EVANS BANCORP INC
Form 10-Q
May 03, 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 March 31, 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)

14 -16 North Main Street, Angola, New York 14006 .

(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: 4,190,257 shares as of April 23, 2013

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

	March 31, 2013	December 31, 2012
ASSETS		
Cash and due from banks	$ 12,509	$ 12,409
Interest-bearing deposits at banks	88,089	78,068
Securities:		
Available for sale, at fair value (cost: $87,957 at March 31, 2013; $88,054 at December 31, 2012)	91,540	92,063
Held to maturity, at amortized cost (fair value: $3,707 at March 31, 2013; $3,721 at December 31, 2012)	3,734	3,744
Federal Home Loan Bank common stock, at amortized cost	1,489	1,804
Federal Reserve Bank common stock, at amortized cost	1,457	1,445
Loans and leases, net of allowance for loan and lease losses of $10,154 at March 31, 2013 and $9,732 at December 31, 2012	577,932	573,163
Properties and equipment, net of depreciation of $14,558 at March 31, 2013 and $14,256 at December 31, 2012	11,020	11,368
Goodwill	8,101	8,101
Intangible assets	266	329
Bank-owned life insurance	15,446	15,333
Other assets	12,131	11,849
TOTAL ASSETS	$ 823,714	$ 809,676
LIABILITIES AND STOCKHOLDERS' EQUITY		
LIABILITIES		
Deposits:		
Demand	$ 123,084	$ 123,405
NOW	73,016	65,753
Regular savings	391,739	380,924
Time	110,461	108,910
Total deposits	698,300	678,992
Securities sold under agreement to repurchase	13,784	12,111
Other short term borrowings	3,000	10,000
Other liabilities	11,805	13,415

Junior subordinated debentures	11,330	11,330
Long term borrowings	9,000	9,000
Total liabilities	747,219	734,848
CONTINGENT LIABILITIES AND COMMITMENTS		
STOCKHOLDERS' EQUITY:		
Common stock, $.50 par value, 10,000,000 shares authorized; 4,190,257 and 4,171,473 shares issued and outstanding at March 31, 2013 and December 31, 2012, respectively	2,096	2,087
Capital surplus	42,095	42,029
Retained earnings	32,427	30,611
Accumulated other comprehensive (loss) gain, net of tax	(123)	101
Total stockholders' equity	76,495	74,828
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	$ 823,714	$ 809,676

See Notes to Unaudited Consolidated Financial Statements

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PART I - FINANCIAL INFORMATION
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EVANS BANCORP, INC. AND SUBSIDIARIES
UNAUDITED CONSOLIDATED STATEMENTS OF INCOME
THREE MONTHS ENDED MARCH 31, 2013 AND 2012
(in thousands, except share and per share amounts)

	Three Months Ended March 31,	
	2013	2012
INTEREST INCOME		
Loans and leases	$ 7,252	$ 7,508
Interest bearing deposits at banks	18	9
Securities:		
Taxable	417	545
Non-taxable	269	306
Total interest income	7,956	8,368
INTEREST EXPENSE		
Deposits	890	1,242
Other borrowings	161	187
Junior subordinated debentures	79	87
Total interest expense	1,130	1,516
NET INTEREST INCOME	6,826	6,852
PROVISION FOR LOAN AND LEASE LOSSES	450	(249)
NET INTEREST INCOME AFTER PROVISION FOR LOAN AND LEASE LOSSES	6,376	7,101
NON-INTEREST INCOME		
Bank charges	482	436
Insurance service and fees	1,999	1,945
Data center income	114	124
Gain on loans sold	25	53
Bank-owned life insurance	113	118
Other	577	613
Total non-interest income	3,310	3,289
NON-INTEREST EXPENSE		
Salaries and employee benefits	4,289	4,214
Occupancy	816	685
Repairs and maintenance	178	169
Advertising and public relations	124	145
Professional services	454	539
Technology and communications	291	263
Amortization of intangibles	63	104
FDIC insurance	138	134
Other	723	656

Total non-interest expense	7,076	6,909
INCOME BEFORE INCOME TAXES	2,610	3,481
INCOME TAX PROVISION	794	1,102
NET INCOME	$ 1,816	$ 2,379
Net income per common share-basic	$ 0.44	$ 0.58
Net income per common share-diluted	$ 0.43	$ 0.58
Cash dividends per common share	$ -	$ 0.22
Weighted average number of common shares outstanding	4,173,978	4,126,656
Weighted average number of diluted shares outstanding	4,210,595	4,131,330

