EVANS BANCORP INC
Form 10-Q
May 01, 2015

United States

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

For quarterly period ended March 31, 2015

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

For the transition period from to _______

Commission file number 001-35021

EVANS BANCORP, INC. .

(Exact name of registrant as specified in its charter)

New York	16-1332767
(State or other jurisdiction of	(I.R.S. Employer

incorporation or organization) Identification No.)

One Grimsby Drive, Hamburg, NY 14075

(Address of principal executive offices) (Zip Code)

(716) 926-2000 .

(Registrant's telephone number, including area code)

Not Applicable .

(Former name, former address and former fiscal year, if changed

since last report)

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

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

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

Large accelerated filer Accelerated filer

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

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

Yes No

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

Common Stock, $.50 par value 4,231,416 shares as of April 30, 2015

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EVANS BANCORP, INC. AND SUBSIDIARIES

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EVANS BANCORP, INC. AND SUBSIDIARIES
UNAUDITED CONSOLIDATED BALANCE SHEETS
MARCH 31, 2015 AND DECEMBER 31, 2014
(in thousands, except share and per share amounts)

	March 31, 2015	December 31, 2014
ASSETS		
Cash and due from banks	$ 14,661	$ 8,784
Interest-bearing deposits at banks	46,033	2,114
Securities:		
Available for sale, at fair value (amortized cost: $96,367 at March 31, 2015; $94,048 at December 31, 2014)	98,393	95,533
Held to maturity, at amortized cost (fair value: $1,576 at March 31, 2015; $1,574 at December 31, 2014)	1,588	1,599
Federal Home Loan Bank common stock, at amortized cost	822	1,439
Federal Reserve Bank common stock, at amortized cost	1,486	1,486
Loans, net of allowance for loan losses of $12,777 at March 31, 2015 and $12,533 at December 31, 2014	688,961	683,131
Properties and equipment, net of accumulated depreciation of $15,390 at March 31, 2015 and $15,129 at December 31, 2014	10,074	10,224
Goodwill	8,101	8,101
Bank-owned life insurance	20,552	20,415
Other assets	13,681	13,983
TOTAL ASSETS	$ 904,352	$ 846,809
LIABILITIES AND STOCKHOLDERS' EQUITY		
LIABILITIES		
Deposits:		
Demand	$ 169,965	$ 158,631
NOW	82,956	72,670
Regular savings	416,317	363,542
Time	111,120	112,792
Total deposits	780,358	707,635
Securities sold under agreement to repurchase	10,673	13,778
Other short term borrowings	-	13,700
Other liabilities	15,290	14,578
Junior subordinated debentures	11,330	11,330
Total liabilities	817,651	761,021
CONTINGENT LIABILITIES AND COMMITMENTS		

STOCKHOLDERS' EQUITY:		
Common stock, $.50 par value, 10,000,000 shares authorized; 4,244,591 and 4,241,797 shares issued at March 31, 2015 and December 31, 2014, respectively, and 4,230,895 and 4,203,684 outstanding at March 31, 2015 and December 31, 2014, respectively	2,123	2,123
Capital surplus	42,682	43,102
Treasury stock, at cost, 13,696 shares and 38,113 at March 31, 2015 and December 31, 2014, respectively	(166)	(751)
Retained earnings	43,210	42,822
Accumulated other comprehensive loss, net of tax	(1,148)	(1,508)
Total stockholders' equity	86,701	85,788
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	$ 904,352	$ 846,809

See Notes to Unaudited Consolidated Financial Statements

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EVANS BANCORP, INC. AND SUBSIDIARIES
UNAUDITED CONSOLIDATED STATEMENTS OF INCOME
THREE MONTHS ENDED MARCH 31, 2015 AND 2014
(in thousands, except share and per share amounts)

