

CHEMUNG FINANCIAL CORP

Form 10-Q

November 07, 2013

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UNITED STATES SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON D.C. 20549

FORM 10-Q

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

For Quarterly period ended September 30, 2013

Or

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

Commission File No. 0-13888

CHEMUNG FINANCIAL CORPORATION  
(Exact name of registrant as specified in its charter)

New York  
(State or other jurisdiction of incorporation or organization)

16-1237038  
I.R.S. Employer Identification No.

One Chemung Canal Plaza, P.O. Box 1522, Elmira, NY  
(Address of principal executive offices)

14902  
(Zip Code)

(607) 737-3711 or (800) 836-3711  
(Registrant's telephone number, including area code)

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 definitions of "large accelerated filer", "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer

Non-accelerated filer

Accelerated filer

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:

The number of shares of the registrant's common stock, \$.01 par value, outstanding on November 6, 2013 was 4,594,315.



CHEMUNG FINANCIAL CORPORATION AND SUBSIDIARIES

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## PART I. FINANCIAL INFORMATION

## Item 1: Financial Statements-Unaudited

## CHEMUNG FINANCIAL CORPORATION AND SUBSIDIARIES

## CONSOLIDATED BALANCE SHEETS

(UNAUDITED)

	SEPTEMBER 30, 2013	DECEMBER 31, 2012
<b>ASSETS</b>		
Cash and due from financial institutions	\$ 37,490,812	\$ 29,239,309
Interest-bearing deposits in other financial institutions	2,438,437	11,001,912
Total cash and cash equivalents	39,929,249	40,241,221
Trading assets, at fair value	313,021	348,241
Securities available for sale, at estimated fair value	259,275,117	239,685,763
Securities held to maturity, estimated fair value of \$7,047,300 at September 30, 2013 and \$6,421,486 at December 31, 2012	6,543,785	5,748,453
Federal Home Loan Bank and Federal Reserve Bank		
Stock, at cost	6,724,950	4,710,300
Loans, net of deferred origination fees and costs, and unearned income	967,634,345	893,516,941
Allowance for loan losses	(11,855,971)	(10,432,650)
Loans, net	955,778,374	883,084,291
Loans held for sale	866,430	1,057,309
Premises and equipment, net	25,086,834	25,484,385
Goodwill	21,824,443	21,824,443
Other intangible assets, net	4,481,019	5,143,820
Bank owned life insurance	2,774,487	2,711,681
Accrued interest receivable and other assets	17,493,059	18,119,801
Total assets	\$ 1,341,090,768	\$ 1,248,159,708
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
<b>Deposits:</b>		
Non-interest-bearing	\$ 297,053,277	\$ 300,610,463
Interest-bearing	791,392,176	744,123,551

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Total deposits	1,088,445,453	1,044,734,014
Securities sold under agreements to repurchase	30,499,228	32,710,650
Federal Home Loan Bank overnight advances	49,100,000	-
Federal Home Loan Bank term advances	26,045,925	27,225,363
Accrued interest payable and other liabilities	12,194,266	12,374,744
Total liabilities	1,206,284,872	1,117,044,771
Shareholders' equity:		
Common stock, \$.01 par value per share, 10,000,000 shares authorized; 5,310,076 issued at September 30, 2013 and December 31, 2012	53,101	53,101
Additional-paid-in capital	45,555,333	45,357,073
Retained earnings	110,740,100	107,078,182
Treasury stock, at cost (715,761 shares at September 30, 2013, 728,680 shares at December 31, 2012)	(18,265,940)	(18,566,490)
Accumulated other comprehensive loss	(3,276,698)	(2,806,929)
Total shareholders' equity	134,805,896	131,114,937
Total liabilities and shareholders' equity	1,341,090,768	\$ 1,248,159,708

See accompanying notes to unaudited consolidated financial statements.

CHEMUNG FINANCIAL CORPORATION AND SUBSIDIARIES  
CONSOLIDATED STATEMENTS OF INCOME  
(UNAUDITED)

	Nine Months Ended		Three Months Ended	
	September 30,	September 30,	September 30,	September 30
	2013	2012	2013	2012
Interest and dividend income:				
Loans, including fees	\$33,605,486	\$34,078,132	\$11,245,062	\$11,373,583
Taxable securities	3,120,023	4,142,224	1,002,968	1,306,484
Tax exempt securities	844,736	976,622	258,478	300,374
Interest-bearing deposits	20,539	122,693	2,848	34,573
Total interest and dividend income	37,590,784	39,319,671	12,509,356	13,015,014
Interest expense:				
Deposits	1,790,994	2,486,771	572,385	759,778
Securities sold under agreements to repurchase	644,602	763,343	213,800	231,043
Borrowed funds	593,798	868,131	206,520	234,155
Total interest expense	3,029,394	4,118,245	992,705	1,224,976
Net interest income	34,561,390	35,201,426	11,516,651	11,790,038
Provision for loan losses	1,755,188	753,897	873,704	225,000
Net interest income after provision for loan losses	32,806,202	34,447,529	10,642,947	11,565,038
Other operating income:				
Wealth management group fee income	5,448,240	5,170,016	1,813,113	1,667,628
Service charges on deposit accounts	3,377,489	3,143,061	1,222,445	1,110,897
Net gain on securities transactions	1,228	300,516	-	597
Net gain on sales of loans held for sale	424,867	270,265	133,698	125,885

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Casualty gains	-	790,248	-	9,813
Net gains (losses) on sales of other real estate owned	33,448	(72,004)	17,452	(67,503)
Income from bank owned life insurance	62,806	64,840	21,120	21,571
Other	3,499,290	3,328,328	1,142,825	1,123,831
Total other operating income	12,847,368	12,995,270	4,350,653	3,992,719
Other operating expenses:				
Salaries and wages	14,138,310	13,710,584	4,721,318	4,661,858
Pension and other employee benefits	4,161,178	4,137,878	1,372,179	1,381,401
Net occupancy expenses	4,016,094	3,849,173	1,315,098	1,269,165
Furniture and equipment expenses	1,599,896	1,599,842	514,369	503,995
Data processing expense	3,432,772	3,279,379	1,192,035	971,601
Professional services	713,039	694,756	187,571	185,619
Amortization of intangible assets	662,801	808,258	213,723	260,069
Marketing and advertising expense	781,804	915,632	296,947	270,567
Other real estate owned expenses	137,844	286,137	75,476	154,238
FDIC insurance	625,216	615,360	205,845	205,317
Merger and acquisition related expenses	216,968	30,145	216,968	21,600
Loan expense	537,592	548,165	202,474	223,120
Other	3,905,449	3,677,793	1,298,699	1,231,911
Total other operating expenses	34,928,963	34,153,102	11,812,702	11,340,461
Income before income tax expense	10,724,607	13,289,697	3,180,898	4,217,296
Income tax expense	3,479,062	4,397,279	1,001,728	1,383,451
Net income	\$ 7,245,545	\$ 8,892,418	\$ 2,179,170	\$ 2,833,845
Weighted average shares outstanding	4,658,199	4,639,985	4,660,336	4,641,547
Basic and diluted earnings per share	\$ 1.56	\$ 1.92	\$ 0.47	\$ 0.61

See accompanying notes to unaudited consolidated financial statements.





CHEMUNG FINANCIAL CORPORATION AND SUBSIDIARIES  
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME  
(UNAUDITED)

	Nine Months Ended September 30,		Three Months Ended September 30,	
	2013	2012	2013	2012
Net income	\$ 7,245,545	\$ 8,892,418	\$2,179,170	\$2,833,845
Other comprehensive income				
Unrealized holding (losses) gains on securities available for sale	(1,900,709)	1,633,195	1,403,995	959,668
Reclassification adjustment gains realized in net income	(1,228)	(300,516)	-	(597)
Net unrealized (losses) gains	(1,901,937)	1,332,679	1,403,995	959,071
Tax effect	(731,105)	544,460	539,696	368,668
Net of tax amount	(1,170,832)	788,219	864,299	590,403
Change in funded status of defined benefit pension plan and other benefit plans				
Reclassification adjustment for amortization of prior service costs	(62,358)	(62,358)	(20,786)	(20,786)
Reclassification adjustment for amortization of net actuarial loss	1,201,594	1,006,644	400,508	335,548
Total before tax effect	1,139,236	944,286	379,722	314,762
Tax effect	438,173	362,982	145,672	120,994
Net of tax amount	701,063	581,304	234,050	193,768
Total other comprehensive (loss) income	(469,769)	1,369,523	1,098,349	784,171
Comprehensive income	\$ 6,775,776	\$10,261,941	\$3,277,519	\$3,618,016

See accompanying notes to unaudited consolidated financial statements.



CHEMUNG FINANCIAL CORPORATION AND SUBSIDIARIES  
CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY  
(UNAUDITED)

	Common Stock	Additional Paid-in Capital	Retained Earnings	Treasury Stock	Accumulated Other Comprehensive Income (Loss)	Total
Balances at December 31, 2011	\$ 53,101	\$ 45,582,861	\$ 100,628,900	\$ (18,894,044)	\$ (1,441,378)	\$ 125,929,440
Net income	-	-	8,892,418	-	-	8,892,418
Other comprehensive income	-	-	-	-	1,369,523	1,369,523
Restricted stock awards	-	61,062	-	-	-	61,062
Restricted stock units for directors' deferred compensation plan	-	65,151	-	-	-	65,151
Cash dividends declared (\$.75 per share)	-	-	(3,429,775)	-	-	(3,429,775)
Distribution of 10,238 shares of treasury stock for directors' compensation	-	(28,121)	-	261,069	-	232,948
Distribution of 3,453 shares of treasury stock for employee compensation	-	(8,052)	-	88,052	-	80,000
Distribution of 3,240 shares of treasury stock for deferred directors' compensation	-	(81,747)	-	82,588	-	841
Distribution of 2,095 shares of treasury stock for employee restricted stock awards	-	(53,412)	-	53,412	-	-
	-	-	-	(579,051)	-	(579,051)

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Purchase of 23,120 shares of treasury stock						
Sale of 10,100 shares of treasury stock	-	101	-	257,449		257,550
Balances at September 30, 2012	\$ 53,101	\$ 45,537,843	\$ 106,091,543	\$ (18,730,525)	\$ (71,855)	\$ 132,880,107
Balances at December 31, 2012	\$ 53,101	\$ 45,357,073	\$ 107,078,182	\$ (18,566,490)	\$ (2,806,929)	\$ 131,114,937
Net income	-	-	7,245,545	-	-	7,245,545
Other comprehensive income	-	-	-	-	(469,769)	(469,769)
Restricted stock awards	-	106,326	-	-	-	106,326
Restricted stock units for directors' deferred compensation plan	-	74,180	-	-	-	74,180
Cash dividends declared (\$.78 per share)	-	-	(3,583,627)	-	-	(3,583,627)
Distribution of 7,969 shares of treasury stock for directors' compensation	-	13,896	-	203,050	-	216,946
Distribution of 3,356 shares of treasury stock for directors' compensation	-	(74,623)	-	85,577	-	10,954
Distribution of 4,116 shares of treasury stock for employee compensation	-	7,278	-	104,876	-	112,154
Purchase of 3,094 shares of treasury stock	-	-	-	(92,630)	-	(92,630)
Sale of 2,369 shares of treasury stock	-	10,518	-	60,362	-	70,880
	-	60,685	-	(60,685)		-

Forfeit 1,797  
shares of  
restricted stock  
awards

Balances at September 30, 2013	\$ 53,101	\$ 45,555,333	\$ 110,740,100	\$ (18,265,940)	\$ (3,276,698)	\$ 134,805,896
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See accompanying notes to unaudited consolidated financial statements.

CHEMUNG FINANCIAL CORPORATION AND SUBSIDIARIES  
CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)  
NINE MONTHS ENDED  
SEPTEMBER 30,

CASH FLOWS FROM OPERATING ACTIVITIES:	2013	2012
Net income	\$ 7,245,545	\$ 8,892,418
Adjustments to reconcile net income to net cash provided by operating activities:		
Amortization of intangible assets	662,801	808,258
Provision for loan losses	1,755,188	753,897
Depreciation and amortization of fixed assets	2,232,587	2,187,234
Amortization of premiums on securities, net	1,692,700	1,343,743
Gains on sales of loans held for sale, net	(424,867)	(270,265)
Proceeds from sales of loans held for sale	15,382,872	8,992,854
Loans originated and held for sale	(14,767,126)	(9,491,912)
Net gains on trading assets	(26,666)	(28,261)
Net gains on securities transactions	(1,228)	(300,516)
Proceeds from sales of trading assets	111,541	96,498
Purchase of trading assets	(49,655)	(48,851)
Net (gains) losses on sale of other real estate owned	(33,448)	72,004
(Increase) decrease in other assets	(1,343,566)	4,294,238
Decrease in prepaid FDIC assessment	1,969,526	559,406
Decrease in accrued interest payable	(113,986)	(337,246)
Expense related to restricted stock units for directors' deferred compensation plan	74,180	65,151
Expense related to employee stock compensation	112,154	80,000
Expense related to employee stock awards	106,326	61,062
Increase (decrease) in other liabilities	409,573	(820,424)
Income from bank owned life insurance	(62,806)	(64,840)
Net cash provided by operating activities	14,931,645	16,844,448

**CASH FLOWS FROM  
INVESTING ACTIVITIES:**

Proceeds from sales and calls of securities available for sale	10,533,633	70,370,086
Proceeds from maturities and principal collected on securities available for sale	36,204,217	21,396,640
Proceeds from maturities and principal collected on securities held to maturity	5,378,939	3,731,924
Purchases of securities available for sale	(69,920,613)	(64,276,418)
Purchases of securities held to maturity	(6,174,271)	(1,582,507)
Purchase of Federal Home Loan Bank and Federal Reserve Bank stock	(8,915,350)	(26,250)
Redemption of Federal Home Loan Bank and Federal Reserve Bank stock	6,900,700	775,100
Purchases of premises and equipment	(1,835,036)	(2,287,654)
Proceeds from sales of other real estate owned	137,200	294,229
Net increase in loans	(74,552,241)	(78,356,344)
Net cash used by investing activities	(102,242,822)	(49,961,194)

**CASH FLOWS FROM  
FINANCING ACTIVITIES:**

Net increase in demand deposits, interest-bearing demand accounts, savings accounts, and insured money market accounts	58,463,290	112,724,881
Net decrease in time deposits	(14,751,851)	(28,042,200)
Net decrease in securities sold under agreements to repurchase	(2,211,422)	(4,189,186)
Increase of Federal Home Loan Bank overnight advances	49,100,000	-
Repayments of Federal Home Loan Bank long term advances	(1,179,438)	(15,298,177)
Purchase of treasury stock	(92,630)	(579,051)
Sale of treasury stock	60,362	257,449
Cash dividends paid	(2,389,106)	(3,427,087)
Net cash provided by financing activities	86,999,205	61,446,629
Net (decrease) increase in cash and cash equivalents	(311,972)	28,329,883
	40,241,221	52,901,853



Cash and cash equivalents, beginning of period		
Cash and cash equivalents, end of period	\$ 39,929,249	\$ 81,231,736

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(continued)

Supplemental disclosure of cash  
flow information:

## Cash paid during the year for:

Interest	\$3,143,380	\$4,501,350
Income Taxes	\$4,310,174	\$ 3,500

Supplemental disclosure of  
non-cash activity:

Transfer of loans to other real estate owned	\$ 102,970	\$ 512,686
Dividends declared, not yet paid	\$1,194,521	\$1,143,770

See accompanying notes to  
unaudited consolidated financial  
statements.

