323,777	-	4,309
Construction	1,505	201	729	2,435	26,506	28,941	-	729
Home equities	32	215	572	819	55,547	56,366	-	618
Direct financing leases	31	7	123	161	1,451	1,612	-	171
Consumer	17	4	23	44	1,250	1,294	-	44
Other	-	-	-	-	2,008	2,008	-	-
Total Loans	$ 15,822	$ 799	$ 6,112	$ 22,733	$ 560,162	$ 582,895	$ -	$ 8,228

NOTE: Loan and lease balances do not include $666 thousand in net deferred loan and lease origination costs as of December 31, 2012.

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Allowance for loan and lease losses

The following tables present the activity in the allowance for loan and lease losses according to portfolio segment, for the six month periods ended June 30, 2013 and 2012:

June 30, 2013

(in thousands)	Commercial and Industrial	Commercial Real Estate Mortgages*	Consumer **	Residential Mortgages*	HELOC	Direct Financing Leases	Unallocated	Total
Allowance for loan and lease losses:								
Beginning balance	$ 3,617	$ 4,493	$ 18	$ 662	$ 746	$ 47	$ 149	$ 9,732
Charge-offs	(10)	(13)	(17)	(6)	(92)	-	-	(138)
Recoveries	123	5	1	-	6	-	-	135
Provision	(17)	425	13	46	110	(47)	-	530
Ending balance	$ 3,713	$ 4,910	$ 15	$ 702	$ 770	$ -	$ 149	$ 10,259
Allowance for loan and lease losses:								
Ending balance:								
Individually evaluated for impairment	$ 332	$ 472	$ 2	$ 5	$ 7	$ -	$ -	$ 818
Collectively evaluated for impairment	3,381	4,438	13	697	763	-	149	9,441
Total	$ 3,713	$ 4,910	$ 15	$ 702	$ 770	$ -	$ 149	$ 10,259
Loans and leases:								
Ending balance:								
Individually evaluated for impairment	$ 969	$ 13,559	$ 11	$ 1,375	$ 502	$ 80	$ -	$ 16,496
Collectively evaluated for impairment	111,294	340,878	2,966	79,660	55,389	257	-	590,444
Total	$ 112,263	$ 354,437	$ 2,977	$ 81,035	$ 55,891	$ 337	$ -	$ 606,940

* Includes construction loans

** Includes other loans

NOTE: Loan and lease balances do not include $839 thousand in net deferred loan and lease origination costs as of June 30, 2013.

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June 30, 2012

(in thousands)	Commercial and Industrial	Commercial Real Estate Mortgages*	Consumer **	Residential Mortgages*	HELOC	Direct Financing Leases	Unallocated	Total
Allowance for loan and lease losses:								
Beginning balance	$ 4,085	$ 4,670	$ 36	$ 793	$ 768	$ 994	$ 149	$ 11,495
Charge-offs	(424)	(546)	(10)	-	(13)	-	-	(993)
Recoveries	70	15	13	-	6	-	-	104
Provision	485	238	9	(95)	42	(627)	-	52
Ending balance	$ 4,216	$ 4,377	$ 48	$ 698	$ 803	$ 367	$ 149	$ 10,658
Allowance for loan and lease losses:								
Ending balance:								
Individually evaluated for impairment	$ 851	$ 252	$ 16	$ -	$ 102	$ 95	$ -	$ 1,316
Collectively evaluated for impairment	3,365	4,125	32	698	701	272	149	9,342
Total	$ 4,216	$ 4,377	$ 48	$ 698	$ 803	$ 367	$ 149	$ 10,658
Loans and leases:								
Ending balance:								
Individually evaluated for impairment	$ 1,916	$ 6,860	$ 36	$ 985	$ 1,234	$ 331	$ -	$ 11,362
Collectively evaluated for impairment	105,891	348,403	3,788	70,882	54,211	3,024	-	586,199
Loans acquired with deteriorated credit quality	-	-	30	-	-	-	-	30
Total	$ 107,807	$ 355,263	$ 3,854	$ 71,867	$ 55,445	$ 3,355	$ -	$ 597,591

* Includes construction loans

** Includes other loans

NOTE: Loan and lease balances do not include $332 thousand in net deferred loan and lease origination costs as of June 30, 2012.