	Three Months Ended March 31,	
	2015	2014
INTEREST INCOME		
Loans	$ 7,813	$ 7,510
Interest bearing deposits at banks	1	15
Securities:		
Taxable	405	449
Non-taxable	237	245
Total interest income	8,456	8,219
INTEREST EXPENSE		
Deposits	781	756
Other borrowings	15	86
Junior subordinated debentures	79	79
Total interest expense	875	921
NET INTEREST INCOME	7,581	7,298
PROVISION (CREDIT) FOR LOAN LOSSES	201	153
NET INTEREST INCOME AFTER PROVISION FOR LOAN LOSSES	7,380	7,145
NON-INTEREST INCOME		
Bank charges	409	461
Insurance service and fees	1,829	2,132
Data center income	24	107
Gain on loans sold	22	-
Bank-owned life insurance	137	145
Other	645	550
Total non-interest income	3,066	3,395
NON-INTEREST EXPENSE		
Salaries and employee benefits	4,794	4,695
Occupancy	695	743
Repairs and maintenance	173	176
Advertising and public relations	211	222
Professional services	511	518
Technology and communications	259	300
Amortization of intangibles	-	41
FDIC insurance	147	162
Other	722	761
Total non-interest expense	7,512	7,618
INCOME BEFORE INCOME TAXES	2,934	2,922
INCOME TAX PROVISION	1,029	909
NET INCOME	$ 1,905	$ 2,013

Net income per common share-basic	$ 0.45	$ 0.48
Net income per common share-diluted	$ 0.44	$ 0.47
Cash dividends per common share	$ 0.36	$ 0.31
Weighted average number of common shares outstanding	4,213,509	4,200,519
Weighted average number of diluted shares outstanding	4,291,676	4,284,016

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UNAUDITED STATEMENTS OF CONSOLIDATED COMPREHENSIVE INCOME
THREE MONTHS ENDED MARCH 31, 2015 AND 2014
(in thousands, except share and per share amounts)

	Three Months Ended March 31,			
	2015		2014	
NET INCOME		$ 1,905		$ 2,013
OTHER COMPREHENSIVE INCOME, NET OF TAX:				
Unrealized gain on available-for-sale securities:				
Unrealized gain on available-for-sale securities	331		361	
Less: Reclassification of gain on sale of securities	-		-	
		331		361
Defined benefit pension plans:				
Amortization of prior service cost	5		5	
Amortization of actuarial assumptions	24		16	
Total		29		21
OTHER COMPREHENSIVE INCOME, NET OF TAX		360		382
COMPREHENSIVE INCOME		$ 2,265		$ 2,395

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THREE MONTHS ENDED MARCH 31, 2015 AND 2014
(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, 2013	$ 2,106	$ 42,619	$ 37,370	$ (1,263)	$ (120)	$ 80,712
Net Income			2,013			2,013
Other comprehensive income				382		382
Cash dividends ($0.31 per common share)			(1,305)			(1,305)
Stock options and restricted stock expense		99				99
Excess tax expense from stock-based compensation		21				21
Issued 3,017 restricted shares	2	(2)				-
Repurchased 59,800 shares					(1,436)	(1,436)
Reissued 3,087 shares in stock option exercise		(27)			58	31
Balance, March 31, 2014	$ 2,108	$ 42,710	$ 38,078	$ (881)	$ (1,498)	$ 80,517
Balance, December 31, 2014	$ 2,123	$ 43,102	$ 42,822	$ (1,508)	$ (751)	$ 85,788
Net Income			1,905			1,905
Other comprehensive income				360		360
Cash dividends ($0.36 per common share)			(1,517)			(1,517)
Stock options and restricted stock expense		117				117
Excess tax benefit from stock-based compensation		14				14
Repurchased 1,397 shares in Treasury stock					(34)	(34)
Reissued 20,942 restricted shares		(503)			503	-
Reissued 4,872 shares through stock option exercise		(48)			116	68
Balance, March 31, 2015	$ 2,123	$ 42,682	$ 43,210	$ (1,148)	$ (166)	$ 86,701

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EVANS BANCORP, INC. AND SUBSIDIARIES
UNAUDITED CONSOLIDATED STATEMENTS OF CASH FLOWS
THREE MONTHS ENDED MARCH 31, 2015 AND 2014
(in thousands)

	Three Months Ended March 31,	
	2015	2014
OPERATING ACTIVITIES:		
Interest received	$ 8,256	$ 8,105
Fees received	2,779	3,388
Interest paid	(896)	(937)
Cash paid to employees and vendors	(7,804)	(8,368)
Income taxes paid	(1)	(960)
Proceeds from sale of loans held for resale	2,658	-
Originations of loans held for resale	(4,995)	(123)
Net cash (used in) provided by operating activities	(3)	1,105
INVESTING ACTIVITIES:		
Available for sales securities:		
Purchases	(4,244)	-
Proceeds from maturities, calls, and payments	2,451	5,543
Held to maturity securities:		
Proceeds from maturities, calls, and payments	11	11
Additions to properties and equipment	(111)	(226)
Purchase of tax credit investment	(667)	-
Net increase in loans	(3,595)	(13,493)
Net cash used in investing activities	(6,155)	(8,165)
FINANCING ACTIVITIES:		
Proceeds from (repayments of) borrowings, net	(16,803)	(1,977)
Net increase in deposits	72,723	15,333
Repurchase of treasury stock	(34)	(1,436)
Reissuance of treasury stock	68	31
Net cash provided by financing activities	55,954	11,951