CHEMUNG FINANCIAL CORPORATION AND SUBSIDIARIES  
NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1                      SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

To assist the reader, the Corporation has provided the following list of commonly used acronyms and abbreviations included in the Notes to Unaudited Consolidated Financial Statements.

FASB: Financial Accounting Standards Board	OTTI: Other-than-temporary impairment
FDIC: Federal Deposit Insurance Corporation	PCI: Purchased credit impaired
FHLB: Federal Home Loan Bank	SEC: Securities and Exchange Commission
GAAP: U.S. generally accepted accounting principles	CDO: Collateralized Debt Obligation

#### Organization and Principles of Consolidation

Chemung Financial Corporation (the “Corporation”) is a bank holding company headquartered in Elmira, New York. The Corporation provides a wide range of financial and fiduciary services through its wholly-owned subsidiaries, Chemung Canal Trust Company (the “Bank”), a state chartered bank, and CFS Group, Inc., a non-bank financial services company. The Corporation and the Bank are subject to the regulation of certain federal and state agencies and undergo periodic examinations by those regulatory authorities. The unaudited consolidated financial statements include the accounts of the Corporation, the Bank and CFS Group, Inc. All significant intercompany accounts and transactions have been eliminated in consolidation. Certain reclassifications of prior period amounts have been made to conform with the current period presentation. These reclassifications had no impact on previously reported net income.

#### Basis of Presentation

The unaudited consolidated financial statements have been prepared pursuant to the rules and regulations of the SEC in Article 10 of Regulation S-X and in accordance with the instructions to Form 10-Q and GAAP for interim financial information. Certain information, accounting policies and footnote disclosures normally included in complete financial statements prepared in accordance with GAAP have been condensed or omitted in accordance with such rules and regulations. These unaudited consolidated financial statements should be read in conjunction with the audited consolidated financial statements and notes thereto included in the Corporation’s annual report on Form 10-K for the year ended December 31, 2012.

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the amounts reported in the unaudited consolidated financial statements and accompanying notes. Primary areas involving the use of estimates and assumptions include the allowance for loan losses, other-than-temporary impairment of securities, the carrying amount of goodwill and the amortization of other intangible assets. Actual results could differ from those estimates. In the opinion of management, all adjustments considered necessary, consisting of normal recurring items, have been included for a fair presentation of the accompanying unaudited consolidated financial statements. Operating results for the three and nine months ended September 30, 2013 are not necessarily indicative of the results that may be expected for the full year or

future periods.

#### Subsequent Events

The Corporation has evaluated events and transactions through the time the unaudited consolidated financial statements were issued. Financial statements are considered issued when they are widely distributed to all shareholders and other financial statement users, or filed with the SEC. In conjunction with applicable accounting standards, all material subsequent events have been either recognized in the unaudited consolidated financial statements or disclosed in the notes to the unaudited consolidated financial statements.

## NOTE 2 EARNING PER COMMON SHARE

Basic earnings per share is net income divided by the weighted average number of common shares outstanding during the period. Issuable shares, including those related to directors' restricted stock units and directors' stock compensation, are considered outstanding and are included in the computation of basic earnings per share. All outstanding unvested share based payment awards that contain rights to nonforfeitable dividends are considered participating securities for this calculation. Restricted stock awards are grants of participating securities. The impact of the participating securities on earnings per share is not material. Earnings per share information is adjusted to present comparative results for stock splits and stock dividends that occur. Earnings per share were computed by dividing net income by 4,658,199 and 4,639,985 weighted average shares outstanding for the nine-month periods ended September 30, 2013 and 2012, and 4,660,336 and 4,641,547 weighted average shares outstanding for the three-month periods ended September 30, 2013 and 2012, respectively. There were no dilutive common stock equivalents during the three or nine-month periods ended September 30, 2013 or 2012.

## NOTE 3 ADOPTION OF NEW ACCOUNTING STANDARDS

In February 2013, the FASB issued Accounting Standards Update ("ASU") No. 2013-02, "Comprehensive Income (Topic 220) – Reporting of Amounts Reclassified Out of Accumulated Other Comprehensive Income." ASU 2013-02 amends recent guidance related to the reporting of comprehensive income to enhance the transparency of the reporting of reclassifications out of accumulated other comprehensive income. ASU 2013-02 became effective for the Corporation on January 1, 2013 and did not have a material impact on the Corporation's financial statements. The additional disclosures are included in Note 8 Accumulated Other Comprehensive Income or Loss.

## NOTE 4 SECURITIES

Amortized cost and estimated fair value of securities available for sale are as follows:

	September 30, 2013			
	Amortized Cost	Unrealized Gains	Unrealized Losses	Estimated Fair Value
Obligations of U.S. Government and U.S. Government sponsored enterprises	\$ 162,811,654	\$ 2,249,365	\$ 431,143	\$ 164,629,876
Mortgage-backed securities, residential	37,566,626	1,466,571	210	39,032,987
Collateralized mortgage obligations	1,475,620	25,081	-	1,500,701
Obligations of states and political	34,172,574	1,066,825	4,862	35,234,537

## subdivisions

Corporate bonds and notes	7,389,928	105,671	11,266	7,484,333
SBA loan pools	1,512,692	27,582	-	1,540,274
Trust Preferred securities	2,525,133	141,392	114,725	2,551,800
Corporate stocks	690,354	6,612,224	1,969	7,300,609
Total	\$ 248,144,581	\$ 11,694,711	\$ 564,175	\$ 259,275,117

	Amortized Cost	December 31, 2012 Unrealized Gains	Unrealized Losses	Estimated Fair Value
Obligations of U.S. Government and U.S. Government sponsored enterprises	\$ 138,041,393	\$ 3,549,821	\$ -	\$ 141,591,214
Mortgage-backed securities, residential	29,591,883	1,923,366	-	31,515,249
Collateralized mortgage obligations	3,494,642	48,718	-	3,543,360
Obligations of states and political subdivisions	39,174,595	1,641,510	1,383	40,814,722
Corporate bonds and notes	11,412,167	239,468	-	11,651,635
SBA loan pools	1,682,736	41,404	-	1,724,140
Trust preferred securities	2,519,379	134,959	183,425	2,470,913
Corporate stocks	736,495	5,645,753	7,718	6,374,530
Total	\$ 226,653,290	\$ 13,224,999	\$ 192,526	\$ 239,685,763

Amortized cost and estimated fair value of securities held to maturity are as follows:

	September 30, 2013			
	Amortized Cost	Unrealized Gains	Unrealized Losses	Estimated Fair Value
Obligations of states and political subdivisions	\$ 5,523,105	\$ 484,520	\$ -	\$ 6,007,625
Time deposits with other financial institutions	1,020,680	18,995	-	1,039,675
<b>Total</b>	<b>\$ 6,543,785</b>	<b>\$ 503,515</b>	<b>\$ -</b>	<b>\$ 7,047,300</b>

	December 31, 2012			
	Amortized Cost	Unrealized Gains	Unrealized Losses	Estimated Fair Value
Obligations of states and political subdivisions	\$ 5,748,453	\$ 673,033	\$ -	\$ 6,421,486

The amortized cost and estimated fair value of debt securities are shown below by expected maturity. Expected maturities may differ from contractual maturities if borrowers have the right to call or prepay obligations with or without call or prepayment penalties. Securities not due at a single maturity date are shown separately:

	September 30, 2013			
	Available for Sale		Held to Maturity	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
Within One Year	\$ 32,358,309	\$ 32,675,479	\$ 2,086,483	\$ 2,124,736
After One, But Within Five Years	157,176,957	159,943,408	3,069,714	3,305,202
After Five, But Within Ten Years	16,734,998	16,767,359	1,387,588	1,617,362
After Ten Years	629,025	514,300	-	-
	<b>206,899,289</b>	<b>209,900,546</b>	<b>6,543,785</b>	<b>7,047,300</b>
Mortgage-backed securities, residential	37,566,626	39,032,987		
Collateralized mortgage obligations	1,475,620	1,500,701		

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SBA loan pools	1,512,692	1,540,274		
Total	\$ 247,454,227	\$ 251,974,508	\$ 6,543,785	\$ 7,047,300

The proceeds from sales and calls of securities resulting in gains or losses at September 30, 2013 and September 30, 2012 are listed below:

	2013	2012
Proceeds	\$ 10,533,633	\$ 70,370,086
Gross gains \$	1,228	\$ 300,516
Gross losses	\$ -	\$ -
Tax expense	\$ 472	\$ 115,518

The following tables summarize the investment securities available for sale with unrealized losses at September 30, 2013 and December 31, 2012 by aggregated major security type and length of time in a continuous unrealized loss position:

September 30, 2013	Less than 12 months		12 months or longer		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Obligations of U.S. Government and U.S. Government sponsored Enterprises	\$ 61,924,270	\$ 431,143	\$ -	\$ -	\$ 61,924,270	\$ 431,143
Mortgage-backed securities, residential	113,804	210	-	-	113,804	210
Obligations of states and political subdivisions	1,003,268	4,579	250,635	283	1,253,903	4,862
Corporate bonds	2,735,068	11,266	-	-	2,735,068	11,266
Trust preferred securities	-	-	514,300	114,725	514,300	114,725
Corporate stocks	-	-	1,668	1,969	1,668	1,969
Total temporarily impaired securities	\$ 65,776,410	\$ 447,198	\$ 766,603	\$ 116,977	\$ 66,543,013	\$ 564,175



December 31, 2012	Less than 12 months		12 months or longer		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Obligations of states and political subdivisions	\$ -	\$ -	\$430,166	\$ 1,383	\$430,166	\$ 1,383
Trust preferred securities	-	-	445,600	183,425	445,600	183,425
Corporate stocks	-	-	45,912	7,718	45,912	7,718
Total temporarily impaired securities	\$ -	\$ -	\$921,678	\$192,526	\$921,678	\$192,526

#### Other-Than-Temporary Impairment

As of September 30, 2013, the majority of the Corporation's unrealized losses in the investment securities portfolio related to obligations of U.S. Government and U.S. Government sponsored enterprises. Because the decline in fair value is attributable to changes in interest rates and not credit quality, and because the Corporation does not have the intent to sell these securities and it is likely that it will not be required to sell these securities before their anticipated recovery, the Corporation does not consider these securities to be other-than-temporarily impaired at September 30, 2013.

As of September 30, 2013, \$114,725 of the Corporation's unrealized losses in the investment securities portfolio related to a CDO consisting of a pool of trust preferred securities. The decline in fair value on this security is primarily attributable to the financial crisis and resulting credit deterioration and financial condition of the underlying issuers, all of which are financial institutions. This deterioration may affect the future receipt of both principal and interest payments on this security. This fact combined with the current illiquidity in the market makes it unlikely that the Corporation would be able to recover its investment in this security if it was sold at this time.

Our analysis of this investment includes a \$629,025 amortized cost of a CDO consisting of a pool of trust preferred securities. This security was rated high quality at inception, but at September 30, 2013 Moody's rated this security as Caa3, which is defined as substantial risk of default. The Corporation uses the OTTI evaluation model to compare the present value of expected cash flows to the previous estimate to determine if there are adverse changes in cash flows during each quarter. The OTTI model considers the structure and term of the CDO and the financial condition of the underlying issuers. Specifically, the model details interest rates, principal balances of note classes and underlying issuers, the timing and amount of interest and principal payments of the underlying issuers, and the allocation of the payments to the note classes. The current estimate of expected cash flows is based on the most recent trustee reports and any other relevant market information including

announcements of interest payment deferrals or defaults of underlying trust preferred securities. Assumptions used in the model include expected future default rates and prepayments. We assume no recoveries on defaults and treat all interest payment deferrals as defaults.

Upon completion of the September 30, 2013 analysis, our model indicated no additional OTTI on this CDO. This security remained classified as available for sale and quarterly interest payments continue to be made.

When conducting the September 30, 2013 analysis, the present value of expected future cash flows using a discount rate equal to the yield in effect at the time of purchase was compared to the previous quarters' analysis. The analysis indicated no further decline in value attributed to credit related factors stemming from further deterioration in the underlying collateral payment streams. Additionally, to estimate fair value the present value of the expected future cash flows was calculated using a current estimated discount rate that a willing market participant might use to value the security based on current market conditions and interest rates. Changes in credit quality may or may not correlate to changes in the overall fair value of the impaired securities as the change in credit quality is only one component in assessing the overall fair value of the impaired securities. Therefore, the recognition of additional credit related OTTI could result in a gain reported in other comprehensive income. Total OTTI recognized in accumulated other comprehensive income was \$74,482 and \$117,118, net of tax for securities available for sale at September 30, 2013 and December 31, 2012, respectively.

The tables below present a roll forward of the cumulative credit losses recognized in earnings for the three and nine-month periods ending September 30, 2013 and 2012:

	2013	2012
Beginning balance, January 1,	\$ 3,506,073	\$ 3,506,073
Amounts related to credit loss for which an other-than-temporary impairment was not previously recognized	-	-
Additions/Subtractions:		
Amounts realized for securities sold during the period	-	-
Amounts related to securities for which the company intends to sell or that it will be more likely than not that the company will be required to sell prior to recovery of amortized cost basis	-	-
Reductions for increase in cash flows expected to be collected that are recognized over the remaining life of the security	-	-
Increases to the amount related to the credit loss for which other-than-temporary impairment was previously recognized	-	-
Ending balance, September 30,	\$ 3,506,073	\$ 3,506,073

Beginning balance, July 1,	\$ 3,506,073	\$ 3,506,073
Amounts related to credit loss for which an other-than-temporary impairment was not previously recognized	-	-
Additions/Subtractions:		
Amounts realized for securities sold during the period	-	-
Amounts related to securities for which the company intends to sell or that it will be more likely than not that the company will be required to sell prior to recovery of amortized cost basis	-	-
Reductions for increase in cash flows expected to be collected that are recognized over the remaining life of the security	-	-

Increases to the amount related to the credit loss for which other-than-temporary impairment was previously recognized	-	-
Ending balance, September 30,	\$ 3,506,073	\$ 3,506,073

#### NOTE 5 LOANS AND ALLOWANCE FOR LOAN LOSSES

The composition of the loan portfolio, net of deferred origination fees and cost, and unearned income is summarized as follows:

	September 30, 2013	December 31, 2012
Commercial and agricultural:		
Commercial and industrial	\$ 140,152,331	\$ 133,154,615
Agricultural	623,656	696,666
Commercial mortgages:		
Construction	21,752,696	43,269,303
Commercial mortgages	338,428,531	276,928,123
Residential mortgages	194,042,042	200,475,097
Consumer loans:		
Credit cards	1,682,987	1,851,145
Home equity lines and loans	93,416,651	87,045,421
Indirect consumer loans	157,257,713	130,573,200
Direct consumer loans	20,277,738	19,523,371
Total loans, net of deferred origination fees and costs, and unearned income	\$ 967,634,345	\$ 893,516,941
Interest receivable on loans	2,260,266	2,383,998
Total recorded investment in loans	\$ 969,894,611	\$ 895,900,939

The Corporation's concentrations of credit risk by loan type are reflected in the preceding table. The concentrations of credit risk with standby letters of credit, committed lines of credit and commitments to originate new loans generally follow the loan classifications in the table above.