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, 2013 AND 2012
(in thousands, except share and per share amounts)

	Three Months Ended March 31,	
	2013	2012
NET INCOME	$ 1,816	$ 2,379
OTHER COMPREHENSIVE INCOME (LOSS), NET OF TAX:		
Unrealized loss on available-for-sale securities	(261)	(115)
Defined benefit pension plans:		
Amortization of prior service cost	10	14
Amortization of actuarial loss	27	26
Total	37	40
OTHER COMPREHENSIVE LOSS, NET OF TAX	(224)	(75)
COMPREHENSIVE INCOME	$ 1,592	$ 2,304

See Notes to Unaudited Consolidated Financial Statements

PART 1 - FINANCIAL INFORMATION
ITEM 1 - FINANCIAL STATEMENTS
EVANS BANCORP, INC. AND SUBSIDIARIES
UNAUDITED CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY
THREE MONTHS ENDED MARCH 31, 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			2,379		2,379
Other comprehensive loss				(75)	(75)
Cash dividends ($0.22 per common share)			(908)		(908)
Stock options and restricted stock expense		71			71
Issued 4,013 restricted shares	2	(2)			-
Balance, March 31, 2012	$ 2,065	$ 41,344	$ 26,775	$ 271	$ 70,455
Balance, December 31, 2012	$ 2,087	$ 42,029	$ 30,611	$ 101	$ 74,828
Net Income			1,816		1,816
Other comprehensive loss				(224)	(224)
Stock options and restricted stock expense		75			75
Issued 18,784 restricted shares	9	(9)			-
Balance, March 31, 2013	$ 2,096	$ 42,095	$ 32,427	$ (123)	$ 76,495

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PART I-FINANCIAL INFORMATION
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EVANS BANCORP, INC. AND SUBSIDIARIES
UNAUDITED CONSOLIDATED STATEMENTS OF CASH FLOWS
THREE MONTHS ENDED MARCH 31, 2013 AND 2012
(in thousands)

	Three Months Ended March 31, 2013	2012
OPERATING ACTIVITIES:		
Interest received	$ 7,638	$ 8,011
Fees received	3,301	3,107
Interest paid	(1,147)	(1,550)
Cash paid to employees and vendors	(8,009)	(7,058)
Cash contributed to pension plan	(95)	-
Income taxes paid	(461)	(720)
Proceeds from sale of loans held for resale	776	6,250
Originations of loans held for resale	(233)	(3,998)
Net cash provided by operating activities	1,770	4,042
INVESTING ACTIVITIES:		
Available for sales securities:		
Purchases	(3,487)	(17,759)
Proceeds from maturities and calls	3,759	9,009
Held to maturity securities:		
Purchases	-	(428)
Proceeds from maturities, calls, and payments	11	396
Additions to properties and equipment	(47)	(117)
Net increase (decrease) in loans	(5,865)	898
Net cash used in investing activities	(5,629)	(8,001)
FINANCING ACTIVITIES:		
Repayments of borrowings	(5,328)	(329)
Net increase in deposits	19,308	33,478
Net cash provided by financing activities	13,980	33,149
Net increase in cash and equivalents	10,121	29,190

CASH AND CASH EQUIVALENTS:		
Beginning of period	90,477	14,678
End of period	$ 100,598	$ 43,868

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EVANS BANCORP, INC. AND SUBSIDIARIES
UNAUDITED CONSOLIDATED STATEMENTS OF CASH FLOWS
THREE MONTHS ENDED MARCH 31, 2013 AND 2012
(in thousands)

	Three Months Ended March 31,	
	2013	2012
RECONCILIATION OF NET INCOME TO NET CASH PROVIDED BY OPERATING ACTIVITIES:		
Net income	$ 1,816	$ 2,379
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	567	510
Deferred tax expense	109	87
Provision for loan and lease losses	450	(249)
Premium on loans sold	(25)	(53)
Stock options and restricted stock expense	75	71
Proceeds from sale of loans held for resale	776	6,250
Originations of loans held for resale	(233)	(3,998)
Cash contributed to pension plan	(95)	-
Changes in assets and liabilities affecting cash flow:		
Other assets	(699)	227
Other liabilities	(971)	(1,182)
NET CASH PROVIDED BY OPERATING ACTIVITIES	$ 1,770	$ 4,042

See Notes to Unaudited Consolidated Financial Statements

PART 1 – FINANCIAL INFORMATION

ITEM 1 – FINANCIAL STATEMENTS

EVANS BANCORP, INC. AND SUBSIDIARIES

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

THREE MONTHS ENDED MARCH 31, 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 quarter ended March 31, 2013, the Company revised the three month period ended, March 31, 2012 Consolidated Statement of Cash Flows to correct a $194 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 month period ended March 31, 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.