Net increase in cash and equivalents	49,796	4,891
CASH AND CASH EQUIVALENTS:		
Beginning of period	10,898	41,954
End of period	$ 60,694	$ 46,845

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UNAUDITED CONSOLIDATED STATEMENTS OF CASH FLOWS
THREE MONTHS ENDED MARCH 31, 2015 AND 2014
(in thousands)

	Three Months Ended March 31, 2015	2014
RECONCILIATION OF NET INCOME TO NET CASH PROVIDED BY OPERATING ACTIVITIES:		
Net income	$ 1,905	$ 2,013
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	356	422
Deferred tax (benefit) expense	42	(13)
Provision for loan losses	201	153
Gain on loans sold	(22)	-
Stock options and restricted stock expense	117	99
Proceeds from sale of loans held for resale	2,658	-
Originations of loans held for resale	(4,995)	(123)
Changes in assets and liabilities affecting cash flow:		
Other assets	327	(377)
Other liabilities	(592)	(1,069)
NET CASH (USED IN) PROVIDED BY OPERATING ACTIVITIES	$ (3)	$ 1,105

See Notes to Unaudited Consolidated Financial Statements

PART 1 – FINANCIAL INFORMATION

ITEM 1 – FINANCIAL STATEMENTS

EVANS BANCORP, INC. AND SUBSIDIARIES

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

THREE MONTHS ENDED MARCH 31, 2015 AND 2014

1. ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

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

The accompanying consolidated financial statements are unaudited. In the opinion of management, all adjustments necessary for a fair presentation of the Company’s financial position and results of operations for the interim periods have been made. During the three month period ended March 31, 2015, the Company revised the unaudited Consolidated Statement of Cash Flows for the three month period ended March 31, 2014 to correct errors of a $40 thousand increase within “Depreciation and amortization”, $236 thousand increase within “Change in other assets affecting cash flow”, and $276 thousand decrease within “Change in other liabilities affecting cash flow” line items. The Company has assessed the materiality of this correction and concluded, based on qualitative and quantitative considerations, in accordance with Staff Accounting Bulletin No. 99, that the adjustments were not material to our previously reported financial statements.

The results of operations for the three month periods ended March 31, 2015 are not necessarily indicative of the results to be expected for the full year. The accompanying unaudited consolidated financial statements should be read in conjunction with the Audited Consolidated Financial Statements and the Notes thereto included in our Annual Report on Form 10-K for the year ended December 31, 2014.

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2. SECURITIES

The amortized cost of securities and their approximate fair value at March 31, 2015 and December 31, 2014 were as follows:

	March 31, 2015 (in thousands)			
	Amortized	Unrealized		Fair
	Cost	Gains	Losses	Value
Available for Sale:				
Debt securities:				
U.S. government agencies	$ 26,593	$ 388	$ (122)	$ 26,859
States and political subdivisions	30,988	969	(28)	31,929
Total debt securities	$ 57,581	$ 1,357	$ (150)	$ 58,788
Mortgage-backed securities:				
FNMA	$ 14,101	$ 578	$ -	$ 14,679
FHLMC	5,620	131	(46)	5,705
GNMA	8,276	133	(9)	8,400
CMO	10,789	88	(56)	10,821
Total mortgage-backed securities	$ 38,786	$ 930	$ (111)	$ 39,605
Total securities designated as available for sale	$ 96,367	$ 2,287	$ (261)	$ 98,393
Held to Maturity:				
Debt securities				
States and political subdivisions	$ 1,588	$ 13	$ (25)	$ 1,576
Total securities designated as held to maturity	$ 1,588	$ 13	$ (25)	$ 1,576

	December 31, 2014 (in thousands)			
	Amortized	Unrealized		Fair
	Cost	Gains	Losses	Value

