EVANS BANCORP INC
Form 10-K
March 03, 2014
UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K

[X]ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the fiscal year ended: December 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 incorporation or organization)	(I.R.S. Employer Identification No.)

One Grimsby Drive, Hamburg, New York	14075
(Address of principal executive offices)	(Zip Code)

(716) 926-2000
Registrant's telephone number (including area code)

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

Title of Each Class	Name of Each Exchange on Which Registered
Common Stock, Par Value $.50 per share	NYSE MKT LLC

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

None
(Title of Class)

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.

Yes No X

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act.

Yes No X

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 checkmark 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 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 if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. [ ]

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 a 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 Act).

Yes No X

On June 28, 2013, the aggregate market value of the registrant's common stock held by non-affiliates was approximately $52.7 million, based upon the closing sale price of a share of the registrant's common stock on the NYSE MKT LLC.

As of February 28, 2014, 4,206,631 shares of the registrant's common stock were outstanding.

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DOCUMENTS INCORPORATED BY REFERENCE

Portions of the registrant's Proxy Statement relating to the registrant's 2014 Annual Meeting of Shareholders, to be held on April 24, 2014, which will be subsequently filed with the Securities and Exchange Commission within 120 days after the end of the fiscal year to which this Report relates, are incorporated by reference into Part III of this Annual Report on Form 10-K where indicated.

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PART I

FORWARD LOOKING STATEMENTS

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

These forward-looking statements are based largely on the expectations of the Company’s management and are subject to a number of risks and uncertainties, including but not limited to: general economic conditions, either nationally or in the Company’s market areas, that are worse than expected; increased competition among depository or other financial institutions; inflation and changes in the interest rate environment that reduce the Company’s margins or reduce the fair value of financial instruments; changes in laws or government regulations affecting financial institutions, including changes in regulatory fees and capital requirements; the Company’s ability to enter new markets successfully and capitalize on growth opportunities; the Company’s ability to successfully integrate acquired entities; changes in accounting pronouncements and practices, as adopted by financial institution regulatory agencies, the Financial Accounting Standards Board (“FASB”) and the Public Company Accounting Oversight Board; changes in consumer spending, borrowing and saving habits; changes in the Company’s organization, compensation and benefit plans; and other factors discussed elsewhere in this Annual Report on Form 10-K including the risk factors described in Item 1A, as well as in the Company’s periodic reports filed with the Securities and Exchange Commission (the “SEC”). Many of these factors are beyond the Company’s control and are difficult to predict.

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

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Item 1.BUSINESS

EVANS BANCORP, INC.

Evans Bancorp, Inc. (the "Company") is a New York business corporation which is registered as a financial holding company under the Bank Holding Company Act of 1956, as amended (the "BHCA"). The principal office of the Company is located at One Grimsby Drive, Hamburg, NY 14075 and its telephone number is (716) 926-2000. This facility is occupied by the Office of the President and Chief Executive Officer of the Company, as well as the Administrative and Loan Divisions of Evans Bank. The Company was incorporated on October 28, 1988, but the continuity of its banking business is traced to the organization of the Evans National Bank of Angola on January 20, 1920. 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 Company's common stock is traded on the NYSE MKT under the symbol "EVBN."

At December 31, 2013, the Company had consolidated total assets of $833.5 million, deposits of $706.6 million and stockholders' equity of $80.7 million.

The Company's primary business is the operation of its subsidiaries. It does not engage in any other substantial business activities. The Company has two direct wholly-owned subsidiaries: (1) Evans Bank, N.A. ("Evans Bank" or the "Bank"), which provides a full range of banking services to consumer and commercial customers in Western New York; and (2) Evans National Financial Services, LLC ("ENFS"), which owns 100% of the membership interests in The Evans Agency, LLC ("TEA"), which sells various premium-based insurance policies on a commission basis. At December 31, 2013, the Bank represented 98.0% and ENFS represented 2.0% of the consolidated assets of the Company. Further discussion of our segments is included in Note 18 to the Company's Consolidated Financial Statements included under Item 8 of this Annual Report on Form 10-K.

Evans Bank

The Bank is a nationally chartered bank that has its headquarters at One Grimsby Drive, Hamburg, NY, and a total of 13 full-service banking offices in Erie County and Chautauqua County, NY.

At December 31, 2013, the Bank had total assets of $824.0 million, investment securities of $104.9 million, net loans of $635.5 million, deposits of $713.8 million and stockholders' equity of $71.7 million, compared to total assets of

$799.6 million, investment securities of $95.8 million, net loans of $573.2 million, deposits of $683.4 million and stockholders' equity of $73.1 million at December 31, 2012. The Bank offers deposit products, which include checking and NOW accounts, savings accounts, and certificates of deposit, as its principal source of funding. The Bank's deposits are insured up to the maximum permitted by the Bank Insurance Fund (the "Insurance Fund") of the Federal Deposit Insurance Corporation ("FDIC"). The Bank offers a variety of loan products to its customers, including commercial and consumer loans and commercial and residential mortgage loans.

As is the case with banking institutions generally, the Bank's operations are significantly influenced by general economic conditions and by related monetary and fiscal policies of banking regulatory agencies, including the Federal Reserve Board ("FRB") and FDIC. The Bank is also subject to the supervision, regulation and examination of the Office of the Comptroller of the Currency of the United States of America (the "OCC").

The Evans Agency, LLC

TEA, a property and casualty insurance agency, is a wholly-owned subsidiary of ENFS. TEA is headquartered in Hamburg, NY, with offices located throughout Western New York. TEA is a full-service insurance agency offering personal, commercial and financial services products. For the year ended December 31, 2013, TEA had total revenue of $6.7 million.

TEA's primary market area is Erie, Chautauqua, Cattaraugus and Niagara counties. Most lines of personal insurance are provided, including automobile, homeowners, boat, recreational vehicle, landlord, and umbrella coverage. Commercial insurance products are also provided, consisting of property, liability, automobile, inland marine, workers compensation, bonds, crop and umbrella insurance. TEA also provides the following financial services products: life and disability insurance, Medicare supplements, long term care, annuities, mutual funds, retirement programs and New York State Disability.

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Other Subsidiaries

In addition to the Bank and TEA, the Company has the following direct and indirect wholly-owned subsidiaries:

Evans National Leasing, Inc. (“ENL”). ENL, a wholly-owned subsidiary of the Bank, provided direct financing leasing of commercial small-ticket general business equipment to companies located throughout the contiguous 48 United States. The Company announced in April 2009 that it was exiting the leasing business. After attempting to sell the leasing portfolio, management decided to service it through to maturity.

Evans National Holding Corp. (“ENHC”). ENHC, a wholly-owned subsidiary of the Bank, operates as a real estate investment trust that holds commercial real estate loans and residential mortgages, providing additional flexibility and planning opportunities for the business of the Bank.

Suchak Data Systems, LLC (“SDS”). SDS, a wholly-owned subsidiary of the Bank, serves the data processing needs of financial institutions with customized solutions and consulting services. SDS hosts the Bank’s core and primary banking systems and provides product development and programming services. SDS’s products and services for its other customers include online banking systems, check imaging, item processing, and automated teller machine (“ATM”) services.

Evans National Financial Services, LLC (“ENFS”). ENFS is a wholly-owned subsidiary of the Company. ENFS's primary business is to own the business and assets of the Company’s non-banking financial services subsidiaries.

Frontier Claims Services, Inc. (“FCS”). FCS is a wholly-owned subsidiary of TEA and provides claims adjusting services to various insurance companies.

The Company also has two special purpose entities: Evans Capital Trust I, a statutory trust formed in September 2004 under the Delaware Statutory Trust Act, solely for the purpose of issuing and selling certain securities representing undivided beneficial interests in the assets of the trust, investing the proceeds thereof in certain debentures of the Company and engaging in those activities necessary, advisable or incidental thereto; and ENB Employers Insurance Trust, a Delaware trust company formed in February 2003 for the sole purpose of holding life insurance policies under the Bank’s bank-owned life insurance (“BOLI”) program.

The Company operates in two operating segments – banking activities and insurance agency activities. See Note 18 to the Company’s Consolidated Financial Statements included under Item 8 of this Annual Report on Form 10-K for more information on the Company’s operating segments.

MARKET AREA

The Company’s primary market area is Erie County, Niagara County, northern Chautauqua County and northwestern Cattaraugus County, NY. This primary market area is the area where the Bank principally receives deposits and makes loans and TEA sells insurance. Even though ENL conducted business outside of this defined market area, prior to the Company’s decision to exit the leasing business in 2009, this activity was not deemed to expand the Company’s primary market.

MARKET RISK

For information about, and a discussion of, the Company's "Market Risk," see Part II, Item 7 "Management's Discussion and Analysis of Financial Condition and Results of Operations - Market Risk" of this Annual Report on Form 10-K.

COMPETITION

All phases of the Company’s business are highly competitive. The Company competes actively with local, regional and national financial institutions, as well as with bank branches and insurance agency offices in the Company’s primary market area of Erie County, Niagara County, northern Chautauqua County, and northwestern Cattaraugus County, NY. These Western New York counties have a high density of financial institutions, many of which are significantly larger and have greater financial resources than the Company. The Company faces competition for loans and deposits from other commercial banks, savings banks, internet banks, savings and loan associations, mortgage banking companies, credit unions, insurance companies and other financial services companies. The Company faces additional competition for deposits and insurance business from non-depository competitors such as the mutual fund industry, securities and brokerage firms, and insurance companies and brokerages.   In the personal insurance area, the majority of TEA’s competition comes from direct writers, as well as some small local agencies located in the same towns and villages in

which TEA has offices. In the commercial business segment, the majority of the competition comes from larger agencies located in and around Buffalo, NY. By offering the large number of carriers which it has available to its customers, TEA has attempted to remain competitive in all aspects of its business.

As an approximate indication of the Company's competitive position, in Erie County, NY, where 13 of the Company's banking offices are located, the Bank had the sixth most deposits according to the FDIC's annual deposit market share report as of June 30, 2013 with 2.0% of the total market's deposits of $33.0 billion. By comparison, the market leaders, M&T Bank and First Niagara Financial Group, have 74.8% of the county's deposits combined. The Company attempts to be generally competitive with all financial institutions in its service area with respect to interest rates paid on time and savings deposits, service charges on deposit accounts, and interest rates charged on loans.

SUPERVISION AND REGULATION

Bank holding companies and banks are extensively regulated under both federal and state laws and regulations that are intended to protect depositors and investors. Because the Company is a public company with shares traded on the NYSE MKT, it is subject to regulation by the Securities and Exchange Commission, as well as the listing standards required by NYSE MKT. To the extent that the following summary describes statutory and regulatory provisions, it is qualified in its entirety by reference to the particular statutory and regulatory provisions. Any change in the applicable law or regulation, or a change in the way such laws or regulations are interpreted by regulatory agencies or courts, may have a material adverse effect on the Company's business, financial condition and results of operations.

Bank Holding Company Regulation (BHCA)

As a financial holding company registered under the BHCA, the Company and its non-banking subsidiaries are subject to regulation and supervision under the BHCA by the FRB. The FRB requires periodic reports from the Company, and is authorized by the BHCA to make regular examinations of the Company and its subsidiaries. Under Regulation Y, a bank holding company must serve as a source of financial and managerial strength for its subsidiary banks and must not conduct its operations in an unsafe or unsound manner.

The Company is required to obtain the prior approval of the FRB before merging with or acquiring all or substantially all of the assets of, or direct or indirect ownership or control of more than 5% of the voting shares of, a bank or bank holding company. The FRB will not approve any acquisition, merger or consolidation that would have a substantial anti-competitive result, unless the anti-competitive effects of the proposed transaction are outweighed by a greater public interest in meeting the needs and convenience of the public.

The FRB also considers managerial, capital and other financial factors in acting on acquisition or merger applications. A bank holding company may not engage in, or acquire direct or indirect control of more than 5% of the voting shares of any company engaged in any non-banking activity, unless such activity has been determined by the FRB to be closely related to banking or managing banks. The FRB has identified by regulation various non-banking activities in which a bank holding company may engage with notice to, or prior approval by, the FRB.

The FRB has enforcement powers over financial holding companies and their subsidiaries, among other things, to interdict activities that represent unsafe or unsound practices or constitute violations of law, rule, regulation, administrative orders, or written agreements with a federal bank regulator. These powers may be exercised through the issuance of cease and desist orders, civil monetary penalties or other actions.

Bank holding companies and their subsidiary banks are also subject to the provisions of the Community Reinvestment Act ("CRA"). Under the terms of the CRA, the FRB (or other appropriate bank regulatory agency, in the case of the Bank, the OCC) is required, in connection with its examination of a bank, to assess such bank's record in meeting the credit needs of the communities served by that bank, including low and moderate-income neighborhoods. Furthermore, such assessment is taken into account in evaluating any application made by a bank holding company or a bank for, among other things, approval of a branch or other deposit facility, office relocation, a merger or an acquisition of bank shares.

Supervision and Regulation of Bank Subsidiaries

The Bank is a nationally chartered banking corporation subject to supervision, examination and regulation by the FRB, the FDIC and the OCC. These regulators have the power to enjoin "unsafe or unsound practices," require affirmative action to correct any conditions resulting from any violation or practice, issue an administrative order that can be judicially enforced, direct an increase in capital, restrict the growth of a bank, assess civil monetary penalties, and remove a bank's officers and directors.

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The operations of the Bank are subject to numerous statutes and regulations. Such statutes and regulations relate to required reserves against deposits, investments, loans, mergers and consolidations, issuance of securities, payment of dividends, establishment of branches, and other aspects of the Bank's operations. Various consumer laws and regulations also affect the operations of the Bank, including state usury laws, laws relating to fiduciaries, consumer credit and equal credit, fair credit reporting, and privacy of non-public financial information.

The Bank is subject to Sections 23A and 23B of the Federal Reserve Act and Regulation W there under, which govern certain transactions, such as loans, extensions of credit, investments and purchases of assets between member banks and their affiliates, including their parent holding companies. These restrictions limit the transfer from its subsidiaries, including the Bank, of funds to the Company in the form of loans, extensions of credit, investments or purchases of assets (collectively, "Transfers"), and they require that the Bank's transactions with the Company be on terms no less favorable to the Bank than comparable transactions between the Bank and unrelated third parties. Transfers by the Bank to any affiliate (including the Company) are limited in amount to 10% of the Bank's capital and surplus, and transfers to all affiliates are limited in the aggregate to 20% of the Bank's capital and surplus. Furthermore, such loans and extensions of credit are also subject to various collateral requirements. These regulations and restrictions may limit the Company's ability to obtain funds from the Bank for its cash needs, including funds for acquisitions, and the payment of dividends, interest and operating expenses.

The Bank is prohibited from engaging in certain tying arrangements in connection with any extension of credit, lease or sale of property or furnishing of services. For example, the Bank may not generally require a customer to obtain other services from the Bank or the Company, and may not require the customer to promise not to obtain other services from a competitor as a condition to an extension of credit. The Bank is also subject to certain restrictions imposed by the Federal Reserve Act on extensions of credit to executive officers, directors, principal stockholders or any related interest of such persons. Extensions of credit: (i) must be made on substantially the same terms (including interest rates and collateral) as those prevailing at the time for, and following credit underwriting procedures that are not less stringent than those applicable to, comparable transactions with persons not covered above and who are not employees, and (ii) must not involve more than the normal risk of repayment or present other unfavorable features. The Bank is also subject to certain lending limits and restrictions on overdrafts to such persons. A violation of these restrictions may result in the assessment of substantial civil monetary penalties on the Bank or any officer, director, employee, agent or other person participating in the conduct of the affairs of the Bank or the imposition of a cease and desist order.

As insurer, the FDIC imposes deposit insurance premiums and is authorized to conduct examinations of and to require reporting by, insured institutions. It may also prohibit an insured institution from engaging in any activity the FDIC determines by regulation or order to pose a serious threat to the FDIC. The FDIC also has the authority to initiate enforcement actions against insured institutions. The FDIC may terminate the deposit insurance of any insured depository institution, including the Bank, if it determines after a hearing that the institution has engaged or is engaging in unsafe or unsound practices, is in an unsafe or unsound condition to continue operations, or has violated any applicable law, regulation, order or any condition imposed by an agreement with the FDIC.

The FDIC has adopted a risk-based premium system that provides for quarterly assessments based on an insured institution's ranking in one of four risk categories based on their examination ratings and capital ratios. In addition, all FDIC-insured institutions are required to pay assessments to the FDIC to fund interest payments on bonds issued by the Financing Corporation ("FICO"), a mixed-ownership Federal government corporation established to recapitalize the Federal Savings and Loan Insurance Corporation. The current annualized assessment rate is 0.62 basis points, or approximately 0.16 basis points per quarter. These assessments will continue until the Financing Corporation bonds mature in 2019. Pursuant to the Dodd-Frank Act, the deposit insurance assessment base was redefined in 2011 to reflect consolidated total assets less average tangible equity. The result is that larger financial institutions, which have more assets leveraged with non-deposit wholesale funds, generally have paid a greater percentage of the aggregate insurance assessment and smaller banks, including the Bank, have paid less.

Regulations promulgated by the FDIC pursuant to the Federal Deposit Insurance Corporation Improvement Act of 1991 place limitations on the ability of certain insured depository institutions to accept, renew or rollover deposits by offering rates of interest which are significantly higher than the prevailing rates of interest on deposits offered by other depository institutions having the same type of charter in such depository institutions' normal market area. Under these regulations, well-capitalized institutions may accept, renew or rollover such deposits without restriction, while adequately capitalized institutions may accept, renew or rollover such deposits with a waiver from the FDIC (subject to certain restrictions on payment of rates). Undercapitalized institutions may not accept, renew or rollover such deposits.

Under the Financial Institutions Reform, Recovery and Enforcement Act of 1989, a depository institution insured by the FDIC can be held liable for any loss incurred by, or reasonably expected to be incurred by, the FDIC in connection with:

(i) the default of a commonly controlled FDIC-insured depository institution, or (ii) any assistance provided by the FDIC to a commonly controlled FDIC-insured institution in danger of default. "Default" is defined generally as the appointment of a conservator or receiver, and "in danger of default" is defined generally as the existence of certain conditions indicating that, in the opinion of the appropriate banking agency, a "default" is likely to occur in the absence of regulatory assistance.

In addition to the forgoing, federal regulators have adopted regulations and examination procedures promoting the safety and soundness of individual institutions by specifically addressing, among other things: (i) internal controls, information systems and internal audit systems; (ii) loan documentation; (iii) credit underwriting; (iv) interest rate exposure; (v) asset growth; (vi) ratio of classified assets to capital; (vii) minimum earnings; and (viii) compensation and benefits standards for management officials. Federal Reserve Board's regulations, for example, generally require a holding company to give the Federal Reserve Board prior notice of any redemption or repurchase of its own equity securities, if the consideration to be paid, together with the consideration paid for any repurchases or redemptions in the preceding year, is equal to 10% or more of the company's consolidated net worth. The Federal Reserve Board has broad authority to prohibit activities of bank holding companies and their non-banking subsidiaries which represent unsafe and unsound banking practices or which constitute violations of laws or regulations, and can assess civil money penalties for certain activities conducted on a knowing and reckless basis, if those activities caused a substantial loss to a depository institution.

Dividends paid by the Bank have been the Company's primary source of operating funds and are expected to be for the foreseeable future. Capital adequacy requirements serve to limit the amount of dividends that may be paid by the Bank. Under OCC regulations, the Bank may not pay a dividend, without prior OCC approval, if the total amount of all dividends declared during the calendar year, including the proposed dividend, exceed the sum of its retained net income to date during the calendar year and its retained net income over the preceding two years. As of December 31, 2013, approximately $12.8 million was available for the payment of dividends without prior OCC approval. The Bank's ability to pay dividends is also subject to the Bank being in compliance with regulatory capital requirements. As indicated below, at December 31, 2013, the Bank was in compliance with these requirements.

Because the Company is a legal entity separate and distinct from the Bank, the Company's right to participate in the distribution of assets of the Bank in the event of the Bank's liquidation or reorganization would be subject to the prior claims of the Bank's creditors. In the event of a liquidation or other resolution of an insured depository institution, the claims of depositors and other general or subordinated creditors are entitled to a priority of payment over the claims of unsecured, non-deposit creditors, including a parent bank holding company (such as the Company) or any shareholder or creditor thereof.

The FRB, the OCC and other federal banking agencies have broad enforcement powers, including the power to terminate deposit insurance, to impose substantial fines and other civil and criminal penalties, and to appoint a conservator or receiver for the assets of a regulated entity. Failure to comply with applicable laws, regulations and supervisory agreements could subject the Company or its subsidiaries, as well as officers, directors and other institution-affiliated parties of these organizations, to administrative sanctions and potential civil monetary penalties.

Capital Adequacy

The FRB, the FDIC and the OCC have adopted risk-based capital adequacy guidelines for bank holding companies and banks under their supervision. These capital adequacy guidelines will be modified pursuant to the Basel III reform measures, described below. Under existing guidelines, the so-called “Tier 1 capital” and “Total capital” as a percentage of risk-weighted assets and certain off-balance sheet instruments must be at least 4% and 8%, respectively.

The FRB, the FDIC and the OCC have also imposed a leverage standard to supplement their risk-based ratios. This leverage standard focuses on a banking institution’s ratio of Tier 1 capital to average total assets, adjusted for goodwill and certain other items. Under these guidelines, banking institutions that meet certain criteria, including excellent asset quality, high liquidity, low interest rate exposure and good earnings, and that have received the highest regulatory rating must maintain a ratio of Tier 1 capital to total adjusted average assets of at least 3%.

Institutions not meeting these criteria, as well as institutions with supervisory, financial or operational weaknesses, along with those experiencing or anticipating significant growth, are expected to maintain a Tier 1 capital to total adjusted average assets ratio equal to at least 4%. As reflected in the following table, the risk-based capital ratios and leverage ratios of the Company and the Bank as of December 31, 2013 and 2012 exceeded the required capital ratios for classification as “well capitalized,” the highest classification under the regulatory capital guidelines.

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Capital Components and Ratios

(dollars in thousands)

	December 31, 2013 (dollars in thousands)							
					Minimum for Capital Adequacy Purposes		Minimum to be Well Capitalized Under Prompt Corrective Action Provisions	
	Company Amount	Ratio	Bank Amount	Ratio	Amount	Ratio	Amount	Ratio
Total Risk-Based Capital (to Risk Weighted Assets)	$ 92,879	14.9 %	$ 86,757	13.9 %	$ 49,864	8.0 %	$ 62,330	10.0 %
Tier I Capital (to Risk Weighted Assets)	$ 85,044	13.6 %	$ 78,932	12.7 %	$ 24,932	4.0 %	$ 37,398	6.0 %
Tier I Capital (to Average Assets)	$ 85,044	10.4 %	$ 78,932	9.6 %	$ 32,823	4.0 %	$ 41,029	5.0 %

	December 31, 2012 (dollars in thousands)							
					Minimum for Capital Adequacy Purposes		Minimum to be Well Capitalized Under Prompt Corrective Action Provisions	
	Company Amount	Ratio	Bank Amount	Ratio	Amount	Ratio	Amount	Ratio
Total Risk-Based Capital (to Risk Weighted Assets)	$ 84,843	14.7 %	$ 80,251	13.9 %	$ 46,287	8.0 %	$ 57,859	10.0 %
Tier I Capital (to Risk Weighted Assets)	$ 77,580	13.4 %	$ 72,988	12.6 %	$ 23,143	4.0 %	$ 34,715	6.0 %
Tier I Capital (to Average Assets)	$ 77,580	9.7 %	$ 72,988	9.1 %	$ 32,020	4.0 %	$ 40,026	5.0 %

The federal banking agencies, including the FRB and the OCC, maintain risk-based capital standards in order to ensure that those standards take adequate account of interest rate risk, concentration of credit risk, the risk of non-traditional activities and equity investments in non-financial companies, as well as reflect the actual performance and expected risk of loss on certain multifamily housing loans. Bank regulators periodically propose amendments to the risk-based capital guidelines and related regulatory framework, and consider changes to the risk-based capital standards that could significantly increase the amount of capital needed to meet the requirements for the capital tiers described below. While the Company's management studies such proposals, the timing of adoption, ultimate form and effect of any such proposed amendments on the Company's capital requirements and operations cannot be predicted.

The federal banking agencies are required to take "prompt corrective action" in respect of depository institutions and their bank holding companies that do not meet minimum capital requirements. The Federal Deposit Insurance Act established five capital tiers: "well capitalized," "adequately capitalized," "undercapitalized," "significantly undercapitalized" and "critically undercapitalized." A depository institution's capital tier, or that of its bank holding company, depends upon where its capital levels are in relation to various relevant capital measures, including a risk-based capital measure and a leverage ratio capital measure, and certain other factors.

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Under the implementing regulations adopted by the federal banking agencies, a bank holding company or bank is considered “well capitalized” if it has: (i) a total risk-based capital ratio of 10% or greater; (ii) a Tier 1 risk-based capital ratio of 6% or greater; and (iii) a leverage ratio of 5% or greater; and is not subject to any order or written directive to meet and maintain a specific capital level for a capital measure. An “adequately capitalized” bank holding company or bank is defined as one that has: (i) a total risk-based capital ratio of 8% or greater; (ii) a Tier 1 risk-based capital ratio of 4% or greater; and (iii) a leverage ratio of 4% or greater (or 3% or greater in the case of a bank with a composite CAMELS rating of (1)). A bank holding company or bank is considered (A) “undercapitalized” if it has: (i) a total risk-based capital ratio of less than 8%; (ii) a Tier 1 risk-based capital ratio of less than 4%; or (iii) a leverage ratio of less than 4% (or 3% in the case of a bank with a composite CAMELS rating of (1)); (B) “significantly undercapitalized” if it has: (i) a total risk-based capital ratio of less than 6%; or (ii) a Tier 1 risk-based capital ratio of less than 3%; or (iii) a leverage ratio of less than 3%; and (C) “critically undercapitalized” if it has a ratio of tangible equity to total assets equal to or less than 2%. The FRB may reclassify a “well capitalized” bank holding company or bank as “adequately capitalized” or subject an “adequately capitalized” or “undercapitalized” institution to the supervisory actions applicable to the next lower capital category if it determines that the bank holding company or bank is in an unsafe or unsound condition or deems the bank holding company or bank to be engaged in an unsafe or unsound practice and not to have corrected the deficiency. As of December 31, 2013, the Company and the Bank met the definition of “well capitalized” institutions.

“Undercapitalized” depository institutions, among other things: are subject to growth limitations; are prohibited, with certain exceptions, from making capital distributions; are limited in their ability to obtain funding from a Federal Reserve Bank; and are required to submit a capital restoration plan. The federal banking agencies may not accept a capital plan without determining, among other things, that the plan is based on realistic assumptions and is likely to succeed in restoring the depository institution’s capital. In addition, for a capital restoration plan to be acceptable, the depository institution’s parent holding company must guarantee that the institution will comply with such capital restoration plan and provide appropriate assurances of performance. If a depository institution fails to submit an acceptable plan, including if the holding company refuses or is unable to make the guarantee described in the previous sentence, it is treated as if it is “significantly undercapitalized.” Failure to submit or implement an acceptable capital plan also is grounds for the appointment of a conservator or a receiver. “Significantly undercapitalized” depository institutions may be subject to a number of additional requirements and restrictions, including orders to sell sufficient voting stock to become “adequately capitalized,” requirements to reduce total assets and cessation of receipt of deposits from correspondent banks. Moreover, the parent holding company of a “significantly undercapitalized” depository institution may be ordered to divest itself of the institution or of non-bank subsidiaries of the holding company. “Critically undercapitalized” institutions, among other things, are prohibited from making any payments of principal and interest on subordinated debt, and are subject to the appointment of a receiver or conservator.

Each federal banking agency prescribes standards for depository institutions and depository institution holding companies relating to internal controls, information systems, internal audit systems, loan documentation, credit underwriting, interest rate exposure, asset growth, compensation, a maximum ratio of classified assets to capital, minimum earnings sufficient to absorb losses, a minimum ratio of market value to book value for publicly traded shares and other standards as they deem appropriate. The FRB and the OCC have adopted such standards.

Dodd-Frank Wall Street Reform and Consumer Protection Act

The Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act") was signed into law by President Obama on July 21, 2010. It is widely regarded as the most sweeping change to financial regulation since the Great Depression. The law is intended to achieve the following objectives: promote robust supervision and regulation of financial firms; establish comprehensive supervision of financial markets; protect consumers and investors from financial abuse; provide the government with the tools to manage a financial crisis; and raise international regulatory standards and improve international cooperation. The Dodd-Frank Act requires more than 60 studies to be conducted and more than 200 regulations to be written. The true impact of the legislation will be unknown until these are complete. Some of the most significant aspects of The Dodd-Frank Act include:

I. The creation of a new oversight regulator, the Financial Stability Oversight Council. The council of regulators monitors and the financial system for systemic risk and will determine which entities pose significant systemic risk and should be subject to greater federal regulation and oversight.

II. The Collins Amendment, which requires the federal banking agencies to establish minimum leverage capital and risk-based capital requirements for insured depository institutions, depository institution holding companies and non-bank financial companies supervised by the FRB (also known as systemically significant financial institutions). The Collins Amendment provides that for certain large depository

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institution holding companies (greater than $15 billion in assets), certain hybrid financial instruments, such as trust preferred securities issued after May 19, 2010, must be phased out of Tier 1 capital over a three-year period beginning January 1, 2013. The Company was well below this threshold at December 31, 2013. At December 31, 2013, the Company had $11.3 million in trust preferred securities included in Tier 1 capital.