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The following tables present the activity in the allowance for loan losses by portfolio segment for the three and nine-month periods ending September 30, 2013 and 2012:

Nine Months Ended September 30, 2013						
Allowance for loan losses	Commercial and Agricultural	Commercial Mortgages	Residential Mortgages	Consumer Loans	Unallocated	Total
Beginning balance:	\$ 1,707,596	\$ 4,427,698	\$ 1,565,571	\$ 2,705,639	\$ 26,146	\$ 10,432,650
Charge						
Offs:	(186,045)	(44,049)	(53,753)	(909,414)	-	(1,193,261)
Recoveries:	453,461	53,402	65,124	289,407	-	861,394
Net recoveries (charge offs)	267,416	9,353	11,371	(620,007)	-	(331,867)
Provision	82,523	976,409	(25,311)	747,713	(26,146)	1,755,188
Ending balance	\$ 2,057,535	\$ 5,413,460	\$ 1,551,631	\$ 2,833,345	\$ -	\$ 11,855,971

Nine Months Ended September 30, 2012						
Allowance for loan losses	Commercial and Agricultural	Commercial Mortgages	Residential Mortgages	Consumer Loans	Unallocated	Total
Beginning balance:	\$ 3,143,372	\$ 2,570,149	\$ 1,309,649	\$ 2,192,729	\$ 443,420	\$ 9,659,319
Reclassification of acquired loan discount	73,227	50,332	-	-	-	123,559
Charge Offs:	(5,792)	(88,371)	(82,442)	(342,867)	-	(519,472)
Recoveries:	591,498	43,031	-	176,139	-	810,668
Net recoveries (charge-offs)	585,706	(45,340)	(82,442)	(166,728)	-	291,196
Provision	(1,165,842)	769,461	232,793	884,943	32,542	753,897
Ending balance	\$ 2,636,463	\$ 3,344,602	\$ 1,460,000	\$ 2,910,944	\$ 475,962	\$ 10,827,971

Three Months Ended September 30, 2013						
Allowance for loan losses	Commercial and Agricultural	Commercial Mortgages	Residential Mortgages	Consumer Loans	Unallocated	Total
Beginning balance:	\$ 1,878,697	\$ 5,134,410	\$ 1,515,424	\$ 2,791,694	\$ -	\$ 11,320,225
Charge Offs:	(167,570)	(44,049)	-	(511,631)	-	(723,250)

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Recoveries:	158,765	34,126	26,514	165,887	-	385,292
Net recoveries (charge offs)	(8,805)	(9,923)	26,514	(345,744)	-	(337,958)
Provision	187,643	288,973	9,693	387,395	-	873,704
Ending balance	\$ 2,057,535	\$ 5,413,460	\$ 1,551,631	\$ 2,833,345	\$-	\$ 11,855,971

Three Months Ended  
September 30, 2012

Allowance for loan losses	Commercial and Agricultural	Commercial Mortgages	Residential Mortgages	Consumer Loans	Unallocated	Total
Beginning balance:	\$ 3,004,211	\$ 3,075,712	\$ 1,424,816	\$ 2,474,185	\$ 413,648	\$ 10,392,572
Charge Offs:	-	(31,019)	(9,829)	(69,439)	-	(110,287)
Recoveries:	239,735	12,535	-	68,416	-	320,686
Net recoveries (charge offs)	239,735	(18,484)	(9,829)	(1,023)	-	210,399
Provision	(607,483)	287,374	45,013	437,782	62,314	225,000
Ending balance	\$ 2,636,463	\$ 3,344,602	\$ 1,460,000	\$ 2,910,944	\$ 475,962	\$ 10,827,971

The following tables present the balance in the allowance for loan losses and the recorded investment in loans by portfolio segment and based on impairment method as of September 30, 2013 and December 31, 2012:

	September 30, 2013					
Allowance for loan losses	Commercial and Agricultural	Commercial Mortgages	Residential Mortgages	Consumer Loans	Unallocated	Total
Ending allowance balance attributable to loans:						
Individually evaluated for impairment	\$ 592,108	\$ 485,209	\$ -	\$ 4,020	\$ -	\$ 1,081,337
Collectively evaluated for impairment	1,465,427	4,062,647	1,531,953	2,829,325	-	9,889,352
Acquired with deteriorated credit quality	-	865,604	19,678	-	-	885,282
Total ending allowance balance	\$ 2,057,535	\$ 5,413,460	\$ 1,551,631	\$ 2,833,345	\$ -	\$ 11,855,971

	December 31, 2012					
Allowance for loan losses	Commercial and Agricultural	Commercial Mortgages	Residential Mortgages	Consumer Loans	Unallocated	Total
Ending allowance balance attributable to loans:						
Individually evaluated for impairment	\$ 133,437	\$ 59,201	\$ -	\$ -	\$ -	\$ 192,638
Collectively evaluated for impairment	1,459,432	3,533,365	1,565,571	2,705,639	26,146	9,290,153
Acquired with deteriorated credit quality	114,727	835,132	-	-	-	949,859
Total ending allowance balance	\$ 1,707,596	\$ 4,427,698	\$ 1,565,571	\$ 2,705,639	\$ 26,146	\$ 10,432,650

	September 30, 2013				
Loans:	Commercial and Agricultural	Commercial Mortgages	Residential Mortgages	Consumer Loans	Total

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Loans individually evaluated for impairment	\$ 2,608,351	\$ 9,002,624	\$ 121,527	\$ 132,533	\$ 11,865,035
Loans collectively evaluated for impairment	137,775,852	343,187,539	194,172,367	273,149,608	948,285,366
Loans acquired with deteriorated credit quality	702,070	8,784,945	257,195	-	9,744,210
Total ending loans balance	\$ 141,086,273	\$ 360,975,108	\$ 194,551,089	\$ 273,282,141	\$ 969,894,611

December 31, 2012

Loans:	Commercial and Agricultural	Commercial Mortgages	Residential Mortgages	Consumer Loans	Total
Loans individually evaluated for impairment	\$ 1,907,395	\$ 10,620,274	\$ 131,909	\$ -	\$ 12,659,578
Loans collectively evaluated for impairment	131,045,609	301,172,164	200,622,600	239,689,455	872,529,828
Loans acquired with deteriorated credit quality	1,241,418	9,225,847	244,268	-	10,711,533
Total ending loans balance	\$ 134,194,422	\$ 321,018,285	\$ 200,998,777	\$ 239,689,455	\$ 895,900,939



The following tables present loans individually evaluated for impairment recognized by class of loans as of September 30, 2013 and December 31, 2012, the average recorded investment and interest income recognized by class of loans as of the three and nine-month periods ended September 30, 2013 and 2012:

With no related allowance recorded: Commercial and agricultural:	September 30, 2013			December 31, 2012		
	Unpaid Principal Balance	Recorded Investment	Allowance for Loan Losses Allocated	Unpaid Principal Balance	Recorded Investment	Allowance for Loan Losses Allocated
Commercial & industrial	\$ 1,542,743	\$ 1,543,755	\$ -	\$ 2,059,027	\$ 1,462,157	\$ -
Commercial mortgages:						
Construction	2,008,009	1,998,022	-	5,168,353	5,166,853	-
Commercial mortgages	5,447,063	5,458,928	-	5,678,565	5,090,399	-
Residential mortgages	121,527	121,527	-	131,909	131,909	-
Consumer loans:						
Home equity lines & loans	72,495	74,320	-	-	-	-
With an allowance recorded: Commercial and agricultural:						
Commercial & industrial	1,064,032	1,064,595	592,108	446,330	445,238	133,437
Commercial mortgages:						
Commercial mortgages	1,556,492	1,545,675	485,209	364,423	363,022	59,201
Consumer loans:						
Home equity lines & loans	57,876	58,213	4,020	-	-	-
<b>Total</b>	<b>\$ 11,870,237</b>	<b>\$ 11,865,035</b>	<b>\$ 1,081,337</b>	<b>\$ 13,848,607</b>	<b>\$ 12,659,578</b>	<b>\$ 192,638</b>

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	Nine-Months Ended September 30, 2013		Nine-Months Ended September 30, 2012		Three Months Ended September 30, 2013		Three Months Ended September 30, 2012	
	Average Recorded Investment	Interest Income Recognized	Average Recorded Investment	Interest Income Recognized	Average Recorded Investment	Interest Income Recognized	Average Recorded Investment	Interest Income Recognized
With no related allowance recorded: Commercial and agricultural:								
Commercial & industrial	\$ 1,528,613	\$ 52,269	\$ 843,910	\$ -	\$ 1,599,481	\$ 17,710	\$ 177,457	\$ -
Commercial mortgages:								
Construction	3,625,534	64,027	10,454	-	2,576,130	21,577	10,454	-
Commercial mortgages	5,628,724	184,027	932,358	-	5,564,316	65,898	1,081,307	-
Residential mortgages	126,801	-	117,737	-	123,473	-	74,441	-
Consumer loans:								
Home equity lines & loans	41,158	1,352	14,892	2,289	59,546	671	-	-
With an allowance recorded: Commercial and agricultural:								
Commercial & industrial	640,288	-	2,328,728	-	818,645	-	2,295,003	-
Commercial mortgages:								
Construction	-	-	4,148	-	-	-	-	-
Commercial mortgages	847,220	-	1,712,578	-	1,333,381	-	830,049	-
Residential mortgages	-	-	32,001	-	-	-	64,003	-
Consumer loans:								
Home equity lines & loans	43,601	2,343	-	-	58,177	1,094	-	-
Direct consumer	3,813	-	-	-	-	-	-	-

loans

Total \$ 12,485,752 \$ 304,198 \$ 5,996,806 \$ 2,289 \$12,133,149 \$106,950 \$4,532,714 \$-

(1) Cash basis interest income approximates interest income recognized.

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The following tables present the recorded investment in past due and non-accrual status by class of loans as of September 30, 2013 and December 31, 2012:

September 30, 2013	Current	30-89 Days Past Due	90 Days or more Past Due and accruing	Loans acquired with deteriorated credit quality	Non-Accrual (1)	Total
Commercial and agricultural:						
Commercial & industrial	138,320,091	\$ 35,277	\$ -	\$ 702,070	\$ 1,403,804	\$ 140,461,242
Agricultural	625,031	-	-	-	-	625,031
Commercial mortgages:						
Construction	19,028,779	-	1,455,128	773,841	542,893	21,800,641
Commercial mortgages	328,305,500	668,762	-	8,011,104	2,189,101	339,174,467
Residential mortgages	189,025,630	2,555,389	-	257,195	2,712,875	194,551,089
Consumer loans:						
Credit cards	1,656,644	16,839	9,504	-	-	1,682,987
Home equity lines & loans	92,808,417	215,994	-	-	613,363	93,637,774
Indirect consumer loans	156,271,223	1,232,135	-	-	118,706	157,622,064
Direct consumer loans	20,237,164	39,679	-	-	62,473	20,339,316
Total	946,278,479	\$ 4,764,075	\$ 1,464,632	\$ 9,744,210	\$ 7,643,215	\$ 969,894,611

(1) Includes all loans on non-accrual status regardless of the number of days such loans were delinquent as of September 30, 2013.

December 31, 2012	Current	30-89 Days Past Due	90 Days or more Past Due and accruing	Loans acquired with deteriorated credit quality	Non-Accrual (1)	Total
Commercial and agricultural:						
Commercial & industrial	131,404,371	\$ 183,269	\$ -	\$ 1,241,418	\$ 666,912	\$ 133,495,970

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Agricultural	698,452	-	-	-	-	698,452
Commercial mortgages:						
Construction	36,988,222	294,565	4,481,066	1,182,037	434,338	43,380,228
Other	266,261,798	1,750,806	-	8,043,810	1,581,643	277,638,057
Residential mortgages	194,185,617	4,145,868	-	244,268	2,423,024	200,998,777
Consumer loans:						
Credit cards	1,847,837	-	3,308	-	-	1,851,145
Home equity lines & loans	86,486,781	211,739	-	-	571,365	87,269,885
Indirect consumer loans	129,789,672	852,818	-	-	335,285	130,977,775
Direct consumer loans	19,481,693	89,619	-	-	19,338	19,590,650
Total	867,144,443	\$7,528,684	\$4,484,374	\$10,711,533	\$6,031,905	\$895,900,939

(1) Includes all loans on non-accrual status regardless of the number of days such loans were delinquent as of December 31, 2012.

### Troubled Debt Restructurings:

As of September 30, 2013 and December 31, 2012, the Corporation has a recorded investment in troubled debt restructurings of \$7,245,570 and \$5,728,610, respectively. There were specific reserves of \$241,973 allocated for troubled debt restructurings at September 30, 2013 and no specific reserves allocated at December 31, 2012. As of September 30, 2013, troubled debt restructurings totaling \$6,152,581 were accruing interest under the modified terms and \$1,092,989 were on non-accrual status. As of December 31, 2012, troubled debt restructurings totaling \$5,363,712 were accruing interest under the modified terms and \$364,898 were on non-accrual status. The Corporation has committed to lend additional amounts totaling up to \$100,000 and \$130,000 as of September 30, 2013 and December 31, 2012, respectively, to customers with outstanding loans that are classified as troubled debt restructurings.

During the nine months ended September 30, 2013 and 2012, the terms of certain loans were modified as troubled debt restructurings. The modification of the terms of such loans included one or a combination of the following: reduced scheduled payments for greater than 3 months or an extension of the maturity date at a stated rate of interest lower than the current market rate for new debt with similar risk.

The following table presents loans by class modified as troubled debt restructurings that occurred during the nine months ended September 30, 2013 and September 30, 2012:

Nine months ended September 30, 2013	Number of Loans	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment
Troubled debt restructurings:			
Commercial and agricultural:			
Commercial & industrial	4	\$ 841,162	\$ 841,162
Commercial mortgages:			
Commercial mortgages	1	133,000	133,000
Consumer loans:			
Home equity lines & loans	3	134,225	134,225
Total	8	\$ 1,108,387	\$ 1,108,387

Nine months ended September 30, 2012

Troubled debt restructurings:

Commercial  
and  
agricultural:

Commercial & industrial	1	\$	74,838	\$	74,838
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Consumer  
loans:

Home equity lines & loans	1	\$	58,823		58,823
Total	2	\$	133,661	\$	133,661

The troubled debt restructurings described above increased the allowance for loan losses by \$96,910 and resulted in no charge offs during the nine months ended September 30, 2013. The troubled debt restructurings described above did not increase the allowance for loan losses and resulted in no charge offs during the nine months ended September 30, 2012.

The following table presents loans by class modified as troubled debt restructurings that occurred during the three months ended September 30, 2013 and September 30, 2012:

Three months ended	Number	Pre-Modification	Post-Modification
September 30, 2013	of	Outstanding	Outstanding
	Loans	Recorded	Recorded
		Investment	Investment
Troubled debt restructurings:			
Consumer loans:			
Home equity lines & loans	1	\$ 30,638	\$ 30,638
Total	1	\$ 30,638	\$ 30,638

Three months ended	Number	Pre-Modification	Post-Modification
September 30, 2012	of	Outstanding	Outstanding
	Loans	Recorded	Recorded
		Investment	Investment
Troubled debt restructurings:			
Commercial and agricultural:			
Commercial & industrial	1	\$ 74,838	\$ 74,838
Total	1	\$ 74,838	\$ 74,838

The troubled debt restructurings described above increased the allowance for loan losses by \$40,445 and resulted in no charge offs during the three months ending September 30, 2013. The troubled debt restructurings described above did not increase the allowance for loan losses and resulted in no charge-offs during the three months ending September 30, 2012.