2. SECURITIES

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

	March 31, 2013 (in thousands)			
	Amortized Cost	Unrealized Gains	Losses	Fair Value
Available for Sale:				
Debt securities:				
U.S. government agencies	$ 27,210	$ 995	$ (78)	$ 28,127
States and political subdivisions	32,543	1,502	(13)	34,032
Total debt securities	$ 59,753	$ 2,497	$ (91)	$ 62,159
Mortgage-backed securities:				
FNMA	$ 13,811	$ 760	$ -	$ 14,571
FHLMC	5,737	178	(7)	5,908
GNMA	7,116	221	-	7,337
CMO	1,540	25	-	1,565
Total mortgage-backed securities	$ 28,204	$ 1,184	$ (7)	$ 29,381
Total securities designated as available for sale	$ 87,957	$ 3,681	$ (98)	$ 91,540
Held to Maturity:				
Debt securities				
States and political subdivisions	3,734	19	(46)	3,707
Total securities designated as held to maturity	$ 3,734	$ 19	$ (46)	$ 3,707
Total securities	$ 91,691	$ 3,700	$ (144)	$ 95,247

	December 31, 2012 (in thousands)			
	Amortized	Unrealized		Fair
	Cost	Gains	Losses	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

Available for sale securities with a total fair value of $90.1 million and $68.0 million at March 31, 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 $12.0 million and $19.0 million in borrowed funds with FHLBNY at March 31, 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 $1.5 million in FHLBNY stock as of March 31, 2013 and $1.8 million as of December 31, 2012 at amortized cost.

The scheduled maturities of debt and mortgage-backed securities at March 31, 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.

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	March 31, 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	$ 2,477	$ 2,497	$ 2,766	$ 2,797
Due after one year through five years	18,231	19,016	16,797	17,561
Due after five years through ten years	30,944	31,897	29,280	30,344
Due after ten years	8,101	8,749	8,296	9,099
	59,753	62,159	57,139	59,801
Mortgage-backed securities available for sale	28,204	29,381	30,915	32,262
Total available for sale securities	$ 87,957	$ 91,540	$ 88,054	$ 92,063
Debt securities held to maturity:				
Due in one year or less	$ 2,241	$ 2,230	$ 2,241	$ 2,228
Due after one year through five years	312	316	317	322
Due after five years through ten years	511	483	516	490
Due after ten years	670	678	670	681
	3,734	3,707	3,744	3,721
Total held to maturity securities	$ 3,734	$ 3,707	$ 3,744	$ 3,721

Information regarding unrealized losses within the Company's available for sale securities at March 31, 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.

	March 31, 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	$ 5,921	$ (78)	$ -	$ -	$ 5,921	$ (78)
States and political subdivisions	963	(10)	105	(3)	1,068	(13)
Total debt securities	$ 6,884	$ (88)	$ 105	$ (3)	$ 6,989	$ (91)
Mortgage-backed securities:						
FNMA	$ 34	$ -	$ -	$ -	$ 34	$ -
FHLMC	1,930	(7)	-	-	1,930	(7)
GNMA	-	-	-	-	-	-
CMO'S	-	-	-	-	-	-
Total mortgage-backed securities	$ 1,964	$ (7)	$ -	$ -	$ 1,964	$ (7)
Held To Maturity:						
Debt securities:						
States and political subdivisions	$ 2,644	$ (46)	$ 16	$ -	$ 2,660	$ (46)
Total temporarily impaired securities	$ 11,492	$ (141)	$ 121	$ (3)	$ 11,613	$ (144)

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 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 March 31, 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 March 31, 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 March 31, 2013 and did not record any OTTI changes 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 0.2% of the total fair value of the securities portfolio at March 31, 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 March 31, 2013 and December 31, 2012:

	Level 1	Level 2	Level 3	Fair Value
March 31, 2013				
Securities available-for-sale:				
U.S. government agencies	$ -	$ 28,127	$ -	$ 28,127
States and political subdivisions	-	34,032	-	34,032
Mortgage-backed securities	-	29,381	-	29,381
Mortgage servicing rights	-	-	455	455
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

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 quarter 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 month periods ended March 31, 2013 and 2012, respectively:

	Three months ended March 31,	
	2013	2012
Beginning balance, Dec 31	$ 467	$ 407
Losses included in earnings	(20)	(7)
Additions from loan sales	8	54
Ending balance, March 31	$ 455	$ 454

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

	3/31/2013	3/31/2012
Servicing fees	0.25 %	0.25 %
Discount rate	10.05 %	10.09 %
Prepayment rate (CPR)	15.06 %	15.48 %

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, 2013 and December 31, 2012:

	Level 1	Level 2	Level 3	Fair Value
March 31, 2013				
Impaired loans	$ -	-	13,103	$ 13,103
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.

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 $14.2 million, with a valuation allowance of $1.1 million, at March 31, 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 March 31, 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:

	March 31, 2013		December 31, 2012	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
	(in thousands)		(in thousands)	
Financial assets:				
Level 1:				
Cash and cash equivalents	$ 100,598	$ 100,598	$ 90,477	$ 90,477
Level 2:				
Available for sale securities	91,540	91,540	92,063	92,063
FHLB and FRB stock	2,946	2,946	3,249	3,249
Level 3:				
Held to maturity securities	3,734	3,707	3,744	3,721
Loans and leases, net	577,932	612,984	573,163	607,916
Mortgage servicing rights	455	455	467	467
Financial liabilities:				
Level 1:				
Demand deposits	$ 123,084	$ 123,084	$ 123,405	$ 123,405
NOW deposits	73,016	73,016	65,753	65,753
Regular savings deposits	391,739	391,739	380,924	380,924
Junior subordinated debentures	11,330	11,330	11,330	11,330
Commitments to extend credit	90	90	49	49
Securities sold under agreement to repurchase	13,784	13,784	12,111	12,111
Level 2:				
Other borrowed funds	12,000	12,377	19,000	19,503
Level 3:				

Time deposits	110,461	113,347	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 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 March 31, 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:

	March 31, 2013	December 31, 2012
Mortgage loans on real estate:	(in thousands)	
Residential Mortgages	$ 74,713	$ 68,135
Commercial and multi-family	321,777	323,777
Construction-Residential	991	811
Construction-Commercial	26,789	28,941
Home equities	54,787	56,366
Total real estate loans	479,057	478,030
Direct financing leases	929	1,612
Commercial and industrial loans	105,982	99,951
Consumer loans	1,047	1,294
Other	340	1,342
Net deferred loan origination costs	731	666
Total gross loans	588,086	582,895
Allowance for loan losses	(10,154)	(9,732)
Loans, net	$ 577,932	$ 573,163

The Bank sells certain fixed rate residential mortgages to FNMA, while maintaining the servicing rights for those mortgages. During the three month periods ended March 31, 2013 and 2012, the Bank sold mortgages to FNMA totaling $0.8 million and $6.2 million, respectively. At March 31, 2013, the Bank had a loan servicing portfolio principal balance of $70.4 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 March 31, 2013 and December 31, 2012. Residential mortgage loans held-for-sale were $0.4 million at March 31, 2013, compared with $0.9 million at December 31, 2012. The Company had no commercial loans held-for-sale at March 31, 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 three months ended March 31, 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 three month period ended March 31, 2013.

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

March 31, 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	$ 24,445	$ 280,137	$ 304,582	$ 84,157
4	671	26,025	26,696	14,209
5	934	7,810	8,744	4,453
6	739	4,087	4,826	2,570
7	-	3,718	3,718	593
Total	$ 26,789	$ 321,777	$ 348,566	$ 105,982

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:

March 31, 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	$ 991	$ 136	$ 689	$ 1,816	$ 104,166	$ 105,982	$ -	$ 1,169
Residential real estate:								
Residential	562	-	938	1,500	73,213	74,713	-	1,413
Construction	-	-	-	-	991	991	-	-
Commercial real estate:								
Commercial	14,658	-	3,457	18,115	303,662	321,777	-	4,719
Construction	1,099	-	-	1,099	25,690	26,789	-	-
Home equities	129	58	544	731	54,056	54,787	18	573
Direct financing leases	24	-	108	132	797	929	-	124
Consumer	120	7	-	127	920	1,047	-	20
Other	-	-	-	-	1,071	1,071	-	-
Total Loans	$ 17,583	$ 201	$ 5,736	$ 23,520	$ 564,566	$ 588,086	$ 18	$ 8,018