III. The Durbin Amendment, which provided that interchange fees that a card issuer or payment network receives or charges for debit transactions will now be regulated by the FRB and must be "reasonable and proportional" to the cost incurred by the card issuer in authorizing, clearing and settling the transaction. The pricing provisions of the Durbin Amendment apply to card issuing financial institutions with more than $10 billion in assets. The Durbin Amendment also prohibits all issuers and networks from restricting the number of networks over which electronic debit transactions may be processed to less than two unaffiliated networks, and prohibits issuers and networks from inhibiting a merchant's ability to direct the routing of the electronic debit transaction over any network that the issuer has enabled to process them. Although the Bank is exempt from the pricing provisions of the Durbin Amendment, it may be impacted by this provision if it has to match the reduced rates being offered by larger competitors. Such a result could have a material adverse effect on the Company's results of operations and cash flows.

IV. A number of deposit insurance reforms, which have generally benefitted the Bank. First, the Dodd-Frank Act redefined the deposit insurance assessment base to reflect consolidated total assets less average tangible equity. The result is that larger financial institutions, which have more assets leveraged with non-deposit wholesale funds, have paid a greater percentage of the aggregate insurance assessment, while smaller banks (such as the Bank) have paid less than they would have under the prior rules. The Dodd-Frank Act also increased the minimum reserve ratio of the Deposit Insurance Fund from 1.15% to 1.35%, but exempted institutions with assets less than $10 billion from funding the cost of the increase. The title also permanently increased deposit insurance coverage to $250,000 per account (subject to certain limitations).

V. A permanent exemption from the provisions of Section 404(b) of the Sarbanes-Oxley Act ("SOX"), which requires that public companies receive an opinion from their external auditors as to the effectiveness of their internal control over financial reporting, for companies with a public market capitalization under $75 million. As a smaller reporting company, the Company qualifies for this exemption. However, the Audit Committee of the Board of Directors and the Company's management have decided to continue to voluntarily comply with SOX 404(b) as they believe it is in the best interest of the Company and its shareholders.

VI. Establishment of the Consumer Financial Protection Bureau (the "CFPB"), an independent agency with the authority to prohibit practices that it finds to be unfair, deceptive, or abusive, in addition to requiring certain disclosures.

VII. The imposition of new regulations on mortgage loan originators, including the imposition of new disclosure requirements and appraisal reforms, such as: the creation of a mortgage originator duty of care; the establishment of certain underwriting requirements designed to ensure that at the time of origination the consumer has a reasonable ability to repay the loan; the creation of document requirements intended to eliminate "no document" and "low document" loans; the prohibition of steering incentives for mortgage originators; a prohibition on yield spread premiums and prepayment penalties in some cases; and a provision that allows borrowers to assert as a foreclosure defense a contention that the lender violated the anti-steering restrictions or the reasonable repayment

requirements.

Basel III

In addition to the Dodd-Frank Act, the international oversight body of the Basel Committee on Banking Supervision reached agreements to require more and higher-quality capital, known as Basel III, in July 2010. Basel III is a comprehensive set of reform measures designed to strengthen the regulation, supervision and risk management of the banking sector. These measures aim to improve the banking sector's ability to absorb shocks arising from financial and economic stress, whatever the source, improve risk management and governance, and strengthen banks' transparency and disclosures. The federal banking agencies issued a final rule to implement Basel III as well as the minimum leverage and risk-based capital requirements of the Dodd-Frank Act in July 2013.

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The Basel III Rules apply to both depository institutions and (subject to certain exceptions not applicable to the Company) their holding companies. Basel III constitutes a fundamental redefinition of bank capital requirements, and increases the minimum requirements for both the quantity and quality of capital held by the Company and the Bank.

The minimum capital level requirements applicable to the Company and the Bank under the Basel III rules are: a new common equity Tier 1 risk-based capital ratio requirement of 4.5%, a Tier 1 risk-based capital ratio of 6.0% (increased from 4.0%), a total risk-based capital ratio of 8.0% (unchanged from current rules), and a Tier 1 leverage ratio of 4.0%. Common equity Tier 1 capital consists of common stock instruments that meet the eligibility criteria in the final rules, retained earnings, accumulated other comprehensive income and common equity Tier 1 minority interest.

The rule also requires a capital conservation buffer composed of common equity Tier 1 capital in an amount greater than 2.5% of total risk-weighted assets. The capital conservation buffer will be phased in over three years beginning in 2016. The capital buffer requirement effectively raises the minimum required common equity Tier 1 capital ratio to 7.0%, the Tier 1 capital ratio to 8.5%, and the total capital ratio to 10.5% on a fully phased-in basis. Institutions that do not maintain the required capital buffer will become subject to progressively more stringent limitations on the percentage of earnings that can be paid out in dividends or used for stock repurchases and on the payment of discretionary bonuses to senior executive management.

The final rules also increase the required capital for certain categories of assets, including higher-risk construction real estate loans and certain exposures related to securitizations. The final rules do not, however, adopt the changes in the proposed rule to the risk weights assigned to certain mortgage loan assets. The final rules instead adopt the risk weights for residential mortgages under the existing general risk-based capital rules, which assign a risk weight of either 50% (for most first-lien exposures) or 100% for other residential mortgage exposures.

In addition, the final rule includes certain exemptions to address concerns about the regulatory burden on community banks. For example, as indicated above, banking organizations with less than $15 billion in consolidated assets as of December 31, 2009 are permitted to include in Tier 1 capital trust preferred securities and cumulative perpetual preferred stock issued and included in Tier 1 capital prior to May 19, 2010 on a permanent basis, without any phase out. Community banks may also elect on a one time basis in their March 31, 2015 quarterly filings to opt-out out of the onerous requirement to include most accumulated other comprehensive income (“AOCI”) components in the calculation of common equity Tier 1 capital and, in effect, retain the AOCI treatment under the current capital rules. Under the final rule, the Company may make a one-time, permanent election to continue to exclude AOCI from capital. If the Company does not make this election, unrealized gains and losses would be included in the calculation of its regulatory capital.

The new minimum capital ratios will become effective for us on January 1, 2015 and will be fully phased-in on January 1, 2019. Management believes that, as of December 31, 2013, the Company and the Bank would have met all capital adequacy requirements under the Basel III Capital Rules on a fully phased-in basis as if such requirements had been in effect on that date.

Potential risks of Basel III to the Company are detailed in the Risk Factors section.

Regulation of Insurance Agency Subsidiary

TEA is regulated by the New York State Insurance Department. As of the date of this report, TEA meets and maintains all licensing and continuing education requirements required by the State of New York.

Monetary Policy and Economic Control

The commercial banking business is affected not only by general economic conditions, but also by the monetary policies of the FRB. Changes in the discount rate on member bank borrowing, availability of borrowing at the "discount window," open market operations, the imposition of changes in reserve requirements against member banks' deposits and assets of foreign branches and the imposition of and changes in reserve requirements against certain borrowings by banks and their affiliates are some of the instruments of monetary policy available to the FRB. These monetary policies are used in varying combinations to influence overall growth and distributions of bank loans, investments and deposits, and this use may affect interest rates charged on loans or paid on deposits. The monetary policies of the FRB have had a significant effect on the operating results of commercial banks and are expected to continue to do so in the future. The monetary policies of these agencies are influenced by various factors, including inflation, unemployment, and short-term and long-term changes in the international trade balance and in the fiscal policies of the United States Government.

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Future monetary policies and the effect of such policies on the future business and earnings of the Company cannot be predicted.

Consumer Laws and Regulations

In addition to the laws and regulations discussed herein, the Bank is also subject to certain consumer laws and regulations that are designed to protect consumers in transactions with banks. These laws and regulations include, but are not limited to, the Truth in Lending Act, the Truth in Savings Act, the Electronic Funds Transfer Act, the Expedited Funds Availability Act, the Equal Credit Opportunity Act, the Fair Housing Act, the Home Mortgage Disclosure Act, the Real Estate Settlement Procedures Act, Federal Financial Privacy Laws, Interagency Guidelines Establishing Information Security Standards, the Right to Financial Privacy Act, and the Fair and Accurate Credit Transactions Reporting Act. These laws and regulations regulate the manner in which financial institutions must deal with customers when taking deposits or making loans to such customers.

EMPLOYEES

As of December 31, 2013, the Company had no direct employees. As of December 31, 2013, the following table summarizes the employment rosters of the Company's subsidiaries using full-time equivalent employees ("FTE"):

	2013	2012	2011	2010	2009
Bank	196	183	186	164	147
ENL	-	2	2	4	7
TEA	41	49	50	52	57
FCS	4	4	4	4	4
	241	238	242	224	215

Management believes that the Company's subsidiaries have good relationships with their employees.

AVAILABLE INFORMATION

The Company's Annual Report on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K and amendments to those reports filed or furnished by the Company pursuant to Section 13(a) or 15(d) of the Exchange Act are available without charge on the Company's website, www.evansbancorp.com - SEC filings section, as soon as reasonably practicable after they are electronically filed with or furnished to the SEC. The Company is providing the address to its Internet site solely for the information of investors. The Company does not intend its Internet address to be an active link or to otherwise incorporate the contents of the website into this Annual Report on Form 10-K or into any other report filed with or furnished to the SEC.

Item 1A.RISK FACTORS

The following factors identified by the Company's management represent significant potential risks that the Company faces in its operations.

The Company’s Business May Be Adversely Affected by Conditions in the Financial Markets and Economic Conditions Generally

The United States was in an economic recession from December 2007-June 2009, according to the U.S. National Bureau of Economic Research. While the recession is technically over, economic growth has been muted and the national and state unemployment rates remain high at 6.7% and 7.1%, respectively (per the U.S. and New York State Department of Labor) as of December 31, 2013. The recession was initially triggered by declines in home prices and the values of subprime mortgages, but spread to all mortgage and real estate asset classes, to leveraged bank loans and to nearly all asset classes, including equities.

The Company’s financial performance generally, and in particular the ability of borrowers to pay interest on and repay principal of outstanding loans and leases and the value of collateral securing those loans and leases, is highly dependent upon the business environment in the markets where the Company operates, in Western New York and in the United States as a whole. A favorable business environment is generally characterized by, among other factors, economic growth, efficient capital markets, low inflation, high business and investor confidence, and strong business earnings. Unfavorable or uncertain economic and market conditions can be caused by: declines in economic growth, declines in housing and real estate valuations, business activity or investor or business confidence; limitations on the availability or

increases in the cost of credit and capital; increases in inflation or interest rates; natural disasters; or a combination of these or other factors.

Overall, during 2013, the business environment showed signs of modest improvement, but continued to be relatively unchanged from 2012 for many households and businesses in the United States and worldwide. It is expected that the business environment in Western New York, the United States and worldwide will continue to be slow to recover from the recession. There can be no assurance that these conditions will improve substantially in the near term. Such conditions could materially adversely affect the credit quality of the Company's loans and leases, and therefore, the Company's results of operations and financial condition.

Commercial Real Estate and Commercial Business Loans Expose the Company to Increased Credit Risks

At December 31, 2013, the Company's portfolio of commercial real estate loans totaled $385.1 million, or 59.5% of total loans and leases outstanding, and the Company's portfolio of commercial and industrial ("C&I") loans totaled $107.0 million, or 16.5% of total loans and leases outstanding. The Company plans to continue to emphasize the origination of commercial loans as they generally earn a higher rate of interest than other loan products offered by the Bank. Commercial loans generally expose a lender to greater risk of non-payment and loss than one-to four-family residential mortgage loans because repayment of commercial real estate and C&I loans often depends on the successful operations and the income stream of the borrowers. Commercial mortgages are collateralized by real property while C&I loans are typically secured by business assets such as equipment and accounts receivable. Such loans typically involve larger loan balances to single borrowers or groups of related borrowers compared to one-to four-family residential mortgage loans. Also, many of the Company's commercial borrowers have more than one commercial real estate or C&I loan outstanding with the Company. Consequently, an adverse development with respect to one loan or one credit relationship can expose the Company to a significantly greater risk of loss compared to an adverse development with respect to a one-to four-family residential mortgage loan. Commercial real estate loans in non-accrual status at December 31, 2013 were $8.9 million, compared with $5.0 million at December 31, 2012. C&I loans in non-accrual status at December 31, 2013 were $3.0 million, compared with $0.9 million at December 31, 2012. Increases in the delinquency levels of commercial real estate and C&I loans could result in an increase in non-performing loans and the provision for loan and lease losses, which could have a material adverse effect on our results of operations and financial condition.

Continuing Concentration of Loans in the Company's Primary Market Area May Increase the Company's Risk

Unlike larger banks that are more geographically diversified, the Company provides banking and financial services to customers located primarily in western New York State ("WNY"). Therefore, the Company's success depends primarily on the general economic conditions in WNY. The Company's business lending and marketing strategies focus on loans to small and medium-sized businesses in this geographic region. Moreover, the Company's assets are heavily concentrated in mortgages on properties located in WNY. Accordingly, the Company's business and operations are vulnerable to downturns in the economy of WNY. The concentration of the Company's loans in this geographic region subjects the Company to the risk that a downturn in the economy or recession in this region could result in a decrease in loan originations and increases in delinquencies and foreclosures, which would more greatly affect the

Company than if the Company's lending were more geographically diversified. In addition, the Company may suffer losses if there is a decline in the value of properties underlying the Company's mortgage loans which would have a material adverse impact on the Company's operations.

In the Event the Company's Allowance for Loan and Lease Losses is Not Sufficient to Cover Actual Loan and Lease Losses, the Company's Earnings Could Decrease

The Company maintains an allowance for loan and lease losses in order to capture the probable losses inherent in its loan and lease portfolio. There is a risk that the Company may experience significant loan and lease losses which could exceed the allowance for loan and lease losses. In determining the amount of the Company's recorded allowance, the Company makes various assumptions and judgments about the collectability of its loan and lease portfolio, including the creditworthiness of its borrowers, the effect of changes in the local economy on the value of the real estate and other assets serving as collateral for the repayment of loans, the effects on the Company's loan and lease portfolio of current economic indicators and their probable impact on borrowers, and the Company's loan quality reviews. The emphasis on the origination of commercial real estate and C&I loans is a significant factor in evaluating an allowance for loan and lease losses. As the Company continues to increase the amount of these loans in the portfolio, additional or increased provisions for loan and lease losses may be necessary and would adversely affect the results of operations. In addition, bank regulators periodically review the Company's loan and lease portfolio and credit underwriting procedures, as well as its allowance for loan and lease losses, and may require the Company to increase its provision for loan and lease losses or recognize further loan and lease charge-offs. At December 31, 2013, the Company had a gross loan portfolio of approximately $647.0 million and the allowance for loan and lease losses was approximately $11.5 million, which represented 1.78% of the total amount of gross loans and leases. If the Company's assumptions and judgments prove to

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be incorrect or bank regulators require the Company to increase its provision for loan and lease losses or recognize further loan and lease charge-offs, the Company may have to increase its allowance for loan and lease losses or loan and lease charge-offs which could have an adverse effect on the Company's operating results and financial condition. There can be no assurances that the Company's allowance for loan and lease losses will be adequate to protect the Company against loan and lease losses that it may incur.

Changes in Interest Rates Could Adversely Affect the Company's Business, Results of Operations and Financial Condition

The Company's results of operations and financial condition are significantly affected by changes in interest rates. The Company's results of operations depend substantially on its net interest income, which is the difference between the interest income earned on its interest-earning assets and the interest expense paid on its interest-bearing liabilities. Because the Company's interest-bearing liabilities generally re-price or mature more quickly than its interest-earning assets, an increase in interest rates generally would tend to result in a decrease in its net interest income.

Changes in interest rates also affect the value of the Company's interest-earning assets, and in particular, the Company's securities portfolio. Generally, the value of securities fluctuates inversely with changes in interest rates. At December 31, 2013, the Company's securities available for sale totaled $99.7 million. Net unrealized gains on securities available for sale, net of tax, amounted to $0.2 million and are reported as a separate component of stockholders' equity. Decreases in the fair value of securities available for sale, therefore, could have an adverse effect on stockholders' equity or earnings.

The Company also is subject to reinvestment risk associated with changes in interest rates. Changes in interest rates may affect the average life of loans and mortgage-related securities. Decreases in interest rates can result in increased prepayments of loans and mortgage-related securities, as borrowers refinance to reduce borrowing costs. Under these circumstances, the Company is subject to reinvestment risk to the extent that it is unable to reinvest the cash received from such prepayments at rates that are comparable to the rates on existing loans and securities. Additionally, increases in interest rates may decrease loan demand and make it more difficult for borrowers to repay adjustable rate loans.

Consistent with its statutory mandate to foster maximum employment and price stability, the Federal Open Market Committee (the “Fed”) had practiced policy accommodation by purchasing additional agency mortgage-backed securities throughout 2012. In its December 2013 meeting, the Fed indicated that it had seen improvement in the economic activity and labor markets consistent with growing underlying strength in the broader economy. In light of the cumulative progress toward maximum employment, the Fed decided to modestly reduce the pace of its asset purchases from $40 billion per month to $35 billion per month. If incoming information broadly supports the Fed’s expectation of ongoing improvement in the labor market and inflation moving back towards it longer run objective, the Fed will likely reduce the pace of asset purchases.

To support continued progress toward maximum employment and price stability, the Fed said that it expects that a highly accommodative stance of monetary policy will remain appropriate for a considerable time after the economic recovery strengthens. In particular, the Fed also decided to keep the target range for the federal funds rate at 0 to 1/4 percent and currently anticipates that exceptionally low levels for the federal funds rate are likely to be warranted past the time the unemployment rate goes below 6.5%.

Easy monetary policy by the FRB may increase the interest rate risk for the Company by lowering interest rates over the near term, but also by inadvertently causing inflation to rise at a rapid pace once the economy more fully rebounds from the recession. High inflation rates are usually accompanied by an increase in interest rates.

The Fed's current accommodative stance has resulted in extraordinarily low interest rates during the past four years and played a part in compressing the Company's net interest margin from 4.16% in 2010 to 3.99% in 2011 to 3.84% in 2012 and 3.74% in 2013. While assets continue to re-price into lower rates as loans and investments mature, the re-pricing opportunities on the liability side have mostly been exhausted. Further compression of the Company's net interest margin could occur as a result of the Fed's accommodative monetary policy, which could have a material adverse effect on the Company's results of operations and financial condition.

The Company May Be Adversely Affected by the Soundness of Other Financial Institutions

Financial services institutions are interrelated as a result of counterparty relationships. The Company has exposure to many different industries and counterparties, and routinely executes transactions with counterparties in the financial services industry. The most important counterparty for the Company, in terms of liquidity, is the Federal Home Loan Bank of New York ("FHLBNY"). The Company uses FHLBNY as its primary source of overnight funds and also has

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several long-term advances with FHLBNY. At December 31, 2013, the Company had a total of $9.0 million in borrowed funds with FHLBNY. The Company has placed sufficient collateral in the form of commercial and residential real estate loans at FHLBNY. As a member of the Federal Home Loan Bank System, the Bank is required to hold stock in FHLBNY. The Bank held FHLBNY stock with a fair value of $1.4 million as of December 31, 2013. The Bank's FHLBNY stock average yield in 2013 was 4.4%.

There are 12 branches of the FHLB, including New York. If a member was at risk of breaching risk-based capital requirements, it could suspend dividends, cut dividend payments, and/or not buy back excess FHLB stock that members hold. FHLBNY has stated that they expect to be able to continue to pay dividends, redeem excess capital stock, and provide competitively priced advances in the future. Nonetheless, the 12 FHLB branches are jointly liable for the consolidated obligations of the FHLB system. To the extent that one FHLB branch cannot meet its obligations to pay its share of the system's debt; other FHLB branches can be called upon to make the payment.

Systemic weakness in the FHLB could result in higher costs of FHLB borrowings, reduced value of FHLB stock, and increased demand for alternative sources of liquidity that are more expensive, such as brokered time deposits, the discount window at the Federal Reserve, or lines of credit with correspondent banks First Tennessee Bank and M&T Bank.

Strong Competition Within the Company's Market Area May Limit its Growth and Profitability

Competition in the banking and financial services industry is intense. The Company competes with commercial banks, savings institutions, mortgage brokerage firms, credit unions, finance companies, mutual funds, insurance companies, and brokerage and investment banking firms operating locally within the Company's market area and elsewhere. Many of these competitors (whether regional or national institutions) have substantially greater resources and lending limits than the Company does, and may offer certain services that the Company does not or cannot provide. The Company's profitability depends upon its continued ability to successfully compete in this market area.

Expansion of the Company's Branch Network May Adversely Affect its Financial Results

The Company opened a new branch office in October 2012. The Company cannot assure that its branch expansion strategy will be accretive to earnings or that it will be accretive to earnings within a reasonable period of time. Numerous factors contribute to the performance of a new branch, such as suitable location, qualified personnel, and an effective marketing strategy. Additionally, it takes time for a new branch to gather sufficient loans and deposits to generate income sufficient to cover its operating expenses. Difficulties the Company experiences in implementing its growth strategy may have a material adverse effect on the Company's financial condition and results of operations.

The Company Operates in a Highly Regulated Environment and May Be Adversely Affected By Changes in Laws and Regulations

The Company and its subsidiaries are subject to regulation, supervision and examination by the OCC, FRB, and by the FDIC, as insurer of its deposits. Such regulation and supervision govern the activities in which a bank and its holding company may engage and are intended primarily for the protection of the deposit insurance funds and depositors. Regulatory requirements affect the Company's lending practices, capital structure, investment practices, dividend policy and growth. These regulatory authorities have extensive discretion in connection with their supervisory and enforcement activities, including the imposition of restrictions on the operation of a bank, the imposition of deposit insurance premiums and other assessments, the classification of assets by a bank and the adequacy of a bank's allowance for loan and lease losses. Any change in such regulation and oversight, particularly through the new rules and regulations expected to be established by the Dodd-Frank Act and Basel III, could have a material adverse impact on the Bank, the Company and its business, financial condition and results of operations.

The impending capital requirement changes from Basel III discussed in Item 1 could have a material adverse impact on the Company. Even though the Bank exceeds current and proposed minimum regulatory capital levels, adverse changes to residential mortgage risk weights, new requirements for common equity capital, inclusion of accumulated other comprehensive income in regulatory capital, the phase out of trust preferred securities, along with the adoption of new capital conservation buffers would reduce the Bank’s current capital position and over time could cause the Bank to fail to meet minimum regulatory requirements. These positions are subject to volatility due to changes in interest rates and credit spreads. The current positive balance is a product of the continued ultra low interest rate environment, which could change in the future. Rapid increases in interest rates and credit spreads could reverse the gain position and force the Company’s accumulated other comprehensive income to become negative and have an adverse impact on the Bank’s regulatory capital. Although there is a phase-in period in the proposed rules, other headwinds such as the ultra-low

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interest rate environment, fragile economic recovery, possible recession, and further constraints on profitability by regulators could impact the Bank's ability to meet the new regulatory minimums once the phase-in periods have ended.

Lack of System Integrity or Credit Quality Related to Funds Settlement could Result in a Financial Loss

The Bank settles funds on behalf of financial institutions, other businesses and consumers and receives funds from clients, card issuers, payment networks and consumers on a daily basis for a variety of transaction types. Transactions facilitated by the Bank include debit card, credit card and electronic bill payment transactions, supporting consumers, financial institutions and other businesses. These payment activities rely upon the technology infrastructure that facilitates the verification of activity with counterparties and the facilitation of the payment. If the continuity of operations or integrity of processing were compromised this could result in a financial loss to the Bank, and therefore the Company, due to a failure in payment facilitation. In addition, the Bank may issue credit to consumers, financial institutions or other businesses as part of the funds settlement. A default on this credit by a counterparty could result in a financial loss to the Bank, and therefore to the Company.

Financial Services Companies Depend on the Accuracy and Completeness of Information about Customers and Counterparties

In deciding whether to extend credit or enter into other transactions, the Company may rely on information furnished by or on behalf of customers and counterparties, including financial statements, credit reports, and other financial information. The Company may also rely on representations of those customers, counterparties, or other third parties, such as independent auditors, as to the accuracy and completeness of that information. While management generally engages only third parties that it knows or believes to be reputable, reliance on inaccurate or misleading financial statements, credit reports, or other financial information could cause the Company to enter into unfavorable transactions, which could have a material adverse effect on the Company's financial condition and results of operations.

Loss of Key Employees May Disrupt Relationships with Certain Customers

The Company's business is primarily relationship-driven in that many of the Company's key employees have extensive customer relationships. Loss of a key employee with such customer relationships may lead to the loss of business if the customers were to follow that employee to a competitor. While management believes that the Company's relationships with its key business producers are good, the Company cannot guarantee that all of its key personnel will remain with the organization. Loss of such key personnel, should they enter into an employment relationship with one of the Company's competitors, could result in the loss of some of the Company's customers. Such losses could have a material adverse effect on the Company's business, financial condition and results of operations.

Future FDIC Insurance Premium Increases May Adversely Affect the Company's Earnings

The Company is generally unable to control the amount of premiums that it is required to pay for FDIC insurance. If there are additional bank or financial institution failures or other similar occurrences, the FDIC may again increase the premiums assessed upon insured institutions. Such increases and any future increases or required prepayments of FDIC insurance premiums may adversely impact the Company's results of operations.

The Company is a Financial Holding Company and Depends on Its Subsidiaries for Dividends, Distributions and Other Payments

The Company is a legal entity separate and distinct from its banking and other subsidiaries. The Company's principal source of cash flow, including cash flow to pay dividends to the Company's stockholders and principal and interest on its outstanding debt, is dividends from the Bank. There are statutory and regulatory limitations on the payment of dividends by the Bank, as well as the payment of dividends by the Company to its stockholders. Regulations of the OCC affect the ability of the Bank to pay dividends and other distributions and to make loans to the Company. If the Bank is unable to make dividend payments and sufficient capital is not otherwise available, the Company may not be able to make dividend payments to its common stockholders or principal and interest payments on its outstanding debt.

Because the Nature of the Financial Services Business Involves a High Volume of Transactions, the Company Faces Significant Operational Risks

The Company operates in diverse markets and relies on the ability of its employees and systems to process a high number of transactions. Operational risk is the risk of loss resulting from the Company's operations, including but not limited to, the risk of fraud by employees or persons outside of the Company, the execution of unauthorized transactions by employees, errors relating to transaction processing and technology, breaches of the internal control system and

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compliance requirements, and business continuation and disaster recovery. This risk of loss also includes the potential legal actions that could arise as a result of an operational deficiency or as a result of noncompliance with applicable regulatory standards, adverse business decisions or their implementation, and customer attrition due to potential negative publicity. In the event of a breakdown in the internal control system, improper operation of systems or improper employee actions, the Company could suffer financial loss, face regulatory action and suffer damage to its reputation.

The Company's Information Systems may Experience an Interruption or Breach in Security

The Company relies heavily on communications and information systems to conduct its business. Any failure, interruption, or breach in security or operational integrity of these systems could result in failures or disruptions in the Company's customer relationship management, general ledger, deposit, loan, and other systems. While the Company has policies and procedures designed to prevent or limit the effect of the failure, interruption, or security breach of its information systems, there can be no assurance that any such failures, interruptions, or security breaches will not occur or, if they do occur, that they will be adequately addressed. If personal, nonpublic, confidential, or proprietary information of customers in the Company's possession were to be mishandled or misused, we could suffer significant regulatory consequences, reputational damage, and financial loss. Such mishandling or misuse could include, for example, if such information were erroneously provided to parties who are not permitted to have the information, either by fault of the Company's systems, employees or counterparties, or where such information is intercepted or otherwise inappropriately taken by third parties. The occurrence of any failures, interruptions, or security breaches of the Company's information systems could damage the Company's reputation, result in a loss of customer business, subject the Company to additional regulatory scrutiny, or expose the Company to civil litigation and possible financial liability, any of which could have a material adverse effect on the Company's financial condition and results of operations.

The Potential for Business Interruption Exists Throughout the Company's Organization

Integral to the Company's performance is the continued efficacy of our technical systems, operational infrastructure, relationships with third parties and the vast array of associates and key executives in the Company's day-to-day and ongoing operations. Failure by any or all of these resources subjects the Company to risks that may vary in size, scale and scope. This includes, but is not limited to, operational or technical failures, pandemics, ineffectiveness or exposure due to interruption in third party support as expected, as well as the loss of key individuals or failure on the part of key individuals to perform properly. Although management has established policies and procedures to address such failures, the occurrence of any such event could have a material adverse effect on the Company's business, which, in turn, could have a material adverse effect on its financial condition and results of operations.

Environmental Factors May Create Liability

In the course of its business, the Bank has acquired and may acquire in the future, property securing loans that are in default. There is a risk that the Bank could be required to investigate and clean-up hazardous or toxic substances or chemical releases at such properties after acquisition by the Bank in a foreclosure action, and that the Bank may be held liable to a governmental entity or third parties for property damage, personal injury and investigation and clean-up costs incurred by such parties in connection with such contamination. In addition, the owner or former owners of contaminated sites may be subject to common law claims by third parties based on damages and costs resulting from environmental contamination emanating from such property. To date, the Bank has not been required

to perform any investigation or clean-up activities, nor has it been subject to any environmental claims. There can be no assurance, however, that this will remain the case in the future.