There were no payment defaults on any loans previously modified as troubled debt restructurings during the nine months ending September 30, 2013 or September 30, 2012, within twelve months following the modification. Additionally there were no payment defaults on any loans previously modified as troubled debt restructurings during the three months ending September 30, 2013 and September 30, 2012, within twelve months following the modification. A loan is considered to be in payment default once it is 90 days contractually past due under the modified terms.

#### Credit Quality Indicators

The Corporation establishes a risk rating at origination for all commercial loans. The main factors considered in assigning risk ratings include, but are not limited to: historic and future debt service coverage, collateral position, operating performance, liquidity, leverage, payment history, management ability, and the customer's industry. Commercial relationship managers monitor all loans in their respective portfolios for any changes in the



borrower's ability to service their debt and affirm the risk ratings for the loans at least annually.

For the retail loans, which include lines of credit, installment, mortgage, and home equity loans, once a loan is properly approved and closed, the Corporation evaluates credit quality based upon loan repayment.

The Corporation uses the risk rating system to identify criticized and classified loans. Commercial relationships within the criticized and classified risk ratings are analyzed quarterly. The Corporation uses the following definitions for criticized and classified loans (which are consistent with regulatory guidelines):

Special Mention – Loans classified as special mention have a potential weakness that deserves management's close attention. If left uncorrected, these potential weaknesses may result in deterioration of the repayment prospects for the loan or the institution's credit position at some future date.

Substandard – Loans classified as substandard are inadequately protected by the current net worth and paying capability of the obligor or of the collateral pledged, if any. Loans so classified have a well-defined weakness or weaknesses that jeopardize the liquidation of the debt. They are characterized by the distinct possibility that the institution will sustain some loss if the deficiencies are not corrected.

Doubtful – Loans classified as doubtful have all the weaknesses inherent in those classified as 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.

Loans not meeting the criteria above that are analyzed individually as part of the above described process are considered to be not rated loans. Based on the analyses performed as of September 30, 2013 and December 31, 2012, the risk category of the recorded investment of loans by class of loans is as follows:

	September 30, 2013					
	Not Rated	Pass	Loans acquired with deteriorated credit quality	Special Mention	Substandard	Doubtful
Commercial and agricultural:						
Commercial & industrial	\$ 125,064,289	\$ 702,070	\$ 9,926,617	\$ 4,332,774	\$ 435,492	
Agricultural	-	625,031	-	-	-	-
Commercial mortgages:						
Construction	-	17,361,075	773,841	2,797,055	868,670	-
Commercial mortgages	-	305,969,292	8,011,104	16,146,231	9,047,840	-
Residential mortgages	19,650,301	-	257,195	-	2,643,593	-
Consumer loans						
Credit lines	1,682,987	-	-	-	-	-
Home equity lines	2,045,959	-	-	-	691,815	-
Indirect consumer loans	157,494,345	-	-	-	127,719	-
Direct consumer loans	20,284,471	-	-	-	54,845	-
Total	\$ 164,058,068	\$ 449,019,687	\$ 9,744,210	\$ 28,869,903	\$ 17,767,256	\$ 435,492

December 31, 2012

	Not Rated	Pass	Loans acquired with deteriorated credit quality	Special Mention	Substandard	Doubtful
Commercial and agricultural:						
Commercial & industrial	\$ 121,145,761	\$ 1,241,418	\$ 8,008,002	\$ 2,606,529	\$ 494,260	
Agricultural	-	698,452	-	-	-	-
Commercial mortgages:						
Construction	-	34,882,896	1,182,037	5,153,918	2,161,377	-
Other	-	247,793,150	8,043,810	11,974,716	9,826,381	-
Residential mortgages	198,336,641	-	244,268	-	2,417,868	-
Consumer loans						
Credit lines	1,851,145	-	-	-	-	-
Home equity lines	86,615,392	-	-	-	654,493	-
Indirect consumer loans	130,642,490	-	-	-	335,285	-
Direct consumer loans	19,571,312	-	-	-	19,338	-
Total	137,016,980	\$ 404,520,259	\$ 10,711,533	\$ 25,136,636	\$ 18,021,271	\$ 494,260

The Corporation considers the performance of the loan portfolio and its impact on the allowance for loan losses. For residential and consumer loan classes, the Corporation also evaluates credit quality based on the aging status of the loan, which was previously presented, and by payment activity. The following table presents the recorded investment in residential and consumer loans based on payment activity as of September 30, 2013 and December 31, 2012:

	September 30, 2013				
	Consumer Loans				
	Residential Mortgages	Credit Card	Home Equity Lines & Loans	Indirect Consumer Loans	Other Direct Consumer Loans
Performing	\$ 191,838,214	\$ 1,673,483	\$ 93,024,411	\$ 157,503,358	\$ 20,276,843
Non-Performing	2,712,875	9,504	613,363	118,706	62,473
Total	\$ 194,551,089	\$ 1,682,987	\$ 93,637,774	\$ 157,622,064	\$ 20,339,316

	December 31, 2012				
	Consumer Loans				
	Residential Mortgages	Credit Card	Home Equity Lines & Loans	Indirect Consumer Loans	Other Direct Consumer Loans
Performing	\$ 198,575,753	\$ 1,847,838	\$ 86,698,520	\$ 130,642,490	\$ 19,571,312
Non-Performing	2,423,024	3,307	571,365	335,285	19,338
	\$ 200,998,777	\$ 1,851,145	\$ 87,269,885	\$ 130,977,775	\$ 19,590,650

At the time of the merger with Fort Orange Financial Corp., the Corporation identified certain loans with evidence of deteriorated credit quality, and the probability that the Corporation would be unable to collect all contractually required payments from the borrower. These loans are classified as PCI loans. The Corporation adjusted its estimates of future expected losses, cash flows, and renewal assumptions on the PCI loans during the current year. These adjustments were made for changes in expected cash flows due to loans refinanced beyond original maturity dates, impairments recognized subsequent to the acquisition, advances made for taxes or insurance to protect collateral held and payments received in excess of amounts originally expected.

The table below summarizes the changes in total contractually required principal and interest cash payments, management's estimate of expected total cash payments and carrying value of the PCI loans from January 1, 2013 to September 30, 2013 and July 1, 2013 to September 30, 2013:

Nine months ended September 30, 2013	Balance at December 31, 2012	Income Accretion	All Other Adjustments	Balance at September 30, 2013
Contractually required principal and interest	\$ 16,896,078	\$ -	\$(5,293,182)	\$ 11,602,896
Contractual cash flows not expected	(3,655,500)	-	2,865,778	(789,722)

to be collected (nonaccretable discount)				
Cash flows expected to be collected	13,240,578	-	(2,427,404)	10,813,174
Interest component of expected cash flows (accretable yield)	(2,529,045)	818,780	641,301	(1,068,964)
Fair value of loans acquired with deteriorating credit quality	\$10,711,533	\$818,780	\$(1,786,103)	\$ 9,744,210

Three months ended September 30, 2013	Balance at June 30, 2013	Income Accretion	All Other Adjustments	Balance at September 30, 2013
Contractually required principal and interest	\$14,700,338	\$ -	\$(3,097,442)	\$11,602,896
Contractual cash flows not expected to be collected (nonaccretable discount)	(1,938,757)	-	1,149,035	(789,722)
Cash flows expected to be collected	12,761,581	-	(1,948,407)	10,813,174
Interest component of expected cash flows (accretable yield)	(2,552,297)	154,919	1,328,414	(1,068,964)
Fair value of loans acquired with deteriorating credit quality	\$10,209,284	\$154,919	\$(619,993)	\$ 9,744,210

NOTE 6 FAIR VALUE

Fair value is the exchange price that would be received for an asset or paid to transfer a liability in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. There are three levels of inputs that may be used to measure fair value:

Level 1: Quoted prices (unadjusted) for identical assets or liabilities in active markets that the entity has the ability to access as of the measurement date.

Level 2: Significant other observable inputs other than Level 1 prices such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data.

Level 3: Significant unobservable inputs that reflect a reporting entity's own assumptions about the assumptions that market participants would use in pricing an asset or liability.

The Corporation used the following methods and significant assumptions to estimate fair value:

Investment Securities: The fair values of securities available for sale are usually determined by obtaining quoted prices on nationally recognized securities exchanges (Level 1 inputs), or matrix pricing, which is a mathematical technique widely used to value debt securities without relying exclusively on quoted prices for the specific securities but rather by relying on the securities' relationship to other benchmark quoted securities (Level 2 inputs).

The Corporation's investment in collateralized debt obligations consisting of pooled trust preferred securities which are issued by financial institutions were historically priced using Level 2 inputs. The lack of observable inputs and market activity in this class of investments has been significant and resulted in unreliable external pricing. Broker pricing and bid/ask spreads, when available, have varied widely. The once active market has become comparatively inactive. As a result, these investments are now priced using Level 3 inputs.

The Corporation utilizes an external model for pricing these securities. This is the same model used in determining OTTI as further described in Note 4. Information such as historical and current performance of the underlying collateral, deferral/default rates, collateral coverage ratios, break in yield calculations, cash flow projections, liquidity and credit premiums required by a market participant, and financial trend analysis with respect to the individual issuing financial institutions, are utilized in determining individual security valuations. Discount rates were utilized along with the cash flow projections in order to calculate an appropriate fair value. These discount rates were calculated based on industry index rates and adjusted for various credit and liquidity factors. Due to current market conditions as well as the limited trading activity of these securities, the market value of the securities is highly sensitive to assumption changes and market volatility.

Trading Assets: Securities that are held to fund a deferred compensation plan are recorded at fair value with changes in fair value included in earnings. The fair values of trading assets are determined by quoted market prices (Level 1 inputs).

**Impaired Loans:** At the time a loan is considered impaired, it is valued at the lower of cost or fair value. Impaired loans carried at fair value have been partially charged-off or receive specific allocations as part of the allowance for loan loss accounting. For collateral dependent loans, fair value is commonly based on real estate appraisals. These appraisals may utilize a single valuation approach or a combination of approaches including comparable sales and the income approach. Adjustments are routinely made in the appraisal process by independent appraisers to adjust for differences between the comparable sales and income data available. Such adjustments are usually significant and typically result in a Level 3 classification of the inputs for determining fair value. Non-real estate collateral may be valued using an appraisal, net book value per the borrower's financial statements, or aging reports, adjusted or discounted based on management's historical knowledge, changes in market conditions from the time of the valuation, and management's expertise and knowledge of the client and client's business, typically resulting in a Level 3 fair value classification. Impaired loans are evaluated on a quarterly basis for additional impairment and adjusted accordingly.

**Other Real Estate Owned:** Assets acquired through or instead of loan foreclosures are initially recorded at fair value less costs to sell when acquired, establishing a new cost basis. These assets are subsequently accounted for at lower of cost or fair value less estimated costs to sell. Fair value is commonly based on recent real estate appraisals. These appraisals may utilize a single valuation approach or a combination of approaches including comparable sales and the income approach. Adjustments are routinely made in the appraisal process by independent appraisers to adjust for differences between the comparable sales and income data available. Such adjustments are usually significant and typically result in a Level 3 classification of the inputs for determining fair value.

Appraisals for both collateral-dependent impaired loans and other real estate owned ("OREO") are performed by certified general appraisers (for commercial properties) or certified residential appraisers (for residential properties) whose qualifications and licenses have been reviewed and verified by the Corporation. Once received, appraisals are reviewed for reasonableness of assumptions, approaches utilized, Uniform Standards of Professional Appraisal Practice and other regulatory compliance, as well as the overall resulting fair value in comparison with independent data sources such as recent market data or industry-wide statistics. Appraisals are generally completed within the previous 12-month period prior to a property being placed into OREO. On impaired loans, appraisal values are adjusted based on the age of the appraisal, the position of the lien, the type of the property and its condition.

Assets and liabilities measured at fair value on a recurring basis are summarized below:

		Fair Value Measurement at September 30, 2013 Using		
		Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Financial Assets:	Fair Value			
Obligations of U.S. Government and U.S. Government sponsored	\$ 164,629,876	\$ 31,593,500	\$ 133,036,376	\$ -

enterprises				
Mortgage-backed securities, residential	39,032,987	-	39,032,987	-
Obligations of states and political subdivisions	35,234,537	-	35,234,537	-
Collateralized mortgage obligations	1,500,701	-	1,500,701	-
Corporate bonds and notes	7,484,333	-	7,484,333	-
SBA loan pools	1,540,274	-	1,540,274	-
Trust Preferred securities	2,551,800	-	2,037,500	514,300
Corporate stocks	7,300,609	6,657,475	643,134	-
Total available for sale securities	\$259,275,117	\$38,250,975	\$220,509,842	\$514,300
Trading assets	\$ 313,021	\$ 313,021	\$ -	\$ -



		Fair Value Measurement at December 31, 2012 Using		
		Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Financial Assets:	Fair Value			
Obligations of U.S. Government and U.S. Government sponsored enterprises	\$ 141,591,214	\$ 37,698,000	\$ 103,893,214	\$ -
Mortgage-backed securities, residential	31,515,249	-	31,515,249	-
Obligations of states and political subdivisions	40,814,722	-	40,814,722	-
Collateralized mortgage obligations	3,543,360	-	3,543,360	-
Corporate bonds and notes	11,651,635	-	11,651,635	-
SBA loan pools	1,724,140	-	1,724,140	-
Trust Preferred securities	2,470,913	-	2,025,313	445,600
Corporate stocks	6,374,530	5,720,533	653,997	-
Total available for sale securities	\$ 239,685,763	\$ 43,418,533	\$ 195,821,630	\$ 445,600
Trading assets	\$ 348,241	\$ 348,241	\$ -	\$ -

There were no transfers between Level 1 and Level 2 during the nine-month period ending September 30, 2013 or the year ending December, 31, 2012.

The significant unobservable inputs used in the fair value measurement of the Corporation's collateralized debt obligations are probabilities of specific-issuer defaults and deferrals and specific-issuer recovery assumptions. Significant increases in specific-issuer default assumptions or decreases in specific-issuer recovery assumptions would result in a significantly lower fair value measurement. Conversely, decreases in specific-issuer default assumptions or increases in specific-issuer recovery assumptions would result in a higher fair value measurement. The Corporation treats all interest payment deferrals as defaults and assumes no recoveries on defaults.