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The following tables present the activity in the allowance for loan and lease losses according to portfolio segment, for the three month periods ended June 30, 2013 and 2012:

June 30, 2013

(in thousands)	Commercial and Industrial	Commercial Real Estate Mortgages	Consumer	Residential Mortgages	HELOC	Direct Financing Leases	Unallocated	To
Allowance for loan and lease losses:								
Beginning balance	$ 3,755	$ 4,747	$ 15	$ 748	$ 740	$ -	$ 149	$ 10
Charge-offs	-	-	(8)	-	(1)	-	-	(9)
Recoveries	26	4	3	-	1	-	-	34
Provision	(68)	159	5	(46)	30	-	-	80
Ending balance	$ 3,713	$ 4,910	$ 15	$ 702	$ 770	$ -	$ 149	$ 10

June 30, 2012

(in thousands)	Commercial and Industrial	Commercial Real Estate Mortgages	Consumer	Residential Mortgages	HELOC	Direct Financing Leases	Unallocated	To
Allowance for loan and lease losses:								
Beginning balance	$ 3,946	$ 4,565	$ 43	$ 719	$ 785	$ 583	$ 149	$ 10
Charge-offs	(15)	(487)	(7)	-	-	-	-	(50
Recoveries	52	15	9	-	-	-	-	76
Provision	233	284	3	(21)	18	(216)	-	30

Ending balance	$ 4,216	$ 4,377	$ 48	$ 698	$ 803	$ 367	$ 149	$ 10

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Impaired Loans and Leases

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

	At June 30, 2013					
	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	$ 232	$ 334	$ -	$ 445	$ 5	$ 4
Residential real estate:						
Residential	1,071	1,241	-	1,111	48	1
Construction	-	-	-	-	-	-
Commercial real estate:						
Commercial	9,517	9,680	-	9,741	95	184
Construction	748	748	-	744	-	14
Home equities	466	499	-	476	12	1
Direct financing leases	-	-	-	-	-	-
Consumer	-	-	-	-	-	-
Other	-	-	-	-	-	-
Total impaired loans and leases	$ 12,034	$ 12,502	$ -	$ 12,517	$ 160	$ 204

	At June 30, 2013 Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Interest Income Foregone	Interest Income Recognized
With a related allowance recorded:	(in thousands)					
Commercial and industrial	$ 2,727	$ 2,794	$ 618	$ 3,415	$ 23	$ 43
Residential real estate:						
Residential	304	318	5	304	11	-
Construction	-	-	-	-	-	-
Commercial real estate:						
Commercial	3,293	3,555	472	3,427	35	21
Construction	934	934	49	934	-	16
Home equities	36	36	7	36	1	-
Direct financing leases	80	80	27	89	4	-
Consumer	11	43	2	31	2	1
Other	-	-	-	-	-	-
Total impaired loans and leases	$ 7,385	$ 7,760	$ 1,180	$ 8,236	$ 76	$ 81

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	At June 30, 2013					
Total:	Recorded Investment (in thousands)	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Interest Income Foregone	Interest Income Recognized
Commercial and industrial	$ 2,959	$ 3,128	$ 618	$ 3,860	$ 28	$ 47
	-	-	-	-	-	-
Residential real estate:						
Residential	1,375	1,559	5	1,415	59	1
Construction	-	-	-	-	-	-
	-	-	-	-	-	-
Commercial real estate:						
Commercial	12,810	13,235	472	13,168	130	205
Construction	1,682	1,682	49	1,678	-	30
	-	-	-	-	-	-
Home equities	502	535	7	512	13	1
	-	-	-	-	-	-
Direct financing leases	80	80	27	89	4	-
	-	-	-	-	-	-
Consumer	11	43	2	31	2	1
	-	-	-	-	-	-
Other	-	-	-	-	-	-
Total impaired loans and leases	$ 19,419	$ 20,262	$ 1,180	$ 20,753	$ 236	$ 285