Anti-takeover Laws and Certain Agreements and Charter Provisions May Adversely Affect Share Value

Certain provisions of the Company's certificate of incorporation and state and federal banking laws, including regulatory approval requirements, could make it more difficult for a third party to acquire control of the Company without approval of the Company's board of directors. Under federal law, subject to certain exemptions, a person, entity or group must notify the FRB before acquiring control of a bank holding company. Acquisition of 10% or more of any class of voting stock of a bank holding company, including shares of the Company's common stock, creates a rebuttable presumption that the acquiror "controls" the bank holding company. Also, a bank holding company must obtain the prior approval of the FRB before, among other things, acquiring direct or indirect ownership or control of more than 5% of the voting shares of any bank, including the Bank. There also are provisions in the Company's certificate of incorporation that may be used to delay or block a takeover attempt. Taken as a whole, these statutory provisions and provisions in the Company's certificate of incorporation could result in the Company being less attractive to a potential acquiror and thus could adversely affect the market price of the Company's common stock.

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Item 1B.UNRESOLVED STAFF COMMENTS

None.

Item 2.PROPERTIES

At December 31, 2013, the Bank conducted its business from its administrative office and 13 branch offices. The Bank's administrative office is located at One Grimsby Drive in Hamburg, NY. The administrative office facility is 26,000 square feet and is owned by the Bank. This facility is occupied by the Office of the President and Chief Executive Officer of the Company, as well as the Administrative and Loan Divisions of the Bank. The Bank also owns a building on Sunset Drive in Hamburg, NY that houses its Operations Center.

The Bank has 13 branch locations. The Bank owns the building and land for five locations. The Bank owns the building but leases the land for four locations. Four other locations are leased.

TEA operates from a 10,000 square foot office located at 6834 Erie Road, Derby, NY, which is owned by the Bank. TEA has 7 retail locations. TEA leases 4 of the locations. The Bank owns two of the locations and TEA owns the remaining building.

The Company owned $11.2 million in properties and equipment, net of depreciation at December 31, 2013, compared with $11.4 million at December 31, 2012.

Item 3.LEGAL PROCEEDINGS

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

On January 22, 2014, the Office of the Attorney General for the State of New York (the “NYAG”) formally confirmed to the Company that it has conducted a nonpublic investigation of certain residential mortgage lending practices, and is considering bringing an enforcement action against the Company and the Bank. The NYAG is requesting certain remedies including payment of a civil penalty and various remedial measures.

We have been engaged in discussions with the NYAG regarding this investigation. The Company believes that it has meritorious defenses to the NYAG’s investigation, denies any wrongdoing, and intends to defend against any allegations.

Based on the indeterminate status of discussions with the NYAG and the limited information known to the Company, we are unable to predict whether a formal action will be filed against us, to assess the likelihood of a favorable or unfavorable outcome in this event, or to estimate the impact, if any, that this matter may have on the Company’s business, financial position, results of operations or cash flows.

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

Item 4.MINE SAFETY DISCLOSURES

Not applicable.

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PART II

Item 5.MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED

STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES

Market Information. The Company's common stock is listed on the NYSE MKT under the symbol EVBN.

The following table shows, for the periods indicated, the high and low sales prices per share of the Company's common stock for fiscal 2013 and 2012 as reported on the NYSE MKT.

	2013		2012	
QUARTER	High	Low	High	Low
FIRST	$ 18.29	$ 15.50	$ 14.35	$ 11.95
SECOND	$ 18.15	$ 17.20	$ 16.49	$ 14.15
THIRD	$ 19.87	$ 17.57	$ 17.95	$ 15.45
FOURTH	$ 21.20	$ 19.75	$ 16.90	$ 15.25

Holders. The approximate number of holders of record of the Company's common stock as of February 28, 2014 was 1,290.

Cash Dividends. The Company paid the following cash dividends on shares of the Company's common stock during fiscal 2012 and 2013:

- A cash dividend of $0.22 per share on April 10, 2012 to holders of record on March 20, 2012.
- A cash dividend of $0.22 per share on October 9, 2012 to holders of record on September 11, 2012.
- A cash dividend of $0.24 per share on December 31, 2012 to holders of record on December 24, 2012.

· A cash dividend of $0.26 per share on October 9, 2013 to holders of record on September 18, 2013.

In 2012, the Company decided it was appropriate to move up the normal semi-annual dividend for April 2013 to December 2012. At the time of the Company's decision, there was much uncertainty around the income tax rates on dividend income. These rates were expiring on December 31, 2012 and it was expected that these rates would increase in 2013. Therefore, in an effort to reduce the tax burden on shareholders, management and the Board of Directors determined that it would be appropriate and in the best interests of the Company's shareholders to pay a third dividend in 2012 in lieu of the first semi-annual dividend in 2013.

The amount and type (cash or stock), if any, of future dividends will be determined by the Company's Board of Directors and will depend upon the Company's earnings, financial conditions and other factors considered by the Board of Directors to be relevant. The Bank pays a dividend to the Company to provide funds for: debt service on the junior subordinated debentures, a portion of the proceeds of which were contributed to the Bank as capital; dividends the Company pays; treasury stock repurchases; and other Company expenses. As discussed above under "Item 1A. Risk Factors," the Company is dependent upon cash flow from its subsidiaries in order to fund its dividend payments. There are various legal limitations with respect to the Bank's ability to supply funds to the Company. In particular, under Federal banking law, the approval of the FRB and OCC may be required in certain circumstances, prior to the payment of dividends by the Company or the Bank. See Note 20 to the Company's Consolidated Financial Statements included in Part II, Item 8 of this Annual Report on Form 10-K for additional information concerning contractual and regulatory restrictions on the payment of dividends.

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PERFORMANCE GRAPH

The following Performance Graph compares the Company's cumulative total stockholder return on its common stock for a five-year period (December 31, 2008 to December 31, 2013) with the cumulative total return of the NYSE MKT Composite Index and the NASDAQ Bank Index. The comparison for each of the periods assumes that $100 was invested on December 31, 2008 in each of the Company's common stock and the stocks included in the NYSE MKT Composite Index and NASDAQ Bank Index, and that all dividends were reinvested without commissions. This table does not forecast future performance of the Company's stock.

Compare 5-Year Cumulative Total Return Among

Evans Bancorp, Inc.,

NYSE MKT Composite Index, and NASDAQ Bank Index

	Period Ending					
Index	12/31/08	12/31/09	12/31/10	12/31/11	12/31/12	12/31/13
Evans Bancorp, Inc.	100.00	79.28	102.50	88.33	120.09	165.73
NYSE MKT Composite Index	100.00	135.58	170.28	180.99	192.95	205.80
NASDAQ Bank	100.00	83.70	95.55	85.52	101.50	143.84

In accordance with and to the extent permitted by applicable law or regulation, the information set forth above under the heading "Performance Graph" shall not be deemed to be "soliciting material" or to be "filed" with the SEC under the Securities Act or the Exchange Act, or subject to the liabilities of Section 18 of the Exchange Act, except to the extent that we specifically request that such information be treated as soliciting material or specifically incorporate it by reference into such a filing.

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Purchases of Equity Securities by the Issuer and Affiliated Purchasers. In March 2013, the Company announced it had been authorized by its Board of Directors to purchase up to 100,000 shares of the Company's outstanding common stock. The Company did not repurchase any shares pursuant to a plan during 2013. During the fourth quarter of 2013, the Company purchased shares of its common stock as follows:

Issuer Purchases of Equity Securities

Period	Total Number of Shares Purchased	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs	Maximum Number of Shares that may yet be Purchased Under the Plans or Programs
October 2013:				
October 1, 2013 - October 31, 2013	13,032	$ 19.20	13,032	86,968
November 2013:				
November 1, 2013 - November 30, 2013	-	$ -	-	-
December 2013:				
December 1, 2013 - December 31, 2013	-	$ -	-	-
Total (1) :	13,032	$ 19.20	13,032	86,968

(1)

(1) All of the foregoing shares were purchased in open market purchases. On March 25, 2013, the Board of Directors authorized the Company to repurchase up to 100,000 shares of the Company's common stock. The repurchase program has no fixed expiration date but may be suspended or discontinued at any time. The Company did not make any repurchases during the quarter ended December 31, 2013 except pursuant to this publicly announced program.

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Item 6.SELECTED FINANCIAL DATA

	As of and for the year ended December 31,				
	2013	2012	2011	2010	2009
	(in thousands, except for per share data)				
Balance Sheet Data					
Assets	$ 833,498	$ 809,676	$ 740,902	$ 671,523	$ 619,444
Interest-earning assets	767,629	750,287	682,140	611,141	562,219
Investment securities	104,880	95,807	103,783	89,562	75,443
Loans and leases, net	635,493	573,163	571,910	517,554	482,597
Deposits	706,612	678,992	616,203	544,457	499,508
Borrowings	33,681	42,441	42,340	52,226	63,146
Stockholders' equity	80,712	74,828	68,988	63,064	45,959
Income Statement Data					
Net interest income	$ 28,347	$ 27,780	$ 25,988	$ 24,495	$ 22,594
Non-interest income	12,161	12,823	12,432	12,633	14,067
Non-interest expense	29,380	28,792	27,241	26,107	26,057
Net income	7,857	8,132	6,112	4,840	707
Per Share Data					
Earnings per share - basic	$ 1.88	$ 1.96	$ 1.49	$ 1.34	$ 0.25
Earnings per share - diluted	1.85	1.95	1.49	1.34	0.25
Cash dividends	0.26	0.68	0.40	0.40	0.61
Book value	19.18	17.94	16.72	15.45	16.34
Performance Ratios					
Return on average assets	0.96 %	1.04 %	0.86 %	0.75 %	0.12 %
Return on average equity	10.06 %	11.20 %	9.17 %	8.35 %	1.57 %
Net interest margin	3.74 %	3.84 %	3.99 %	4.16 %	4.33 %
Efficiency ratio *	71.98 %	70.05 %	69.68 %	67.90 %	63.16 %
Dividend payout ratio	13.83 %	34.69 %	26.85 %	29.85 %	244.00 %
Capital Ratios					
Tier 1 capital to average assets	10.36 %	9.69 %	9.71 %	9.93 %	7.80 %
Equity to assets	9.68 %	9.24 %	9.31 %	9.39 %	7.42 %
Asset Quality Ratios					
Total non-performing assets to total assets	1.65 %	1.02 %	2.05 %	2.07 %	2.10 %

Total non-performing loans and leases to total loans and leases	2.12	%	1.41	%	2.60	%	2.64	%	2.64	%
Net charge-offs (recoveries) to average loans and leases	(0.04)	%	0.29	%	0.26	%	0.10	%	2.19	%
Allowance for loan and lease losses to total loans and leases	1.78	%	1.67	%	1.97	%	1.97	%	1.42	%

See Item 7, “Management’s Discussion and Analysis of Financial Condition and Results of Operations,” and Item 8, “Consolidated Financial Statements and Supplementary Data,” of this Report on Form 10-K for further information and analysis of changes in the Company's financial condition and results of operations.

* The calculation of the efficiency ratio excludes amortization of intangibles, goodwill impairment, and gains and losses on sales and calls of securities, for comparative purposes.

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Item 7.MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

OVERVIEW

This discussion is intended to compare the performance of the Company for the years ended December 31, 2013, 2012 and 2011. The review of the information presented should be read in conjunction with Part I, Item 1: "Business" and Part II, Item 6: "Selected Financial Data" and Item 8: "Financial Statements and Supplementary Data" of this Annual Report on Form 10-K.

The Company is a financial holding company registered under the BHCA. The Company currently conducts its business through its two direct wholly-owned subsidiaries: the Bank and the Bank's subsidiaries, ENL and ENHC; and ENFS and its subsidiary, TEA. The Company does not engage in any other substantial business. Unless the context otherwise requires, the term "Company" refers collectively to Evans Bancorp, Inc. and its subsidiaries.

Summary

In 2013, the Company experienced continued strong earnings results moderated slightly by a significantly higher provision for loan and lease losses. The Company's stated public intentions are to continue to grow to increase market share and achieve scale while improving profitability and returning value to shareholders. Net income in 2013 was $7.9 million, a 3.4% decrease from 2012 net income of $8.1 million, but above the 2011 net income of $6.1 million. The Company's provision for loan and lease losses increased $1.6 million from ($0.1) million in 2012 to $1.5 million in 2013. As the leasing portfolio declined and existing leases continued to perform, the benefit from additional releases in the provision for lease losses in the current year had been exhausted, resulting in a benefit to provision of $0.3 million, as compared to a $0.9 million benefit in 2012. The Company's total criticized commercial loans increased $10.6 million from $20.2 million as of December 31, 2012 to $30.8 million at December 31, 2013. The ratio of non-performing loans and leases to total loans and leases also increased from 1.41% at December 31, 2012 to 2.12% as of December 31, 2013. Additionally, the Company recognized $0.6 million in provision for loan losses in 2013 related to the termination of the FDIC loss sharing agreement. These factors, combined with loan growth in 2013, resulted in a provision for loan and lease losses for the year of $1.6 million. Overall, the provision for loan and lease losses for the Company has returned to a more historic level in 2013.

In 2013, two non-routine events occurred. The Company and the FDIC agreed in the third quarter of 2013 to terminate the loss sharing agreement with the FDIC as described under Footnote 3 – "Loans and Leases" below, which eliminated the FDIC guarantees on acquired loan losses. Upon termination of the loss sharing agreement, the Company recognized $0.6 million in provision for loan and lease losses, with an offsetting gain on the termination in non-interest income of $0.7 million. Secondly, the Company entered into a historic tax credit investment in 2013 for a

community based project. In the third quarter of 2013, the Company recorded a loss on the tax credit investment of $1.6 million into non-interest income, but realized a $1.8 million tax benefit in the Company's income tax provision.

As for the Company's core performance, 2013 was marked by solid growth in commercial loans and deposits in the face of the continued headwinds of a sluggish economy and a very competitive local market in Western New York. The Company experienced large loan growth in the fourth quarter of 2013, in contrast to some large pay-offs in the fourth quarter of 2012, resulting in a year-over-year increase in total gross loans of $64.1 million, or 11.0% as of December 31, 2013, and an increase in average total gross loans and leases of $16.8 million, or 2.8%, in 2013 when compared with 2012. The growth in average loans and leases combined with rate cuts on interest-bearing deposits in 2013 helped drive a 2.0% increase in net interest income, despite a 10 basis point decrease in net interest margin to 3.74% as the low interest rate environment continued to put pressure on the Company's net interest margin. To continue to support the Company's high organic growth rates and increasing regulatory requirements, management has focused on retaining and attracting talented individuals, resulting in an increase in non-interest expenses. Non-interest income decreased 5.2% in 2013 when compared with 2012, driven by the two non-routine events described above. Excluding the one-time gain on termination of the FDIC loss sharing agreement and loss on historic tax credit, non-interest income increased $0.2 million, or 1.4%, from the prior year.

Strategy

To sustain future growth and to meet the Company's financial objectives, the Company has defined a number of strategies. Six of the more important strategies are:

· Continuing to differentiate through proactively building and maintaining customer relationships;

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- Continuing growth of non-interest income through financial services revenues, employee benefits insurance and retirement programs sales, and cash management;
- Continuing to develop opportunities with a segmented market approach to develop a more diversified portfolio and strengthen presence with community investment initiatives;
- Leveraging our resources and capabilities to continuously improve operational efficiency and to utilize technology effectively;
- Maintaining a balanced risk appetite within a risk management framework that drives shareholder value.

The Company's strategies are designed to direct tactical investment decisions supporting its financial objectives. While the Company intends to focus its efforts on the pursuit of these strategies, there can be no assurance that the Company will successfully implement these strategies or that the strategies will produce the desired results. The Company's most significant revenue source continues to be net interest income, defined as total interest income less interest expense. Net interest income accounted for approximately 70% of total revenue in 2013. To produce net interest income and consistent earnings growth over the long-term, the Company must generate loan and deposit growth at acceptable margins within its market area. To generate and grow loans and deposits, the Company must focus on a number of areas including, but not limited to, opportunistic branch expansion, sales practices, customer and employee satisfaction and retention, competition, evolving customer behavior, technology, product innovation, interest rates, credit performance of its customers and vendor relationships.

The Company also considers non-interest income important to its continued financial success. Fee income generation is partly related to the Company's loan and deposit operations, such as deposit service charges, as well as to its financial products, such as commercial and personal insurance sold through TEA. Improved performance in non-interest income can help increase capital ratios because most of the non-interest income is generated without recording assets on the balance sheet. The Company has and will continue to face challenges in increasing its non-interest income as the regulatory environment changes.

While the Company reviews and manages all customer units, it has focused increased efforts on targeted segments in its community such as (1) smaller businesses with smaller credit needs but rich in deposits and other services; (2) middle market commercial businesses; (3) commercial real estate lending; and (4) retail customers. The overarching goal is to cross-sell between our insurance, financial services and banking lines of business to deepen our relationships with all of our customers. The Company believes that these efforts resulted in growth in the commercial loan portfolio and core deposits during fiscal 2013 and 2012.

The Bank opened a new branch office in Williamsville, NY in October 2012. With all new and existing branches, the Company has strived to provide a personal touch to customer service and is committed to maintaining a local community based philosophy. The Bank has emphasized hiring local branch and lending personnel with strong ties to the specific local communities it enters and serves.

The Bank serves its market through 14 banking offices in Western New York, located in Amherst, Buffalo, Clarence, Derby, Evans, Forestville, Hamburg, Lancaster, North Boston, Tonawanda, West Seneca, and Williamsville. The Company's principal source of funding is through deposits, which it reinvests in the community in the form of loans and investments. Deposits are insured up to the maximum permitted by the Insurance Fund of the FDIC. The Bank is regulated by the OCC.

APPLICATION OF CRITICAL ACCOUNTING ESTIMATES

The Company's Consolidated Financial Statements are prepared in accordance with U.S. generally accepted accounting principles ("GAAP") and follow general practices within the industries in which it operates. Application of these principles requires management to make estimates, assumptions and judgments that affect the amounts reported in the Company's Consolidated Financial Statements and Notes. These estimates, assumptions and judgments are based on information available as of the date of the Consolidated Financial Statements. Accordingly, as this information changes, the Consolidated Financial Statements could reflect different estimates, assumptions and judgments. Certain policies inherently have a greater reliance on the use of estimates, assumptions and judgments, and as such, have a greater possibility of producing results that could be materially different than originally reported.

The most significant accounting policies followed by the Company are presented in Note 1 to the Consolidated Financial Statements included in Item 8 of this Annual Report on Form 10-K. These policies, along with the disclosures presented in the other Notes to the Company's Consolidated Financial Statements contained in this Annual Report on Form 10-K and in this financial review, provide information on how significant assets and liabilities are valued in the Company's Consolidated Financial Statements and how those values are determined.

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Estimates, assumptions and judgments are necessary when assets and liabilities are required to be recorded at fair value, when a decline in the value of an asset not carried on the financial statements at fair value warrants an impairment write-down or valuation reserve to be established, or when an asset or liability needs to be recorded contingent upon a future event. Carrying assets and liabilities at fair value inherently results in more financial statement volatility. The fair values and the information used to record valuation adjustments for certain assets and liabilities are based either on quoted market prices or are provided by other third-party sources, when available. When third-party information is not available, valuation adjustments are estimated in good faith by management primarily through the use of internal cash flow modeling techniques.

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

Allowance for Loan and Lease Losses

The allowance for loan and lease losses represents management's estimate of probable losses in the Bank's loan and lease portfolio. Determining the amount of the allowance for loan and lease losses is considered a critical accounting estimate because it requires significant judgment on the part of management and the use of estimates related to the amount and timing of expected future cash flows on impaired loans and leases, estimated losses on pools of homogeneous loans and leases based on historical loss experience and consideration of current economic trends and conditions, all of which may be susceptible to significant change. The loan portfolio also represents the largest asset type on the Company's consolidated balance sheets.

On a quarterly basis, management of the Bank meets to review and determine the adequacy of the allowance for loan and lease losses. In making this determination, the Bank's management analyzes the ultimate collectability of the loans and leases in its portfolio by incorporating feedback provided by the Bank's internal loan and lease staff, an independent internal loan and lease review function and information provided by examinations performed by regulatory agencies.

The analysis of the allowance for loan and lease losses is composed of two components: specific credit allocation and general portfolio allocation. The specific credit allocation includes a detailed review of each impaired loan and allocation is made based on this analysis. Factors may include the appraisal value of the collateral, the age of the appraisal, the type of collateral, the performance of the loan to date, the performance of the borrower's business based on financial statements, and legal judgments involving the borrower. The Company has an appraisal policy in which appraisals are obtained upon a loan being downgraded on the Company's 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 loans are either graded a 6 or 7 on the internal loan rating scale. Subsequent to the downgrade, 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. The general portfolio allocation consists of an assigned reserve percentage based on the historical loss experience and other quantitative and qualitative factors of the loan or lease category.

The general portfolio allocation is segmented into pools of loans with similar characteristics. Separate pools of loans include loans pooled by loan grade and by portfolio segment. Loans graded a 5 or worse ("criticized loans") that exceed a material balance threshold are evaluated by the Company's credit department to determine if the collateral for the loan is worth less than the loan. All of these "shortfalls" are added together and divided by the respective loan pool to calculate the quantitative factor applied to the respective pool as this represents a potential loss exposure. These loans are not considered individually impaired because the cash flow of the customer and the payment history of the loan suggest that it is not probable that the Company will be unable to collect the full amount of principal and interest as contracted and are thus still accruing interest.

Loans that are graded 4 or better ("non-criticized loans") are reserved in separate loan pools in the general portfolio allocation. A weighted average 5-year historical charge-off ratio by portfolio segment is calculated and applied against these loan pools.

For both the criticized and non-criticized loan pools in the general portfolio allocation, additional qualitative factors are applied. The qualitative factors applied to the general portfolio allocation reflect management's evaluation of various conditions. The conditions evaluated include the following: industry and regional conditions; seasoning of the loan and lease portfolio and changes in the composition of and growth in the loan and lease portfolio; the strength and duration of the business cycle; existing general economic and business conditions in the lending areas; credit quality trends in non-

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accruing loans and leases; timing of the identification of downgrades; historical loan and lease charge-off experience; and the results of bank regulatory examinations. Due to the nature of the loans, the criticized loan pools carry significantly higher qualitative factors than the non-criticized pools.

Direct financing leases are segregated from the rest of the loan portfolio in determining the appropriate allowance for that portfolio segment. The Company performs a migration analysis for non-accruing leases based on historical loss data. Management periodically updates this analysis by examining the non-accruing lease portfolio at different points in time and studying what percentage of the non-accruing portfolio ends up being charged off. All of the remaining leases not in non-accrual are allocated a reserve based on several factors including: delinquency and non-accrual trends, charge-off trends, and national economic conditions.

For further discussion on the allowance for loan and lease losses, please see Note 1 and Note 3 to the Consolidated Financial Statements included in Item 8 of this Annual Report on Form 10-K.

Goodwill and Intangible Assets

The amount of goodwill reflected in the Company's Consolidated Financial Statements is required to be tested by management for impairment on at least an annual basis. The test for impairment of goodwill in an identified reporting unit is considered a critical accounting estimate because it requires judgment on the part of management and the use of estimates related to the growth assumptions and market multiples used in the valuation model. As of December 31, 2013, TEA had $8.1 million in goodwill. The banking and ENL reporting units do not have any goodwill. All of the goodwill at TEA stems from the acquisition of various insurances agencies, not the purchase of diverse companies in which goodwill was subjectively allocated to different reporting units. Therefore, total market capitalization reconciliation was not performed because not all of the reporting units had goodwill. As a result, such an analysis would not be meaningful.

Management valued TEA, the reporting unit with goodwill, using cash flow modeling and earnings multiple techniques. When using the cash flow models, management considered historical information, the operating budget for 2014, economic and insurance market cycles, and strategic goals in projecting net income and cash flows for the next five years. The fair value calculated substantially exceeded the book value of TEA. The value based on a multiple to earnings before interest, taxes, depreciation, and amortization ("EBITDA") was higher, a result of conservative growth assumptions used by the Company in the cash flow model as well as an implied control premium in the multiple. The multiple used was based on historical industry data and consistent with the previous year's assumption.

While the fair values determined in the impairment tests were substantially higher than the carrying value for TEA, the risk of a future impairment charge still exists. Management used growth rates that are achievable over the long

run through both soft and hard insurance cycles. A soft insurance market has persisted for several years, resulting in a modest increase in revenue of 3.5% in 2013 compared with 2012. A worsening of the soft insurance market over the long term could result in lower than projected revenue and profitability growth rates and result in depressed pricing multiples in the acquisition marketplace. Further softening of the insurance market is the biggest risk to the Company's valuation model.

For further discussion of the Company's accounting for goodwill and other intangible assets, see Note 1 to the Consolidated Financial Statements included in Item 8 of this Annual Report on Form 10-K.

RECENT ACCOUNTING PRONOUNCEMENTS AND DEVELOPMENTS

Note 1 to the Company's Consolidated Financial Statements included in Item 8 of this Annual Report on Form 10-K discusses new accounting policies adopted by the Company during fiscal 2013. Below is an accounting policy recently issued or proposed but not yet required to be adopted. To the extent management believes the adoption of new accounting standards materially affects the Company's financial condition, results of operations, or liquidity, the impacts are discussed below.

Accounting Standards Update ("ASU") 2013-11, Presentation of an Unrecognized Tax Benefit When a Net Operating Loss Carryforward, a Similar Tax Loss, or a Tax Credit Carryforward Exists. The objective of this ASU is to eliminate diversity in practice for presentation of an unrecognized tax benefit when a net operating loss carryforward, a similar tax loss, or a tax credit carryforward exists. The main provision states that an unrecognized tax benefit, or a portion of an unrecognized tax benefit, should be presented in the financial statements as a reduction to a deferred tax asset for a net operating loss carryforward, a similar tax loss, or a tax credit carryforward. This ASU is effective for fiscal years and interim periods within those years, beginning after December 15, 2013 and did not have a material impact on the Company's financial statements.

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ASU 2014-04, Reclassification of Collateralized Mortgage Loans upon a Troubled Debt Restructuring. The objective of this proposed ASU is to clarify when an in substance repossession or foreclosure occurs, that is, when a creditor should be considered to have received physical possession of residential real estate property collateralizing a consumer mortgage loan, such that all or a portion of the loan should be derecognized and the real estate property recognized. The main provisions would also require additional disclosures regarding the amount of foreclosed residential real estate property held by the creditor and the recorded investments of consumer mortgage loans that are in the process of foreclosure at each interim and annual reporting period. This ASU is effective for fiscal years and interim periods within those years, beginning after December 15, 2014.

RESULTS OF OPERATIONS FOR THE YEARS ENDED DECEMBER 31, 2013 AND DECEMBER 31, 2012

Net Income

Net income of $7.9 million in 2013 consisted of $6.6 million related to the Company’s banking activities and $1.3 million in net income related to the Company’s insurance agency activities. The total net income of $7.9 million was a 3.4% decrease from $8.1 million in 2012. Earnings per diluted share for 2013 of $1.85 showed a decrease of 5.2% from $1.95 per diluted share for 2012.

Net Interest Income

Net interest income, the difference between interest income and fee income on earning assets, such as loans and securities, and interest expense on deposits and borrowings, provides the primary basis for the Company’s results of operations.

Net interest income is dependent on the amounts and yields earned on interest earning assets as compared to the amounts of and rates paid on interest bearing liabilities.

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AVERAGE BALANCE SHEET INFORMATION

The following table presents the significant categories of the assets and liabilities of the Bank, interest income and interest expense, and the corresponding yields earned and rates paid in 2013, 2012 and 2011. The assets and liabilities are presented as daily averages. The average loan balances include both performing and non-performing loans. Interest income on loans does not include interest on loans for which the Bank has ceased to accrue interest. Securities are stated at fair value. Interest and yield are not presented on a tax-equivalent basis.

	2013			2012			2011		
	Average Outstanding Balance	Interest Earned/ Paid	Yield/ Rate	Average Outstanding Balance	Interest Earned/ Paid	Yield/ Rate	Average Outstanding Balance	Interest Earned/ Paid	Yield/ Rate
	(dollars in thousands)			(dollars in thousands)			(dollars in thousands)		
ASSETS									
Interest-earning assets:									
Loans and leases, net	$ 596,783	$ 29,546	4.95 %	$ 579,586	$ 30,300	5.23 %	$ 535,526	$ 29,140	5.44 %
Taxable securities	63,890	1,666	2.61 %	67,679	1,870	2.76 %	62,269	2,115	3.40 %
Tax-exempt securities	35,255	1,060	3.01 %	34,104	1,153	3.38 %	37,201	1,434	3.85 %
Interest bearing deposits at banks	62,286	132	0.21 %	42,817	53	0.12 %	16,395	26	0.16 %
Total interest-earning assets	758,214	$ 32,404	4.27 %	724,186	$ 33,376	4.61 %	651,391	$ 32,715	5.02 %
Non interest-earning assets:									
Cash and due from banks	14,481			11,634			14,223		
Premises and equipment, net	11,250			10,748			10,607		

Other assets	36,702			36,009			35,760		
Total Assets	$ 820,647			$ 782,577			$ 711,981		
LIABILITIES & STOCKHOLDERS' EQUITY									
Interest-bearing liabilities:									
NOW	$ 67,548	$ 357	0.53 %	$ 59,811	$ 615	1.03 %	$ 44,639	$ 548	1.23 %
Regular savings	357,098	1,097	0.31 %	341,739	1,931	0.57 %	280,606	2,019	0.72 %
Muni-vest savings	26,052	60	0.23 %	24,937	79	0.32 %	27,272	131	0.48 %
Time deposits	111,165	1,782	1.60 %	109,508	1,921	1.75 %	131,171	2,923	2.23 %
Other borrowed funds	11,617	407	3.50 %	20,161	681	3.38 %	23,287	760	3.26 %
Junior subordinated debentures	11,330	325	2.87 %	11,331	348	3.07 %	11,330	331	2.92 %
Securities sold under agreement to repurchase	14,767	29	0.20 %	10,009	22	0.22 %	6,679	15	0.22 %
Total interest-bearing liabilities	599,577	$ 4,057	0.68 %	577,496	$ 5,597	0.97 %	524,984	$ 6,727	1.28 %
Noninterest-bearing liabilities:									
Demand deposits	131,041			119,805			108,522		
Other	11,955			12,381			11,829		
Total liabilities	$ 742,573			$ 709,682			$ 645,335		
Stockholders' equity	78,074			72,895			66,646		
Total Liabilities and Equity	$ 820,647			$ 782,577			$ 711,981		
Net interest earnings		$ 28,347			$ 27,779			$ 25,988	
Net interest margin			3.74 %			3.84 %			3.99 %
Interest rate spread			3.59 %			3.64 %			3.74 %

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The following table segregates changes in interest earned and paid for the past two years into amounts attributable to changes in volume and changes in rates by major categories of assets and liabilities. The change in interest income and expense due to both volume and rate has been allocated in the table to volume and rate changes in proportion to the relationship of the absolute dollar amounts of the change in each.