The tables below present a reconciliation of all assets measured at fair value on a recurring basis using

significant unobservable inputs (Level 3) for the three and nine-month periods ending September 30, 2013 and 2012:

	Fair Value Measurement for Nine-Months Ended September 30, 2013 Using Significant Unobservable Inputs (Level 3)	Fair Value Measurement for Nine-Months Ended September 30, 2012 Using Significant Unobservable Inputs (Level 3)
Trust Preferred Securities Available for Sale		
Beginning balance December 31	\$ 445,600	\$ 294,910
Total gains/losses (realized/unrealized):		
Included in earnings:		
Income on securities	-	-
Impairment charge on investment securities	-	-
Included in other comprehensive income	68,700	150,690
Transfers in and/or out of Level 3	-	-
Ending balance September 30	\$ 514,300	\$ 445,600

	Fair Value Measurement for Three-Months Ended September 30, 2013 Using Significant Unobservable Inputs (Level 3)	Fair Value Measurement for Three-Months Ended September 30, 2012 Using Significant Unobservable Inputs (Level 3)
Trust Preferred Securities Available for Sale		
Beginning balance June 30	\$ 514,300	\$ 343,035
Total gains/losses (realized/unrealized):		
Included in earnings:		
Income on securities	-	-
Impairment charge on investment securities	-	-
Included in other comprehensive income	-	102,565
Transfers in and/or out of Level 3	-	-
Ending balance September 30	\$ 514,300	\$ 445,600

Assets and liabilities measured at fair value on a non-recurring basis are summarized below:

		Fair Value Measurement at September 30, 2013 Using		
		Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Financial Assets:	Fair Value			

Impaired Loans:					
Commercial and agricultural:					
Commercial & industrial	\$ 471,954	\$ -	\$ -	\$ 471,954	
Commercial mortgages:					
Other	1,071,283	-	-	1,071,283	
Consumer loans:					
Home equity lines & loans	53,856	-	-	53,856	
Total Impaired Loans	\$ 1,597,093	\$ -	\$ -	\$ 1,597,093	
Other real estate owned:					
Commercial and agricultural:					
Commercial and industrial	\$ 101,200	\$ -	\$ -	\$ 101,200	
Commercial mortgages:					
Other	265,702	-	-	265,702	
Residential mortgages	129,939	-	-	129,939	
Consumer loans:					
Home equity lines & loans	66,959	-	-	66,959	
Total Other real estate owned, net	\$ 563,800	\$ -	\$ -	\$ 563,800	

Financial Assets:	Fair Value	Fair Value Measurement at December 31, 2012 Using		
		Quoted Prices in Active Markets Significant for Identical Assets (Level 1)	Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Impaired Loans:				
Commercial and agricultural:				
Commercial & industrial	\$ 235,501	\$ -	\$ -	\$ 235,501
Commercial mortgages:				
Other	305,222	-	-	305,222
Total Impaired Loans	\$ 540,723	\$ -	\$ -	\$ 540,723
Other real estate owned:				
Commercial and agricultural:				
Commercial and industrial	\$ 101,200	\$ -	\$ -	\$ 101,200
Commercial mortgages:				
Other	257,702	-	-	257,702
Residential mortgages	201,679	-	-	201,679
Consumer loans:				
Home equity lines & loans	4,000	-	-	4,000
Total Other real estate owned, net	\$ 564,581	\$ -	\$ -	\$ 564,581

The following table presents information related to Level 3 non-recurring fair value measurement at September 30, 2013 and December 31, 2012:

Description	Fair Value at September 30, 2013	Technique	Unobservable Inputs
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Impaired loans	\$ 1,597,093	Third party real estate and a 100% discount of personal property	1	Management discount based on underlying collateral characteristics and market conditions
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Other real estate owned	\$ 563,800	Third party appraisals	1	Estimated holding period
			2	Estimated closing costs

Description	Fair Value at December 31, 2012	Technique	Unobservable Inputs	
Impaired loans	\$ 540,723	Third party real estate and a 100% discount of personal property	1	Management discount based on underlying collateral characteristics and market conditions

Other real estate owned	\$ 564,581	Third party appraisals	1	Estimated holding period
			2	Estimated closing costs

Impaired loans, which are measured for impairment using the fair value of the collateral for collateral dependent loans, had a principal balance of \$2,678,430 with a valuation allowance of \$1,081,337 as of September 30, 2013, resulting in \$311,110 and \$888,699 increase in the provision for loan losses for the three and nine-month periods ended September 30, 2013, respectively. Impaired loans had a principal balance of \$733,361, with a valuation allowance of \$192,638 as of December 31, 2012, resulting in no additional provision for loan losses for the year ending December 31, 2012.

OREO, which is measured by the lower of carrying or fair value less costs to sell, had a net carrying amount of \$563,800 at September 30, 2013. The net carrying amount reflects the outstanding balance of \$756,167, net of a valuation allowance of \$192,367, at September 30, 2013. There were no write downs for the three and nine-month periods ending September 30, 2013. OREO had a net carrying amount of \$564,581 at December 31, 2012. The net carrying amount reflects the outstanding balance of \$756,948, net of a valuation allowance of \$192,367, at December 31, 2012, which resulted in write downs of \$116,840 for the year ending December 31, 2012.

The carrying amounts and estimated fair values of other financial instruments, at September 30, 2013 and December 31, 2012, are as follows (dollars in thousands):

Financial assets:	Carrying Amount	Fair Value Measurements at September 30, 2013 Using			Estimated Fair Value (1)
		Quoted Prices in Active Markets Significant for Identical Assets (Level 1)	Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	
Cash and due from financial institutions	\$ 37,491	\$ 37,491	\$ -	- \$	37,491
Interest-bearing deposits in other financial institutions	2,438	2,438	-	-	2,438
Trading assets	313	313	-	-	313
Securities available for sale	259,275	38,251	220,510	514	259,275
Securities held to maturity	6,544	-	7,047	-	7,047
Federal Home Loan and Federal Reserve Bank stock	6,725	-	-	-	N/A
Net loans	955,778	-	-	985,182	985,182
Loans held for sale	866	-	866	-	-
Accrued interest receivable	4,142	360	1,549	2,233	4,142
Financial liabilities:					
Deposits:					
Demand, savings, and insured money market accounts	\$866,507	\$866,507	\$ -	- \$	866,507

Time deposits	221,938	-	222,944	-	222,944
Securities sold under agreements to repurchase	30,499	-	31,757	-	31,757
Federal Home Loan Bank term advances	26,046	-	27,207	-	27,207
Federal Home Loan Bank overnight advances	49,100	-	49,103	-	49,103
Accrued interest payable	339	13	174	152	339

(1) Fair value estimates are made at a specific point in time, based on relevant market information and information about the financial instrument. These estimates are subjective in nature and involve uncertainties and matters of significant judgment and, therefore, cannot be determined with precision. Changes in assumptions could significantly affect the estimates.



## Fair Value Measurements at December 31, 2012

Financial Assets:	Carrying Amount	Quoted Prices in Active Markets Significant for Other Significant			Estimated Fair Value (1)
		Assets (Level 1)	Inputs (Level 2)	Inputs (Level 3)	
Cash and due from financial institutions	\$ 29,239	\$ 29,239	\$ -	\$ -	\$ 29,239
Interest-bearing deposits in other financial institutions	11,002	8,645	2,357	-	11,002
Trading assets	348	348	-	-	348
Securities available for sale	239,686	43,419	195,822	445	239,686
Securities held to maturity	5,748	-	6,421	-	6,421
Federal Reserve Bank stock	4,710	-	-	-	N/A
Net loans	883,084	-	-	916,289	916,289
Loans held for sale	1,057	-	1,057	-	1,057
Accrued interest receivable	3,788	175	1,257	2,356	3,788
Financial liabilities:					
Deposits:					
Demand, savings, and insured money market accounts	\$808,044	\$ 808,044	\$ -	\$ -	\$ 808,044
Time deposits	236,690	-	238,245	-	238,245
Securities sold under agreements to repurchase	32,711	-	35,260	-	35,260

Federal Home Loan Bank advances	27,225	-	29,688	-	29,688
Accrued interest payable	453	12	279	162	453

(1) Fair value estimates are made at a specific point in time, based on relevant market information and information about the financial instrument. These estimates are subjective in nature and involve uncertainties and matters of significant judgment and, therefore, cannot be determined with precision. Changes in assumptions could significantly affect the estimates.

The methods and assumptions used to estimate fair value are described as follows:

#### Cash, Due From and Interest-Bearing Deposits in Other Financial Institutions

For those short-term instruments that generally mature in 90 days or less, the carrying value approximates fair value of which non interest-bearing deposits are classified as Level 1 and interest-bearing deposits with the Federal Home Loan Bank of New York (“FHLB”) and Federal Reserve Bank of New York (“FRB”) are classified as Level 1.

#### FHLB and FRB Stock

It is not practicable to determine the fair value of FHLB and FRB stock due to restrictions placed on its transferability.

#### Loans Receivable

For variable-rate loans that reprice frequently, fair values approximate carrying values. The fair values for other loans are estimated through discounted cash flow analysis using interest rates currently being offered for loans with similar terms and credit quality. Loans are classified as Level 3. The methods utilized to estimate the fair value of loans do not necessarily represent an exit price. Loans held for sale are classified as Level 2.

### Deposits

The fair values disclosed for demand deposits, savings accounts and money market accounts are, by definition, equal to the amounts payable on demand at the reporting date (i.e., their carrying values) and classified as Level 1.

The fair value of certificates of deposits is estimated using a discounted cash flow approach that applies interest rates currently being offered on certificates to a schedule of the weighted-average expected monthly maturities and classified as Level 2.

### Securities Sold Under Agreements to Repurchase (Repurchase Agreements)

These instruments bear both variable and fixed rates of interest. Therefore, the carrying value approximates fair value for the variable rate instruments and the fair value of fixed rate instruments is based on discounted cash flows to maturity. These are classified as Level 2.

### Federal Home Loan Bank Advances

These instruments bear a stated rate of interest to maturity and, therefore, the fair value is based on discounted cash flows to maturity and classified as Level 2.

### Accrued Interest Receivable and Payable

For these short-term instruments, the carrying value approximates fair value resulting in a classification of Level 1, Level 2 or Level 3 depending upon the classification of the asset/liability they are associated with.

## NOTE 7 GOODWILL AND INTANGIBLE ASSETS

The changes in goodwill included in the core banking segment during the periods ending September 30, 2013 and 2012 were as follows:

	2013	2012
Beginning of year	\$ 21,824,443	\$ 21,983,617
Acquired goodwill	-	
Adjustment of Acquired goodwill (1)	-	(159,174)
Ending balance September 30,	\$ 21,824,443	\$ 21,824,443

(1) Adjustment related to Fort Orange Financial Corp. acquisition.

Acquired intangible assets were as follows at September 30, 2013 and December 31, 2012:

	At September 30, 2013		At December 31, 2012	
	Balance Acquired	Accumulated Amortization	Balance Acquired	Accumulated Amortization
Core deposit intangibles	\$ 3,819,798	\$ 2,173,923	\$ 3,819,798	\$ 1,796,853
Other customer relationship intangibles	6,063,423	3,228,279	6,063,423	2,942,548
Total	\$ 9,883,221	\$ 5,402,202	\$ 9,883,221	\$ 4,739,401

Aggregate amortization expense was \$662,801 and \$808,258 for the nine-month periods ended September 30, 2013 and 2012, respectively.

The remaining estimated aggregate amortization expense at September 30, 2013 is listed below:

Year	Estimated Expense
2013	\$ 213,723
2014	777,801
2015	681,176
2016	607,713
2017	557,893
	1,642,713

2018 and  
thereafter

Total	\$ 4,481,019
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## NOTE 8 ACCUMULATED OTHER COMPREHENSIVE INCOME OR LOSS

Accumulated other comprehensive income or loss represents the net unrealized holding gains or losses on securities available for sale and the funded status of the Corporation's defined benefit pension plan and other benefit plans, as of the consolidated balance sheet dates, net of the related tax effect.

The following is a summary of the changes in accumulated other comprehensive income or loss by component, net of tax, for the periods indicated:

	Unrealized Gains and Losses on Securities Available for Sale	Defined Benefit and Other Benefit Plans	Total
Balance at December 31, 2012	\$ 8,022,790	\$ (10,829,719)	\$ (2,806,929)
Other comprehensive income before reclassification	(1,170,076)	-	(1,170,076)
Amounts reclassified from accumulated other comprehensive income	(756)	701,063	700,307
Net current period other comprehensive loss	(1,170,832)	701,063	(469,769)
Balance at September 30, 2013	\$ 6,851,958	\$ (10,128,656)	\$ (3,276,698)

	Unrealized Gains and Losses on Securities Available for Sale	Defined Benefit and Other Benefit Plans	Total
Balance at June 30, 2013	\$ 5,987,659	\$ (10,362,706)	\$ (4,375,047)
Other comprehensive	864,299	-	864,299

income before reclassification			
Amounts reclassified from accumulated other comprehensive income	-	234,050	234,050
Net current period other comprehensive loss	864,299	234,050	1,098,349
Balance at September 30, 2013	\$ 6,851,958	\$ (10,128,656)	\$ (3,276,698)

	Unrealized Gains and Losses on Securities Available for Sale	Defined Benefit and Other Benefit Plans	Total
Balance at December 31, 2011	\$ 7,987,055	\$ (9,428,433)	\$ (1,441,378)
Other comprehensive income before reclassification	973,217	-	973,217
Amounts reclassified from accumulated other comprehensive income	(184,998)	581,304	396,306
Net current period other comprehensive income	788,219	581,304	1,369,523
Balance at September 30, 2012	\$ 8,775,274	\$ (8,847,129)	\$ (71,855)

Unrealized Gains and Losses on Securities	Defined Benefit and Other Benefit Plans	Total
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Available for  
Sale

Balance at June 30, 2012	\$ 8,184,871	\$ (9,040,897)	\$ (856,026)
Other comprehensive income before reclassification	590,771	-	590,771
Amounts reclassified from accumulated other comprehensive income	(368)	193,768	193,400
Net current period other comprehensive income	590,403	193,768	784,171
Balance at September 30, 2012	\$ 8,775,274	\$ (8,847,129)	\$ (71,855)



The following is the reclassification out of accumulated other comprehensive income for the periods indicated:

Details about Accumulated Other Comprehensive Income Components	Nine Months Ended September 30,		Affected Line Item in the Statement Where Net Income is Presented
	2013	2012	
Unrealized gains and losses on securities available for sale:			
Realized gains on securities available for sale	\$ 1,228	\$ 300,516	Net gains on securities transactions
Income tax expense	472	115,518	Income tax expense
Net of tax	756	184,998	
Amortization of defined pension plan and other benefit plan items:			
Prior service costs (a)	62,358	62,358	Pension and other employee benefits
Actuarial losses (a)	(1,201,594)	(1,006,644)	Pension and other employee benefits
Income tax benefit	438,173	362,982	Income tax expense
Net of tax	(701,063)	(581,304)	
Total reclassification for the period, net of tax	\$ (700,307)	\$ (396,306)	

(a) These accumulated other comprehensive income components are included in the computation of net periodic pension and other benefit plan costs (see Note 10 for additional information).

Details about Accumulated Other Comprehensive Income Components	Three Months Ended September 30,	Affected Line Item in the Statement Where Net Income is Presented
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	2013	2012	
Unrealized gains and losses on securities available for sale:			
Realized gains on securities available for sale	\$ -	\$ 597	Net gains on securities transactions
Income tax expense	-	230	Income tax expense
Net of tax	-	367	
Amortization of defined pension plan and other benefit plan items:			
Prior service costs (a)	20,786	20,786	Pension and other employee benefits
Actuarial losses (a)	(400,508)	(335,548)	Pension and other employee benefits
Income tax benefit	145,672	120,994	Income tax expense
Net of tax	(234,050)	(193,768)	
Total reclassification for the period, net of tax	\$ (234,050)	\$ (193,401)	

(a) These accumulated other comprehensive income components are included in the computation of net periodic pension and other benefit plan costs (see Note 10 for additional information).