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

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 three month periods ended March 31, 2013 and 2012:

March 31, 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)	(10)	(6)	(91)	-	-	(130)
Recoveries	97	1	3	1	-	-	-	102
Provision	51	266	4	91	85	(47)	-	450
Ending balance	$ 3,755	$ 4,747	$ 15	$ 748	$ 740	$ -	$ 149	$ 10,154
Allowance for loan and lease losses: Ending balance: Individually evaluated for impairment	$ 387	$ 412	$ 4	$ 5	$ 7	$ -	$ -	$ 815
Collectively evaluated for impairment	3,368	4,335	11	743	733	-	149	9,339
Total	$ 3,755	$ 4,747	$ 15	$ 748	$ 740	$ -	$ 149	$ 10,154
Loans and leases: Ending balance: Individually evaluated for impairment	$ 1,417	$ 7,867	$ 20	$ 1,441	$ 573	$ 115	$ -	$ 11,433
Collectively evaluated for impairment	104,565	340,699	1,367	74,263	54,214	814	-	575,922
Total	$ 105,982	$ 348,566	$ 1,387	$ 75,704	$ 54,787	$ 929	$ -	$ 587,355

* Includes construction loans

** Includes other loans

NOTE: Loan and lease balances do not include $731 thousand in net deferred loan and lease origination costs as of March 31, 2013.

March 31, 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	(409)	(59)	(3)	-	(13)	-	-	(484)
Recoveries	18	-	4	-	6	-	-	28
Provision	252	(46)	6	(74)	24	(411)	-	(249)
Ending balance	$ 3,946	$ 4,565	$ 43	$ 719	$ 785	$ 583	$ 149	$ 10,790
Allowance for loan and lease losses:								
Ending balance:								
Individually evaluated for impairment	$ 637	$ 609	$ 14	$ -	$ 102	$ 280	$ -	$ 1,642
Collectively evaluated for impairment	3,309	3,956	29	719	683	303	149	9,148
Total	$ 3,946	$ 4,565	$ 43	$ 719	$ 785	$ 583	$ 149	$ 10,790
Loans and leases:								
Ending balance:								
Individually evaluated for impairment	$ 1,999	$ 7,948	$ 46	$ 1,047	$ 1,204	$ 712	$ -	$ 12,956
Collectively evaluated for impairment	101,108	332,546	1,900	73,179	53,837	3,800	-	566,370
Total	$ 103,107	$ 340,494	$ 1,946	$ 74,226	$ 55,041	$ 4,512	$ -	$ 579,326

* Includes construction loans

** Includes other loans

NOTE: Loan and lease balances do not include $374 thousand in net deferred loan and lease origination costs as of March 31, 2012.

Impaired Loans and Leases

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

	At March 31, 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	$ 287	$ 399	$ -	$ 301	$ 5	$ 1
Residential real estate:						
Residential	1,109	1,253	-	1,132	38	-
Construction	-	-	-	-	-	-
Commercial real estate:						
Commercial	3,818	4,065	-	3,831	39	31
Construction	739	739	-	739	-	6
Home equities	537	568	-	539	8	-
Direct financing leases	115	117	-	135	2	-
Consumer	-	-	-	-	-	-
Other	-	-	-	-	-	-
Total impaired loans and leases	$ 6,605	$ 7,141	$ -	$ 6,677	$ 92	$ 38

	At March 31, 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	$ 3,029	$ 3,089	$ 640	$ 3,041	$ 11	$ 30
Residential real estate:						
Residential	304	318	5	304	6	-
Construction	-	-	-	-	-	-
Commercial real estate:						
Commercial	3,310	3,486	412	3,341	52	16
Construction	934	934	49	934	-	8
Home equities	36	36	7	36	1	-
Direct financing leases	-	-	-	-	-	-
Consumer	20	51	4	24	1	-
Other	-	-	-	-	-	-
Total impaired loans and leases	$ 7,633	$ 7,914	$ 1,117	$ 7,680	$ 71	$ 54