Available for Sale:				
Debt securities:				
U.S. government agencies	$ 26,687	$ 305	$ (275)	$ 26,717
States and political subdivisions	30,182	927	(49)	31,060
Total debt securities	$ 56,869	$ 1,232	$ (324)	$ 57,777
Mortgage-backed securities:				
FNMA	$ 14,653	$ 516	$ (15)	$ 15,154
FHLMC	5,901	121	(64)	5,958
GNMA	6,014	143	(27)	6,130
CMO	10,611	42	(139)	10,514
Total mortgage-backed securities	$ 37,179	$ 822	$ (245)	$ 37,756
Total securities designated as available for sale	$ 94,048	$ 2,054	$ (569)	$ 95,533
Held to Maturity:				
Debt securities				
States and political subdivisions	$ 1,599	$ 7	$ (32)	$ 1,574
Total securities designated as held to maturity	$ 1,599	$ 7	$ (32)	$ 1,574

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Available for sale securities with a total fair value of $85.6 million and $68.8 million at March 31, 2015 and December 31, 2014, respectively, were pledged as collateral to secure public deposits and for other purposes required or permitted by law.

The Company uses the Federal Home Loan Bank of New York (“FHLBNY”) as its primary source of overnight funds and also has several long-term advances with FHLBNY. The Company had no borrowed funds as of March 31, 2015, and had a total of $13.7 million in borrowed funds with FHLBNY at December 31, 2014. The Company has placed sufficient collateral in the form of residential and commercial real estate loans at FHLBNY that meet FHLB collateral requirements. As a member of the Federal Home Loan Bank (“FHLB”) System, the Bank is required to hold stock in FHLBNY. The Bank held $0.8 million and $1.4 million in FHLBNY stock as of March 31, 2015 and December 31, 2014 at amortized cost. The Company regularly evaluates investments in FHLBNY for impairment, considering liquidity, operating performance, capital position, stock repurchase and dividend history. At this time, the Company does not believe any impairment in FHLBNY stock is warranted.

The scheduled maturities of debt and mortgage-backed securities at March 31, 2015 and December 31, 2014 are summarized below. All maturity amounts are contractual maturities. Actual maturities may differ from contractual maturities because certain issuers have the right to call or prepay obligations with or without call premiums.

	March 31, 2015		December 31, 2014	
	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	$ 8,033	$ 8,084	$ 8,172	$ 8,256
Due after one year through five years	23,284	23,893	22,118	22,597
Due after five years through ten years	19,310	19,590	20,517	20,589
Due after ten years	6,954	7,221	6,062	6,335
	57,581	58,788	56,869	57,777
Mortgage-backed securities available for sale	38,786	39,605	37,179	37,756

Total available for sale securities	$ 96,367	$ 98,393	$ 94,048	$ 95,533
Debt securities held to maturity:				
Due in one year or less	$ 478	$ 478	$ 478	$ 477
Due after one year through five years	66	67	77	78
Due after five years through ten years	932	924	932	914
Due after ten years	112	107	112	105
	1,588	1,576	1,599	1,574
Total held to maturity securities	$ 1,588	$ 1,576	$ 1,599	$ 1,574

Information regarding unrealized losses within the Company's available for sale securities at March 31, 2015 and December 31, 2014 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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	March 31, 2015					
	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	$ 1,991	$ (9)	$ 5,887	$ (113)	$ 7,878	$ (122)
States and political subdivisions	1,989	(10)	1,130	(18)	3,119	(28)
Total debt securities	$ 3,980	$ (19)	$ 7,017	$ (131)	$ 10,997	$ (150)
Mortgage-backed securities:						
FNMA	$ -	$ -	$ - -	$ -	$ -	$ -
FHLMC	-	-	1,454	(46)	1,454	(46)
GNMA	1,207	(1)	795	(8)	2,002	(9)
CMO'S	1,670	(4)	4,232	(52)	5,902	(56)
Total mortgage-backed securities	$ 2,877	$ (5)	$ 6,481	$ (106)	$ 9,358	$ (111)
Held To Maturity:						
Debt securities:						
States and political subdivisions	$ 371	$ (1)	$ 473	$ (24)	$ 844	$ (25)
Total temporarily impaired securities	$ 7,228	$ (25)	$ 13,971	$ (261)	$ 21,199	$ (286)