## NOTE 9 COMMITMENTS AND CONTINGENCIES

The Corporation is a party to certain financial instruments with off-balance sheet risk such as commitments under standby letters of credit, unused portions of lines of credit, overdraft protection and commitments to fund new loans. In accordance with U.S. GAAP, these financial instruments are not recorded in the financial statements. The Corporation's policy is to record such instruments when funded. These transactions involve, to varying degrees, elements of credit, interest rate and liquidity risk. Such transactions are generally used by the Corporation to manage clients' requests for funding and other client needs.

The Bank is a party in two legal proceedings involving its Wealth Management Group Services. In both proceedings, the Bank, as trustee pursuant to written trust instruments, has sought judicial settlement of trust accounts in the New York Surrogate's Court for Chemung County. Individuals who are beneficiaries under the trusts have filed formal objections and/or demand letters with the Court in both of these accounting proceedings, objecting to the final settlement of the trust accounts. The objectants primarily assert that the Bank acted imprudently by failing to diversify the trusts' investments and they claim \$9.6 million and \$24.1 million, consisting of damages and disallowed trustee's commissions, plus unspecified legal fees in the respective proceedings. These proceedings are pending in the Surrogate's Court and are now in the discovery phase. While the outcome of litigation is not predictable the Bank believes that the claims are without merit and is vigorously defending them. As of September 30, 2013, no amount has been accrued for potential losses related to these proceedings as a potential loss is not considered probable or reasonably estimable in the opinion of management.

In the normal course of business, there are various outstanding claims and legal proceedings involving the Corporation or its subsidiaries. Except for the above matter, we believe that we are not a party to any pending legal, arbitration, or regulatory proceedings that could have a material adverse impact on our financial results or liquidity.

## NOTE 10 COMPONENTS OF QUARTERLY AND YEAR TO DATE NET PERIODIC BENEFIT COSTS

	Nine Months Ended		Three Months Ended	
	September 30 2013	September 30 2012	September 30 2013	September 30 2012
Qualified Pension				
Service cost, benefits earned during the period	\$ 1,048,212	\$ 970,053	\$ 349,404	\$ 323,351
Interest cost on projected benefit obligation	1,225,863	1,218,330	408,621	406,110
Expected return on plan assets	(2,181,516)	(1,990,479)	(727,172)	(663,493)
Amortization of unrecognized transition obligation	-	-	-	-
Amortization of unrecognized prior service cost	10,392	10,392	3,464	3,464

Amortization of unrecognized net loss	1,172,049	991,704	390,683	330,568
Net periodic pension expense	\$ 1,275,000	\$ 1,200,000	\$ 425,000	\$ 400,000

#### Supplemental Pension

Service cost, benefits earned during the period	\$ 30,012	\$ 26,076	\$ 10,004	\$ 8,692
Interest cost on projected benefit obligation	35,924	38,320	11,974	12,773
Expected return on plan assets	-	-	-	-
Amortization of unrecognized prior service cost	-	-	-	-
Amortization of unrecognized net loss	25,725	14,940	8,575	4,980
Net periodic supplemental pension expense	\$ 91,661	\$ 79,336	30,553	\$ 26,445

#### Postretirement, Medical and Life

Service cost, benefits earned during the period	\$ 36,106	\$ 26,250	\$ 12,045	\$ 8,750
Interest cost on projected benefit obligation	47,824	54,000	15,955	18,000
Expected return on plan assets	-	-	-	-
Amortization of unrecognized prior service cost	(72,750)	(72,750)	(24,250)	(24,250)
Amortization of unrecognized net loss	3,820	-	1,250	-
Net periodic postretirement, medical and life expense	\$ 15,000	\$ 7,500	\$ 5,000	\$ 2,500

## NOTE 11 SEGMENT REPORTING

The Corporation manages its operations through two primary business segments: core banking and wealth management group services. The core banking segment provides revenues by attracting deposits from the general public and using such funds to originate consumer, commercial, commercial real estate, and residential mortgage loans, primarily in the Corporation's local markets and to invest in securities. The wealth management group services segment provides revenues by providing trust and investment advisory services to clients.

Accounting policies for the segments are the same as those described in Note 1. Summarized financial information concerning the Corporation's reportable segments and the reconciliation to the Corporation's consolidated results are shown in the following table. Income taxes are allocated based on the separate taxable income of each entity and indirect overhead expenses are allocated based on reasonable and equitable allocations applicable to the reportable segment. Holding company amounts are the primary differences between segment amounts and consolidated totals, and are reflected in the Holding Company and Other column below, along with amounts to eliminate transactions between segments.

	Three Months Ended September 30, 2013				Nine Months Ended September 30, 2013			
	Core Banking	Wealth Management Group Services	Holding Company And Other	Consolidated Totals	Core Banking	Wealth Management Group Services	Holding Company And Other	Consolidated Totals
Net interest income	\$ 11,514,644	\$ -	\$ 2,007	\$ 11,516,651	\$ 34,553,827	\$ -	\$ 7,563	\$ 34,561,390
Provision for loan losses	873,704	-	-	873,704	1,755,188	-	-	1,755,188
Net interest income after provision for loan losses	10,640,940	-	2,007	10,642,947	32,798,639	-	7,563	32,806,202
Other operating income	2,402,021	1,813,113	135,519	4,350,653	6,714,682	5,448,240	684,446	12,847,368
Other operating expenses	10,275,098	1,371,418	166,186	11,812,702	30,137,242	4,174,319	617,402	34,928,963
Income before income tax expense	2,767,863	441,695	(28,660)	3,180,898	9,376,079	1,273,921	74,607	10,724,607
Income tax expense	860,187	169,788	(28,247)	1,001,728	2,995,405	489,695	(6,038)	3,479,062
Segment net	\$ 1,907,676	\$ 271,907	\$ (413)	\$ 2,179,170	\$ 6,380,674	\$ 784,226	\$ 80,645	\$ 7,245,545

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income

Segment

assets

\$1,334,375,485 \$5,023,415 \$1,691,868 \$1,341,090,

	Three Months Ended September 30, 2012				Nine Months Ended September 30, 2012			
	Core Banking	Wealth Management Group Services	Holding Company And Other	Consolidated Totals	Core Banking	Wealth Management Group Services	Holding Company And Other	Consolidated Totals
Net interest income	\$11,788,521	\$ -	\$ 1,517	\$ 11,790,038	\$ 35,194,815	\$ -	\$ 6,611	\$ 35,194,815
Provision for loan losses	225,000	-	-	225,000	753,897	-	-	753,897
Net interest income after provision for loan losses	11,563,521	-	1,517	11,565,038	34,440,918	-	6,611	34,440,918
Other operating income	2,112,173	1,667,628	212,918	3,992,719	7,303,607	5,170,016	521,647	12,995,270
Other operating expenses	9,887,762	1,277,545	175,154	11,340,461	29,456,209	4,120,082	576,811	34,153,102
Income before income tax expense	3,787,932	390,083	39,281	4,217,296	12,288,316	1,049,934	(48,553)	13,339,797
Income tax expense (benefit)	1,235,752	149,948	(2,249)	1,383,451	4,065,505	403,595	(71,821)	4,497,279
Segment net income	\$ 2,552,180	\$ 240,135	\$ 41,530	\$ 2,833,845	\$ 8,222,811	\$ 646,339	\$ 23,268	\$ 8,892,418
Segment assets					\$1,279,106,549	\$5,249,476	\$2,623,832	\$1,286,979,857

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## NOTE 12 STOCK BASED COMPENSATION

## Board of Director's Stock Compensation

Members of the Board of Directors receive common shares of the Corporation equal in value to the amount of fees individually earned during the previous year for service as a director. The common shares are distributed to the Corporation's individual board members from treasury shares of the Corporation on or about January 15 following the calendar year of service.

Additionally, the President and Chief Executive Officer of the Corporation, who does not receive cash compensation as a member of the Board of Directors, is awarded common shares equal in value to the average of those awarded to board members not employed by the Corporation who have served for 12 months during the prior year.

During January 2013 and 2012, 7,969 and 10,238 shares, respectively, were re-issued from treasury to fund the stock component of directors' compensation. An expense of \$185,263 and \$156,863 related to this compensation was recognized during the nine month period ending September 30, 2013 and September 30, 2012, respectively. This expense is accrued as shares are earned.

## Restricted Stock Plan

Pursuant to the Corporation's Restricted Stock Plan (the "Plan"), the Corporation may make discretionary grants of restricted stock to officers other than the Corporation's Chief Executive Officer. Compensation expense is recognized over the vesting period of the awards based on the fair value of the stock at issue date.

A summary of restricted stock activity from December 31, 2012 to September 30, 2013 is presented below:

	Shares	Weighted-Average Grant Date Fair Value
Nonvested at December 31, 2012	20,009	\$ 23.84
Granted	-	-
Vested	2,197	22.60
Forfeited or Cancelled	1,797	25.04
Nonvested at September 30, 2013	16,015	\$ 23.98

As of September 30, 2013, there was \$313,272 of total unrecognized compensation cost related to nonvested shares granted under the Plan. The cost is expected to be recognized over a weighted-average period of 3.60 years. The total fair value of shares vested during the nine months ended September 30, 2013 was \$66,780.

## NOTE 13 PENDING ACQUISITION

On July 10, 2013, the Bank, the wholly-owned banking subsidiary of the Corporation, entered into a Purchase and Assumption Agreement with Bank of America, National Association ("BOA") pursuant to which the Bank agreed to acquire certain assets and assume certain liabilities of six BOA branch offices located in Auburn, Cortland, Ithaca and Seneca Falls, New York. Subject to the terms of the Purchase Agreement, the Bank will acquire

approximately \$261,000,000 in deposits and \$1,600,000 in loans, for a purchase price equal to the sum of a deposit premium of 1.5% based on the 30-day average balances prior to the close of the transaction, the aggregate net book value of all assets and accrued interest on the loans acquired. The Bank will not receive any loans that are past due 30 days or more on the closing date. The transaction, which has received regulatory approval, is expected to close in the fourth quarter of 2013.



Item 2: Management's Discussion and Analysis of Financial Condition and Results of Operations

The purpose of this review is to present information about the financial condition and results of operations of Chemung Financial Corporation (the "Corporation") for the three and nine-month periods ended September 30, 2013 and 2012. The following discussion and unaudited consolidated interim financial statements and related notes included in this report should be read in conjunction with our 2012 Annual Report on Form 10-K, which was filed with the Securities and Exchange Commission on March 15, 2013. The results for the periods presented are not necessarily indicative of results to be expected for the entire fiscal year or any other interim period.

To assist the reader, the Corporation has provided the following list of commonly used acronyms and abbreviations included in Management's Discussion and Analysis of Financial Condition and Results of Operations.

CDO: Collateralized Debt Obligation	OTTI: Other-than-temporary Impairment
FASB: Financial Accounting Standards Board	PCI: Purchased Credit Impaired
FDIC: Federal Deposit Insurance Corporation	SEC: Securities and Exchange Commission
FHLB: Federal Home Loan Bank	TDR: Troubled Debt Restructurings
GAAP: U.S. generally accepted accounting principles	

Forward-looking Statements

This discussion contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. The Corporation intends its forward-looking statements to be covered by the safe harbor provisions for forward-looking statements in these sections. All statements regarding, among other things, the Corporation's expected financial condition and results of operations, the Corporation's business strategy, the Corporation's financial plans, forecasted demographic and economic trends relating to the Corporation's industry and similar matters are forward-looking statements. These statements can sometimes be identified by the Corporation's use of forward-looking words such as "may," "will," "anticipate," "estimate," "expect," "believe" or "intend." The Corporation cannot promise that its expectations in such forward-looking statements will turn out to be correct. The Corporation's actual results could be materially different from expectations because of various factors, including changes in economic conditions, including our local, state and national real estate markets and employment trends, or changes in interest rates, credit risk, difficulties in managing the Corporation's growth, competition, changes in law or the regulatory environment, including the Dodd-Frank Wall Street Reform and Consumer Protection Acts, the Jumpstart Our Business Startups Act, the capital ratios of Basel III, as adopted by the federal banking authorities, political instability and changes in general business and economic trends or demand for loans. Information concerning these and other factors can be found in the Corporation's periodic filings with the SEC, including in our 2012 Annual Report on Form 10-K. These filings are available publicly on the SEC's web site at <http://www.sec.gov>, on the Corporation's web site at <http://www.chemungcanal.com> or upon request from the Corporate Secretary at (607) 737-3746. Except as otherwise required by law, the Corporation undertakes no obligation to publicly update or revise its forward-looking statements, whether as a result of new information, future

events, or otherwise.

#### Critical Accounting Policies, Estimates and Risks and Uncertainties

Critical accounting policies include the areas where the Corporation has made what it considers to be particularly difficult, subjective or complex judgments concerning estimates, and where these estimates can significantly affect the Corporation's financial results under different assumptions and conditions. The Corporation prepares its financial statements in conformity with GAAP. As a result, the Corporation is required to make certain estimates, judgments and assumptions that it believes are reasonable based upon the information available at that time. These estimates, judgments and assumptions affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the periods presented. Actual results could be different from these estimates.

Management considers the accounting policy relating to the allowance for loan losses to be a critical accounting policy given the uncertainty in evaluating the level of the allowance required to cover probable incurred credit losses inherent in the loan portfolio, and the material effect that such judgments can have on the Corporation's results of operations. While management's current evaluation of the allowance for loan losses indicates that the allowance is adequate, under adversely different conditions or assumptions the allowance would need to be increased. For example, if historical loan loss experience significantly worsened or if current economic conditions significantly deteriorated, additional provisions for loan losses would be required to increase the allowance. In addition, the assumptions and estimates used in the internal reviews of the Corporation's non-performing loans and potential problem loans, and the associated evaluation of the related collateral coverage for these loans, has a significant impact on the overall analysis of the adequacy of the allowance for loan losses. Real estate values in the Corporation's market area did not increase dramatically in the prior several years, and, as a result, any declines in real estate values have been modest. While management has concluded that the current evaluation of collateral values is reasonable under the circumstances, if collateral evaluations were significantly lowered, the Corporation's allowance for loan losses policy would also require additional provisions for loan losses.

Management also considers the accounting policy relating to OTTI of investment securities to be a critical accounting policy. The determination of whether a decline in market value is other-than-temporary is necessarily a matter of subjective judgment. The timing and amount of any realized losses reported in the Corporation's financial statements could vary if management's conclusions were to change as to whether other-than-temporary impairment exists. The Corporation assesses whether it intends to sell, or it is more likely than not that it will be required to sell a security in an unrealized loss position before recovery of its amortized cost basis. If either of these criteria is met, the entire difference between amortized cost and fair value is recognized through a charge to earnings. For those securities that do not meet the aforementioned criteria, such as those that management has determined to be other-than-temporarily impaired, the amount of impairment charged to earnings is limited to the amount related to credit losses, while impairment related to other factors is recognized in other comprehensive income. The Corporation uses an OTTI evaluation model to compare the present value of expected cash flows to the previous estimate to determine if there are adverse changes in cash flows during the quarter. The OTTI model considers the structure and term of the CDO and the financial condition of the underlying issuers. Specifically, the model details interest rates, principal balances of note classes and underlying issuers, the timing and amount of interest and principal payments of the underlying issuers, and the allocation of the payments to the note classes.