	2013 Compared to 2012 Increase (Decrease) Due to (in thousands)			2012 Compared to 2011 Increase (Decrease) Due to		
	Volume	Rate	Total	Volume	Rate	Total
Interest earned on:						
Loans	$ 884	$ (1,638)	$ (754)	$ 2,331	$ (1,171)	$ 1,160
Taxable securities	(100)	(104)	(204)	171	(416)	(245)
Tax-exempt securities	38	(131)	(93)	(113)	(168)	(281)
Federal funds sold	31	47	78	34	(6)	28
Total interest-earning assets	$ 853	$ (1,826)	$ (973)	$ 2,423	$ (1,761)	$ 662
Interest paid on:						
NOW accounts	$ 75	$ (333)	$ (258)	$ 166	$ (99)	$ 67
Savings deposits	81	(915)	(834)	395	(483)	(88)
Muni-vest	4	(23)	(19)	(11)	(41)	(52)
Time deposits	29	(168)	(139)	(438)	(564)	(1,002)
Fed funds purchased & other borrowings borrowings	(88)	(202)	(290)	3	(58)	(55)
Total interest-bearing liabilities	$ 101	$ (1,641)	$ (1,540)	$ 115	$ (1,245)	$ (1,130)

Net interest income increased by $0.6 million, or 2.0%, to $28.3 million in 2013 from $27.8 million in 2012. As indicated in the preceding table, rates earned and paid on interest-earning assets and interest-bearing liabilities negatively impacted net interest income by $0.2 million, while the volume on those respective assets and liabilities positively impacted net interest income by $0.8 million. Overall, the volume in loans and securities along with the benefit of lower rates paid on deposits were partially offset by a decrease in interest earned on loans and securities.

The FRB has executed on a monetary policy designed to keep interest rates at all time lows for the past four years. The target overnight rate has been between 0.00% and 0.25% since the end of 2008. The FRB has also executed on other quantitative easing strategies, including the purchase of mortgage-backed securities, in an attempt to depress longer-term market interest rates. Although the Fed has modestly reduced its pace of asset purchases, its accommodation policy kept rates historically low during 2013. This interest rate environment resulted in lower interest yields earned on assets as well as lower rates paid on liabilities. Assets continue to re-price into lower yields as older loans and securities mature and new loans are originated and securities purchased at much lower yields than

those they are replacing.

The Company has invested in adding to its commercial loan portfolio significantly in the past several years by adding several commercial loan officers while existing loan officers have successfully increased production. Total commercial loan portfolio balance, including commercial real estate and commercial and industrial loans, increased $9.1 million, or 2.0%, from a $456.5 million average balance in 2012 to a $465.6 million average balance in 2013. Consumer loans increased 8.1% from a $130.0 million average balance in 2012 to $140.4 million in 2013.

On the funding side, the Company has been successful in attracting new deposit customers, with most of that success coming from growth in the regular savings products, such as Better Savings, Statement Savings, and business money market accounts. These products have begun to mature in their product life cycle and competitors have reduced rates on virtually all deposit products, creating an opportunity for the Company to reduce rates on these products while remaining competitive and retaining core customers. Due to customer preference for liquid deposits with long-term rates at all-time lows, there was strong growth in the Company’s demand deposit balances, marked by an $11.5 million increase in average demand deposit balances during 2013 compared with 2012.

Net interest spread, or the difference between yield on interest-earning assets and rate on interest-bearing liabilities, declined to 3.59% in 2013, compared with 3.64% in 2012. The yield on interest-earning assets decreased 34 basis points from 4.61% in 2012 to 4.27% in 2013, and the cost of interest-bearing liabilities decreased 29 basis points, from 0.97%

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in 2012 to 0.68% in 2013. Net interest spread decreased as the yield curve, or the difference between long-term rates and short-term rates, flattened throughout 2013. Banks traditionally benefit from a steep yield curve because the duration of interest-earnings assets is typically longer than the duration of interest-bearing liabilities. In addition, the Company's opportunities to re-price on the liability side during 2013 were not enough to make up for the steeper decrease in asset yields from re-pricing.

The Company's net interest margin decreased from 3.84% in 2012 to 3.74% in 2013, reflecting the changes to the net interest spread. It should be noted that several factors could put additional pressure on the Company's net interest margin in the future, including further flattening of the yield curve and increased pricing competition for loans and deposits.

The Bank regularly monitors its exposure to interest rate risk. Management believes that the proper management of interest-sensitive funds will help protect the Bank's earnings against changes in interest rates. The Bank's Asset/Liability Management Committee ("ALCO") meets monthly for the purpose of evaluating the Bank's short-term and long-term liquidity position and the potential impact on capital and earnings of changes in interest rates. The Bank has adopted an asset/liability policy that specifies minimum limits for liquidity and capital ratios. This policy includes setting ranges for the negative impact acceptable on net interest income and on the fair value of equity as a result of a shift in interest rates. The asset/liability policy also includes guidelines for investment activities and funds management. At its monthly meetings, ALCO reviews the Bank's status and formulates its strategies based on current economic conditions, interest rate forecasts, loan demand, deposit volatility and the Bank's earnings objectives.

Provision for Loan and Lease Losses

The Company's provision for loan and lease losses increased $1.6 million from ($0.1) million in 2012 to $1.5 million in 2013. The overall increase was a result of increases in impaired commercial loans, commercial loans classified as criticized loans, and the growth in the general loan portfolio, as well as recognition of provision for previously covered loans under the FDIC loss sharing agreement and continued run-off of the leasing portfolio. The increase in the provision for loan losses in 2013 was driven mostly by increases in loans, impaired commercial loans and commercial loans classified as criticized loans. As noted in Note 1 to the Consolidated Financial Statements included in Item 8 of this Annual Report on Form 10-K, the Company reserves a specific allocation on impaired loans and a higher percentage on criticized loans, or those loans risk rated 5 or higher. The Company had $1.2 million in specific reserve credit allocation on impaired loans at December 31, 2013, compared with $1.0 million at December 31, 2012. There was one criticized commercial loan relationship that became impaired in 2013 and required a significant specific reserve. At December 31, 2013, loans risk rated 5 or higher were up $10.6 million to $30.8 million, compared with $20.2 million at December 31, 2012, mostly driven by one large commercial and multi-family relationship classified as a criticized loan during the year. Additionally, total loans collectively evaluated for impairment increased $58.0 million to $629.2 million in 2013, compared with $571.2 million as of December 31, 2012. In addition, upon termination of the FDIC loss sharing agreement in 2013, the Company recognized a $0.6 million in provision on loans previously referred to as "covered" due to the FDIC guarantee governing those acquired loans. Termination of the loss sharing agreement with the FDIC eliminated the guarantee on the losses associated with the acquired portfolio, and required the Company to realize $0.6 million provision on those loans previously

covered under the FDIC guarantee. The Company's provision for lease losses benefitted from a negative provision of $0.9 million in 2012, as the portfolio demonstrated improved performance, compared with a negative provision of $0.1 million in 2013. As the leasing portfolio significantly declined and existing leases continued to perform in 2013, the benefit from additional releases in the provision for lease losses in the current year had been exhausted. The increases in the provision for loan and lease losses was partially offset by $0.2 million in net recoveries in 2013, compared with net charge-offs of $1.7 million in 2012.

The ratio of non-performing loans and leases to total loans and leases increased significantly from 1.41% at December 31, 2012 to 2.12% at December 31, 2013. The increase is attributable to one large commercial and multi-family relationship that became a non-performing loan in 2013. The loan is well secured, and the Company actively monitors this relationship on a routine basis. Excluding this one large commercial and multi-family relationship, the ratio of non-performing loans and leases to total loans and leases as of December 31, 2013 would have been less than 1%. The Company experienced a positive trend in the ratio of non-performing loans and leases to total loans and leases over the previous three years from 2.64% at December 31, 2010 to 2.60% at December 31, 2011 and 1.41% at December 31, 2012. Trends in non-performing loans and charge-offs are good indicators of credit quality and provide context for the movement in the provision for loan and lease losses, and are presented and discussed in the next section. A description of how the allowance for loan and lease losses is determined along with tabular data depicting the key factors in calculating the allowance is set forth in Notes 1 and 3 of the Notes to Consolidated Financial Statements included in Part II, Item 8 of this Annual Report on Form 10-K.

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Prior to July 1, 2013, loans acquired in connection with the Company’s 2009 acquisition of Waterford Village Bank were covered by a loss sharing agreement with the FDIC, under which the FDIC agreed to bear 80% of loan and foreclosed real estate losses up to $5.6 million and 95% of losses beyond $5.6 million. The former Waterford loans are referred to as covered loans in this document because they were “covered” by the FDIC guarantee. The loss sharing agreement with the FDIC was terminated in 2013; thereby eliminating classification of loans deemed “covered” by the FDIC guarantee. As of December 31, 2013, the Company incurs losses on the previously covered loan portfolio in the same manner as loans originated by the Bank and managed in the Company’s total loan portfolio.

Non-accrual, Past Due and Restructured Loans and Leases

The following table summarizes the Bank’s non-accrual and accruing loans and leases 90 days or more past due as of the dates listed below. See Note 3 of the Notes to Consolidated Financial Statements included in Part II, Item 8 of this Annual Report on Form 10-K for further information about the Company's non-accrual, past due and restructured loans and leases.

	At December 31,				
	2013	2012	2011	2010	2009
	(in thousands)				
Non-accruing loans and leases:					
Mortgage loans on real estate:					
Residential mortgages	$ 1,376	$ 1,443	$ 1,048	$ 742	$ 978
Commercial and multi-family	8,873	4,309	6,858	5,724	2,328
Construction-residential	-	-	167	186	-
Construction-commercial	-	729	1,442	850	417
Home equities	447	618	946	256	181
Total mortgage loans on real estate	10,696	7,099	10,461	7,758	3,904
Direct financing leases	47	171	1,160	2,930	2,905
Commercial and industrial loans	2,970	914	2,180	2,203	1,784
Consumer installment loans	20	44	76	230	243
Other	-	-	-	-	-
Total non-accruing loans and leases	$ 13,733	$ 8,228	$ 13,877	$ 13,121	$ 8,836

Accruing loans 90+ days past due	-	-	1,299	806	4,112
Total non-performing loans and leases	$ 13,733	$ 8,228	$ 15,176	$ 13,927	$ 12,948
Total non-performing loans and leases to total assets	1.65 %	1.02 %	2.05 %	2.07 %	2.09 %
Total non-performing loans and leases to total loans and leases	2.12 %	1.41 %	2.60 %	2.64 %	2.64 %

Non-performing loans and leases increased $5.5 million from $8.2 million at December 31, 2012 to $13.7 million at December 31, 2013. In 2013, one large commercial and multi-family loan relationship and one large commercial and industrial loan relationship were moved into non-accrual status, and were primary drivers in the increase in total non-performing loans and leases since December 31, 2012.

Non-accruing loans and leases also increased $5.5 million from $8.2 million at December 31, 2012 to $13.7 million at December 31, 2013, as there were no accruing loans categorized as 90 days past due at December 31, 2012 and 2013. The largest portion of non-accruing loans and leases remains the commercial real estate portfolio (classified in the preceding table as commercial and multi-family real estate and construction-commercial). Five commercial real estate loan relationships, totaling $8.6 million at December 31, 2013, entered into non-accruing status in 2013, however, $4.5 million paid off, $0.2 million charged off, and $0.1 million paid down during the year.

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Non-accruing consumer real estate loans, including residential mortgages and home equity loans and lines of credit, decreased from $2.1 million at December 31, 2012 to $1.8 million at December 31, 2013. Historical losses in these portfolios have been relatively low as the Company has typically loaned at conservative loan-to-value ratios, resulting in fewer losses.

The next largest segment of non-accruing loans and leases are the commercial and industrial loans. There was a $2.0 million increase in commercial and industrial loans from prior year end, primarily due to five commercial loans, totaling $2.9 million at December 31, 2013, moved into non-accruing status in 2013 that were still accruing as of December 31, 2012. One commercial loan totaling $0.5 million was paid off, one commercial loan totaling $0.1 million was restored to accruing status, and an additional $0.2 million in commercial loans were paid down or charged-off since December 31, 2012.

Non-accruing leases decreased from $0.2 million at December 31, 2012 to less than $0.1 million at December 31, 2013. The Company discontinued direct financing lease originations in April 2009 and plans to service the portfolio to maturity. Similar to 2012, the charge-offs and pay-downs of non-accruing leases in 2013 exceeded the amount of leases going into non-accruing status, resulting in the decrease in the non-accruing lease balance.

The Company had $17.1 million in loans and leases that were restructured and deemed to be a troubled debt restructuring ("TDR") at December 31, 2013 with $12.0 million of those balances in non-accrual status. Any TDR that is placed on non-accrual is not reverted back to accruing status until the borrower makes timely payments as contracted for at least six months and future collection under the revised terms is probable. All of the restructurings were allowed in an effort to maximize the Company's 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 years ended December 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.

The following table presents the Company's TDR loans and leases as of December 31, 2013:

	December 31, 2013 ($ in thousands)			
	Total	Nonaccruing	Accruing	Related Allowance
Commercial and industrial	$ 4,262	$ 2,903	$ 1,359	$ 983

Residential real estate:				
Residential	1,031	454	577	-
Construction	-	-	-	-
Commercial real estate:				
Commercial and multi family	10,211	8,563	1,648	33
Construction	1,533	-	1,533	-
Home equities	56	56	-	-
Direct financing leases	26	12	14	-
Consumer loans	-	-	-	-
Other	-	-	-	-
Total troubled restructured loans and leases	$ 17,119	$ 11,988	$ 5,131	$ 1,016

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Allowance for Loan and Lease Losses

The following table summarizes the Bank's allowance for loan and lease losses and changes in the allowance for loan and lease losses by categories:

ANALYSIS OF THE ALLOWANCE FOR LOAN AND LEASE LOSSES

	2013	2012	2011	2010	2009
	(in thousands)				
BALANCE AT THE BEGINNING OF THE YEAR	$ 9,732	$ 11,495	$ 10,424	$ 6,971	$ 6,087
CHARGE-OFFS:					
Residential mortgages	(39)	(12)	-	-	-
Commercial and multi-family	(460)	(900)	(189)	-	-
Construction-residential	-	-	-	-	-
Construction-commercial	-	-	-	(104)	-
Home equities	(128)	(114)	-	-	(34)
Direct financing leases	-	-	-	-	(9,483)
Commercial and industrial loans	(20)	(862)	(1,305)	(388)	(285)
Consumer installment loans	(64)	(32)	(2)	(4)	-
Other	-	-	(26)	(53)	(56)
TOTAL CHARGE-OFFS	(711)	(1,920)	(1,522)	(549)	(9,858)
RECOVERIES:					
Residential mortgages	2	1	-	-	-
Commercial and multi-family	444	15	57	-	-
Construction-residential	-	-	-	-	-
Construction-commercial	-	-	-	30	-
Home equities	1	6	2	1	-
Direct financing leases	242	-	-	-	211
Commercial and industrial loans	240	184	39	4	9
Consumer installment loans	13	19	1	-	-
Other	-	-	10	24	22
TOTAL RECOVERIES	942	225	109	59	242
NET (CHARGE-OFFS) RECOVERIES	231	(1,695)	(1,413)	(490)	(9,616)
PROVISION FOR LOAN AND					

LEASE LOSSES	1,540	(68)	2,484	3,943	10,500
BALANCE AT THE END OF YEAR	$ 11,503	$ 9,732	$ 11,495	$ 10,424	$ 6,971
RATIO OF NET CHARGE-OFFS (RECOVERIES) TO AVERAGE NET LOANS AND LEASES OUTSTANDING	(0.04) %	0.29 %	0.26 %	0.10 %	2.19 %
RATIO OF ALLOWANCE FOR LOAN AND LEASE LOSSES TO TOTAL LOANS AND LEASES	1.78 %	1.67 %	1.97 %	1.97 %	1.42 %

Net charge-offs (net recoveries) significantly decreased from $1.7 million in 2012 to ($0.2) million in 2013. The ratio of net charge-offs (net recoveries) to average net loans and leases outstanding correspondingly decreased from 0.29% to (0.04)%. The largest net recoveries occurred in the commercial and industrial loan portfolio due to fewer commercial loan charge-offs and an increase in commercial loan recoveries in 2013 when compared to the prior year. $0.2 million of the $0.9 million in recoveries in 2013 were related to leasing recoveries on leases previously marked down to fair value in 2009 when the Company announced its intention to sell the direct financing lease portfolio.

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The troubled economy resulted in a significant increase in net charge-offs in the direct financing lease portfolio during 2009. The $9.3 million in net leasing charge-offs in that year included a mark-to-market adjustment of $7.2 million on the total portfolio after the Company initially announced its intention to sell the portfolio during the second quarter of 2009. The fair value calculation was based on competitive bids. Subsequent to that initial announcement, the Company decided to keep and service the remaining leasing portfolio until maturity rather than sell the portfolio at a distressed value in a difficult market. Under GAAP, the Company did not reverse the mark-to-market adjustment made at June 30, 2009, even though it no longer intended to sell the portfolio. The adjustment initially represented the difference between the leasing portfolio's principal value and fair value. Although leases are not valued at fair value any longer as the Company no longer intends to sell the portfolio, there remains a difference between the principal value and carrying value. As leases are deemed uncollectible, the principal value is written down and the difference between the principal value and the carrying value becomes smaller. The following table illustrates the charge-off activity in the leasing portfolio along with some relevant credit quality data:

	As of December 31,		
	2013	2012	2011
	(in thousands)		
Direct financing lease principal balance	$ 105	$ 1,742	$ 6,509
Mark-to-market adjustment	(105)	(130)	(488)
Direct financing lease carrying balance	-	1,612	6,021

	For the year ended December 31,		
	2013	2012	2011
	(in thousands)		
Beginning balance of the mark	$ 130	$ 488	$ 1,493
Mark-to-market adjustment	(242)	-	-
Net write-offs (recoveries)	217	(358)	(1,005)
Remaining mark	105	130	488
Allowance for lease losses, beginning balance	$ 47	$ 994	$ 1,471
(Reduction of) provision for lease losses	(47)	(947)	(477)
Leasing net charge-offs	-	-	-
Allowance for lease losses, ending balance	-	47	994
Total mark plus allowance	$ 105	$ 177	$ 1,482
Mark plus allowance / leasing principal balance	100 %	10.16 %	22.77 %
Non-accruing leases	$ 47	$ 171	$ 1,160
Non-accruing leases / leasing principal balance	44.76 %	9.82 %	17.82 %

In 2010, the leasing portfolio continued to deteriorate as non-accruing leases increased slightly, despite the overall principal balance of the portfolio declining by 52.4%, resulting in an increase in the non-accruing lease ratio from 8.15% at December 31, 2009 to 17.27% at December 31, 2010. The apparent deterioration in the portfolio resulted in management provisioning for $1.5 million in additional lease losses. In 2011, performance in the portfolio improved with non-accruing leases declining 60.4% as the portfolio continued to roll off. Consequently, the non-accruing lease

ratio stabilized at 17.82% at December 31, 2011, compared with 17.27% at December 31, 2010. Also, net write-offs slowed in 2011 at $1.0 million compared with $2.7 million in 2010. This caused the mark plus allowance ratio to improve from 17.47% at December 31, 2010 to 22.77% at December 31, 2011. The combined impact of the reduced non-accruing leases and net lease write-offs was a sharp increase in the coverage of the mark plus allowance compared with non-accruing leases. The improved credit quality metrics in 2011 resulted in management releasing allowance of $0.5 million. There was continued improvement in the portfolio over the past three years, as non-accruing leases declined to less than $0.1 million at December 31, 2013 from $0.2 million and $1.2 million at December 31, 2012 and 2011, respectively. The par value of the leasing portfolio is down to zero as of December 31, 2013 compared with $1.6 million at December 31, 2012. With an increasingly low level of non-accruing leases and the portfolio nearing the end of its life, management exhausted the allowance for lease losses in 2013 after a significant reduction in the allowance for

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lease losses of $0.9 million in 2012. As the direct finance leasing principal balance runs off, the Company records a mark-to-market adjustment in the amount that the mark-to-market balance exceeds the principal balance, as a recovery on the original mark-to-market adjustment of $7.2 million recorded in 2009.

An allocation of the allowance for loan and lease losses by portfolio type over the past five years follows (dollars in thousands):

	Balance at 12/31/2013 Attributable to:	Percent of loans in each category to total loans:	Balance at 12/31/2012 Attributable to:	Percent of loans in each category to total loans:	Balance at 12/31/2011 Attributable to:	Percent of loans in each category to total loans:	Balance at 12/31/2010 Attributable to:	Percent of loans in each category to total loans:	Balance at 12/31/2009 Attributable to:	Percent of loans in each category to total loans:
Residential mortgages *	$ 1,038	14.77 %	$ 662	11.84 %	$ 793	13.00 %	$ 548	13.50 %	$ 559	14.20
Commercial mortgages *	4,912	59.53 %	4,493	60.58 %	4,670	57.30 %	4,252	55.60 %	3,324	53.50
Home equities	878	8.85 %	746	9.68 %	768	9.40 %	540	10.10 %	495	10.20
Commercial loans	4,489	16.53 %	3,617	17.17 %	4,085	18.80 %	3,435	17.30 %	2,387	14.90
Consumer loans **	37	0.32 %	18	0.45 %	36	0.50 %	29	0.60 %	57	0.80
Direct financing leases	-	- %	47	0.28 %	994	1.00 %	1,471	2.90 %	-	6.40
Unallocated	149	- %	149	- %	149	- %	149	- %	149	-
	$ 11,503	100.00 %	$ 9,732	100.00 %	$ 11,495	100.00 %	$ 10,424	100.00 %	$ 6,971	100.00

* includes construction loans

** includes other loans

Allowance for C&I loans comprises 39.0% of the allowance for loan and lease losses despite being only 16.5% of the loan and lease portfolio, while the allowance related to commercial mortgages comprises 42.7% of the allowance for loan and lease losses despite being 59.5% of the total loan and lease portfolio. Although the commercial mortgage portfolio experienced greater losses than the C&I loan portfolio in 2013, C&I loans suffered far greater losses during the previous four years and therefore comprise a greater relative portion of the allowance.

Overall, the ratio of the allowance for loan and lease losses to total loan and leases slightly increased from 1.67% at December 31, 2012 to 1.78% on December 31, 2013. The increase is a reflection of the $0.6 million in provision recognized on the acquired loans previously covered under the FDIC loss sharing agreement. Excluding the impact of this additional provision would yield a 1.68% ratio of the allowance for loan and lease losses to total loan and leases.

At December 31, 2012, the Company had $20.8 million in loans from the Company's 2009 acquisition of Waterford Village Bank that were covered under the loss sharing agreement with the FDIC. Under the agreement, the Company was eligible to be reimbursed for 80% of losses on the acquired loan portfolio up to $5.6 million, and 95% of losses above $5.6 million, based on the acquired loans' original carrying value. Prior to termination of the FDIC loss sharing agreement, the allowance on the covered loan portfolio was presented net of the 80% FDIC guarantee. As of December 31, 2012, the net allowance on the previously covered loan portfolio was $0.1 million, or 0.57% of the acquired loan portfolio; however, excluding the 80% FDIC guarantee, the gross allowance was 2.77%, or $0.6 million, of the acquired loan portfolio of $20.8 million. The Company's total allowance for loan and lease losses, excluding the 80% FDIC guarantee, was $10.2 million, or 1.75%, of the total loan and leases outstanding of $582.9 million at December 31, 2012. This is comparable to the ratio of the allowance for loan and lease losses to total loan and leases of 1.78% at December 31, 2013.

The Company's coverage ratio of the allowance for loan and lease losses to non-performing loans and leases decreased from 118% at December 31, 2012 to 84% at December 31, 2013, due to the year over year increase in non-performing

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loans and leases of $5.5 million from $8.2 million at December 31, 2012 to $13.7 million at December 31, 2013. The increase in non-performing loans and leases is mostly due to one commercial mortgage loan which was placed in non-accrual status in 2013, but that loan been successfully restructured with a new borrower and is well-secured by collateral value with no reserve considered necessary.

The Company maintains a robust loan review process to ensure that specific credits are appropriately reserved. Management is cognizant that commercial real estate values may be more susceptible to decline than other types of loans in an adverse economy. Management believes that the allowance for loan and lease losses is reflective of a fair assessment of the current environment and credit quality trends.

Non-Interest Income

Total non-interest income decreased by $0.7 million, or 5.2%, from 2012 to 2013. The primary factor driving the decrease was a non-routine loss on a tax credit investment of $1.6 million. The loss was moderated by a $0.7 million one-time gain realized from the termination of the FDIC loss sharing agreement. The Company was able to reduce its overall tax provision by $2.0 million, or 53.8%, from prior year tax provision of $3.7 million, largely as a result of investing in a community project in 2013 which generated historic tax credits. Conversely, the $0.7 million gain on termination of the FDIC loss sharing agreement was offset by a $0.6 million increase in provision for loan and lease losses.

In addition, Bank charges on deposits increased $0.2 million, or 9.7%, from $1.8 million at December 31, 2012 to $2.0 million at December 31, 2013, along with an increase of $0.1 million, or 12.2%, in interchange fee income from $0.9 million at December 31, 2012 to $1.0 million at December 31, 2013. This is attributable to the growth in deposits and the Company's strategic focus on increasing fee revenue on commercial checking accounts and customer card activity. Insurance service and fee revenue increased $0.2 million, or 3.5%, to $7.2 million at December 31, 2013. TEA's revenue remains the largest component of non-interest income at 59.3% of total non-interest income. TEA is a source of diversification in the earnings of the Company and helps generate income not directly impacted by difficult credit or interest rate environments. Despite a soft insurance market environment in recent years, the Company continued gradual growth in insurance revenue. These increases were somewhat offset by a decrease in gains from premiums on loans sold to FNMA of $0.4 million. In 2013, market interest rates continued to decline and compressed the margin on gains that could be realized on selling residential mortgages to FNMA. As a result, the Company was able to originate and hold more residential mortgages, as reflected in the $26.6 million increase in residential mortgages loans.

Non-Interest Expense

Total non-interest expense increased $0.6 million, or 2.0%, from $28.8 million in 2012 to $29.4 million in 2013. The largest increase in non-interest expense was in salaries and employee benefits, which increased $0.5 million, or 2.6%, in comparison to 2012. Excluding a $0.6 million severance cost in 2012, salaries and employee benefits increased $1.0 million, or 6.0%, from 2012. The increase stems from merit increases, rising health care costs, and the addition of new employees as a part of the Company's planned growth strategy.

Occupancy expenses increased $0.2 million, or 8.1%, from prior year, primarily due to a write-off of capitalized software costs on a discontinued project and expenses related to the new Williamsville branch opened in 2012.

Technology and communications expense increased $0.1 million, or 7.2%, to $1.3 million in 2013. The increase is entirely attributable to an increase in ATM and debit card processing fees paid by the Company as customer usage of ATM and debit cards continued to rise.

FDIC insurance costs also increased $0.1 million, or 10.6%, from prior year due to an increase in the assessment from deposit growth.

In 2013, the Company benefited from the expiration of the amortization of intangibles related to its purchase of an insurance agency in 2008. Amortization expense declined from $0.3 million in 2012 to $0.2 million in 2013.

Repairs and maintenance and advertising expenses decreased $0.1 million in 2013. The 6.0% reduction in repairs and maintenance from 2012 relates to efficiencies gained due to consolidation of the Company's offices and business operations. Advertising costs were reduced 3.4% due to more stringent expense control.

The efficiency ratio expresses the relationship of operating expenses to revenues. The Company's efficiency ratio, or non-interest operating expenses (exclusive of non-cash goodwill impairment and intangible amortization) divided by the sum of net interest income and non-interest income (exclusive of gains and losses from investment securities), was

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71.98% in 2013, an increase from 70.05% in 2012 and 69.68% in 2011. The increase is a product of the Company's declining net interest margin and investments in additional employees and infrastructure.

Taxes

The provision for income taxes in 2013 was $1.7 million on pre-tax income of $9.6 million for an effective tax rate of 18.1%, compared with an effective rate of 31.5% in 2012. The decrease in tax provision is a direct result of investing in a community project in 2013 which generated historic tax credits. Excluding the $1.6 million loss on the historic tax credit purchase and the $1.8 million tax credit benefit recorded in 2013, the provision for income taxes is $3.5 million on pre-tax income of $11.1 million, yielding an effective rate of 31.7% that is consistent with prior year.