December 31, 2014

	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	$ 3,906	$ (26)	$ 7,751	$ (249)	$ 11,657	$ (275)
States and political subdivisions	4,752	(9)	1,902	(40)	6,654	(49)
Total debt securities	$ 8,658	$ (35)	$ 9,653	$ (289)	$ 18,311	$ (324)
Mortgage-backed securities:						
FNMA	$ 1,498	$ (10)	$ 1,731	$ (5)	$ 3,229	$ (15)
FHLMC	-	-	1,482	(64)	1,482	(64)
GNMA	-	-	2,079	(27)	2,079	(27)
CMO'S	1,722	(11)	4,290	(128)	6,012	(139)
Total mortgage-backed securities	$ 3,220	$ (21)	$ 9,582	$ (224)	$ 12,802	$ (245)
Held To Maturity:						
Debt securities:						
States and political subdivisions	$ 371	$ (1)	$ 556	$ (31)	$ 927	$ (32)
Total temporarily impaired securities	$ 12,249	$ (57)	$ 19,791	$ (544)	$ 32,040	$ (601)

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Management has assessed the securities available for sale in an unrealized loss position at March 31, 2015 and December 31, 2014 and determined the decline in fair value below amortized cost to be temporary. In making this determination, management considered the period of time the securities were in a loss position, the percentage decline in comparison to the securities' amortized cost, and the financial condition of the issuer (primarily government or government-sponsored enterprises). In addition, management does not intend to sell these securities and it is not more likely than not that the Company will be required to sell these securities before recovery of their amortized cost. Management believes the decline in fair value is primarily related to market interest rate fluctuations and not to the credit deterioration of the individual issuers.

The Company had not recorded any other-than-temporary impairment ("OTTI") charges as of March 31, 2015 and did not record any OTTI charges during 2014. Nevertheless, it remains possible that there could be deterioration in the asset quality of the securities portfolio in the future. The credit worthiness of the Company's portfolio is largely reliant on the ability of U.S. government sponsored agencies such as FHLB, Federal National Mortgage Association ("FNMA"), Government National Mortgage Association ("GNMA"), and Federal Home Loan Mortgage Corporation ("FHLMC"), and municipalities throughout New York State to meet their obligations. In addition, dysfunctional markets could materially alter the liquidity, interest rate, and pricing risk of the portfolio. The relatively stable past performance is not a guarantee for similar performance of the Company's securities portfolio going forward.

3. FAIR VALUE MEASUREMENTS

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

There are three levels of inputs to fair value measurements:

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

Observable market data should be used when available.

FINANCIAL INSTRUMENTS MEASURED AT FAIR VALUE ON A RECURRING BASIS

The following table presents for each of the fair-value hierarchy levels as defined in this footnote, those financial instruments which are measured at fair value on a recurring basis at March 31, 2015 and December 31, 2014:

(in thousands)	Level 1	Level 2	Level 3	Fair Value
March 31, 2015				
Securities available-for-sale:				
U.S. government agencies	$ -	$ 26,859	$ -	$ 26,859
States and political subdivisions	-	31,929	-	31,929
Mortgage-backed securities	-	39,605	-	39,605
Mortgage servicing rights	-	-	497	497
December 31, 2014				
Securities available-for-sale:				
U.S. government agencies	$ -	$ 26,717	$ -	$ 26,717
States and political subdivisions	-	31,060	-	31,060
Mortgage-backed securities	-	37,756	-	37,756
Mortgage servicing rights	-	-	518	518

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Securities available for sale

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

Management believes that it has a sufficient understanding of the third party service's valuation models, assumptions and inputs used in determining the fair value of securities to enable management to maintain an appropriate system of internal control. On a quarterly basis, the Company reviews changes in the market value of its security portfolio. Individual changes in valuations are reviewed for consistency with general interest rate movements and any known credit concerns for specific securities. Additionally, on an annual basis, the Company has its entire security portfolio priced by a second pricing service to determine consistency with another market evaluator. If, on the Company's review or in comparing with another servicer, a material difference between pricing evaluations were to exist, the Company would submit an inquiry to the service provider regarding the data used to value a particular security.   If the Company determines it has market information that would support a different valuation than the initial evaluation it can submit a challenge for a change to that security's valuation. There were no material differences in valuations noted in the first quarter of 2015 or during fiscal year 2014.