The current estimate of expected cash flows is based on the most recent trustee reports and any other relevant market information including announcements of interest payment deferrals or defaults of underlying trust preferred securities. Assumptions used in the model include expected future default rates and prepayments. We assume no recoveries on defaults and treat all interest payment deferrals as defaults. Additional default assumptions were made based on credit quality ratios and performance measures of the remaining financial institutions in the pool, as well as overall default rates based on historical bank debt default rate averages.

Management also considers the accounting policy relating to the valuation of goodwill and other intangible assets to be a critical accounting policy. The initial carrying value of goodwill and other intangible assets is determined using estimated fair values developed from various sources and other generally accepted valuation techniques. Estimates are based upon financial, economic, market and other conditions as they existed as of the date of a particular acquisition. These estimates of fair value are the results of judgments made by the Corporation based upon estimates that are inherently uncertain and changes in the assumptions upon which the estimates were based may have a significant impact on the resulting estimates. In addition to the initial determination of the carrying value, on an ongoing basis management must assess whether there is any impairment of goodwill and other intangible assets that would require an adjustment in carrying value and recognition of a loss in the consolidated

statement of income.

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## Financial Condition

### Summary

Assets totaled \$1.341 billion at September 30, 2013 compared with \$1.248 at December 31, 2012, an increase of \$92.9 million, or 7.4%. The growth was due primarily to increases of \$74.1 million, or 8.3%, in total portfolio loans and \$22.4 million, or 9.0%, in investment securities. The increase in portfolio loans was due to strong growth of \$46.9 million in commercial loans and \$33.6 million in consumer loans.

Total liabilities were \$1.206 billion at September 30, 2013 compared with \$1.117 billion at December 31, 2012, an increase of \$89.2 million, or 8.0%. The increase was due primarily to increases of \$43.7 million in deposits and \$47.9 million in FHLB advances.

Total equity was \$134.8 million at September 30, 2013 compared with \$131.1 million at December 31, 2012. The increase was due primarily to net income of \$7.2 million for the nine months ended September 30, 2013, partially offset by dividends declared of \$3.6 million. The total equity to total assets ratio was 10.05% at September 30, 2013 compared with 10.50% at December 31, 2012. The tangible equity to tangible assets ratio was 8.25% at September 30, 2013 compared with 8.53% at December 31, 2012.

The market value of total assets under management or administration in the Corporation's Wealth Management Group was \$1.829 billion at September 30, 2013 compared with \$1.735 billion at December 31, 2012.

On July 12, 2013, the Corporation announced that its banking subsidiary, Chemung Canal Trust Company entered into an agreement with Bank of America to purchase six branch offices. See the heading under this Item 2 entitled "Pending Acquisition" for more information. Included in the acquisition process was management's decision to establish a pre-funding strategy based upon receiving \$260.9 million in deposits during the fourth quarter of 2013. The objective of the strategy was to maximize revenue before and during the funds deployment into new commercial and consumer loans. In the short term, funds would be used to purchase investment securities of varying maturities. Management started the strategy during the third quarter of 2013 which produced a \$22.4 million increase in investment securities and a \$49.1 million increase in short-term FHLB advances. The short-term FHLB advances will be paid off upon receipt of the deposits during the fourth quarter of 2013. The maturities and cash flows of the securities will be structured to provide funding for the anticipated deployment into new commercial and consumer loans originated in the near future.

### Cash and Cash Equivalents

Total cash and cash equivalents decreased slightly since December 31, 2012, due primarily to a decrease of \$8.6 million in interest-bearing deposits in other financial institutions, partially offset by an increase of \$8.3 million in cash and due from financial institutions.

### Securities

The Corporation's Funds Management Policy includes an investment policy that in general, requires debt securities purchased for the bond portfolio to carry a minimum agency rating of "A". After a credit analysis is performed, the policy also allows the Corporation to purchase local municipal obligations that are not rated. The Corporation intends to maintain a reasonable level of securities to provide adequate liquidity and in order to have securities available to pledge to secure public deposits, repurchase agreements and other types of transactions. Fluctuations in the fair value of the Corporation's securities relate primarily to changes in interest rates.



Marketable securities are classified as Available for Sale, while investments in local municipal obligations are generally classified as Held to Maturity. The composition of the available for sale segment of the securities portfolio is summarized as follows (in thousands of dollars):

Securities Available for Sale	September 30, 2013			December 31, 2012		
	Amortized Cost	Fair Value	Estimated Unrealized Gains (Losses)	Amortized Cost	Fair Value	Estimated Unrealized Gains (Losses)
Obligations of U.S. Government and U.S Government sponsored enterprises	\$ 162,812	\$ 164,630	\$ 1,818	\$ 138,041	\$ 141,591	\$ 3,550
Mortgage-backed securities, residential	37,567	39,033	1,466	29,592	31,515	1,923
Collateralized mortgage obligations	1,476	1,501	25	3,495	3,543	48
Obligations of states and political subdivisions	34,173	35,235	1,062	39,175	40,815	1,640
Corporate bonds and notes	7,390	7,484	94	11,412	11,652	240
SBA loan pools	1,513	1,540	27	1,683	1,724	41
Trust preferred securities	2,525	2,552	27	2,519	2,471	(48)
Corporate stocks	689	7,301	6,612	736	6,375	5,639
Totals	\$248,145	\$259,276	\$11,131	\$226,653	\$239,686	\$13,033

The available for sale segment of the securities portfolio totaled \$259.3 million at September 30, 2013, an increase of \$19.6 million, or 8.2%, from \$239.7 million at December 31, 2012. The increase in the securities portfolio was primarily related to a pre-funding strategy associated with the acquisition of six Bank of America branches, scheduled to close in the fourth quarter of 2013. The increase primarily consisted of purchases of \$69.9 million, partially offset by sales and calls of \$10.5 million, maturities and principal collected of \$36.2 million and a decrease of \$1.9 million in unrealized gains.

The held to maturity segment of the securities portfolio consists of obligations of political subdivisions in the Corporation's market areas. These securities totaled \$6.5 million at September 30, 2013, a net increase of \$0.8 million due primarily to the purchase of securities, from December 31, 2012.

#### Loans

The composition of the loan portfolio, net of deferred origination fees and costs, and unearned income is summarized as follows (in thousands of dollars):

	September 30, 2013	December 31, 2012
Commercial and agricultural	\$ 139,893	\$ 133,851
Commercial mortgages	361,063	320,198
Residential mortgages	194,042	200,475
Consumer loans	272,636	238,993
Total loans, net	\$ 967,634	\$ 893,517

Portfolio loans totaled \$967.6 million at September 30, 2013, an increase of \$74.1 million, or 8.3%, from \$893.5 million at December 31, 2012. The increase in portfolio loans was due to strong growth of \$46.9 million, or 10.3%, in commercial loans and \$33.6 million in consumer loans. The growth in commercial loans was due primarily to an increase in commercial mortgages in the Albany, New York region, of the Corporation's Capital Bank division. The growth in consumer loans was primarily in indirect consumer loans as the Corporation extended into 2013 its loan program with reduced pricing on high quality indirect auto loans.

Residential mortgage loans totaled \$194.0 million at September 30, 2013, a decrease of \$6.4 million, or 3.2%, from December 31, 2012. In addition, during the nine months ended September 30, 2013, \$14.9 million of newly originated residential mortgages were sold in the secondary market to Federal Home Loan Mortgage Corporation and \$0.6 million in residential mortgages were sold to the State of New York Mortgage Agency. During the twelve months ended December 31, 2012, \$15.8 million of residential mortgages were sold in the secondary market.



The Corporation anticipates that future growth in portfolio loans will continue to be in commercial mortgages and indirect consumer loans.

#### Non-Performing Assets

Non-performing assets consist of non-accrual loans, non-accrual troubled debt restructurings and other real estate owned that has been acquired in partial or full satisfaction of loan obligations or upon foreclosure.

Past due status on all loans is based on the contractual terms of the loan. It is generally the Corporation's policy that a loan 90 days past due be placed in non-accrual status unless factors exist that would eliminate the need to place a loan in this status. A loan may also be designated as non-accrual at any time if payment of principal or interest in full is not expected due to deterioration in the financial condition of the borrower. At the time loans are placed in non-accrual status, the accrual of interest is discontinued and previously accrued interest is reversed. All payments received on non-accrual loans are applied to principal. Loans can be returned to accrual status when they become current as to principal and interest and remain current for a period of six consecutive months or when, in the opinion of management, the Corporation expects to receive all of its original principal and interest. In the case of non-accrual loans where a portion of the loan has been charged off, the remaining balance is kept in non-accrual status until the entire principal balance has been recovered.

The following table summarizes the Corporation's non-performing assets, excluding acquired PCI loans (in thousands of dollars):

	September 30, 2013	December 31, 2012	
Non-accrual loans	\$ 6,550	\$ 5,667	
Non-accrual troubled debt restructurings	1,093	365	
Total non-performing loans	\$ 7,643	\$ 6,032	
Other real estate owned	564	565	
Total non-performing assets	\$ 8,207	\$ 6,597	
Ratio of non-performing loans to total loans	0.79%	0.68	%
Ratio of non-performing assets to total assets	0.61%	0.53	%
Ratio of allowance for loan losses to non-performing loans	155.12%	172.96	%
Accruing loans past due 90 days or more	\$ 1,465	\$ 4,484	
Accruing troubled debt restructurings	\$ 6,153	\$ 5,364	

#### Non-Performing Loans

The recorded investment in non-performing loans at September 30, 2013 totaled \$7.6 million compared to \$6.0

million at December 31, 2012, an increase of \$1.6 million. The increase in non-performing loans was due primarily to an increase of \$0.7 million in non-accrual commercial mortgages and \$0.7 million in commercial and industrial loans. In addition, non-accrual residential mortgages increased \$0.3 million while there was a slight increase in non-accrual consumer loans.

The recorded investment in accruing loans past due 90 days or more totaled \$1.5 million at September 30, 2013 compared with \$4.5 million at December 31, 2012. The decrease was due primarily to a \$3.0 million reduction in acquired construction loans not considered by management to be PCI loans, which for a variety of reasons are 90 days or more past their stated maturity dates. These loans totaled \$1.5 million at September 30, 2013. However, the borrowers continue to make required interest payments. Additionally, these loans carry third party credit enhancements, and based upon the strength of those credit enhancements, the Corporation has not identified these loans as PCI loans and expects to incur no losses on these loans.

Not included in non-performing loans at September 30, 2013 are \$9.2 million of acquired loans which the Corporation has identified as PCI loans. The PCI loans are accounted for under separate accounting guidance, Accounting Standards Codification (“ASC”) Subtopic 310-30, “Receivables - Loans and Debt Securities Acquired with Deteriorated Credit Quality” as disclosed in “Note 5 Loans and Allowance for Loan Losses” to the unaudited interim financial statements.

### Troubled Debt Restructurings

The Corporation works closely with borrowers that have financial difficulties to identify viable solutions that minimize the potential for loss. In that regard, the Corporation modified the terms of select loans to maximize their collectability. The modified loans are considered TDRs under current accounting guidance. Modifications generally involve short-term deferrals of principal and/or interest payments, reductions of scheduled payment amounts, interest rates or principal of the loan, and forgiveness of accrued interest. As of September 30, 2013, the Corporation had \$1.1 million of non-accrual TDRs compared with \$0.4 million as of December 31, 2012. As of September 30, 2013, the Corporation had \$6.2 million of accruing TDRs compared with \$5.4 million as of December 31, 2012. The increase in total TDRs was due primarily to restructuring the loans of four commercial borrowers that experienced financial difficulties during the second quarter of 2013.

### Impaired Loans

Impaired loans at September 30, 2013 totaled \$11.9 million, including performing TDRs of \$6.2 million, compared to \$12.7 million, including performing TDRs of \$5.4 million, at December 31, 2012. The decrease in impaired loans was due primarily to a decrease of \$1.6 million in commercial mortgages, partially offset by an increase of \$0.7 million in commercial and industrial loans. Included in the impaired loan total at September 30, 2013 are loans totaling \$2.7 million for which impairment allowances of \$1.1 million have been specifically allocated to the allowance for loan losses. Included in the impaired loan total at December 31, 2012, are loans totaling \$0.8 million for which impairment allowances of \$0.2 million have been specifically allocated to the allowance for loan losses. Not included in the impaired loan totals are acquired loans identified as PCI loans.

The majority of the Corporation's impaired loans are secured and measured for impairment based on collateral evaluations. It is the Corporation's policy to obtain updated appraisals, by independent third parties, on loans secured by real estate at the time a loan is determined to be impaired. Prior to the receipt of the updated appraisal, an impairment measurement is performed based upon the most recent appraisal on file to determine the amount of any specific allocation or charge-off. In determining the amount of any specific allocation or charge-off, the Corporation will make adjustments to reflect the estimated costs to sell the property. Upon receipt and review of the updated appraisal, an additional measurement is performed to determine if any adjustments are necessary to reflect the proper provisioning or charge-off. Impaired loans are reviewed on a quarterly basis to determine if any changes in credit quality or market conditions would require any additional allocation or recognition of additional charge-offs. Real estate values in the Corporation's market area had not increased dramatically in the prior several years and, as a result, declines in real estate values have been modest. Non-real estate collateral may be valued using (i) an appraisal, (ii) net book value of the collateral per the borrower's financial statements, or (iii) aging reports, that may be adjusted based on management's knowledge of the client and client's business. If market conditions warrant, future appraisals are obtained for both real estate and non-real estate collateral.

## Allowance for Loan Losses

The allowance is an amount that management believes will be adequate to absorb probable incurred losses on existing loans. The allowance for loan losses is increased through a provision for loan losses charged to operations. Loans are charged against the allowance for loan losses when management believes that the collectability of all or a portion of the principal is unlikely. Management's evaluation of the adequacy of the allowance for loan losses is performed on a periodic basis and takes into consideration such factors as the credit risk grade assigned to the loan, historical loan loss experience (general component) and review of specific impaired loans (including evaluations of the underlying collateral and expected cash flows). Historical loss experience is adjusted by management based on their judgment as to the current impact of qualitative factors including changes in the composition and volume of the loan portfolio, overall portfolio quality, and current economic conditions that may affect the borrowers' ability to pay. Management believes that the allowance for loan losses is adequate to absorb probable incurred losses. While management uses available information to recognize losses on loans, future additions to the allowance may be necessary based on changes in economic conditions. In addition, various regulatory agencies, as an integral part of their examination process, periodically review the Corporation's allowance for loan losses. Such agencies may require the Corporation to recognize additions to the allowance based on their judgments about information available to them at the time of their examination.

Management, after considering current information and events regarding the borrower's ability to repay their obligations, classifies a loan as impaired when it is probable that the Corporation will be unable to collect all amounts due according to the contractual terms of the loan agreement. Factors considered by management in determining impairment include payment status, collateral value, and the probability of collecting scheduled principal and interest payments when due. Loans that experience insignificant payment delays and payment shortfalls generally are not classified as impaired. Management determines the significance of payment delays and payment shortfalls on a case-by-case basis, taking into consideration all of the circumstances surrounding the loan and the borrower, including the length of the delay, the reasons for the delay, the borrower's prior payment record, and the amount of the shortfall in relation to the principal and interest owed. If a loan is determined to be impaired and is placed on nonaccrual status, all future payments received are applied to principal.