RESULTS OF OPERATIONS FOR YEARS ENDED DECEMBER 31, 2012 AND DECEMBER 31, 2011

Net Income

Net income of $8.1 million in 2012 consisted of $7.0 million related to the Company's banking activities and $1.1 million in net income related to the Company's insurance agency activities. The total net income of $8.1 million was an increase of 32.8% from $6.1 million in 2011. Earnings per diluted share for 2012 of $1.95 were an increase of 30.9% from $1.49 per diluted share for 2011.

Net Interest Income

Net interest income increased by $1.8 million, or 6.9%, to $27.8 million in 2012 from $26.0 million in 2011. Interest-earning asset and interest-bearing liability volume positively impacted net interest income by $2.3 million, while rates earned and paid on those respective assets and liabilities negatively impacted net interest income by $0.5 million. Overall, the increase in the volume of loans and the benefit of lower rates paid on deposits was partially offset by lower rates earned on interest-earning assets, particularly loans and leases.

The Company had invested in adding to its commercial loan portfolio significantly by adding several commercial loan officers while existing loan officers successfully increased production. Total commercial loan portfolio balance, including commercial real estate and commercial and industrial loans, increased by 10.2%, from a $417.5 million average balance in 2011 to a $460.2 million average balance in 2012. Consumer loans increased 1.2% from $128.5 million average balance in 2011 to $130.0 million in 2012.

On the funding side, the Company was successful in attracting new deposit customers, with most of that success coming in the premium-rate Better Checking, Better Savings, and business money market accounts. These products had begun to mature in their product life cycle and competitors had reduced rates on virtually all deposit products, creating an opportunity for the Company to reduce rates on these products while remaining competitive and retaining core customers. Due to customer preference for liquid deposits with long-term rates at all-time lows, time deposit balances decreased in 2012 as demand for the product remained weak. Also, as time deposits rolled off, they were replaced by lower rate deposits due to the low interest rate environment.

Net interest spread, or the difference between yield on interest-earning assets and rate on interest-bearing liabilities, declined to 3.64% in 2012, compared with 3.74% in 2011. The yield on interest-earning assets decreased 41 basis points from 5.02% in 2011 to 4.61% in 2012, and the cost of interest-bearing liabilities decreased 31 basis points, from 1.28% in 2011 to 0.97% in 2012. Net interest spread shrank as the yield curve, or the difference between long-term rates and short-term rates, flattened throughout 2012. Banks traditionally benefit from a steep yield curve because the duration of interest-earnings assets is typically longer than the duration of interest-bearing liabilities. In addition, the Company’s opportunities to re-price on the liability side were not enough to make up for the steeper decrease in asset yields from re-pricing. The Company’s net interest margin decreased from 3.99% in 2011 to 3.84% in 2012, reflecting the changes to the net interest spread.

Provision for Loan and Lease Losses

The Company’s provision for loan and lease losses decreased $2.6 million from $2.5 million in 2011 to ($0.1) million in 2012. The overall decrease was a result of a decline in the provision for loan losses of $2.1 million from $3.0 million in 2011 to $0.9 million in 2012, combined with a larger negative provision of $0.9 million for the leasing portfolio in 2012, compared with a negative provision for lease losses of $0.5 million in 2011. The decrease in the provision for loan losses in 2012 stemmed mostly from a low growth rate in the loan portfolio, lower levels of criticized loans, and recoveries of previous charge-offs, offset somewhat by the increase in specific reserves on several impaired loan relationships and an increase in historical loss factors. Loan recoveries increased from $0.1 million in 2011 to $0.2

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million in 2012. The Company had $20.2 million in loans risk rated 5 or higher at December 31, 2012, compared with $23.5 million at December 31, 2011. Loan growth, not including leases, was $3.9 million in 2012, compared with $64.9 million in 2011, resulting in a significantly lower provision for loan growth in 2012. There were five commercial loans that were either already impaired at December 31, 2011 and deteriorated, or became impaired in 2012 and required a specific reserve. The net charge-off ratio increased from 0.26% in 2011 to 0.29% in 2012, resulting in an increase in the Company's historical loss factors. The negative provision for leasing was higher in 2012 as the portfolio continued to wind down with non-accruing leases and charge-offs declining significantly, justifying a continued release of reserves.

The ratio of non-performing loans and leases to total loans and leases declined significantly from 2.64% at December 31, 2010 and 2.60% at December 31, 2011 to 1.41% at December 31, 2012.

Non-Interest Income

Total non-interest income increased $0.4 million, or 3.2%, from 2011 to 2012. The primary factor driving the increase was the gain on loans sold to Fannie Mae, which rose $0.3 million. The Company was able to achieve higher than usual gains per mortgage sold due to historically low rates offered by Fannie Mae. The Company was able to maintain its competitive position in the marketplace while achieving more discipline in its mortgage pricing. In addition, insurance service and fee revenue increased $0.1 million, or 0.9%, to $7.0 million. TEA's revenue was the largest component of non-interest income at 54.3% of total non-interest income in 2012. However, during 2012, TEA revenue growth continued to remain relatively flat due to the soft insurance market. Deposit service charges increased $0.1 million, or 4.2%, from prior year, to $1.9 million. This was attributable to the Company increasing fee revenue on commercial checking accounts. These increases were somewhat offset by a decrease in data center revenue of $0.2 million.

Non-Interest Expense

Total non-interest expense increased $1.6 million, or 5.7%, from $27.2 million in 2011 to $28.8 million in 2012. The largest increase in non-interest expense was in salaries and employee benefits, which increased $1.5 million, or 9.4%, in comparison to 2011. The increase resulted from merit increases, increased incentive pay, pension and supplemental executive retirement plan expenses, and increased health care costs.

Professional service expenses increased $0.1 million, or 8.4%, to $1.9 million in 2012. Most of the increase was attributable to increased legal expenses related to non-performing loans. While non-performing loans as a percentage of total loans and leases actually decreased, there were two large commercial loan relationships that caused the company to incur significant legal expenses in 2012.

Technology and communications expense increased $0.2 million, or 21.8%, to $1.2 million in 2012. The increase was entirely attributable to an increase in ATM and debit card processing fees paid by the Company as customer usage of ATM and debit cards continued to rise.

Other non-interest expenses also increased $0.2 million, or 7.9%. Various items drove this increase, including increased charitable contributions ($0.1 million), increased fraud losses on debit cards ($0.1 million), and increased ATM fee rebate costs associated with the Company's Better Checking product.

These increases were somewhat offset by decreases in occupancy expenses, FDIC insurance premiums and intangible amortization expense. Occupancy expenses decreased $0.3 million, or 10.7%, due to efficiencies achieved in the consolidation of several TEA insurance offices and the run-off of fully depreciated fixed assets.

After a significant increase in FDIC insurance premiums in 2009 and 2010, the Company benefited from the change in calculation of the assessment base stipulated by the Dodd-Frank Act in mid-2011. The change in the calculation resulted in a decrease in FDIC insurance expense of $0.1 million to $0.5 million in 2012 as a result of the effect of the full year of decreased premiums.

In 2012, the Company benefited from the expiration of the amortization of intangibles related to its purchase of an insurance agency in 2007. Amortization expense declined from $0.5 million in 2011 to $0.3 million in 2012.

The Company's efficiency ratio was 70.1% in 2012, an increase from 2011's ratio of 69.7% as a result of the Company's declining net interest margin and investments in additional employees and infrastructure.

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FINANCIAL CONDITION

The Company had total assets of $833.5 million at December 31, 2013, an increase of $23.8 million or 2.9% from $809.7 million at December 31, 2012. Net loans of $635.5 million increased $62.3 million or 10.9% from $573.2 million at December 31, 2012. Securities increased $6.2 million or 6.5% over 2012, and deposits increased by $27.6 million or 4.1%. Stockholders' equity increased $5.9 million or 7.9% from 2012.

Securities Activities

The primary objectives of the Bank's securities portfolio are to provide liquidity and maximize income while preserving safety of principal. Secondary objectives include: providing collateral to secure local municipal deposits, the investment of funds during periods of decreased loan demand, interest rate sensitivity considerations, supporting local communities through the purchase of tax-exempt securities and tax planning considerations. The Bank's Board of Directors is responsible for establishing overall policy and reviewing performance of the Bank's investments.

Under the Bank's policy, acceptable portfolio investments include: United States Government obligations, obligations of federal agencies or U.S. Government-sponsored enterprises, mortgage backed securities, municipal obligations (general obligations, revenue obligations, school districts and non-rated issues from the Bank's general market area), banker's acceptances, certificates of deposit, Industrial Development Authority Bonds, Public Housing Authority Bonds, corporate bonds (each corporation limited to the Bank's legal lending limit), collateralized mortgage obligations, Small Business Investment Companies (SBIC), Federal Reserve stock and Federal Home Loan Bank stock.

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 December 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, 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 credit troubles in this portfolio and does not believe any credit troubles are imminent. 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 to 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

Pursuant to FASB Accounting Standards Codification ("ASC") 320, "Investments – Debt and Equity Securities," which establishes accounting treatment for investments in securities, all securities in the Bank's investment portfolio are either designated as "held to maturity" or "available for sale."

Fair values for available for sale securities are determined using independent pricing services and market-participating brokers. The Company's independent pricing service is Interactive Data. Interactive Data 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, Interactive Data's 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, Interactive Data uses model processes, such as the Option Adjusted Spread model, 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. Interactive Data, at times, may determine that it does not have sufficient verifiable information to value a particular security. In these cases the Company will utilize valuations from another pricing service.

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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, as submitted by Interactive Data, in the market value of its securities 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 securities 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 Interactive Data regarding the data used to value a particular security. If the Company determines it has market information that would support a different valuation than Interactive Data's evaluation it can submit a challenge for a change to that security's valuation. There were no material differences in valuations noted in 2013 or 2012.

Securities and interest-bearing deposits at banks made up 21.3% of the Company's total average interest-earning assets in 2013 compared with 20.0% in 2012. These assets provide the Company with additional sources of liquidity and income and act as collateral for the Bank's municipal deposits. The Company's securities portfolio outstanding balances increased 6.5% from $95.8 million at December 31, 2012 to $102.0 million at December 31, 2013, while the interest-bearing deposits at banks decreased from $78.1 million to $27.3 million over the same time period. The interest-bearing deposits are liquid interest-bearing cash accounts at correspondent banks. The $50.8 million decrease in the Company's cash position is a result of the securities and loan growth in 2013. The Company also purchased $4.0 million of additional bank-owned life insurance ("BOLI"), as the balance of BOLI increased by $4.5 million or 29.4% in 2013. These decreases in the Company's cash position were partially offset by growth in total deposits of $27.6 million or 4.1% in 2013. In an uncertain economy like the current environment, creditworthy businesses are less likely to take risks, make large investments, and seek credit, and are more likely to deposit their excess cash flow in a safe investment like a bank deposit. With long-term rates at historic lows, the Company did not make significant investments from the excess liquidity in non-core assets such as long-term bonds. In 2013, $10.0 million in FHLB borrowings matured and were not replaced due the current liquidity position of the Company. Another $9.0 million in FHLB borrowings will mature in 2014, and if the current liquid position continues to hold, the Company does not intend to replace these borrowings. Over time, management anticipates that the Company's excess liquidity will shrink as the balance sheet mix shifts based on the long-term strategy. At December 31, 2013, the Company's concentration in U.S. government-sponsored agency bonds was 31.3% of the total securities balance versus 29.6% at December 31, 2012. Government-sponsored mortgage-backed securities made up 35.1% of the portfolio at December 31, 2013, compared with 33.7% of the portfolio at December 31, 2012, and tax-advantaged municipal bonds made up 31.2% of the portfolio at December 31, 2013 versus 32.8% of the portfolio at December 31, 2012.

As a member of both the Federal Reserve System and the FHLB, the Bank is required to hold stock in those entities. The Bank held $1.4 million and $1.8 million in FHLB stock as of December 31, 2013 and 2012, respectively, and $1.5 million and $1.4 million in FRB stock at December 31, 2013 and 2012, respectively.

All fixed and adjustable rate mortgage pools contain a certain amount of risk related to the uncertainty of prepayments of the underlying mortgages. Interest rate changes have a direct impact on prepayment rates. The Company uses a third-party developed model to monitor the average life and yield volatility of mortgage pools under various interest rate assumptions.

The Company designates all securities at the time of purchase as either “held to maturity” or “available for sale.” Securities designated as held to maturity are stated on the Company’s Consolidated Balance Sheets included under Item 8 of this Annual Report on Form 10-K at amortized cost. Those designated as available for sale are reported at fair market value. At December 31, 2013, $2.4 million in securities were designated as held to maturity. These bonds are primarily municipal investments that the Bank has made in its local market area.

The available for sale portfolio totaled $99.7 million or approximately 97.7% of the Company’s securities portfolio at December 31, 2013. Net unrealized gains and losses on available for sale securities resulted in a net unrealized gain of $0.3 million at December 31, 2013, as compared with a net unrealized gain of $4.0 million at December 31, 2012. Unrealized gains and losses on available-for-sale securities are reported, net of taxes, as a separate component of stockholders’ equity. For the year ended December 31, 2013, the impact on stockholders’ equity was a net unrealized loss, net of taxes, of approximately $2.3 million.

Certain securities available for sale were in an unrealized loss position at December 31, 2013. Management has assessed those securities available for sale in an unrealized loss position at December 31, 2013 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, the financial condition of the issuer (primarily government or government-sponsored enterprises) and the Company’s ability and

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intent to hold these securities until their fair value recovers to 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 issuer.

Income from securities held in the Bank’s investment portfolio represented approximately 8.8% of total interest income of the Company in 2013 as compared with 9.2% in 2012 and 10.9% in 2011. At December 31, 2013, the Bank’s securities portfolio of $102.0 million consisted primarily of state and municipal securities, mortgage-backed securities issued by the Federal National Mortgage Association (“FNMA”) and Federal Home Loan Mortgage Corp ("FHLMC"), and U.S. and federal agency obligations. The $0.2 million and $0.5 million decrease in investment securities income in 2013 and 2012, respectively, was a result of a significant decline in investment yields as sustained stimulus by the FRB continued to drive down bond yields to all-time lows. Taxable investment yields dropped from 2.76% in 2012 to 2.61% in 2013, and tax-exempt security yields fell from 3.38% in 2012 to 3.01% in 2013.

Available for sale securities with a total fair value of $71.1 million at December 31, 2013 were pledged as collateral to secure public deposits and for other purposes required or permitted by law.

The following table summarizes the Bank’s securities with those designated as available for sale valued at fair value and securities designated as held to maturity at amortized cost as of December 31, 2013, 2012 and 2011:

	At December 31,		
	2013	2012	2011
	(in thousands)		
Available for Sale:			
Debt securities			
U.S. government agencies	$ 31,992	$ 28,332	$ 30,252
States and local subdivisions	31,880	31,469	32,326
Total debt securities	$ 63,872	$ 59,801	$ 62,578
Mortgage-backed securities			
FNMA	$ 13,501	$ 16,077	$ 20,718
FHLMC	7,118	6,481	8,321
GNMA	7,573	8,013	6,143
CMO's	7,601	1,691	2,221
Total mortgage-backed securities	$ 35,793	$ 32,262	$ 37,403
Total available for sale securities	$ 99,665	$ 92,063	$ 99,981

Held to Maturity:			
Debt securities			
States and local subdivisions	$ 2,384	$ 3,744	$ 3,802
Total held to maturity securities	$ 2,384	$ 3,744	$ 3,802

The following table sets forth the contractual maturities and weighted average interest yields of the Bank’s securities portfolio (yields on tax-exempt obligations are not presented on a tax-equivalent basis) as of December 31, 2013. Expected maturities will differ from contracted maturities since issuers may have the right to call or prepay obligations without penalties.

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	Maturing Within One Year		After One But Within Five Years		After Five But Within Ten Years		After Ten Years	
	Amount	Yield	Amount	Yield	Amount	Yield	Amount	Yield
	(dollars in thousands)							
Available for Sale:								
Debt Securities								
U.S. Government agencies	$ -	- %	$ 9,437	3.19 %	$ 18,429	2.36 %	$ 4,126	5.38 %
States and political subdivisions	454	4.13 %	14,982	3.55 %	12,517	3.39 %	3,927	4.28 %
Total debt securities	$ 454	4.13 %	$ 24,419	3.41 %	$ 30,946	2.78 %	$ 8,053	4.84 %
Mortgage-backed securities								
FNMA	$ -	- %	$ 694	5.00 %	$ 4,856	3.88 %	$ 7,951	3.55 %
FHLMC	-	- %	335	5.00 %	65	6.50 %	6,718	2.94 %
GNMA	-	- %	-	- %	-	- %	7,573	3.24 %
CMO's	-	- %	10	4.25 %	-	- %	7,591	2.01 %
Total mortgage-backed securities	$ -	- %	$ 1,039	4.99 %	$ 4,921	3.91 %	$ 29,833	2.94 %
Total available for sale	$ 454	4.13 %	$ 25,458	3.47 %	$ 35,867	2.94 %	$ 37,886	3.35 %
Held to Maturity:								
Debt Securities								
U.S. Government agencies	$ -	- %	$ -	- %	$ -	- %	$ -	- %
States and political subdivisions	1,023	1.65 %	178	2.83 %	1,064	2.94 %	119	2.80 %
Total held to maturity	$ 1,023	1.65 %	$ 178	2.83 %	$ 1,064	2.94 %	$ 119	2.80 %
Total securities	$ 1,477	2.41 %	$ 25,636	3.47 %	$ 36,931	2.94 %	$ 38,005	3.34 %

LENDING AND LEASING ACTIVITIES

The Bank has a loan and lease policy which is approved by its Board of Directors on an annual basis. The loan and lease policy governs the conditions under which loans and leases may be made, addresses the lending authority of Bank officers, documentation, appraisal policy, charge-off policies and desired portfolio mix. The Bank's lending limit to any one borrower is subject to regulation by the OCC. The Bank continually monitors its loan portfolio to review compliance with new and existing regulations.

The Bank offers a variety of loan products to its customers, including residential and commercial real estate mortgage loans, commercial loans, and installment loans. The Bank primarily extends loans to customers located within the Western New York area. Until it announced that it was exiting the direct financing leasing business in April 2009, ENL originated direct financing leases in all 48 contiguous states. Interest income on loans and leases represented approximately 91.2% of the total interest income of the Company in 2013 and approximately 90.8% and 89.1% of total interest income in 2012 and 2011, respectively. The Bank's loan and lease portfolio, net of the allowances for loan and lease losses, totaled $635.5 million and $573.2 million at December 31, 2013 and December 31, 2012, respectively. The net loan and lease portfolio represented approximately 76.2% and 70.8% of the Company's total assets at December 31, 2013 and December 31, 2012, respectively.

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The following table summarizes the major classifications of the Bank's loans and leases as of the dates indicated:

	December 31,				
	2013	2012	2011	2010	2009
	(in thousands)				
Mortgage loans on real estate:					
Residential Mortgages	$ 94,027	$ 68,135	$ 73,579	$ 69,958	$ 67,330
Commercial and multi-family	361,247	323,777	306,683	261,371	243,415
Construction-Residential	1,509	811	2,392	1,320	2,086
Construction-Commercial	23,902	28,941	27,887	32,332	18,156
Home equities	57,228	56,366	54,673	53,120	50,049
Total real estate loans	537,913	478,030	465,214	418,101	381,036
Direct financing leases	-	1,612	6,021	15,475	31,486
Commercial and industrial loans	106,952	99,951	109,513	91,445	73,145
Consumer loans	938	1,294	1,677	2,458	2,883
Other	323	1,342	586	252	493
Net deferred loan origination costs	870	666	394	247	525
Total gross loans and leases	646,996	582,895	583,405	527,978	489,568
Allowance for loan and lease losses	(11,503)	(9,732)	(11,495)	(10,424)	(6,971)
Loans and leases, net	$ 635,493	$ 573,163	$ 571,910	$ 517,554	$ 482,597

Real Estate Loans

Approximately 83.1% of the Bank's total loan and lease portfolio at December 31, 2013 consisted of real estate loans or loans collateralized by mortgages on real estate, including residential mortgages, commercial mortgages and other types of real estate loans. The Bank's real estate loan portfolio was $537.9 million at December 31, 2013, compared with $478.0 million at December 31, 2012. The real estate loan portfolio increased by approximately 12.5% in 2013 over 2012 compared with an increase of 2.8% in 2012 over 2011.

The Bank offers fixed rate residential mortgage loans with terms of 10 to 30 years with, typically, up to an 80% loan-to-value ("LTV") ratio. Any loans with a greater than 80% LTV have private mortgage insurance. Fixed rate residential mortgage loans outstanding totaled $85.7 million at December 31, 2013, which was approximately 13.2% of total loans and leases outstanding, compared with $54.7 million and 9.7%, respectively, at December 31, 2012. This balance did not include any construction residential mortgage loans, which are discussed below. The Bank has a contractual arrangement with FNMA, pursuant to which the Bank sells certain mortgage loans to FNMA and the Bank retains the servicing rights to those loans. The Bank determines with each origination of residential real estate loans which desired maturities, within the context of overall maturities in the loan portfolio, provide the appropriate mix to optimize the Bank's ability to absorb the corresponding interest rate risk within the Company's tolerance ranges.

In 2013, the Bank sold $0.8 million in mortgages to FNMA under this arrangement, compared with $24.6 million in mortgages sold in 2012. The decline in mortgages sold to FNMA was due to the continued low rate environment, where the opportunity to realize gains on sales to FNMA were compressed. As a result, the Company strategically held these residential mortgages in its own portfolio, which led to an increase in balances of total residential mortgages of $25.9 million, or 38.0%, at December 31, 2013 compared to December 31, 2012.

The Bank currently retains the servicing rights on $63.5 million in mortgages sold to FNMA at December 31, 2013, compared with $73.7 million in mortgages sold to FNMA at December 31, 2012. The Company has recorded a net servicing asset for such loans of $0.5 million at December 31, 2013 and 2012. Despite the 13.8% decrease in the size of the servicing portfolio, the value of the mortgage servicing rights remained approximately the same due to the Company's valuation model projecting lower prepayment speeds and slightly lower durations for the existing loans in the servicing portfolio.

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The Bank offers adjustable rate residential mortgage loans with terms of up to 30 years. Rates on these mortgage loans remain fixed for a predetermined time and are adjusted annually thereafter. The Bank's outstanding adjustable rate residential mortgage loans were $7.2 million or 1.1% of total loans and leases outstanding at December 31, 2013 as compared with $11.4 million or 2.0% at December 31, 2012. With rates on fixed rate mortgage products at all-time lows, there has been little demand for variable-rate products which has resulted in a decline in variable rate mortgage loan balances.

Overall, residential real estate loans increased $25.9 million, or 38.0%, from $68.1 million at December 31, 2012 to $94.0 million at December 31, 2013.

The Bank also offers commercial mortgage loans with up to an 80% LTV ratio for up to 20 years on a variable and fixed rate basis. To the extent required, loans exceeding an 80% LTV are reported on an exception report to the Board of Directors. Many of these mortgage loans either mature or are subject to a rate call after three to five years. The Bank's outstanding commercial mortgage loans were $361.2 million at December 31, 2013, which was 55.8% of total loans and leases outstanding, compared with $323.8 million and 55.6% at December 31, 2012. The Bank believes that the strong relationships with customers in the local community that have been fostered over the years with its loan officers have resulted in sustained loan production in 2013. The balance at December 31, 2013 included $113.7 million in fixed rate and $247.5 million in variable rate commercial mortgage loans, which include interest rate calls.

The Bank also offers other types of loans collateralized by real estate, such as home equity loans. The Bank offers home equity loans at variable and fixed interest rates with terms of up to 15 years and up to an 85% combined LTV ratio. To the extent required, loans exceeding an 85% LTV ratio are reported on an exception report to the Board of Directors. At December 31, 2013, the real estate loan portfolio included $57.2 million of home equity loans outstanding, which represented 8.8% of total loans and leases outstanding, compared with $56.4 million and 9.7% at December 31, 2012, respectively. The total home equity portfolio included $49.8 million in variable rate loans and $7.4 million in fixed rate loans.

The Bank also offers both residential and commercial real estate construction loans at up to an 80% LTV ratio at fixed interest or adjustable interest rates and multiple maturities. At December 31, 2013, fixed rate real estate construction loans outstanding totaled $3.2 million, or 0.5% of total loans and leases outstanding, and adjustable rate construction loans outstanding totaled $22.2 million, or 3.4% of total loans and leases outstanding. At December 31, 2012, fixed rate real estate construction loans outstanding totaled $2.2 million, or 0.4% of total loans and leases outstanding, and adjustable rate construction loans outstanding totaled $27.6 million, or 4.7% of total loans and leases outstanding.

Direct Financing Leases

Direct financing leases totaled $0.0 million and $1.6 million at December 31, 2013 and 2012, respectively, representing 0.0% and 0.3% of the Bank's total loans and leases outstanding at December 31, 2013 and 2012, respectively. The balances reflect the book values as of the respectively year-end period, net of the mark-to-market balance in those same periods. The decline reflects management's decision to exit the leasing business and to manage the remaining portfolio through its estimated maturity in 2014.

Commercial and Industrial Loans

The Bank offers commercial and industrial ("C&I") loans on a secured and unsecured basis, including lines of credit and term loans at fixed and variable interest rates and multiple maturities. The Bank's C&I loan portfolio totaled $107.0 million at December 31, 2013, compared with $100.0 million and $109.5 million at December 31, 2012 and 2011, respectively. The portfolio grew 7.0% since the previous year-end. The growth is attributable to an increased number of C&I loan officers and good results achieved through the Bank's community-focused and relationship-based lending approach in the local market. Commercial loans represented 16.5% and 17.2% of the Bank's total loans at December 31, 2013 and 2012, respectively.

Collateral for C&I loans, where applicable, may consist of inventory, receivables, equipment and other business assets. At December 31, 2013, 55.5% of the Bank's C&I loans were at variable rates which are typically tied to the prime rate. The Company has a small number of loans that are tied to LIBOR.

Consumer Loans

The Bank's consumer installment loan portfolio totaled $0.9 million and $1.3 million at December 31, 2013 and 2012, respectively, representing 0.1% and 0.2% of the Bank's total loans and leases outstanding at December 31, 2013 and 2012, respectively. Traditional installment loans are offered at fixed interest rates with various maturities of up to 60

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months, on a secured and unsecured basis. This segment of the portfolio is done on an accommodation basis for customers. The Company does not actively try to grow the portfolio in a significant way.

Other Loans

Other loans totaled $0.3 million and $1.3 million at December 31, 2013 and December 31, 2012, respectively. Other loans consisted primarily of overdrafts and loan clearing accounts.

Loan Maturities and Sensitivities of Loans to Changes in Interest Rates

The following table shows the maturities of commercial loans and real estate construction loans outstanding as of December 31, 2013 and the classification of such loans due after one year according to sensitivity to changes in interest rates.

	Within One Year	After One But Within Five Years	After Five Years	Total
	(in thousands)			
Commercial	$ 10,350	$ 33,014	$ 63,588	$ 106,952
Real estate construction	14,246	8,624	1,032	23,902
	$ 24,596	$ 41,638	$ 64,620	$ 130,854
Loans maturing after one year with:				
Fixed Rates		$ 27,920	$ 63,803	
Variable Rates		13,718	817	
		$ 41,638	$ 64,620	

SOURCES OF FUNDS

General

Customer deposits represent the primary source of the Bank’s funds for lending and other investment purposes. In addition to deposits, other sources of funds include loan and lease repayments, loan sales on the secondary market, interest and dividend income from investments, matured investments, and borrowings from the Federal Home Loan Bank (“FHLB”) and from correspondent banks First Tennessee Bank and M&T Bank.

Deposits

The Bank offers a variety of deposit products, including checking, savings, NOW accounts, certificates of deposit and jumbo certificates of deposit. Bank deposits are insured up to the limits provided by the FDIC. The following table details the Bank’s deposits as of the dates indicated:

	December 31,		
	2013	2012	2011
	(in thousands)		
Demand deposits	$ 139,973	$ 123,405	$ 118,037
NOW accounts	65,927	65,753	50,761
Regular savings	362,440	357,741	313,777
Muni-vest savings	28,135	23,183	20,161
Time deposits, $100,000 and over	64,936	42,083	39,557
Other time deposits	45,201	66,827	73,910
Total	$ 706,612	$ 678,992	$ 616,203

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The following schedule sets forth the maturities of the Bank's time deposits as of December 31, 2013:

	Time Deposit Maturity Schedule				
	0-3 Mos.	3-6 Mos.	6-12 Mos.	Over 12 Mos.	Total
	(in thousands)				
Time deposits - $100,000 and over	$ 2,244	$ 2,150	$ 5,486	$ 35,321	$ 45,201
Other time deposits	5,746	5,825	13,013	40,352	64,936
Total time deposits	$ 7,990	$ 7,975	$ 18,499	$ 75,673	$ 110,137

Total deposits increased $27.6 million or 4.1% in 2013 from 2012. The Company successfully grew core transactional checking and saving accounts, including non-interest bearing demand deposits and interest-bearing savings and time accounts, by 4.9% to $530.5 million at December 31, 2013. Non-interest bearing demand deposits increased by $16.6 million, or 13.4%, to $140.0 million as the Company was able to attract new core customers and some current commercial customers kept higher cash balances in a difficult economy.