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

Mortgage servicing rights

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

The following table summarizes the changes in fair value for mortgage servicing rights during the three month periods ended March 31, 2015 and 2014, respectively:

	Three months ended March 31,	
(in thousands)	2015	2014
Mortgage servicing rights - January 1	$ 518	$ 509
Gains (losses) included in earnings	(45)	(38)
Additions from loan sales	24	-
Mortgage servicing rights - March 31	$ 497	$ 471

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

	3/31/2015		12/31/2014	
Servicing fees	0.25	%	0.25	%
Discount rate	9.52	%	9.52	%
Prepayment rate (CPR)	9.80	%	9.28	%

FINANCIAL INSTRUMENTS MEASURED AT FAIR VALUE ON A NONRECURRING BASIS

The Company is required, on a nonrecurring basis, to adjust the carrying value of certain assets or provide valuation allowances related to certain assets using fair value measurements. The following table presents for each of the fair-value hierarchy levels as defined in this footnote, those financial instruments which are measured at fair value on a nonrecurring basis at March 31, 2015 and December 31, 2014:

(in thousands)	Level 1	Level 2	Level 3	Fair Value
March 31, 2015				
Impaired loans	$ -	-	14,569	$ 14,569
December 31, 2014				
Impaired loans	$ -	-	13,716	$ 13,716

Impaired loans

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

The Company has an appraisal policy in which appraisals are obtained upon a commercial loan being downgraded on the Company internal loan rating scale to a 5 (special mention) or a 6 (substandard) depending on the amount of the loan, the type of loan and the type of collateral. All impaired commercial loans are either graded a 6 or 7 on the internal loan rating scale. For consumer loans, the Company obtains appraisals when a loan becomes 90 days past due or is determined to be impaired, whichever occurs first. Subsequent to the downgrade or reaching 90 days past due, if the loan remains outstanding and impaired for at least one year more, management may require another follow-up appraisal. Between receipts of updated appraisals, if necessary, management may perform an internal valuation based on any known changing conditions in the marketplace such as sales of similar properties, a change in the condition of the collateral, or feedback from local appraisers. Impaired loans had a gross value of $15.7 million, with a valuation allowance of $1.2 million, at March 31, 2015, compared to a gross value for impaired loans of $15.0 million, with a valuation allowance of $1.3 million, at December 31, 2014.

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FAIR VALUE OF FINANCIAL INSTRUMENTS

At March 31, 2015 and December 31, 2014, the estimated fair values of the Company's financial instruments, including those that are not measured and reported at fair value on a recurring basis or nonrecurring basis, were as follows:

	March 31, 2015		December 31, 2014	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
	(in thousands)		(in thousands)	
Financial assets:				
Level 1:				
Cash and cash equivalents	$ 60,694	$ 60,694	$ 10,898	$ 10,898
Level 2:				
Available for sale securities	98,393	98,393	95,533	95,533
FHLB and FRB stock	2,308	2,308	2,925	2,925
Level 3:				
Held to maturity securities	1,588	1,576	1,599	1,574
Loans and leases, net	688,961	700,338	683,131	685,148
Mortgage servicing rights	497	497	518	518
Financial liabilities:				
Level 1:				
Demand deposits	$ 169,965	$ 169,965	$ 158,631	$ 158,631
NOW deposits	82,956	82,956	72,670	72,670
Regular savings deposits	416,317	416,317	363,542	363,542
Commitments to extend credit	93	93	245	245
Securities sold under agreement to repurchase	10,673	10,673	13,778	13,778
Level 2:				
Other borrowed funds	-	-	13,700	13,700
Junior subordinated debentures	11,330	11,330	11,330	11,330
Level 3:				
Time deposits	111,120	110,678	112,792	113,854

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

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

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

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

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

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

Junior Subordinated Debentures. There is no active market for the Company's debentures. The fair value of the junior subordinated debentures is determined using an expected prevent value technique. The fair value of the adjustable-rate debentures approximates their face amount.

Commitments to extend credit and standby letters of credit. As described in Note 8 - "Contingent Liabilities and Commitments" to these Unaudited Consolidated Financial Statements, the Company was a party to financial instruments with off-balance sheet risk at March 31, 2015 and December 31, 2014. Such financial instruments consist of commitments to extend permanent financing and letters of credit. If the options are exercised by the prospective borrowers, these financial instruments will become interest-earning assets of the Company. If the options expire, the Company retains any fees paid by the counterparty in order to obtain the commitment or guarantee. The fees collected for these commitments are recorded as “unearned commitment fees” in Other Liabilities. The carrying value approximates the fair value.

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

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

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4. LOANS AND THE ALLOWANCE FOR LOAN LOSSES

Loan Portfolio Composition

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

	March 31, 2015	December 31, 2014
Mortgage loans on real estate:	(in thousands)	
Residential Mortgages	$ 100,548	$ 98,374
Commercial and multi-family		