	At December 31, 2012					
	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	$ 277	$ 289	$ -	$ 392	$ 10	$ 6
Residential real estate:						
Residential	1,437	1,558	-	1,444	56	12
Construction	-	-	-	-	-	-
Commercial real estate:						
Commercial	3,313	3,555	-	3,711	174	94
Construction	729	814	-	778	26	-
Home equities	938	973	-	856	26	14
Direct financing leases	-	-	-	-	-	-
Consumer	-	-	-	-	-	-
Other	-	-	-	-	-	-
Total impaired loans and leases	$ 6,694	$ 7,189	$ -	$ 7,181	$ 292	$ 126

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	At December 31, 2012					
	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Interest Income Foregone	Interest Income Recognized
With a related allowance recorded:	(in thousands)					
Commercial and industrial	$ 2,509	$ 2,662	$ 747	$ 2,938	$ 49	$ 107
Residential real estate:						
Residential	6	6	-	6	-	-
Construction	-	-	-	-	-	-
Commercial real estate:						
Commercial	3,241	3,425	471	3,267	172	3
Construction	934	934	49	934	-	30
Home equities	-	-	-	-	-	-
Direct financing leases	164	178	13	266	14	-
Consumer	44	121	9	60	9	-
Other	-	-	-	-	-	-
Total impaired loans and leases	$ 6,898	$ 7,326	$ 1,289	$ 7,471	$ 244	$ 140

	At December 31, 2012					
	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Interest Income Foregone	Interest Income Recognized
Total:	(in thousands)					

Commercial and industrial	$ 2,786	$ 2,951	$ 747	$ 3,330	$ 59	$ 113
	-	-	-	-	-	-
Residential real estate:						
Residential	1,443	1,564	-	1,450	56	12
Construction	-	-	-	-	-	-
	-	-	-	-	-	-
Commercial real estate:						
Commercial	6,554	6,980	471	6,978	346	97
Construction	1,663	1,748	49	1,712	26	30
	-	-	-	-	-	-
Home equities	938	973	-	856	26	14
	-	-	-	-	-	-
Direct financing leases	164	178	13	266	14	-
	-	-	-	-	-	-
Consumer	44	121	9	60	9	-
	-	-	-	-	-	-
Other	-	-	-	-	-	-
Total impaired loans and leases	$ 13,592	$ 14,515	$ 1,289	$ 14,652	$ 536	$ 266

The Company had five commercial loans identified as impaired with an unpaid principal balance of $2.9 million as of June 30, 2013, and two commercial loans identified as impaired with an unpaid principal balance of $2.6 as of December 31, 2012, with respect to which it was unable to perform an appropriate impairment calculation due to the lack of reliable financial information from the borrower. The reserve on these loans was $0.3 million at June 30, 2013 and December 31, 2012, as determined according to the credit risk rating per the Company’s allowance for loan and lease losses methodology, as described in Note 1 – “Organization and Summary of Significant Accounting Policies” in the Company’s Annual Report on Form 10-K for the year ended December 31, 2012.

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Non-performing loans and leases

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

	June 30, 2013	December 31, 2012
	(in thousands)	
Non-accruing loans and leases:		
Commercial and industrial loans	$ 834	$ 914
Residential real estate:		
Residential	1,347	1,443
Construction	-	-
Commercial real estate:		
Commercial and multi-family	10,591	4,309
Construction	-	729
Home equities	502	618
Direct financing leases	101	171
Consumer loans	11	44
Other	-	-
Total non-accruing loans and leases	$ 13,386	$ 8,228
Accruing loans 90+ days past due	70	-
Total non-performing loans and leases	$ 13,456	$ 8,228
Total non-performing loans and leases to total assets	1.65 %	1.02 %
Total non-performing loans and leases to total loans and leases	2.21 %	1.41 %

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Troubled debt restructurings