Much of the organic growth in savings deposits in 2013 was due to the Better Savings account offered by the Bank. The Bank paid a competitive interest rate on that product throughout 2013. The Company believes this product was popular because customers preferred to keep their deposits liquid in a low-interest rate environment with a difficult economy. With long-term rates so low, customers often do not believe there is enough value in locking up their funds long-term. In addition, the Company's focus on C&I lending helped drive an increase in commercial savings account balances. The result of the growth in Better Savings and commercial savings balances is reflected in the growth of total regular and muni-vest savings accounts, which increased by 2.5%, or $9.7 million, to $390.6 million.

Time deposits increased $1.2 million, or 1.1%, from $108.9 million at December 31, 2012 to $110.1 million as of December 31, 2013. Given the excess liquidity provided by the growth in checking and savings accounts, management did not replace brokered time deposits as they matured in 2013. Because the interest rate environment continues to remain low, the average rate paid on time deposits decreased from 1.75% in 2012 to 1.60% in 2013.

The following table shows daily average deposits and average rates paid on significant deposit categories by the Bank (dollars in thousands):

	2013		2012		2011	
		Weighted		Weighted		Weighted
	Average	Average	Average	Average	Average	Average
	Balance	Rate	Balance	Rate	Balance	Rate
	(dollars in thousands)					
Demand deposits	$ 131,041	- %	$ 119,805	- %	$ 108,522	- %
NOW accounts	67,549	0.53 %	59,811	1.03 %	44,639	1.23 %
Regular savings	357,098	0.31 %	341,739	0.57 %	280,606	0.72 %
Muni-vest savings	26,052	0.23 %	24,937	0.32 %	27,272	0.48 %
Time deposits	111,165	1.60 %	109,508	1.75 %	131,171	2.23 %
Total	$ 692,905	0.48 %	$ 655,800	0.69 %	$ 592,210	0.95 %

Federal Funds Purchased and Other Borrowed Funds. Another source of the Bank's funds for lending and investing activities at December 31, 2013 consisted of short term borrowings from the Federal Home Loan Bank.

Other borrowed funds consisted primarily of various advances from the FHLB with both fixed and variable interest rate terms ranging from 3.48% to 3.55%. The maturities and weighted average rates of other borrowed funds at December 31, 2013 are as follows (dollars in thousands):

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	Maturities (in thousands)	Weighted Average Rate
2014	$ 9,000	3.53 %
2015	-	- %
2016	-	- %
2017	-	- %
Thereafter	-	- %
Total	$ 9,000	- %

Securities Sold Under Agreements to Repurchase

The Bank enters into agreements with certain customers to sell securities owned by the Bank to those customers and repurchase the identical security, generally within one day. No physical movement of the securities is involved. The customer is informed that the securities are held in safekeeping by the Bank on behalf of the customer. Securities sold under agreements to repurchase totaled $13.4 million at December 31, 2013 compared to $12.1 million at December 31, 2012. Balances can vary day to day based on customer needs.

Pension

The Bank maintains a qualified defined benefit pension plan (the "Pension Plan"), which covered substantially all employees of the Company at the time the Pension Plan was frozen on January 31, 2008. All benefits eligible participants accrued in the Pension Plan to the freeze date have been retained. Employees have not accrued additional benefits in the Pension Plan from that date. Employees will be eligible to receive these benefits at normal retirement age. Additionally, the Company has entered into individual retirement agreements with certain of its executive officers providing for unfunded supplemental pension benefits under the Company's Supplemental Executive Retirement Plan and Senior Executive Supplemental Executive Retirement Plan (collectively, the "SERP plans"). The Company's pension expense for the Pension Plan and the SERP plans approximated $0.6 million, $0.6 million, and $0.5 million for each of the years ended December 31, 2013, 2012, and 2011, respectively, and is calculated based upon a number of actuarial assumptions, including an expected long-term rate of return on the Company's plan assets of 7.50% for 2013, 2012 and 2011 for the Pension Plan; no compensation rate increases for 2013, 2012, and 2011 for

the Pension Plan and compensation rate increases of 3.50%, 3.50%, and 3.12% in 2013, 2012 and 2011, respectively, for the SERP plans.

The expected long-term rate of return on pension plan assets assumption was determined based on historical returns earned by equity and fixed income securities, adjusted to reflect future return expectations based on pension plan targeted asset allocation. The SERP Plans are unfunded so there is no return on plan assets assumption. In evaluating compensation rate increases, the Company evaluated historical salary data, as well as expected future increases. The compensation rate increase assumption is zero for the Pension Plan because the Pension Plan has been frozen and employees can no longer accrue additional benefits. The Company will continue to evaluate its actuarial assumptions, including its expected rate of return and compensation rate increases at least annually, and will adjust as necessary.

The Company bases its determination of pension expense or income on a market-related valuation of assets, which reduces year-to-year volatility. Investment gains or losses for this purpose are the difference between the expected return calculated using the market-related value of assets and the actual return based on the market-related value of assets.

The discount rate utilized by the Company for determining future pension obligations is based on a review of long-term bonds that receive one of the two highest ratings given by a recognized rating agency. The discount rate determined on this basis has increased from 3.88% at December 31, 2012 to 4.78% at December 31, 2013 for the Company’s Pension Plan and from 3.17% to 4.15% for the SERP plans.

Management tested the sensitivity of the pension expense to changes in two key assumptions: return on plan assets and the discount rate. A 0.25% decrease in the rate of return on plan assets would have resulted in a decrease in pension

expense of 300.3% or $9 thousand. A 0.25% decrease in the discount rate would have resulted in a decrease in pension expense of 111.2% or $3 thousand. The SERP has no plan assets; therefore there is no rate of return on plan assets. A 0.25% decrease in the discount rate would have resulted in an increase in SERP expense of 0.96% or $5 thousand. Increases of 25 basis points in those assumptions would have resulted in similar changes in amount, but in the opposite direction from the changes presented in the preceding sentences. Since the Pension Plan has been frozen, pension expense is not sensitive to compensation scale increases or decreases.

As of December 31, 2013, the Company had cumulative actuarial losses of approximately $2.1 million that will result in an increase in the Company's future pension expense because such losses at each measurement date exceed 10% of the greater of the projected benefit obligation or the market-related value of plan assets. In accordance with GAAP, net unrecognized gains or losses that exceed that threshold are required to be amortized over the expected service period of active employees, and are included as a component of net pension cost. Amortization of these net actuarial losses had the effect of increasing the Company's pension expense by approximately $176 thousand in 2013, $171 thousand in 2012, and $36 thousand in 2011.

The Company contributed $185 thousand to the Pension Plan in 2013.

Liquidity

The Company utilizes cash flows from its investment portfolio and federal funds sold balances to manage the liquidity requirements it experiences due to loan demand and deposit fluctuations. The Bank also has many borrowing options. As a member of the FHLB, the Bank is able to borrow funds at competitive rates. Given the current collateral available, advances of up to $94.4 million can be drawn on the FHLB via the Bank’s Overnight Line of Credit Agreement. An amount equal to 25% of the Bank’s total assets could be borrowed through the advance programs under certain qualifying circumstances. The Bank also has the ability to purchase up to $14.0 million in federal funds from its correspondent banks. By placing sufficient collateral in safekeeping at the Federal Reserve Bank, the Bank could also borrow at the FRB’s discount window. The Company’s liquidity needs also can be met by more aggressively pursuing time deposits, or accessing the brokered time deposit market, including the Certificate of Deposit Account Registry Service (“CDARS”) network. Additionally, the Company has access to capital markets as a funding source.

The cash flows from the Company’s investment portfolio are laddered, so that securities mature at regular intervals, to provide funds from principal and interest payments at various times as liquidity needs may arise. Contractual maturities are also laddered, with consideration as to the volatility of market prices, so that securities are available for sale from time-to-time without the need to incur significant losses. At December 31, 2013, approximately 1.4% of the Company’s debt securities had maturity dates of one year or less, and approximately 25.6% had maturity dates of five years or less. In addition, the Company receives regular cash flows on its mortgage-backed securities.

Management, on an ongoing basis, closely monitors the Company's liquidity position for compliance with internal policies, and believes that available sources of liquidity are adequate to meet funding needs in the normal course of business. As part of that monitoring process, management calculates the 90-day liquidity each month by analyzing the cash needs of the Bank. Included in the calculation are liquid assets and potential liabilities. Management stresses the potential liabilities calculation to ensure a strong liquidity position. Included in the calculation are assumptions of some significant deposit run-off as well as funds needed for loan closing and investment purchases. At December 31, 2013, in the stress test, the Bank had net short-term liquidity available of $121.8 million as compared with $75.5 million at December 31, 2012. Available assets of $136.0 million divided by public and purchased funds of $114.6 million, resulted in a long-term liquidity ratio of 119% at December 31, 2013, compared with 155% at December 31, 2012.

Management does not anticipate engaging in any activities, either currently or over the long-term, for which adequate funding would not be available and which would therefore result in significant pressure on liquidity. However, continued economic recession could negatively impact the Company's liquidity. The Bank relies heavily on FHLBNY as a source of funds, particularly with its overnight line of credit. To conserve capital, some FHLB branches have suspended dividends, cut dividend payments, and not bought back excess FHLB stock that members hold. FHLBNY has stated that they expect to be able to continue to pay dividends, redeem excess capital stock, and provide competitively priced advances in the future. The most severe problems in FHLB have been at some of the other FHLB branches. Nonetheless, the 12 FHLB branches are jointly liable for the consolidated obligations of the FHLB system. To the extent that one FHLB branch cannot meet its obligations to pay its share of the system's debt, other FHLB branches can be called upon to make the payment.

Systemic weakness in the FHLB could result in higher costs of FHLB borrowings and increased demand for alternative sources of liquidity that are more expensive, such as brokered time deposits, the discount window at the Federal Reserve, or lines of credit with correspondent banks First Tennessee Bank and M&T Bank.

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Contractual Obligations

The Company is party to contractual financial obligations, including repayment of borrowings, operating lease payments and commitments to extend credit. The table below presents certain future financial obligations.

	Payments due within time period at December 31, 2013 (in thousands)				
	Total	Less Than 1 Year	1 - 3 Years	3 - 5 Years	More Than 5 Years
Contractual Obligations:					
Securities sold under agreement to repurchase	$ 13,351	$ 13,351	$ -	$ -	$ -
Operating lease obligations	7,206	622	1,042	888	4,654
Other borrowed funds	9,000	9,000	-	-	-
Junior subordinated debentures	11,330	-	-	-	11,330
Total	$ 40,887	$ 22,973	$ 1,042	$ 888	$ 15,984
Interest expense on fixed rate debt	$ 198	$ 198	$ -	$ -	$ -

The Company’s variable rate debt included in other borrowed funds is related to short-term funding which is used only to cover seasonal funding needs, which are subject to fluctuation.

At December 31, 2013, the Company had commitments to extend credit of $177.0 million compared to $135.0 million at December 31, 2012. For additional information regarding future financial commitments, this disclosure should be read in conjunction with Note 16 to the Company’s Consolidated Financial Statements included in Item 8 of this Annual Report on Form 10-K.

Capital

The Company and the Bank have consistently maintained regulatory capital ratios above well capitalized standards. The Company's financial performance generally, and in particular the ability of borrowers to pay interest on and repay principal of outstanding loans and the value of collateral securing those loans, is highly dependent on the business environment in the markets where the Company operates, in Western New York and in the United States as a whole. Some banks experienced such a sharp drop-off in financial performance due to the deteriorating economy that they were forced to raise capital with the U.S. government through the Troubled Asset Relief Program ("TARP") in order to maintain appropriate capital ratios. The Bank applied for and was approved for funds under TARP but declined the offer after determining that the Bank's capital position was more than sufficient and that the restrictions on capital management imposed by TARP were too onerous.

Overall, during 2013, the business environment continues to be adverse for many households and businesses in Western New York, in the United States and worldwide. There can be no assurance that these conditions will improve in the near term. Such conditions could materially adversely affect the credit quality of the Company's loans and leases, and therefore, the Company's results of operations, financial condition, and capital position.

For further detail on capital and capital ratios, see Note 20 to the Company's Consolidated Financial Statements included under Item 8 of this Annual Report on Form 10-K.

Total Company stockholders' equity was $80.7 million at December 31, 2013, increased from $74.8 million at December 31, 2012. Equity as a percentage of assets was 9.7% at December 31, 2013, compared to 9.2% at December 31, 2012. Book value per share of common stock increased to $19.18 at December 31, 2013 from $17.94 at December 31, 2012. The reason for the increase in stockholders' equity and book value per share was $7.9 million in net income, and a $0.6 million addition to paid in capital for stock issuances under the Company's dividend reinvestment plan and employee stock purchase plan, and restricted stock and stock option activity. These increases were somewhat offset by $1.1 million in dividends to common stockholders, a $1.4 million decrease in accumulated other comprehensive income, and $0.1 million increase in Treasury stock.

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The dividend payment of $0.26 per share in 2013 was $0.02 higher per share than the accelerated dividend paid in December of 2012 and $0.04 higher than the semi-annual dividends paid in 2012. The Company typically pays a semi-annual dividend in April and October of each year. In 2012, the Company decided it was appropriate to move up the normal semi-annual dividend for April 2013 to December 2012. At the time of the Company's decision, there was much uncertainty around the income tax rates on dividend income. These rates were scheduled to expire on December 31, 2012 and it was expected that these rates would increase in 2013. Therefore, in an effort to reduce the tax burden on stockholders, management and the Board of Directors agreed that it would be appropriate to pay a third dividend in 2012 in lieu of the first semi-annual dividend in 2013.

Management and the Board of Directors of the Company believe that the dividend level is prudent to maintain available capital to support the continued growth of the Company, as well as to manage the Company's and the Bank's capital ratios, while providing a dividend yield (dividend per share divided by stock price) competitive with peers in the industry at an annualized rate of 2.46% at December 31, 2013. When annualized for the typical semi-annual dividend, the Company's dividend payout ratio (dividends paid divided by net income) was 27.9% in 2013.

Included in stockholders' equity was accumulated other comprehensive income which includes the net after-tax impact of unrealized gains or losses on investment securities classified as available for sale. Net unrealized gains after tax were $0.2 million, or $0.05 per share of common stock, at December 31, 2013, as compared to net unrealized gains on available-for-sale investment securities after tax of $2.4 million, and $0.59 per share of common stock, at December 31, 2012. Such unrealized gains and losses are generally due to changes in interest rates and represent the difference, net of applicable income tax effect, between the estimated fair value and amortized cost of investment securities classified as available-for-sale. The Company had no other-than-temporary impairment charges in its investment portfolio in 2013 or 2012.

Market Risk

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

ALCO, which includes members of the Bank’s senior management, monitors the Bank’s interest rate sensitivity with the aid of a model that considers the impact of ongoing lending and deposit gathering activities, as well as the interrelationships between the magnitude and timing of the re-pricing of financial instruments, including the effect of changing interest rates on expected prepayments and maturities. When deemed prudent, the Bank’s management has taken actions and intends to do so in the future, to mitigate the Bank's exposure to interest rate risk through the use of on or off-balance sheet financial instruments. Possible actions include, but are not limited to, changes in the pricing of loan and deposit products, modifying the composition of interest-earning assets and interest-bearing liabilities, and the purchase of other financial instruments used for interest rate risk management purposes. In 2012 and 2013, the Bank did not use off-balance sheet financial instruments to manage interest rate risk.

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SENSITIVITY OF NET INTEREST INCOME TO CHANGES IN INTEREST RATES

Changes in interest rates	Calculated increase in projected annual net interest income (in thousands) December 31, 2013	December 31, 2012
+200 basis points	$ 789	$ 1,055
+100 basis points	1,263	1,588
-100 basis points	NM	NM
-200 basis points	NM	NM

Many assumptions are utilized by the Bank to calculate the impact that changes in interest rates may have on net interest income. The more significant assumptions relate to the rate of prepayments of mortgage-related assets, loan and deposit volumes and pricing, and deposit maturities. The Bank also assumes immediate changes in rates, including 100 and 200 basis point rate changes. In the event that a 100 or 200 basis point rate change cannot be achieved, the applicable rate changes are limited to lesser amounts, such that interest rates cannot be less than zero. These assumptions are inherently uncertain and, as a result, the Bank cannot precisely predict the impact of changes in interest rates on net interest income. Actual results may differ significantly due to the timing, magnitude, and frequency of interest rate changes in market conditions and interest rate differentials (spreads) between maturity/re-pricing categories, as well as any actions, such as those previously described, which management may take to counter such changes. At December 31, 2013 the Bank's projected net interest income benefitted more from a 100 basis point increase in market rates compared with a 200 basis point increase in rates. This relationship was due in part to expected increases in deposit rates needed to retain deposit customers if rates moved up 200 basis points but were not required if rates only moved 100 basis points higher. Continued decreases in market interest rates during 2013 produced a greater sensitivity of customers to any level of market interest rate increases, therefore projecting a more proportional relationship to increased changes in rates at December 31, 2013. In regards to the declining rate scenarios, management believes that projections using such significant decreases in interest rates is not meaningful based on the current low interest rate environment. In light of the uncertainties and assumptions associated with the process, the amounts presented in the table, and changes in such amounts, are not considered significant to the Bank’s projected net interest income.

Financial instruments with off-balance sheet risk at December 31, 2013 included $108.9 million in undisbursed lines of credit at an average interest rate of 4.04%; $10.2 million in fixed rate loan origination commitments at 4.99%; $38.9 million in adjustable rate loan origination commitments at 4.20%; and $2.7 million in adjustable rate letters of credit, which if drawn upon, would typically earn an interest rate equal to the prime lending rate plus 2%. Unused

overdraft protection lines totaled $19.0 million, which if drawn upon, would also typically earn an interest rate equal to the prime lending rate plus 2%.

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The following table represents expected maturities of interest-bearing assets and liabilities and their corresponding average interest rates.

Expected maturity year ended December 31,

	2014 (in thousands)		2015		2016		2017		2018		Thereafter		Total		Fair V
Interest - Assets															
Gross loan and lease receivables	$ 53,506		$ 19,263		$ 32,539		$ 39,737		$ 39,413		$ 462,538		$ 646,996		$ 652
Average interest	4.59	%	4.63	%	5.40	%	4.62	%	4.91	%	4.69	%	4.72	%	4.7
Investment securities	$ 1,477		$ 8,551		$ 4,922		$ 3,685		$ 8,477		$ 74,937		$ 102,049		$ 101
Average interest	2.41	%	3.25	%	4.23	%	3.13	%	3.39	%	3.14	%	3.21	%	3.2
Interest -Liabilities															
Interest bearing deposits	$ 494,265		$ 40,302		$ 16,680		$ 9,265		$ 5,943		$ 184		$ 566,639		$ 568
Average interest	0.61	%	2.30	%	1.91	%	1.24	%	1.01	%	7.47	%	0.78	%	0.7
Borrowed funds & securities sold under agreements to repurchase	$ 22,351		$ -		$ -		$ -		$ -		$ -		$ 22,351		$ 22,
Average interest	1.54	%	-	%	-	%	-	%	-	%	-	%	1.54	%	1.5
Junior subordinated debt	$ -		$ -		$ -		$ -		$ -		$ 11,330		$ 11,330		$ 11,
	-	%	-	%	-	%	-	%	-	%	2.96	%	2.96	%	2.9

Average
interest

When rates rise or fall, the market value of the Company's rate-sensitive assets and liabilities, increases or decreases. As a part of the Company's asset/liability policy, the Company has set limitations on the acceptable level of the negative impact of such rate fluctuations on the market value of the Company's balance sheet. The Bank's securities portfolio is priced monthly and adjustments are made on the balance sheet to reflect the market value of the available for sale portfolio per ASC Topic 320 "Investments – Debt and Equity Securities." At December 31, 2013, the impact to equity, net of tax, as a result of marking available for sale securities to market was an unrealized gain of $0.1 million. On a monthly basis, the available for sale portfolio is shocked for immediate rate increases of 200 basis points. At December 31, 2013, the Company determined it would take an immediate increase in rates in excess of 200 basis points to eliminate the current capital cushion in excess of regulatory requirements. The Company's and the Bank's capital ratios are also reviewed by management on a quarterly basis.

Capital Expenditures

Significant planned expenditures for 2014 include the purchase of technology to improve workflow automation and operational efficiency. The Company believes it has a sufficient capital base to support these known and potential capital expenditures, currently expected to total $0.3 million, with current assets.

Impact of Inflation and Changing Prices

There will continually be economic events, such as changes in the economic policies of the FRB, which will have an impact on the profitability of the Company. Inflation may result in impaired asset growth, reduced earnings and substandard capital ratios. The net interest margin can be adversely impacted by the volatility of interest rates throughout the year. Since these factors are unknown, management attempts to structure the balance sheet and re-pricing frequency of assets and liabilities to avoid a significant concentration that could result in a negative impact on earnings.

Segment Information

In accordance with the provisions of ASC 280, "Segment Reporting," the Company's operating segments have been determined based upon its internal profitability reporting. The Company's operating segments consist of banking activities and insurance agency activities.

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The banking activities segment includes all of the activities of the Bank in its function as a full-service commercial bank. This includes the operations of SDS and ENL. The net income from banking activities was $6.6 million in 2013 compared with $7.0 million in 2012. The decrease in net income from banking activities was driven primarily by the provision for loan and lease losses, which increased from $(0.1) million in 2012 to $1.5 million in 2013. Total assets of the banking activities segment increased $24.4 million or 3.1% during 2013 to $824.0 million at December 31, 2013, due primarily to strong loan and deposit growth.

The insurance activities segment includes activities of TEA, a property and casualty insurance agency with locations in the Western New York area. Net income from insurance activities was $1.3 million in 2013, up slightly from $1.2 million in 2012. Most of the increase was a result of a decrease in amortization and non-interest expenses of $0.3 million. TEA's total assets of the insurance activities segment were $9.5 million at December 31, 2013, compared with $10.1 million at December 31, 2012.

Fourth Quarter Results

Net income was $1.7 million in the fourth quarter of 2013, down from $2.1 million in the fourth quarter of 2012, primarily as a result of a $0.4 million increase in the provision for loan and lease losses in the current quarter. The prior year period benefitted from a $129 thousand release of loan and lease loss reserves as the Company's leasing portfolio credit quality continued to improve. As a result, return on average equity was 8.35% from the fourth quarter of 2013 compared with 11.33% in the fourth quarter of 2012.

Net interest income was $7.3 million for the fourth quarter, an increase of 3.4% from the prior-year period, and up 2.4% from the trailing third quarter of 2013. Growth in loans and non-interest bearing demand deposits drove the increase over both the prior-year period and the trailing quarter.

Net interest margin improved 6 basis points to 3.85% compared with 3.79% in the trailing third quarter, and primarily reflects an increase in interest-earning assets. Net interest margin also improved over the 2012 fourth quarter rate of 3.78%. The increase in net interest margin from the prior-year period was due to a 24 basis point decrease in pricing on the Company's interest bearing liabilities, partially offset by a 13 basis point decrease in the yield on interest-earning assets.

The provision for loan and lease losses was $0.2 million in the fourth quarter, up $0.4 million from the prior-year period, during which a release of loss reserves was recorded as a result of improvement in the leasing portfolio's credit quality. When compared with the trailing third quarter of 2013, the provision decreased by $0.5 million. In the third quarter, the termination of the FDIC loss share agreement related to the Company's 2009 acquisition of Waterford

Village Bank resulted in a $0.6 million loan loss provision and a corresponding gain of $0.7 million in non-interest income.

Non-interest income was $3.0 million, or 29.1% of total revenue, in the fourth quarter, down $0.3 million, or 8.0%, from the prior-year period. Service charges on deposits increased 2.4% to $510 thousand from the prior-year period as a result of growing commercial deposit transactional relationships which have historically higher fees. This was offset by a $0.3 million decrease in other income, mostly as a result of a reduction in premiums on sales of residential mortgages. The Company primarily booked originated residential mortgages in 2013 rather than selling the mortgages to FNMA as was done in 2012. Insurance agency revenue of $1.6 million was down $25 thousand, or 1.6%, from the 2012 fourth quarter, due mostly to decreases in commercial lines revenue. Compared with the trailing third quarter of 2013, total non-interest income increased by 15.3%, mostly related to the loss on a tax credit investment in the third quarter of 2013.

Total non-interest expense was $7.7 million, an increase of 6.9% from the prior-year period. Personnel expenses, the largest expense item for the Company, were up $521 thousand, or 12.8%, from the prior-year period, and reflect merit increases and personnel hires to support the Company's growth strategy. These strategic additions impacted the current quarter; however, the Company has efficiently managed the full year's non-interest expense as compared with prior year.

Income tax expense for the quarter was $0.8 million, representing an effective tax rate of 31.3% compared with an effective tax rate of 35.8% in the fourth quarter of 2012. The decrease in tax rate was primarily due to higher tax exempt income as a percentage of total income.

Total assets grew 2.9% to $833.5 million at December 31, 2013, from $809.7 million on December 31, 2012, and were up 0.8% from $827.0 million at the end of the 2013 third quarter. Loans grew 11.3% in the year to end at $647.0 million from $581.3 million at December 31, 2012. Loans also grew in the fourth quarter and were up 3.4% from $625.6 million at September 30, 2013.

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Investment securities were $104.9 million at the end of the year, up 5.9% from the end of 2012 and up 5.8% from the trailing 2013 third quarter.

Total deposits increased $27.6 million, or 4.1%, to $706.6 million at December 31, 2013, from $679.0 million at December 31, 2012, and increased $4.0 million, or 0.6%, from the 2013 third quarter-end. The year-over-year growth was attributable to deposit increases in commercial demand deposits and consumer savings deposits. The increase from the 2013 third quarter was the result of savings deposit growth.

There were net recoveries from two prior-year charged off loans in the fourth quarter, resulting in a (0.15%) ratio of net charge offs to average total loans and leases. This was an improvement from net charge offs of 0.24% in the fourth quarter of 2012 and 0.09% in the third quarter of 2013.

The ratio of non-performing loans and leases to total loans and leases increased to 2.12% at the end of 2013, from 1.41% at year-end 2012, but decreased from 2.29% at September 30, 2013. Of the $13.7 million in non-performing loans and leases at the end of 2013, approximately $8.0 million was due to one well collateralized commercial real estate loan, which has been successfully restructured with a new borrower.

The ratio of the allowance for loan and lease losses to total loans and leases was 1.78% at December 31, 2013 compared with 1.74% at September 30, 2013 and 1.67% at December 31, 2012. The coverage ratio was 83.8% at year-end 2013 compared with 76.1% at the end of the trailing third quarter and 118.3% at year-end 2012.

Item 7A.QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

The information called for by this Item is incorporated by reference to the discussion of "Liquidity" and "Market Risk," including the discussion under the caption "Sensitivity of Net Interest Income to Changes in Interest Rates" included in Part II, Item 7. Management’s Discussion and Analysis of Financial Condition and Results of Operations of this Annual Report on Form 10-K.

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Item 8.FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

Financial Statements and Supplementary Data consist of the financial statements as indexed and presented below and the Unaudited Quarterly Financial Data presented in Note 22 to our Consolidated Financial Statements.

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Consolidated Balance Sheets – December 31, 2013 and 2012	61
Consolidated Statements of Income – Years Ended December 31, 2013, 2012 and 2011	62
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Management's Annual Report on Internal Control Over Financial Reporting

Management is responsible for establishing and maintaining adequate internal control over financial reporting for Evans Bancorp, Inc. and subsidiaries (the "Company"). Management has assessed the effectiveness of the Company's internal control over financial reporting as of December 31, 2013 based on criteria established in Internal Control-Integrated Framework (1992) issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Based on that assessment, management concluded that the Company maintained effective internal control over financial reporting as of December 31, 2013.

The Company's consolidated financial statements for the fiscal year ended December 31, 2013 were audited by KPMG LLP, an independent registered public accounting firm. KPMG LLP also audited the effectiveness of the Company's internal control over financial reporting as of December 31, 2013, as stated in their report, which appears in the "Report of Independent Registered Public Accounting Firm" immediately following this annual report of management.

EVANS BANCORP, INC. AND SUBSIDIARIES

/s/ David J. Nasca

David J. Nasca

President and Chief Executive Officer

/s/ Gary A. Kajtoch

Gary A. Kajtoch

Treasurer

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Report of Independent Registered Public Accounting Firm

The Board of Directors and Stockholders

Evans Bancorp, Inc.:

We have audited the accompanying consolidated balance sheets of Evans Bancorp, Inc. and subsidiaries (the Company) as of December 31, 2013 and 2012, and the related consolidated statements of income, comprehensive income, stockholders' equity, and cash flows for each of the years in the three-year period ended December 31, 2013. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Evans Bancorp, Inc. and subsidiaries as of December 31, 2013 and 2012, and the results of their operations and their cash flows for each of the years in the three-year period ended December 31, 2013, in conformity with U.S. generally accepted accounting principles.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the Company's internal control over financial reporting as of December 31, 2013, based on criteria established in Internal Control – Integrated Framework (1992) issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO), and our report dated March 3, 2014 expressed an unqualified opinion on the effectiveness of the Company's internal control over financial reporting.

/s/ KPMG

Buffalo, New York

March 3, 2014

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Report of Independent Registered Public Accounting Firm

The Board of Directors and Stockholders

Evans Bancorp, Inc.:

We have audited Evans Bancorp, Inc. and subsidiaries' (the Company) internal control over financial reporting as of December 31, 2013, based on criteria established in Internal Control Integrated Framework (1992) issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). The Company's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Management's Annual Report on Internal Control Over Financial Reporting. Our responsibility is to express an opinion on the Company's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audit also included performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2013, based on criteria established in Internal Control Integrated Framework (1992) issued by the Committee of Sponsoring Organizations of the Treadway Commission.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets of the Company as of December 31, 2013 and 2012, and the related consolidated statements of income, comprehensive income, stockholders' equity, and cash flows for each of the years in the three year period ended December 31, 2013, and our report dated March 3, 2014 expressed an unqualified opinion on those consolidated financial statements.