	At March 31, 2013					
	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Interest Income Foregone	Interest Income Recognized
Total:	(in thousands)					
Commercial and industrial	$ 3,316	$ 3,488	$ 640	$ 3,342	$ 16	$ 31

	-	-	-	-	-	-
Residential real estate:						
Residential	1,413	1,571	5	1,436	44	-
Construction	-	-	-	-	-	-
	-	-	-	-	-	-
Commercial real estate:						
Commercial	7,128	7,551	412	7,172	91	47
Construction	1,673	1,673	49	1,673	-	14
	-	-	-	-	-	-
Home equities	573	604	7	575	9	-
	-	-	-	-	-	-
Direct financing leases	115	117	-	135	2	-
	-	-	-	-	-	-
Consumer	20	51	4	24	1	-
	-	-	-	-	-	-
Other	-	-	-	-	-	-
Total impaired loans and leases	$ 14,238	$ 15,055	$ 1,117	$ 14,357	$ 163	$ 92

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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 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

	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					
		Unpaid		Average	Interest	Interest
	Recorded	Principal	Related	Recorded	Income	Income
	Investment	Balance	Allowance	Investment	Foregone	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 three commercial loans identified as impaired with an unpaid principal balance of $2.8 million as of March 31, 2013, and two commercial loans identified as impaired with an unpaid principal balance of $2.6 as of December 31, 2012, in 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 were $0.3 million at March 31, 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” within the Annual Report for the year ended December, 31, 2012.

Non-performing loans and leases

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

	March 31, 2013	December 31, 2012
	(in thousands)	
Non-accruing loans and leases:		
Commercial and industrial loans	$ 1,169	$ 914
Residential real estate:		
Residential	1,413	1,443
Construction	-	-
Commercial real estate:		
Commercial and multi-family	4,719	4,309
Construction	-	729
Home equities	573	618
Direct financing leases	124	171
Consumer loans	20	44
Other	-	-
Total non-accruing loans and leases	$ 8,018	$ 8,228
Accruing loans 90+ days past due	18	-
Total non-performing loans and leases	$ 8,036	$ 8,228
Total non-performing loans and leases to total assets	0.98 %	1.02 %
Total non-performing loans and leases to total loans and leases	1.37 %	1.41 %

Troubled debt restructurings

The Company had $12.0 million in loans and leases that were restructured in a troubled debt restructuring ("TDR") at March 31, 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 March 31, 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 March 31, 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 five loans restructured prior to 2013 with a combined balance of $1.1 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. Modifications made to loans in a troubled debt restructuring did not have a material impact on the Company's net income for the three month periods ended March 31, 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 March 31, 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 and 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:

	March 31, 2013 ($ in thousands)			
	Total	Nonaccruing	Accruing	Related Allowance
Commercial and industrial	$ 3,199	$ 1,052	$ 2,147	$ 280
Residential real estate:				
Residential	503	475	28	-
Construction	-	-	-	-
Commercial real estate:				
Commercial and multi family	5,852	3,443	2,409	412
Construction	2,365	691	1,674	-
	-	-	-	-
Home equities	-	-	-	-
Direct financing leases	115	51	64	-

Consumer loans	-	-	-	-
Other	-	-	-	-
Total troubled restructured loans and leases	$ 12,034	$ 5,712	$ 6,322	$ 692

	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 month periods ended March 31, 2013 and 2012:

	Three Months Ended March 31, 2013 ($ in thousands)			Three Months Ended March 31, 2012 ($ in thousands)		
Troubled Debt Restructurings	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	2	$ 330	$ 330	2	$ 256	$ 256
Residential Real Estate:						
Residential	1	28	28	-	-	-
Construction	-	-	-	-	-	-
Commercial Real Estate:						
Commercial & Multi-Family	-	-	-	1	85	85
Construction	2	739	739	-	-	-
Home Equities	-	-	-	-	-	-
Direct financing leases	-	-	-	-	-	-
Consumer loans	-	-	-	-	-	-
Other	-	-	-	-	-	-

The general practice of the Bank is to work with borrowers so that they are able to pay back their loan or lease in full. If a borrower continues to be delinquent or cannot meet the terms of a TDR and the loan or lease is determined to be uncollectible, the loan or lease will be charged off. The following table presents loans and leases which were classified as TDR's during the previous 12 months which have defaulted during the three month periods ended March 31, 2013 and 2012:

	Three Months Ended March 31, 2013 ($ in thousands)		Three Months Ended March 31, 2012	
Troubled Debt Restructurings That Subsequently Defaulted	Number of Contracts	Recorded Investment	Number of Contracts	Recorded Investment
Commercial and Industrial	-	$ -	4	$ 1,272
Residential Real Estate:				
Residential	-	-	-	-
Construction	-	-	-	-
Commercial Real Estate:				
Commercial and Multi-Family	-	-	6	4,289
Construction	-	-	-	-
Home Equities	-	-	-	-
Direct financing leases	-	-	-	-
Consumer loans	-	-	-	-
Other	-	-	-	-

Covered Loans and the Related Allowance

On July 24, 2009, the Bank entered into a definitive purchase and assumption agreement with the FDIC under which the Bank assumed approximately $51.0 million in liabilities, consisting almost entirely of deposits, and purchased substantially all of the assets of Waterford Village Bank. The loan portfolio acquired in the transaction totaled $42.0 million. The loans acquired in that acquisition are referred to as "covered" loans because they are "covered" by a loss sharing agreement with the FDIC. The agreement calls for the FDIC to reimburse the Bank for 80% of losses up to $5.6 million and 95% of losses beyond that threshold. At acquisition, the Company marked the covered loan portfolio to its market value and the allowance for loan and lease losses related to the covered loans was zero. Since acquisition, management has provisioned for any incremental increases in estimated credit losses due to deterioration in specific loans or increased risk factors on pools of loans. As a result of the FDIC guarantees, the provision for loan and lease losses and the allowance for loan and lease losses at March 31, 2013 and December 31, 2012 are presented net of FDIC guarantees related to covered loans. The following table depicts the allowance for loan and lease losses related to covered loans as of March 31, 2013 and December 31, 2012:

	March 31, 2013	December 31, 2012
	(in thousands)	
Covered loans	$ 17,444	$ 20,787
Incremental estimated credit losses since acquisition	885	595
FDIC guarantee	(708)	(476)
Allowance for loan and lease losses, covered loans	$ 177	$ 119

5. PER SHARE DATA

The common stock per share information is based upon the weighted average number of shares outstanding during each period. For the three month period ended March 31, 2013, the Company had an average of 36,617 dilutive shares. The Company had an average of 4,674 dilutive shares for the three month period ended March 31, 2012.

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 periods ended March 31, 2013 and 2012, there was an average of 90,071 and 203,394 shares, respectively, that were not included in calculating diluted earnings per share because their effect was anti-dilutive.

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, 2013 and 2012:

	Balance at December 31, 2012	Net Change	Balance at March 31, 2013
Net unrealized loss on investment securities	$ 2,457	$ 261	$ 2,196
Net defined benefit pension plans adjustments	(2,356)	(37)	(2,319)
Total	$ 101	$ 224	$ (123)

	Balance at December 31, 2011	Net Change	Balance at March 31, 2012
Net unrealized loss on investment securities	$ 2,534	$ 115	$ 2,419
Net defined benefit pension plans adjustments	(2,188)	(40)	(2,148)
Total	$ 346	$ 75	$ 271

	Three Months Ended, March 31,					
	2013			2012		
	Before-Tax Amount	Income Tax (Provision) Benefit	Net-of-Tax Amount	Before-Tax Amount	Income Tax (Provision) Benefit	Net-of-Tax Amount
Unrealized loss on investment securities:						
Unrealized loss on investment securities	$ (426)	$ 165	$ (261)	$ (188)	$ 73	$ (115)

Reclassification from accumulated other comprehensive income for (losses) gains		-		-		-		-		-		-
Net change	$	(426)	$	165	$	(261)	$	(188)	$	73	$	(115)
Defined benefit pension plans adjustments:												
Net actuarial (loss) gain	$	-	$	-	$	-	$	-	$	-	$	-
Reclassifications from accumulated other comprehensive income for (losses) gains												
Amortization of prior service cost [(a)]		17		(7)		10		22		(8)		14
Amortization of actuarial loss [(a)]		44		(17)		27		43		(17)		26
Net change	$	61	$	(24)	$	37	$	65	$	(25)	$	40
Other Comprehensive Loss	$	(365)	$	141	$	(224)	$	(123)	$	48	$	(75)

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

7. SEGMENT INFORMATION

The Company is comprised of two primary business segments, banking and insurance agency activities. The following tables set forth information regarding these segments for the three month periods ended March 31, 2013 and 2012.