The Company had $11.8 million in loans and leases that were restructured in a troubled debt restructuring ("TDR") at June 30, 2013, compared with $11.5 million at December 31, 2012. $5.7 million and $6.0 million of those balances were in non-accrual status at June 30, 2013 and December 31, 2012, respectively. Any TDR that is placed on non-accrual is not reverted back to accruing status until the borrower makes timely payments as contracted for at least six months. Those loans and leases that are in accruing status have shown evidence of performance for at least six months as of June 30, 2013 and December 31, 2012. One residential mortgage for $0.4 million was made under a government assistance program in 2012. Two commercial loans with a combined balance of $0.3 million restructured in 2013, in addition to three loans restructured prior to 2013 with a combined balance of $0.3 million, are covered under the Bank's loss-sharing arrangement with the FDIC. For additional details on this agreement, see discussion under "Covered Loans and the Related Allowance" below. All of the Company's restructurings were allowed in an effort to maximize its ability to collect on loans and leases where borrowers were experiencing financial difficulty. The Company did not engage in any re-modifications during the three or six month periods ended June 30, 2013 and 2012. Modifications made to loans in a troubled debt restructuring did not have a material impact on the Company's net income for the three or six month periods ended June 30, 2013 and 2012.

The reserve for a TDR is based upon the present value of the future expected cash flows discounted at the loan's original effective rate or upon the fair value of the collateral less costs to sell, if the loan is deemed collateral dependent. This reserve methodology is used because all TDR loans are considered impaired. As of June 30, 2013, there were no commitments to lend additional funds to debtors owing loans or leases whose terms have been modified in TDRs. The Company's TDRs involve interest only payments and lengthening of terms as concessions to try to maximize the collectability of the loans.

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

	June 30, 2013 ($ in thousands)			
	Total	Nonaccruing	Accruing	Related Allowance
Commercial and industrial	$ 2,806	$ 681	$ 2,125	$ 298
Residential real estate:				
Residential	1,051	1,023	28	-
Construction	-	-	-	-
Commercial real estate:				

Commercial and multi family	6,136	3,917	2,219	435
Construction	1,682	-	1,682	-
	-	-	-	-
Home equities	-	-	-	-
Direct financing leases	80	41	39	27
Consumer loans	-	-	-	-
Other	-	-	-	-
Total troubled restructured loans and leases	$ 11,755	$ 5,662	$ 6,093	$ 760

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	December 31, 2012 ($ in thousands)			
	Total	Nonaccruing	Accruing	Related Allowance
Commercial and industrial	$ 2,592	$ 720	$ 1,872	$ 335
Residential real estate:				
Residential	509	509	-	-
Construction	-	-	-	-
Commercial real estate:				
Commercial and multi family	6,203	3,958	2,245	471
Construction	1,663	729	934	-
				-
Home equities	320	-	320	-
Direct financing leases	164	70	94	13
Consumer loans	-	-	-	-
Other	-	-	-	-
Total troubled restructured loans and leases	$ 11,451	$ 5,986	$ 5,465	$ 819

The following table shows the data for TDR activity for the three and six month periods ended June 30, 2013 and 2012:

	Three Months Ended June 30, 2013 ($ in thousands)			Three Months Ended June 30, 2012 ($ in thousands)		
Troubled Debt Restructurings	Number of Contracts	Pre-Modification Outstanding Recorded	Post-Modification Outstanding Recorded	Number of Contracts	Pre-Modification Outstanding Recorded	Post-Modification Outstanding Recorded

		Investment	Investment		Investment	Investment
Commercial and Industrial	6	$ 611	$ 611	-	$ -	$ -
Residential Real Estate:						
Residential	3	555	555	1	44	44
Construction	-	-	-	-	-	-
Commercial Real Estate:						
Commercial & Multi-Family	-	-	-	1	637	637
Construction	-	-	-	-	-	-
Home Equities	-	-	-	-	-	-
Direct financing leases	-	-	-	-	-	-
Consumer loans	-	-	-	-	-	-
Other	-	-	-	-	-	-

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	Six Months Ended June 30, 2013 ($ in thousands)	Six Months Ended June 30, 2012 ($ in thousands)
Troubled Debt Restructurings	Number of Contracts	