/s/ KPMG

Buffalo, New York

March 3, 2014

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EVANS BANCORP, INC. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
DECEMBER 31, 2013 and 2012
(in thousands, except share and per share amounts)

	December 31, 2013	December 31, 2012
ASSETS		
Cash and due from banks	$ 14,698	$ 12,409
Interest-bearing deposits at banks	27,256	78,068
Securities:		
Available for sale, at fair value (amortized cost: $99,353 at December 31, 2013; $88,054 at December 31, 2012)	99,665	92,063
Held to maturity, at amortized cost (fair value: $2,319 at December 31 2013; $3,721 at December 31, 2012)	2,384	3,744
Federal Home Loan Bank common stock, at amortized cost	1,364	1,804
Federal Reserve Bank common stock, at amortized cost	1,467	1,445
Loans and leases, net of allowance for loan and lease losses of $11,503 at December 31, 2013 and $9,732 at December 31, 2012	635,493	573,163
Properties and equipment, net of accumulated depreciation of $14,226 at December 31, 2013 and $14,256 at December 31, 2012	11,163	11,368
Goodwill	8,101	8,101
Intangible assets	108	329
Bank-owned life insurance	19,840	15,333
Other assets	11,959	11,849
TOTAL ASSETS	$ 833,498	$ 809,676
LIABILITIES AND STOCKHOLDERS' EQUITY		
LIABILITIES		
Deposits:		
Demand	$ 139,973	$ 123,405
NOW	65,927	65,753
Regular and muni-vest savings	390,575	380,924
Time	110,137	108,910

Total deposits	706,612	678,992
Securities sold under agreement to repurchase	13,351	12,111
Other short term borrowings	9,000	10,000
Other liabilities	12,493	13,415
Junior subordinated debentures	11,330	11,330
Long term borrowings	-	9,000
Total liabilities	752,786	734,848
CONTINGENT LIABILITIES AND COMMITMENTS		
STOCKHOLDERS' EQUITY:		
Common stock, $.50 par value, 10,000,000 shares authorized; 4,208,459 and 4,171,473 shares issued at December 31, 2013 and December 31, 2012, respectively, and 4,201,362 and 4,171,473 outstanding at December 31, 2013 and December 31, 2012, respectively	2,106	2,087
Capital surplus	42,619	42,029
Treasury Stock, at cost, 4,906 and 0 shares at December 31, 2013 and December 31, 2012, respectively	(120)	-
Retained earnings	37,370	30,611
Accumulated other comprehensive (loss) gain, net of tax	(1,263)	101
Total stockholders' equity	80,712	74,828
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	$ 833,498	$ 809,676

See Notes to Consolidated Financial Statements

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EVANS BANCORP, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF INCOME
YEARS ENDED DECEMBER 31, 2013, 2012, AND 2011
(in thousands, except share and per share amounts)

	2013	2012	2011
INTEREST INCOME			
Loans and leases	$ 29,546	$ 30,300	$ 29,140
Interest bearing deposits at banks	132	53	26
Securities:			
Taxable	1,666	1,871	2,115
Non-taxable	1,060	1,153	1,434
Total interest income	32,404	33,377	32,715
INTEREST EXPENSE			
Deposits	3,296	4,546	5,621
Other borrowings	436	703	775
Junior subordinated debentures	325	348	331
Total interest expense	4,057	5,597	6,727
NET INTEREST INCOME	28,347	27,780	25,988
PROVISION FOR LOAN AND LEASE LOSSES	1,540	(68)	2,484
NET INTEREST INCOME AFTER PROVISION FOR LOAN AND LEASE LOSSES	26,807	27,848	23,504
NON-INTEREST INCOME			
Bank charges	2,039	1,858	1,783
Insurance service and fees	7,211	6,966	6,902
Data center income	464	456	678
Net gain on sales and calls of securities	-	-	26
Gain on loans sold	25	464	188
Bank-owned life insurance	508	489	454
Loss on tax credit investment	(1,555)	-	-
Interchange fee income	1,059	944	887
Gain on termination of loss sharing agreement	716	-	-
Other	1,694	1,646	1,514
Total non-interest income	12,161	12,823	12,432
NON-INTEREST EXPENSE			
Salaries and employee benefits	17,755	17,304	15,820
Occupancy	3,010	2,785	3,119
Repairs and maintenance	723	769	689
Advertising and public relations	786	814	812
Professional services	1,892	1,925	1,776
Technology and communications	1,283	1,197	984
Amortization of intangibles	221	349	490
FDIC insurance	576	521	652
Other	3,134	3,128	2,899

Total non-interest expense	29,380	28,792	27,241
INCOME BEFORE INCOME TAXES	9,588	11,879	8,695
INCOME TAX PROVISION	1,731	3,747	2,583
NET INCOME	$ 7,857	$ 8,132	$ 6,112
Net income per common share-basic	$ 1.88	$ 1.96	$ 1.49
Net income per common share-diluted	$ 1.85	$ 1.95	$ 1.49
Cash dividends per common share	$ 0.26	$ 0.68	$ 0.40
Weighted average number of common shares outstanding	4,189,769	4,144,322	4,102,142
Weighted average number of diluted shares outstanding	4,239,037	4,159,690	4,104,533

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EVANS BANCORP, INC. AND SUBSIDIARIES
STATEMENTS OF CONSOLIDATED COMPREHENSIVE INCOME
YEARS ENDED DECEMBER 31, 2013, 2012, AND 2011
(in thousands, except share and per share amounts)

	2013		2012		2011	
NET INCOME		$ 7,857		$ 8,132		$ 6,112
OTHER COMPREHENSIVE INCOME (LOSS), NET OF TAX:						
Unrealized gain (loss) on available-for-sale securities:						
Unrealized gain (loss) on available-for-sale securities	(2,266)		(77)		1,737	
Less: Reclassification of gain on sale of securities	-		-		16	
		(2,266)		(77)		1,721
Defined benefit pension plans:						
Amortization of prior service cost	42		53		54	
Amortization of actuarial assumptions	108		105		23	
Actuarial gains (losses)	752		(326)		(979)	
Total		902		(168)		(902)
OTHER COMPREHENSIVE INCOME (LOSS), NET OF TAX		(1,364)		(245)		819
COMPREHENSIVE INCOME		$ 6,493		$ 7,887		$ 6,931

See Notes to Consolidated Financial Statements

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EVANS BANCORP, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY
YEARS ENDED DECEMBER 31, 2013, 2012, AND 2011
(in thousands, except share and per share amounts)

	Common Stock	Capital Surplus	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Treasury Stock	Total
Balance, December 31, 2010	$ 2,041	$ 40,660	$ 20,836	$ (473)	$ -	$ 63,064
Net Income			6,112			6,112
Other comprehensive income				819		819
Cash dividends ($0.40 per common share)			(1,644)			(1,644)
Stock options and restricted stock expense		274				274
Excess tax benefit from stock-based compensation		3				3
Issued 13,539 shares under dividend reinvestment plan	7	166				173
Issued 13,978 restricted shares, net of 1,768 forfeitures	6	(6)				-
Issued 17,256 shares under Employee Stock Purchase Plan	9	178				187
Balance, December 31, 2011	$ 2,063	$ 41,275	$ 25,304	$ 346	$ -	$ 68,988
Net Income			8,132			8,132
Other comprehensive (loss)				(245)		(245)
Cash dividends ($0.68 per common share)			(2,825)			(2,825)
Stock options and restricted stock expense		305				305
Excess tax benefit from stock-based compensation		6				6
Issued 1,439 shares through stock option exercise	1	(1)				-
Issued 17,785 and reissued 380 shares under dividend reinvestment plan	9	268				277
Issued 10,145 restricted shares, net of 1,348 forfeitures	6	(6)				-
Issued 16,831 shares under Employee Stock Purchase Plan	8	182				190
Balance, December 31, 2012	$ 2,087	$ 42,029	$ 30,611	$ 101	$ -	$ 74,828
Net Income			7,857			7,857
Other comprehensive income (loss)				(1,364)		(1,364)
Cash dividends ($0.26 per common share)			(1,098)			(1,098)

Stock options and restricted stock expense		352				352
Excess tax expense from stock-based compensation		(9)				(9)
Issued 19,431 restricted shares, net of 2,191 forfeitures	9	(9)				-
Issued 13,455 shares in Employee Stock Purchase Plan	7	184				191
Issued 4,100 shares through stock option exercise	2	55				57
Repurchased 13,032 shares in Treasury stock					(250)	(250)
Reissued 5,126 shares under dividend reinvestment plan		3			99	102
Reissued 3,000 shares through stock option exercise	1	14			31	46
Balance, December 31, 2013	$ 2,106	$ 42,619	$ 37,370	$ (1,263)	$ (120)	$ 80,712

See Notes to Consolidated Financial Statements

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EVANS BANCORP, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
YEARS ENDED DECEMBER 31, 2013, 2012, AND 2011
(in thousands)

	2013	2012	2011
OPERATING ACTIVITIES:			
Interest received	$ 32,176	$ 33,281	$ 32,236
Fees received	14,786	12,004	12,846
Interest paid	(4,070)	(5,630)	(7,016)
Cash paid to employees and vendors	(27,004)	(25,057)	(23,583)
Cash contributed to pension plan	(185)	(370)	(120)
Income taxes paid	(1,902)	(3,200)	(3,004)
Proceeds from sale of loans held for resale	776	24,035	24,267
Originations of loans held for resale	187	(20,915)	(24,811)
Net cash provided by operating activities	14,764	14,148	10,815
INVESTING ACTIVITIES:			
Available for sales securities:			
Purchases	(27,055)	(32,767)	(31,627)
Proceeds from sales	-	-	770
Proceeds from maturities, calls, and payments	15,750	40,349	21,610
Held to maturity securities:			
Purchases	(941)	(3,118)	(2,475)
Proceeds from maturities, calls, and payments	2,302	3,176	778
Cash paid for bank owned life insurance	(4,000)	-	(2,000)
Additions to properties and equipment	(1,448)	(2,002)	(726)
Proceeds from sales of fixed assets	365	-	-
Purchase of tax credit investment	(225)	-	-
Net (increase) decrease in loans	(65,943)	(4,520)	(56,765)
Net cash provided by (used in) investing activities	(81,195)	1,118	(70,435)
FINANCING ACTIVITIES:			
Proceeds from (repayments of) borrowings	(8,760)	101	(9,885)
Net increase in deposits	27,620	62,790	71,745
Dividends paid	(1,098)	(2,825)	(1,644)
Repurchase of treasury stock	(124)	-	-
Issuance of common stock	270	467	360

Net cash provided by financing activities	17,908	60,533	60,576
Net increase (decrease) in cash and equivalents	(48,523)	75,799	956
CASH AND CASH EQUIVALENTS:			
Beginning of period	90,477	14,678	13,722
End of period	$ 41,954	$ 90,477	$ 14,678

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EVANS BANCORP, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
YEARS ENDED DECEMBER 31, 2013, 2012, AND 2011
(in thousands)

	2013	2012	2011
RECONCILIATION OF NET INCOME TO NET CASH PROVIDED BY OPERATING ACTIVITIES:			
Net income	$ 7,857	$ 8,132	$ 6,112
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation and amortization	1,848	2,015	1,996
Deferred tax expense (benefit)	(372)	539	(322)
Provision for loan and lease losses	1,540	(68)	2,484
Loss on tax credit investment	1,555	-	-
Net gain on sales of securities	-	-	(26)
Gain on loans sold	(25)	(464)	(188)
Stock options and restricted stock expense	352	305	274
Proceeds from sale of loans held for resale	776	24,035	24,267
Originations of loans held for resale	187	(20,915)	(24,811)
Changes in assets and liabilities affecting cash flow:			
Other assets	(274)	1,173	636
Other liabilities	1,320	(604)	393
NET CASH PROVIDED BY OPERATING ACTIVITIES	$ 14,764	$ 14,148	$ 10,815

See Notes to Consolidated Financial Statements

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12, 2011 AND 2010

EVANS BANCORP, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

YEARS ENDED DECEMBER 31, 2013, 2012 AND 2011

1. ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Organization and General

Evans Bancorp, Inc. (the "Company") was organized as a New York business corporation and incorporated under the laws of the State of New York on October 28, 1988 for the purpose of becoming a bank holding company. Through August 2004, the Company was registered with the Federal Reserve Board ("FRB") as a bank holding company under the Bank Holding Company Act of 1956, as amended. In August 2004, the Company filed for, and was approved as, a Financial Holding Company under the Bank Holding Company Act. The Company currently conducts its business through its two subsidiaries: Evans Bank, N.A. (the "Bank"), a nationally chartered bank, and its subsidiaries, Suchak Data Systems, LLC ("SDS"), Evans National Leasing, Inc. ("ENL") and Evans National Holding Corp. ("ENHC"); and Evans National Financial Services, LLC ("ENFS") and its subsidiary, The Evans Agency LLC ("TEA"). Unless the context otherwise requires, the term "Company" refers collectively to Evans Bancorp, Inc. and its subsidiaries. The Company conducts its business through its subsidiaries. It does not engage in any other substantial business.

During the twelve-month period ended December 31, 2013, the Company revised the Consolidated Statement of Cash Flows for the twelve-month period ended December 31, 2011 to correct a $526 thousand error within "Depreciation and Amortization" and "Change 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.

Regulatory Requirements

The Company is subject to the rules, regulations, and reporting requirements of various regulatory bodies, including the FRB, the Federal Deposit Insurance Corporation ("FDIC"), the Office of the Comptroller of the Currency ("OCC"), and the SEC.

Principles of Consolidation

The consolidated financial statements include the accounts of the Company, the Bank, ENFS and their subsidiaries. All material inter-company accounts and transactions are eliminated in consolidation.

Accounting Estimates

Management has made a number of estimates and assumptions relating to the reporting of assets and liabilities and disclosure of contingent assets and liabilities in order to prepare these consolidated financial statements in conformity with U.S. generally accepted accounting principles. The estimates and assumptions that management deems to be critical involve our accounting policies relating to the determination of our allowance for loan and lease losses and the valuation of goodwill. These estimates and assumptions are based on management's best estimates and judgment and management evaluates them on an ongoing basis using historical experience and other factors, including the current economic environment, which management believes to be reasonable under the circumstances. We adjust our estimates and assumptions when facts and circumstances dictate. The current economic recession increases the uncertainty inherent in our estimates and assumptions. As future events cannot be determined with precision, actual results could differ significantly from our estimates. Changes in those estimates resulting from continuing changes in the economic environment will be reflected in the consolidated financial statements in periods as they occur.

Cash and Cash Equivalents

For purposes of reporting cash flows, cash and cash equivalents include cash and due from banks and interest-bearing deposits at banks.

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Securities

Securities which the Bank has the positive intent and ability to hold to maturity are classified as held to maturity and are stated at cost, adjusted for discounts and premiums that are recognized in interest income over the period to the earlier of the call date or maturity using the level yield method. These securities represent debt issuances of local municipalities in the Bank's market area for which market prices are not readily available. Management periodically evaluates the financial condition of the municipalities to see if there is any cause for impairment in their bonds.

Securities classified as available for sale are stated at fair value with unrealized gains and losses excluded from earnings and reported, net of deferred income taxes, in accumulated other comprehensive income or loss, a component of stockholders' equity. Gains and losses on sales of securities are computed using the specific identification method.

Securities, which experience an other-than-temporary decline in fair value, are written down to a new cost basis with the amount of the write-down, due to credit problems, included in earnings as a realized loss. The new cost basis is not changed for subsequent recoveries in fair value. Factors which management considers in determining whether an impairment in value of an investment is other than temporary include the period of time the securities were in a loss position, management's intent and ability to hold securities until fair values recover to amortized cost or if it is considered more likely than not that the Company will have to sell the security, the extent to which fair value is less than amortized cost, the issuer's financial performance and near term prospects, the financial condition and prospects for the issuer's geographic region and industry, and recoveries or declines in fair value subsequent to the balance sheet date. There were no charges associated with other-than-temporary impairment declines in fair value of securities in 2013 or 2012.

The Bank does not engage in securities trading activities.

Loans

Loans that management has the intent and ability to hold for the foreseeable future, or until maturity or pay-off, generally are reported at their outstanding unpaid principal balances adjusted for unamortized deferred fees or costs. Interest income is accrued on the unpaid principal balance and is recognized using the interest method. Loan origination fees, net of certain direct origination costs, are deferred and recognized as an adjustment of the related loan yield using the effective yield method of accounting.

Loans become past due when the payment date has been missed. If payment has not been received within 30 days, then the loan is delinquent. Delinquent loans are placed into three categories; 30-59 days past due, 60-89 days past due, or 90+ days past due. Loans 90 or more days past due are considered non-performing.

The accrual of interest on loans is discontinued at the time the loan is 90 days delinquent, unless the credit is well secured and in process of collection. If the credit is not well secured and in the process of collection, the loan is placed on non-accrual status and is subject to charge-off if collection of principal or interest is considered doubtful. A loan can also be placed on nonaccrual before it is 90 days delinquent if management determines that it is probable that the Bank will be unable to collect principal or interest due according to the contractual terms of the loan.

All interest due but not collected for loans that are placed on non-accrual status or charged off is reversed against interest income. The interest on these loans is accounted for on the cost-recovery method, until it again qualifies for an accrual basis. Any cash receipts on non-accrual loans reduce the carrying value of the loans. Loans are returned to accrual status when all principal and interest amounts contractually due are brought current, the adverse circumstances which resulted in the delinquent payment status are resolved, and payments are made in a timely manner for a period of time sufficient to reasonably assure their future dependability.

The Bank considers a loan impaired when, based on current information and events, it is probable that it will be unable to collect principal or interest due according to the contractual terms of the loan. These loans are individually assessed for any impairment. Loan impairment is measured based on the present value of expected cash flows discounted at the loan's effective interest rate or, as a practical expedient, at the loan's observable market price or the fair value of the collateral if the loan is collateral dependent. 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 loan being downgraded on the Company's 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 loans are either graded a 6 or 7 on the internal loan rating scale. Subsequent to the downgrade, if the loan

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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. Consumer installment loans and direct financing leases are collectively evaluated for impairment. Since these loans and leases are not individually identified and evaluated, they are not considered impaired loans. The one exception is for consumer loans and direct financing leases that are considered troubled debt restructurings ("TDR") since all TDR loans and leases are considered impaired.

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: Risk Rated 1-3 loans are loans with a slight risk of loss. The loan is secured by collateral of sufficient value to cover the loan by an acceptable margin. The financial statements of the company demonstrate sufficient net worth and repayment ability. The company has established an acceptable credit history with the bank and typically has a proven track record of performance. Management is experienced, and has an at least average ability to manage the company. The industry has an average or less than average susceptibility to wide fluctuations in business cycles.

· 4-Watch: Although generally acceptable, a higher degree of risk is evident in these watch credits.   Obligor assessment factors may have elements which reflect marginally acceptable conditions warranting more careful review and analysis and monitoring.

The obligor's balance sheet reflects generally acceptable asset quality with some elements weak or marginally acceptable. Liquidity may be somewhat strained, but is at an acceptable level to support operations. Obligor may be fully leveraged with ratios higher than industry averages. High leverage is negatively impacting the company, leaving it vulnerable to adverse change. Inconsistent or declining capability to service existing debt requirements evidenced by debt service coverage temporarily below or near acceptable level.   The margin of collateral may be adequate, but declining or fluctuating in value. Company management may be unproven, but capable. Rapid expansion or acquisition may increase leverage or reduce cash flow.

Negative industry conditions or weaker management could also be characteristic. Proper consideration should be given to companies in a high growth phase or in development business segments that may not have achieved sustainable earnings.

Obligors demonstrate sufficient financial flexibility to react to and positively address the root cause of the adverse financial trends without significant deviations from their current business strategy. The rating is also used for borrowers that have made significant progress in resolving their financial weaknesses.

- 5-O.A.E.M. (Other Assets Especially Mentioned): Special Mention ("SM") – A special mention asset has potential weaknesses that warrant management's close attention. If left uncorrected, these potential weaknesses may result in deterioration of the repayment prospects for the asset or in the institution's credit position at some future date. SM assets are not adversely classified and do not expose an institution to sufficient risk to warrant adverse classification.

SM assets have potential weaknesses that may, if not checked or corrected, weaken the asset or inadequately protect the institution's position at some future date. These assets pose elevated risk, but their weakness does not yet justify a substandard classification. Borrowers may be experiencing adverse operating trends (declining revenues or margins) or an ill proportioned balance sheet (e.g. increasing inventory without an increase in sales, high leverage, tight liquidity).

Adverse economic or market conditions, such as interest rate increases or the entry of a new competitor, may also support a special mention rating.

Nonfinancial reasons for rating a credit exposure special mention include management problems, pending litigation, an ineffective loan agreement or other material structural weakness, and any other significant deviation from prudent lending practices.

The SM rating is designed to identify a specific level of risk and concern about asset quality. Although an SM asset has a higher profitability of default than a pass asset, its default is not imminent.

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- 6-Substandard: A substandard asset is inadequately protected by the current sound worth and paying capacity of the obligor or of the collateral pledged, if any. Assets so classified must have a well-defined weakness, or weaknesses, that jeopardize the liquidation of the debt. They are characterized by the distinct possibility that the Bank will sustain some loss if the deficiencies are not corrected.

Substandard assets have a high probability of payment default, or they have other well-defined weaknesses. They require more intensive supervision by Bank management.

Substandard assets are generally characterized by current or expected unprofitable operations, inadequate debt service coverage, inadequate liquidity, or marginal capitalization. Repayment may depend on collateral or other credit risk subsidies. For some substandard assets, the likelihood of full collection of interest and principal may be in doubt; such assets should be placed on non-accrual. Although substandard assets in the aggregate will have distinct potential for loss, an individual asset's loss potential does not have to be distinct for the asset to be rated substandard. These loans are periodically reviewed and tested for impairment.

- 7-Doubtful: An asset classified doubtful has all the weaknesses inherent in one classified substandard with the added characteristic that the weaknesses make collection or liquidation in full, on the basis of currently existing facts, conditions, and values, highly questionable and improbable.

A doubtful asset has a high probability of total or substantial loss, but because of specific pending events that may strengthen the asset, its classification of loss is deferred.

Doubtful borrowers are usually in default, lack adequate liquidity or capital, and lack the resources necessary to remain an operating entity. Pending events can include mergers, acquisitions, liquidations, capital injections, the perfection of liens on additional collateral, the valuation of collateral, and refinancing.

Generally, pending events should be resolved within a relatively short period and the ratings will be adjusted based on the new information. Because of high probability of loss, non-accrual accounting treatment is required for doubtful assets.

- 8-Loss: Assets classified loss are considered uncollectable and of such little value that their continuance as bankable assets is not warranted. This classification does not mean that the assets have absolutely no recovery or salvage value, but rather that it is not practical or desirable to defer writing off this basically worthless asset even though partial recovery may be affected in the future.

With loss assets, the underlying borrowers are often in bankruptcy, have formally suspended debt repayments, or have otherwise ceased normal business operations. Once an asset is classified loss, there is little prospect of collecting either its principal or interest. When access to collateral, rather than the value of the collateral, is a problem, a less severe classification may be appropriate. Losses are to be recorded in the period an obligation becomes uncollectible.

The Company’s consumer loans, including residential mortgages and home equities, are not individually risk rated or reviewed in the Company’s loan review process. Consumers are not required to provide the Company with updated financial information as 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 does not have credit risk ratings for consumer loans and instead uses delinquency status as the credit quality indicator for consumer loans. However, once a consumer loan is identified as impaired, it is individually evaluated for impairment in the same way a commercial loan is evaluated.

Leases

The Bank's leasing operations consist principally of the leasing of various types of small ticket commercial equipment. The Company follows ASC Topic 840, "Leases," for all of its direct financing leases. The net investment in direct financing leases is the sum of all minimum lease payments and estimated residual values, less unearned income, net of the remaining mark. In the third quarter of 2009, the Company announced its intention to sell the leasing portfolio. As a result, the Company classified the leasing portfolio as held-for-sale and marked the portfolio down to its fair market value as of June 30, 2009. As of September 30, 2009, management decided to service the portfolio to maturity and transferred it to held-for-investment. At December 31, 2013 and 2012, the carrying value of the leasing portfolio amounted to $0.0 and $1.6 million, respectively. All of the Bank's leases are classified as direct financing leases.

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Allowance for Loan and Lease Losses

The provision for loan and lease losses represents the amount charged against the Bank's earnings to maintain an allowance for probable loan and lease losses inherent in the portfolio based on management's evaluation of the loan and lease portfolio at the balance sheet date. Factors considered by the Bank's management in establishing the allowance include: the collectability of individual loans and leases, current loan and lease concentrations, charge-off history, delinquent loan and lease percentages, the fair value of the collateral, input from regulatory agencies, and general economic conditions.

On a quarterly basis, management of the Bank meets to review and determine the adequacy of the allowance for loan and lease losses. In making this determination, the Bank's management analyzes the ultimate collectability of the loans and leases in its portfolio by incorporating feedback provided by the Bank's internal loan and lease staff, an independent internal loan and lease review function and information provided by examinations performed by regulatory agencies.

The analysis of the allowance for loan and lease losses is composed of two components: specific credit allocation and general portfolio allocation. The specific credit allocation includes a detailed review of each impaired loan and allocation is made based on this analysis. Factors may include the appraisal value of the collateral, the age of the appraisal, the type of collateral, the performance of the loan to date, the performance of the borrower's business based on financial statements, and legal judgments involving the borrower. The general portfolio allocation consists of an assigned reserve percentage based on the historical loss experience and other quantitative and qualitative factors of the loan or lease category.

The general portfolio allocation is segmented into pools of loans with similar characteristics. Separate pools of loans include loans pooled by loan grade and by portfolio segment. Loans graded a 5 or worse ("criticized loans") that exceed a material balance threshold are evaluated by the Company's credit department to determine if the collateral for the loan is worth less than the loan. All of these "shortfalls" are added together and divided by the respective loan pool to calculate the quantitative factor applied to the respective pool. These loans are not considered impaired because the cash flow of the customer and the payment history of the loan suggest that it is not probable that the Company will be unable to collect the full amount of principal and interest as contracted and are thus still accruing interest.

Loans that are graded 4 or better ("non-criticized loans") are reserved in separate loan pools in the general portfolio allocation. A weighted average 5-year historical charge-off ratio by portfolio segment is calculated and applied against these loan pools.

For both the criticized and non-criticized loan pools in the general portfolio allocation, additional qualitative factors are applied. The qualitative factors applied to the general portfolio allocation reflect management's evaluation of various conditions. The conditions evaluated include the following: industry and regional conditions; seasoning of the loan and lease portfolio and changes in the composition of and growth in the loan and lease portfolio; the strength and duration of the business cycle; existing general economic and business conditions in the lending areas; credit quality trends in non-accruing loans and leases; timing of the identification of downgrades; historical loan and lease charge-off experience; and the results of bank regulatory examinations. Due to the nature of the loans, the criticized loan pools carry significantly higher qualitative factors than the non-criticized pools.

Direct financing leases are segregated from the rest of the loan portfolio in determining the appropriate allowance for that portfolio segment. Unlike the loan portfolio, the Company does have sufficient historical loss data to perform a migration analysis for non-accruing leases. Management periodically updates this analysis by examining the non-accruing lease portfolio at different points in time and studying what percentage of the non-accruing portfolio ends up being charged off. All of the remaining leases not in non-accrual are allocated a reserve based on the several factors including: delinquency and non-accrual trends, charge-off trends, and national economic conditions.

Foreclosed Real Estate

Foreclosed real estate is initially recorded at the lower of carrying or fair value (net of costs of disposal) at the date of foreclosure. Costs relating to development and improvement of property are capitalized, whereas costs relating to the holding of property are expensed. Assessments are periodically performed by management, and an allowance for losses is established through a charge to operations if the carrying value of a property exceeds fair value. The Company held no foreclosed real estate at December 31, 2013 or December 31, 2012.

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Insurance Commissions and Fees

Commission revenue is recognized as of the effective date of the insurance policy or the date the customer is billed, whichever is later. The Company also receives contingent commissions from insurance companies which are based on the overall profitability of their relationship based primarily on the loss experience of the insurance placed by the Company. Contingent commissions from insurance companies are recognized when determinable.

Goodwill and Other Intangible Assets

The Company accounts for goodwill and other intangible assets in accordance with ASC Topic 350, "Intangibles – Goodwill and Other." The Company records the excess of the cost of acquired entities over the fair value of identifiable tangible and intangible assets acquired, less liabilities assumed, as goodwill. The Company amortizes acquired intangible assets with definite useful economic lives over their useful economic lives utilizing the straight-line method. On a periodic basis, management assesses whether events or changes in circumstances indicate that the carrying amounts of the intangible assets may be impaired. The Company does not amortize goodwill and any acquired intangible asset with an indefinite useful economic life, but reviews them for impairment at a reporting unit level on an annual basis, or when events or changes in circumstances indicate that the carrying amounts may be impaired. A reporting unit is defined as any distinct, separately identifiable component of one of our operating segments for which complete, discrete financial information is available and reviewed regularly by the segment's management. The only reporting unit with goodwill as of December 31, 2013 is the insurance agency activities reporting unit.

The fair value of the insurance agency activities reporting unit is measured annually as of December 31st utilizing the average of a discounted cash flow model and a market value based on a multiple to earnings before interest, taxes, depreciation, and amortization ("EBITDA") for similar companies. The calculated value of the insurance agency reporting unit was substantially in excess of the carrying amount at December 31, 2013. A review of the period subsequent to the measurement date is performed to determine if there were any significant adverse changes in operations or events that would alter our determination as of the measurement date. The Company has performed the required goodwill impairment tests and has determined that goodwill was not impaired as of December 31, 2013.

Bank-Owned Life Insurance

The Bank has purchased insurance on the lives of Company directors and certain members of the Bank's and TEA's management. The policies accumulate asset values to meet future liabilities, including the payment of employee benefits, such as retirement benefits. Increases in the cash surrender value are recorded as other income in the Company's Consolidated Statements of Income.

Properties and Equipment

Properties and equipment are stated at cost less accumulated depreciation. Depreciation is computed using the straight-line method over the estimated useful lives of the assets, which range from 3 to 39 years. Impairment losses on properties and equipment are realized if the carrying amount is not recoverable from its undiscounted cash flows and exceeds its fair value in accordance with ASC Topic 360, "Property, Plant, and Equipment."

Income Taxes

Income taxes are accounted for under the asset and liability method under ASC Topic 740, "Income Taxes." Deferred tax assets and liabilities are reflected at currently enacted income tax rates applicable to the periods in which the deferred tax assets or liabilities are expected to be realized or settled. As changes in tax laws or rates are enacted, deferred tax assets and liabilities are adjusted through income tax expense.

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Net Income Per Share

Net income per common share is determined by dividing net income by the weighted average number of shares outstanding during the period. Diluted earnings per common share is based on increasing the weighted-average number of shares of common stock by the number of shares of common stock that would be issued assuming the exercise of stock options and immediate vesting of restricted shares. Such adjustments to weighted-average number of shares of common stock outstanding are made only when such adjustments are expected to dilute earnings per common share. There were 49,268, 15,368, and 2,391 potentially dilutive shares of common stock included in calculating diluted earnings per share for the years ended December 31, 2013, 2012, and 2011, respectively. Potential common shares that would have the effect of increasing diluted earnings per share are considered to be anti-dilutive. In accordance with ASC Topic 260, "Earnings Per Share," these shares were not included in calculating diluted earnings per share. As of December 31, 2013, 2012, and 2011, there were 42 thousand, 157 thousand, and 213 thousand shares, respectively, that are not included in calculating diluted earnings per share because their effect was anti-dilutive.

Treasury Stock

Repurchases of shares of Evans Bancorp, Inc. stock are recorded at cost as a reduction of shareholders' equity. Reissuances of shares of treasury stock are recorded at market value.

Comprehensive Income

Comprehensive income includes both net income and other comprehensive income, including the change in unrealized gains and losses on securities available for sale, and the change in the liability related to pension costs, net of tax.

Employee Benefits

The Bank maintains a non-contributory, qualified, defined benefit pension plan (the "Pension Plan") that covered substantially all employees before it was frozen on January 31, 2008. All benefits eligible participants had accrued in the Pension Plan until the freeze date have been retained. Employees have not accrued additional benefits in the Pension Plan from that date. The actuarially determined pension benefit in the form of a life annuity is based on the employee's combined years of service, age and compensation. The Bank's policy is to fund the minimum amount required by government regulations. Employees are eligible to receive these benefits at normal retirement age.

The Bank maintains a defined contribution 401(k) plan and accrues contributions due under this plan as earned by employees. In addition, the Bank maintains a non-qualified Supplemental Executive Retirement Plan for certain members of senior management, a non-qualified Deferred Compensation Plan for directors and certain members of management, and a non-qualified Executive Incentive Retirement Plan for certain members of management, as described more fully in Note 11 to the Consolidated Financial Statements, "Employee Benefits and Deferred Compensation Plans."

Stock-based Compensation

Stock-based compensation expense is recognized over the vesting period of the stock-based grant based on the estimated grant date value of the stock-based compensation that is expected to vest. Information on the determination of the estimated value of stock-based awards used to calculate stock-based compensation expense is included in Note 12 to the Consolidated Financial Statements, "Stock-Based Compensation."

Loss Contingencies

Loss contingencies, including claims and legal actions arising in the ordinary course of business, are recorded as liabilities when the likelihood of loss is probable and an amount or range of loss can be reasonably estimated.

Financial Instruments with Off-Balance Sheet Risk

In the ordinary course of business, the Bank has entered into off-balance sheet financial arrangements consisting of commitments to extend credit and standby letters of credit. The Bank has not incurred any losses on its commitments during the past three years and has not recorded a reserve for its commitments.

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Advertising costs

Advertising costs are expensed as incurred.

New Accounting Standards

The following significant accounting pronouncements became effective for the Company in 2013:

Accounting Standards Update ("ASU") 2012-06, Subsequent Accounting for an Indemnification Asset Recognized at the Acquisition Date as a Result of a Government-Assisted Acquisition of a Financial Institution. Accounting for a business combination requires that at each subsequent reporting date, an acquirer measure an indemnification asset on the same basis as the indemnified liability or asset, subject to any contractual limitations on its amount, and, for an indemnification asset that is not subsequently measured at its fair value, management's assessment of the collectability of the indemnification asset. The objective of this ASU is to address the diversity in practice about how to interpret the terms on the same basis and contractual limitations when subsequently measuring an indemnification asset recognized in a government-assisted (Federal Deposit Insurance Corporation) acquisition of a financial institution that includes a loss-sharing agreement (indemnification agreement). The new guidance is effective for interim and annual periods beginning after December 15, 2012. The Company adopted this ASU effective January 1, 2013. The Company was party to an indemnification agreement with the FDIC related to the Company's acquisition of Waterford Village Bank in July 2009, however, this agreement was terminated effective July 1, 2013. The adoption of this ASU did not have a material impact on the Company's financial statements.

ASU 2013-02, Reporting of Amounts Reclassified Out of Accumulated Other Comprehensive Income. The objective of this ASU is to improve the reporting of reclassifications out of accumulated other comprehensive income by requiring an entity to report the effect of significant reclassifications out of accumulated other comprehensive income on the respective line items in net income, if the amount being reclassified is required to be reclassified into net income in its entirety. For other amounts that are not required under U.S. GAAP to be reclassified in their entirety to net income, an entity is required to cross-reference to other disclosures required under U.S. GAAP that provide additional detail about those amounts. This ASU is effective for reporting periods beginning after December 15, 2012. The Company adopted this ASU effective January 1, 2013, as reflected herein at Note 10 – "Comprehensive Income (Loss)."

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2.SECURITIES

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

	2013 (in thousands)			
	Amortized Cost	Unrealized Gains	Losses	Fair Value
Available for Sale:				
Debt securities:				
U.S. government agencies	$ 32,176	$ 439	$ (623)	$ 31,992
States and political subdivisions	31,266	802	(188)	31,880
Total debt securities	$ 63,442	$ 1,241	$ (811)	$ 63,872
Mortgage-backed securities:				
FNMA	$ 13,204	$ 354	$ (57)	$ 13,501
FHLMC	7,156	109	(147)	7,118
GNMA	7,570	99	(96)	7,573
CMO	7,981	9	(389)	7,601
Total mortgage-backed securities	$ 35,911	$ 571	$ (689)	$ 35,793
Total securities designated as available for sale	$ 99,353	$ 1,812	$ (1,500)	$ 99,665
Held to Maturity:				
Debt securities				
States and political subdivisions	$ 2,384	$ 6	$ (71)	$ 2,319
Total securities designated as held to maturity	$ 2,384	$ 6	$ (71)	$ 2,319

	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

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Available for sale securities with a total fair value of $71.1 million and $68.0 million were pledged as collateral to secure public deposits and for other purposes required or permitted by law at December 31, 2013 and 2012, respectively.

The scheduled maturity of debt and mortgage-backed securities at December 31st of the respective years is 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.

	2013		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	$ 447	$ 454	$ 2,766	$ 2,797
Due after one year through five years	23,732	24,419	16,797	17,561
Due after five years through ten years	31,450	30,946	29,280	30,344
Due after ten years	7,813	8,053	8,296	9,099
	63,442	63,872	57,139	59,801
Mortgage-backed securities available for sale	35,911	35,793	30,915	32,262
Total available for sale securities	$ 99,353	$ 99,665	$ 88,054	$ 92,063
Debt securities held to maturity:				
Due in one year or less	$ 1,023	$ 1,020	$ 2,241	$ 2,228
Due after one year through five years	178	179	317	322
Due after five years through ten years	1,064	1,015	516	490
Due after ten years	119	105	670	681
	2,384	2,319	3,744	3,721
Total held to maturity securities	$ 2,384	$ 2,319	$ 3,744	$ 3,721

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

There were no realized gains and losses from gross sales of securities in 2013 and 2012. Realized gains and losses from gross sales of securities of $1.0 million for the year ended December 31, 2011 were $35 thousand and $9 thousand, respectively.

Information regarding unrealized losses within the Company’s available for sale securities at December 31st of the respective years 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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	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	$ 10,553	$ (486)	$ 1,863	$ (137)	$ 12,416	$ (623)
States and political subdivisions	7,953	(150)	590	(38)	8,543	(188)
Total debt securities	$ 18,506	$ (636)	$ 2,453	$ (175)	$ 20,959	$ (811)
Mortgage-backed securities:						
FNMA	$ 4,819	$ (57)	$ 21	$ -	$ 4,840	$ (57)
FHLMC	2,677	(46)	1,700	(101)	4,377	(147)
GNMA	2,751	(96)	-	-	2,751	(96)
CMO'S	6,466	(389)	-	-	6,466	(389)
Total mortgage-backed securities	$ 16,713	$ (588)	$ 1,721	$ (101)	$ 18,434	$ (689)
Held To Maturity:						
Debt securities:						
States and political subdivisions	$ 1,210	$ (24)	$ 504	$ (47)	$ 1,714	$ (71)
Total temporarily impaired securities	$ 36,429	$ (1,248)	$ 4,678	$ (323)	$ 41,107	$ (1,571)

	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	$ -
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)

Management has assessed the securities available for sale in an unrealized loss position at December 31, 2013 and 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 we 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 holds no securities backed by sub-prime or Alt-A residential mortgages or commercial mortgages and also does not hold any trust-preferred securities.

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While the Company did not record any other-than-temporary impairment charges in 2013 or 2012, and gross unrealized losses amounted to only $1.6 million at December 31, 2013, it remains possible that economic conditions could negatively impact the securities portfolio in 2014. The credit worthiness of the Company's portfolio is largely reliant on the ability of U.S. government agencies such as the Federal Home Loan Bank ("FHLB"), Federal National Mortgage Association ("FNMA"), and the Federal Home Loan Mortgage Corporation ("FHLMC"), and municipalities throughout New York State to meet their obligations. In addition, dysfunctional markets could materially alter the liquidity, interest rate, and pricing risk of the portfolio. The stable past performance is not a guarantee for similar performance going forward.

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. At December 31, 2013, the Company had a total of $9 million in borrowed funds with FHLBNY. The Company has placed sufficient collateral in the form of residential real estate loans at FHLBNY. As a member of the Federal Home Loan Bank System, the Bank is required to hold stock in FHLBNY. The Bank held FHLBNY stock with a carrying value of $1.4 million as of December 31, 2013 and $1.8 million as of December 31, 2012, respectively.

Systemic weakness in the FHLB could result in impairment of the Company's FHLB stock. However, FHLBNY has stated that it currently meets all of its capital requirements, continues to redeem excess stock for members, and has the expressed ability and intent to continue paying dividends. FHLBNY has a Aaa credit rating and a negative outlook. The outlook on FHLB is negative reflecting the negative outlook on the US government. Markets have largely ignored the rating agencies' negative outlook and downgrades on US government debt as government bond yields continued to decrease in 2013. Despite the perceived budget and debt problems of the US government, investors have continued to view US government debt as a relatively safe investment, as evidenced by the lack of risk premium priced into US Treasury bond yields. The Aaa rating reflects FHLB's financial strength, sound management, low derivatives risk exposure, status as a government-sponsored enterprise and other links to the US government. Due to the relatively strong financial health of FHLBNY and FHLB, there was no impairment in the Bank's FHLB stock as of December 31, 2013 and 2012.

3.LOANS AND LEASES, NET

Major categories of loans and leases at December 31, 2013 and 2012 are summarized as follows:

	2013	2012
Mortgage loans on real estate:	(in thousands)	
Residential Mortgages	$ 94,027	$ 68,135
Commercial and multi-family	361,247	323,777
Construction-Residential	1,509	811
Construction-Commercial	23,902	28,941
Home equities	57,228	56,366
Total real estate loans	537,913	478,030
Direct financing leases	-	1,612
Commercial and industrial loans	106,952	99,951
Consumer loans	938	1,294
Other	323	1,342
Net deferred loan origination costs	870	666
Total gross loans	646,996	582,895
Allowance for loan losses	(11,503)	(9,732)
Loans, net	$ 635,493	$ 573,163

Residential Mortgages: The Company originates adjustable-rate and fixed-rate, one-to-four-family residential real estate loans for the construction, purchase or refinancing of a mortgage. These loans are collateralized by owner-occupied properties located in the Company’s market area. They are amortized over 10 to 30 years. Loans on one-to-four-family residential real estate are mostly originated in amounts of no more than 80% of appraised value or have private mortgage insurance. Mortgage title insurance and hazard insurance are normally required. Construction loans have a unique risk, because they are secured by an incomplete dwelling.

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The Bank, in its normal course of business, sells certain residential mortgages which it originates to FNMA. The Company maintains servicing rights on the loans that it sells to FNMA and earns a fee thereon. The Bank determines with each origination of residential real estate loans which desired maturities, within the context of overall maturities in the loan portfolio, provide the appropriate mix to optimize the Bank's ability to absorb the corresponding interest rate risk within the Company's tolerance ranges. This practice allows the Company to manage interest rate risk, liquidity risk, and credit risk. At December 31, 2013 and 2012, the Company had approximately $63.5 million and $73.7 million, respectively, in unpaid principal balances of loans that it services for FNMA. For the years ended December 31, 2013 and 2012, the Company sold $0.8 million and $24.6 million, respectively, in loans to FNMA and realized gains on those sales of $25 thousand and $464 thousand, respectively. Gains or losses recognized upon the sale of loans are determined on a specific identification basis. The Company had a related asset of approximately $0.5 million for the servicing portfolio rights as of December 31, 2013 and 2012. There were no loans held for sale at December 31, 2013 compared with $0.9 million at December 31, 2012. Loans held for sale are typically in the portfolio for less than a month. As a result, the carrying value approximates fair value. The Company has never been contacted by FNMA to repurchase any loans due to improper documentation or fraud.

Due to the lack of foreclosure activity and absence of any ongoing litigation, the Company has no accrual for loss contingencies or potential costs associated with foreclosure-related activities.

Commercial and Multi-Family Mortgages and Commercial Construction Loans: Commercial real estate loans are made to finance the purchases of real estate with completed structures or in the midst of being constructed. These commercial real estate loans are secured by first liens on the real estate, which may include apartments, hotels, retail stores or plazas, healthcare facilities, and other non-owner-occupied facilities. These loans are less risky than commercial and industrial loans, since they are secured by real estate and buildings. The Company offers commercial mortgage loans with up to an 80% LTV ratio for up to 20 years on a variable and fixed rate basis. Many of these mortgage loans either mature or are subject to a rate call after three to five years. The Company's underwriting analysis includes credit verification, independent appraisals, a review of the borrower's financial condition, and the underlying cash flows. These loans are typically originated in amounts of no more than 80% of the appraised value of the property. Construction loans have a unique risk, because they are secured by an incomplete dwelling.

As of December 31, 2013, there were $164.0 million in residential and commercial mortgage loans pledged to FHLBNY to serve as collateral for borrowings.

Home Equities: The Company originates home equity lines of credit and second mortgage loans (loans secured by a second lien position on one-to-four-family residential real estate). These loans carry a higher risk than first mortgage residential loans as they are in a second position relating to collateral. Risk is reduced through underwriting criteria, which include credit verification, appraisals, a review of the borrower's financial condition, and personal cash flows. A security interest, with title insurance when necessary, is taken in the underlying real estate.

Direct Financing Leases: From 2005 to April 2009 the Company originated direct financing leases of commercial small-ticket general business equipment to companies located throughout the United States. These leases carry a high risk of loss. As a result of the increase in credit risks, poor performance in the portfolio, the lack of strategic fit with the Company's community banking philosophy, and with the intention of reallocating capital back to its core business, management announced its exit from the national leasing business in April 2009. As a result of management's decision to sell the portfolio a mark-to-market adjustment of $7.2 million was created on June 30, 2009. The mark was charged off against the allowance. The portfolio was subsequently placed back into held-for-investment as of September 30, 2009 after management determined that a greater value for the portfolio would be realized by keeping it rather than selling it. The portfolio was re-classified as held-for-investment using the same $7.2 million mark. Since that time, leases that are determined to have no value have been applied to the remaining mark, rather than charged off through the allowance.

Commercial and Industrial Loans: These loans generally include term loans and lines of credit. Such loans are made available to businesses for working capital (including inventory and receivables), business expansion (including acquisition of real estate, expansion and improvements) and equipment purchases. As a general practice, a collateral lien is placed on equipment or other assets owned by the borrower. These loans carry a higher risk than commercial real estate loans based on the nature of the underlying collateral, which can be business assets such as equipment and accounts receivable. To reduce the risk, management also attempts to secure real estate as collateral and obtain personal guarantees of the borrowers. To further reduce risk and enhance liquidity, these loans generally carry variable rates of interest, re-pricing in three- to five-year periods, and have a maturity of five years or less. Lines of credit generally carry floating rates of interest (e.g., prime plus a margin).

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Consumer Loans: The Company funds a variety of consumer loans, including direct automobile loans, recreational vehicle loans, boat loans, aircraft loans, home improvement loans, and personal loans (collateralized and uncollateralized). Most of these loans carry a fixed rate of interest with principal repayment terms typically ranging up to five years, based upon the nature of the collateral and the size of the loan. The majority of consumer loans are underwritten on a secured basis using the underlying collateral being financed. A minimal amount of loans are unsecured, which carry a higher risk of loss.

Other Loans: These loans included $0.2 million at December 31, 2013 and $1.6 million at December 31, 2012 of overdrawn deposit accounts classified as loans.

Net loan commitment fees are deferred and amortized into fee income or other expense on a straight-line basis over the commitment period.

Loans Purchased in FDIC-Assisted Transaction: During the third quarter of 2009, the Bank entered into a definitive purchase and assumption agreement (the “Agreement”) with the FDIC to purchase a failed community bank located in Clarence, NY called Waterford Village Bank (“Waterford”). Included in the purchase was a loan portfolio of $42.0 million. Included in that purchased portfolio were $2.0 million in credit-impaired loans, which were written down by $1.2 million at the time of acquisition for a net carrying amount at acquisition of $0.8 million.

All of the purchased loans and foreclosed real estate purchased by the Bank under the Agreement were covered by a loss sharing agreement between the FDIC and the Bank which was included in the Agreement. The loans acquired in that acquisition were referred to as “covered” loans because they were covered by the loss sharing agreement. Under this loss sharing agreement, the FDIC had agreed to bear 80% of loan and foreclosed real estate losses up to $5.6 million and 95% of losses that exceed $5.6 million. Reimbursable losses were based on the book value of the relevant loans and foreclosed assets as determined by the FDIC as of the date of the acquisition.

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 had provisioned for any incremental increases in estimated credit losses due to deterioration in specific loans or increased risk factors on pools of loans.

On July 1, 2013, the loss sharing agreement between the FDIC and the Bank was terminated. The Bank received $1.1 million from the FDIC in consideration for termination of the loss sharing agreement. As a result of the termination, the FDIC guarantees on covered loan losses were eliminated, and the Company recognized $0.6 million in allowance on the previously covered loans. At termination of the loss sharing agreement, the covered loan portfolio was $16.6

million with a gross allowance of $0.8 million and a $0.6 million in FDIC guarantee on those estimated losses, as compared with a covered loan portfolio of $20.8 million with a gross allowance of $0.6 million and a $0.5 million in FDIC guarantee on those estimated losses as of December 31, 2012.

The Company maintains an allowance for loan and lease losses in order to capture the probable losses inherent in its loan and lease portfolio. There is a risk that the Company may experience significant loan and lease losses in 2014 and beyond which could exceed the allowance for loan and lease losses. This risk is heightened by the current uncertain and adverse economic conditions. If the Company's assumptions and judgments prove to be incorrect or bank regulators require the Company to increase its provision for loan and lease losses or recognize further loan and lease charge-offs, the Company may have to increase its allowance for loan and lease losses or loan and lease charge-offs which could have a material adverse effect on the Company's operating results and financial condition. There can be no assurance that the Company's allowance for loan and lease losses will be adequate to protect the Company against loan and lease losses that it may incur.

Changes in the allowance for loan and lease losses for the years ended December 31, 2013, 2012 and 2011 are as follows:

	2013	2012	2011
	(in thousands)		
Balance, beginning of year	$ 9,732	$ 11,495	$ 10,424
Provisions for loan and lease losses	1,540	(68)	2,484
Recoveries	942	225	109
Loans and leases charged off	(711)	(1,920)	(1,522)
Balance, end of year	$ 11,503	$ 9,732	$ 11,495

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The following tables summarize the allowance for loan and lease losses, as of December 31, 2013 and 2012, respectively, by portfolio segments. The segments presented are at the level management uses to assess and monitor the risk and performance of the portfolio. The Company does not currently consider other factors such as industry and geography in assessing the loan portfolio.

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	(20)	(460)	(64)	(39)	(128)	-	-	(711)
Recoveries	240	444	13	2	1	242	-	942
Provision	652	435	70	413	259	(289)	-	1,540
Ending balance	$ 4,489	$ 4,912	$ 37	$ 1,038	$ 878	$ -	$ 149	$ 11,503
Allowance for loan and lease losses:								
Ending balance:								
Individually evaluated for impairment	$ 1,187	$ 216	$ 20	$ 47	$ 39	$ -	$ -	$ 1,509
Collectively evaluated for impairment	3,302	4,696	17	991	839	-	149	9,994
Total	$ 4,489	$ 4,912	$ 37	$ 1,038	$ 878	$ -	$ 149	$ 11,503
Loans and leases:								
Ending balance:								
Individually evaluated for impairment	$ 4,388	$ 12,054	$ 20	$ 1,952	$ 447	$ -	$ -	$ 18,861
Collectively evaluated for impairment	102,564	373,095	1,241	93,584	56,781	-	-	627,265
Total	$ 106,952	$ 385,149	$ 1,261	$ 95,536	$ 57,228	$ -	$ -	$ 646,126

Note: Loan and lease balances do not include $870 thousand in net deferred loan and lease originations as of December 31, 2013.

* includes construction loans

** includes other loans

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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	(862)	(900)	(32)	(12)	(114)	-	-	(1,920)
Recoveries	184	15	19	1	6	-	-	225
Provision	210	708	(5)	(120)	86	(947)	-	(68)
Ending balance	$ 3,617	$ 4,493	$ 18	$ 662	$ 746	$ 47	$ 149	$ 9,732
Allowance for loan and lease losses:								
Ending balance:								
Individually evaluated for impairment	$ 472	$ 471	$ 5	$ -	$ -	$ 13	$ -	$ 961
Collectively evaluated for impairment	3,145	4,022	9	662	746	34	149	8,767
Loans acquired with deteriorated credit quality	-	-	4	-	-	-	-	4
Total	$ 3,617	$ 4,493	$ 18	$ 662	$ 746	$ 47	$ 149	$ 9,732
Loans and leases:								
Ending balance:								
Individually evaluated for impairment	$ 1,159	$ 7,283	$ 22	$ 1,443	$ 938	$ 164	$ -	$ 11,009
Collectively evaluated for impairment	98,792	345,435	2,592	67,503	55,428	1,448	-	571,198
Loans acquired with deteriorated credit quality	-	-	22	-	-	-	-	22
Total	$ 99,951	$ 352,718	$ 2,636	$ 68,946	$ 56,366	$ 1,612	$ -	$ 582,229

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

* includes construction loans

** includes other loans

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The national economy continued to slowly shows signs of improvement in 2013, with unemployment improving from 7.8% to 6.7%. However, the unemployment rate remains high by historical standards and other economic indicators such as GDP growth continue to reflect gradual improvement in the economy. Although the economy has yielded signs of improvement, management did not impact the provision for loan losses specifically related to the current economic environment. The current year provision for loans was driven by the increased in criticized loans in 2013 and provision recognized as a result of the termination of the FDIC loss sharing agreement in 2013.

The following table depicts the activity in the leasing portfolio, including the mark:

	As of December 31,		
	2013	2012	2011
	(in thousands)		
Direct financing lease principal balance	$ 105	$ 1,742	$ 6,509
Mark-to-market adjustment	(105)	(130)	(488)
Direct financing lease carrying balance	-	1,612	6,021

	For the year ended December 31,		
	2013	2012	2011
	(in thousands)		
Beginning balance of the mark	$ 130	$ 488	$ 1,493
Mark-to-market adjustment	(242)	-	-
Net write-offs (recoveries)	217	(358)	(1,005)
Remaining mark	105	130	488
Allowance for lease losses, beginning balance	$ 47	$ 994	$ 1,471
(Reduction of) provision for lease losses	(47)	(947)	(477)
Leasing net charge-offs	-	-	-
Allowance for lease losses, ending balance	-	47	994
Total mark plus allowance	$ 105	$ 177	$ 1,482
Mark plus allowance / leasing principal balance	100 %	10.16 %	22.77 %
Non-accruing leases	$ 47	$ 171	$ 1,160
Non-accruing leases / leasing principal balance	44.76 %	9.82 %	17.82 %

The reduction of provision for lease losses in 2013 brought the allowance for lease losses to zero. The leasing portfolio continued running off during the year, while lease recoveries have continued to increase. As a result, the mark-to-market balance was adjusted during 2013 to equal the remaining net lease receivable balance.

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The following table provides data, at the class level, of credit quality indicators of certain loans and leases, as of December 31, 2013 and 2012, respectively:

December 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	$ 19,086	$ 297,819	$ 316,905	$ 78,294
4	3,283	47,584	50,867	15,194
5	-	4,028	4,028	9,468
6	1,533	11,479	13,012	3,744
7	-	337	337	252
Total	$ 23,902	$ 361,247	$ 385,149	$ 106,952

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

The Company's risk ratings are monitored by the individual relationship managers and changed as deemed appropriate after receiving updated financial information from the borrowers or deterioration or improvement in the performance of a loan is evident in the customer's payment history. Each commercial relationship is individually assigned a risk rating. The Company also maintains a loan review process that monitors the management of the Company's commercial loan portfolio by the relationship managers. The Company's loan review function reviews at least 40% of the commercial and commercial mortgage portfolio annually.

The Company's consumer loans, including residential mortgages and home equities, are not individually risk rated or reviewed in the Company's loan review process. Consumers are not required to provide the Company with updated financial information as a commercial customer is. Consumer loans are also smaller in balances. Given the lack of updated information since the initial underwriting of the loan and small size of individual loans, the Company uses the delinquency status as the credit quality indicator for consumer loans. The delinquency table is shown below. The Company does not lend to sub-prime borrowers. Unless the loan is well secured and in the process of collection, all consumer loans that are more than 90 days past due are placed in non-accrual status.

Once a consumer loan reaches 90 days past due, management orders an appraisal and runs a credit report on the borrower. If the loan is placed in nonaccrual status, an impairment test is performed. The book value of the loan is compared to the collateral value as determined by an independent appraisal, discounted for potential selling costs, appraisal age, or other factors particular to the property or borrower. In order to perform the impairment test, management determines the amount of the senior liens held by other lenders in the cases in which the Company holds a junior lien. When the Company is not in the first lien position, the collateral value is more heavily discounted to account for the increased risk.

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Similar to consumer loans, direct financing leases were evaluated in pools according to delinquency and accruing status rather than assigned risk ratings. Given the comparably lower credit quality of the leasing portfolio, leases were rarely kept in accruing status beyond 30 days past due. Non-accrual leases were assigned a reserve percentage based on the historical loss history of the Company's non-accrual lease portfolio. Evaluating non-accruing leases as a pool was appropriate as they were small-balance and homogeneous in nature. On a quarterly basis, leases were evaluated for any deterioration not readily apparent through payment performance. If any risk factors become apparent during the review such as deteriorating financial performance for the customer's business or requests for a restructuring from the original terms of the contract, management placed those large leases that were performing from a payment perspective but had some indications of credit deterioration into a second pool. These large leases with additional risk were assigned a reserve percentage reflective of the additional risk characteristics while taking into account the adequate payment performance. All other leases were placed in a third pool and assigned a reserve percentage commensurate with the credit history of the Company's leasing portfolio, delinquency trends, non-accrual trends, charge-off trends, and general macro-economic factors.

The following table provides an analysis of the age of the recorded investment in loans and leases that were past due as of December 31, 2013 and 2012, respectively:

December 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	$ 197	$ 447	$ 358	$ 1,002	$ 105,950	$ 106,952	$ -	$ 2,970
Residential real estate:								
Residential	392	72	915	1,379	92,648	94,027	-	1,376
Construction	-	-	-	-	1,509	1,509	-	-
Commercial real estate:								
Commercial	6,976	1,050	75	8,101	353,146	361,247	-	8,873
Construction	-	-	-	-	23,902	23,902	-	-
Home equities	100	267	76	443	56,785	57,228	-	447
Direct financing leases	1	2	47	50	-	-	-	47
Consumer	1	21	-	22	916			