If a loan is impaired, a portion of the allowance is allocated so that the loan is reported, net, at the present value of estimated future cash flows using the loan's existing rate or at the fair value of collateral if repayment is expected solely from the collateral. Troubled debt restructurings are impaired loans.

The general component covers non-impaired loans and is based on historical loss experience adjusted for current factors. Loans not impaired but classified as substandard and special mention use a historical loss factor on a rolling five year history of net losses. For all other unclassified loans, the historical loss experience is determined by portfolio class and is based on the actual loss history experienced by the Corporation over the most recent two years. This actual loss experience is supplemented with other economic factors based on the risks present for each portfolio class. These economic factors include consideration of the following: (1) lending policies and procedures, including underwriting standards and collection, charge-off and recovery policies, (2) national and local economic and business conditions and developments, including the condition of various market segments, (3) loan profiles and volume of the portfolio, (4) the experience, ability, and depth of lending management and staff, (5) the volume and severity of past due, classified and watch-list loans, non-accrual loans and troubled debt restructurings, (6) the quality of the Bank's loan review system and the degree of oversight by the Bank's Board of Directors, (7) collateral related issues: secured vs. unsecured, type, declining valuation environment and trend of other related factors, (8) the existence and effect of any concentrations of credit, and changes in the level of such concentrations, (9) the effect of external factors, such as competition and legal and regulatory requirements,

on the level of estimated credit losses in the Bank's current portfolio and (10) impact of the global economy.

The allowance for loan losses was \$11.9 million at September 30, 2013, up from \$10.4 million at December 31, 2012. The ratio of allowance for loan losses to total loans was 1.23% at September 30, 2013, up from 1.17% at December 31, 2012. The increase in the allowance for loan losses was due primarily to loan portfolio growth, including allowances for this growth after consideration of the factors discussed above and higher net charge-offs. Net charge-offs for the nine months ended September 30, 2013 were \$0.3 million compared with net recoveries of \$0.3 million for the prior year. The increase in net charge-offs was primarily in the consumer loan portfolio.

The following table summarizes the activity in the allowance for loan losses for the nine months ended September 30, 2013 and 2012 (in thousands of dollars, except ratio data):

	Nine Months Ended	
	September 30, 2013	September 30, 2012
Balance at beginning of period	\$ 10,433	\$ 9,659
Reclassification of acquired loan discount	-	124
Charge-offs:		
Commercial and agricultural	186	6
Commercial mortgages	44	88
Residential mortgages	54	83
Consumer loans	909	343
Total charge-offs	1,193	520
Recoveries:		
Commercial and agricultural	454	592
Commercial mortgages	53	43
Residential mortgages	65	-
Consumer loans	289	176
Total recoveries	861	811
Net charge-offs (recoveries)	332	(291)
Provision charged to operations	1,755	754
	\$ 11,856	\$ 10,828

Balance at end  
of period

Ratio of net  
charge-offs  
(recoveries) to  
average loans  
outstanding

	0.05%	(0.05)%
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Ratio of  
allowance for  
loan losses to  
total loans  
outstanding

	1.23%	1.24%
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## Deposits

A summary of deposits at September 30, 2013 and December 31, 2012 is as follows (in thousands of dollars):

	September 30, 2013	December 31, 2012	Dollar Change	Percent Change
Non-interest-bearing demand deposits	\$ 297,053	\$ 300,610	\$ (3,557)	(1.18)%
Interest-bearing demand deposits	96,191	90,730	5,461	6.02 %
Insured money market accounts	289,459	243,115	46,344	19.06 %
Savings deposits	183,804	173,589	10,215	5.88 %
Time deposits	221,938	236,690	(14,752)	(6.23)%
Total	\$ 1,088,445	\$ 1,044,734	\$ 43,711	4.18 %

The growth in deposits is a result of the Corporation's deposit strategy, which is to fund the Bank with stable, low-cost deposits, primarily checking account deposits and other low interest-bearing deposit accounts. A checking account is the driver of a banking relationship and consumers consider the bank where they have their checking account as their primary bank. These customers will typically turn to their primary bank first when in need of other financial services. Strategies that have been developed and implemented to generate these deposits include: (i) acquire deposits by entering new markets through de novo branching, (ii) an annual checking account marketing campaign, (iii) training branch employees to identify and meet client financial needs with Bank products and services, (iv) link business and consumer loans to primary checking account at the Bank, (v) aggressively promote direct deposit of client's payroll checks or benefit checks and (vi) constantly monitor the Corporation's pricing strategies to ensure competitive products and services.

Sorted by public, commercial and consumer sources, the \$43.7 million growth in deposits was due to an increase of \$49.7 million in public funds, partially offset by decreases of \$3.5 million in commercial deposits and \$2.5 million in consumer deposits. The growth in public funds was due primarily to increases of \$29.8 million in insured money market accounts and \$11.9 million in interest-bearing demand deposits. The Corporation had anticipated a decline in time deposits since its strategy was to focus on core checking accounts.

The Corporation also considers brokered deposits to be an element of its deposit strategy and anticipates that it will continue using brokered deposits as a secondary source of funding to support growth. The Corporation's use of brokered deposits as part of its funding strategy complies with the FDIC's guidance and regulations on the use of brokered deposits by insured banks. Brokered deposits include funds obtained through brokers, and the Bank's participation in the Certificate of Deposit Account Registry Service ("CDARS") program and Insured Cash Sweep ("ICS") service. The CDARS and ICS programs both involve a network of financial institutions that exchange funds among members in order to ensure FDIC insurance coverage on customer deposits above the single institution limit. Using a sophisticated matching system, funds are exchanged on a dollar-for-dollar basis, so that the equivalent of an original deposit comes back to the originating institution.

In the summary of deposits table above, ICS funds were included in insured money market accounts. Funds obtained through brokers or CDARS were included in time deposits. Deposits obtained through brokers were \$6.0 million as of September 30, 2013 compared with \$8.8 million as of December 31, 2012. Deposits obtained through CDARS and ICS were \$9.3 million and \$17.1 million, respectively, as of September 30, 2013. Deposits obtained through CDARS were \$8.1 million as of December 31, 2012.



### Borrowings

Both FHLB term advances and securities sold under agreements to repurchase decreased \$1.2 million and \$2.2 million, respectively, during the nine months ended September 30, 2013. The increase of \$49.1 million in FHLB overnight advances was related to a pre-funding strategy associated with the acquisition of six Bank of America branches, scheduled to close in the fourth quarter of 2013. The overnight FHLB advances will be paid off after the acquisition is closed.

## Shareholders' Equity

Total shareholders' equity was \$134.8 million at September 30, 2013 compared with \$131.1 million at December 31, 2012. The increase was due primarily to \$7.2 million in net income for 2013, partially offset by dividends declared of \$3.6 million. The total shareholders' equity to total assets ratio was 10.05% at September 30, 2013 compared with 10.50% at December 31, 2012. The tangible equity to tangible assets ratio was 8.25% at September 30, 2013 compared with 8.53% at December 31, 2012. Book value per share increased to \$28.93 at September 30, 2013 from \$28.20 at December 31, 2012.

The Corporation and the Bank are subject to capital adequacy guidelines of the Federal Reserve and establish a framework for the classification of financial holding companies and financial institutions into five categories: well-capitalized, adequately capitalized, undercapitalized, significantly undercapitalized and critically undercapitalized. As of September 30, 2013, both the Corporation's and the Bank's capital ratios were in excess of those required to be considered well-capitalized under regulatory capital guidelines.

## Results of Operations

### Comparison of Nine Months Ended September 30, 2013 and 2012

#### Net Income

Net income for the nine months ended September 30, 2013 was \$7.2 million, a decrease of \$1.7 million, or 18.5%, compared with \$8.9 million for the nine months ended September 30, 2012. Earnings per share for the nine months ended September 30, 2013 was \$1.56, compared with \$1.92 for the nine months ended September 30, 2012. Return on average assets and return on average equity for nine months ended September 30, 2013 were 0.76% and 7.25%, respectively, compared with 0.95% and 9.12%, respectively, for the same period in the prior year.

The decline in 2013 earnings was due primarily to a decrease of \$0.6 million in net interest income and reductions of \$0.3 million in net gain on securities transactions and \$0.8 million in pre-tax casualty gains from insurance reimbursements. In addition, the provision for loan losses increased \$1.0 million and non-interest expense increased \$0.8 million. These items were partially offset by an increase of \$0.9 million in the remaining non-interest income categories and a reduction of \$0.9 million in income taxes.

#### Net Interest Income

Net interest income, which is the difference between income received on interest-earning assets, such as loans and securities, and interest paid on interest-bearing liabilities, such as deposits and borrowings, is the largest contributor to earnings.

Net interest income for the nine months ended September 30, 2013 totaled \$34.6 million, a decrease of \$0.6 million, or 1.8%, compared with \$35.2 million for the same period in the prior year. Net interest margin was 3.93% for the nine months ended September 30, 2013 compared with 4.10% for the same period in the prior year. The decline in net interest income was primarily due to a 31 basis point decrease in yield on interest-earning assets, partially offset by a 17 basis point decline in the cost of funds and an increase of \$30.6 million in average earning assets. The decline in net interest margin was due primarily to yields on interest-earning assets decreasing as a faster rate than the cost of interest-bearing liabilities. The decrease in yield on interest-earning assets was attributable to a 66 basis point decrease in yield on loans, a result of loans continuing to reprice at

current historically low market rates.

## Average Consolidated Balance Sheet and Interest Analysis

The following table sets forth certain information related to the Corporation's average consolidated balance sheets and its consolidated statements of income for the nine month periods ended September 30, 2013 and 2012. The table also reflects the average yield on assets and average cost of liabilities for the nine month periods ended September 30, 2013 and 2012. For the purpose of the table below, non-accruing loans are included in the daily average loan amounts outstanding. Daily balances were used for average balance computations. Investment securities are stated at amortized cost. No tax equivalent adjustments have been made in calculating yields on obligations of states and political subdivisions.

(in thousands of dollars)	Nine Months Ended September 30, 2013			Nine Months Ended September 30, 2012		
	Average Balance	Interest	Yield/ Rate	Average Balance	Interest	Yield/ Rate
<b>Assets</b>						
<b>Earning assets:</b>						
Loans	\$ 929,906	\$ 33,605	4.83%	\$ 829,396	\$ 34,078	5.49%
Taxable securities	193,016	3,120	2.16%	219,985	4,142	2.52%
Tax-exempt securities	43,101	845	2.62%	49,796	977	2.62%
Interest-bearing deposits	10,873	21	0.25%	47,075	123	0.35%
<b>Total earning assets</b>	<b>1,176,896</b>	<b>37,591</b>	<b>4.27%</b>	<b>1,146,252</b>	<b>39,320</b>	<b>4.58%</b>
<b>Non-earning assets:</b>						
Cash and due from banks	23,291			23,967		
Premises and equipment, net	25,144			24,762		
Other assets	46,918			51,815		
Allowance for loan losses	(10,924)			(10,262)		
AFS valuation allowance	11,881			13,698		
<b>Total</b>	<b>\$ 1,273,206</b>			<b>\$ 1,250,232</b>		
<b>Liabilities and Shareholders' Equity</b>						
<b>Interest-bearing liabilities:</b>						
Interest-bearing demand deposits	\$ 95,218	70	0.10%	\$ 88,005	70	0.11%
Savings and insured money market deposits	446,094	613	0.18%	409,081	622	0.20%
Time deposits	229,362	1,108	0.65%	261,549	1,795	0.92%
Federal Home Loan Bank	61,690	1,239	2.68%	73,944	1,631	2.95%

advances and  
securities sold  
under agreements  
repurchase

Total interest-bearing liabilities	832,364	3,030	0.49%	832,579	4,118	0.66%
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Non-interest-bearing  
liabilities:

Demand deposits	296,089			278,473		
Other liabilities	11,039			8,962		
Total liabilities	1,139,492			1,120,014		
Shareholders' equity	133,714			130,218		
Total	\$ 1,273,206			\$ 1,250,232		

Net interest income		\$ 34,561			\$ 35,202	
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Net interest rate spread(1)			3.78%			3.92%
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Net interest margin(2)			3.93%			4.10%
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(1) Net interest rate spread is the difference in the yield received on earning assets less the rate paid on interest-bearing liabilities.

(2) Net interest margin is the ratio of net interest income divided by average earning assets

## Changes Due to Volume and Rate

Net interest income can be analyzed in terms of the impact of changes in rates and volumes. The following table illustrates the extent to which changes in interest rates and in the volume of average interest-earning assets and interest-bearing liabilities have affected the Corporation's interest income and interest expense during the periods indicated. Information is provided in each category with respect to (i) changes attributable to changes in volume (changes in volume multiplied by prior rate); (ii) changes attributable to changes in rates (changes in rates multiplied by prior volume); and (iii) the net changes. For purposes of this table, changes that are not due solely to volume or rate changes have been allocated to these categories based on the respective percentage changes in average volume and rate. Due to the numerous simultaneous volume and rate changes during the periods analyzed, it is not possible to precisely allocate changes between volume and rates. In addition, average earning assets include non-accrual loans and no tax equivalent adjustments were made.

(in thousands of dollars)	Nine Months Ended		
	2012	September 30, 2013 vs.	
	Total Change	Increase/(Decrease) Due to Volume	Due to Rate
Interest and dividends earned on:			
Loans	\$ (473)	3,862	(4,335)
Taxable investment securities	(1,022)	(476)	(546)
Tax-exempt investment securities	(132)	(132)	-
Interest-bearing deposits	(102)	(75)	(27)
Total earning assets	\$ (1,729 )	\$ 3,179	\$ (4,908 )
Interest paid on:			
Interest-bearing demand deposits	\$ -	\$ 6	\$ (6)
Savings and insured money market deposits	(9)	53	(62)
Time deposits	(687)	(202)	(485)
FHLB advances and securities sold under	(392)	(255)	(137)

agreements to repurchase			
Total interest-bearing liabilities	\$ (1,088 )	\$ (398 )	\$ (690 )
Net interest income	\$ (641 )	\$ 3,577	\$ (4,218 )

#### Provision for Loan Losses

The provision for loan losses for the nine months ended September 30, 2013 totaled \$1.8 million compared with \$0.8 million for the nine months ended September 30, 2012. The increase in the provision for loan losses was due primarily to one commercial and industrial loan, loan portfolio growth and higher net charge-offs.

#### Non-Interest Income

Non-interest income for the nine months ended September 30, 2013 totaled \$12.8 million, a decrease of \$0.2 million, or 1.1%, compared with \$13.0 million for the same period in the prior year. The decline was due primarily to reductions of \$0.8 million in casualty gains from insurance reimbursements and \$0.3 million in net gain on securities transactions. These items were partially offset by increases \$0.3 million in Wealth Management Group fee income, \$0.2 million in service charges on deposit accounts and \$0.2 million in net gain on sales of loans held for sale.

### Non-Interest Expense

Non-interest expense for the nine months ended September 30, 2013 totaled \$34.9 million, an increase of \$0.7 million, or 2.3%, compared with \$34.2 million for the same period in the prior year. The increase was due primarily to increases of \$0.4 million in salaries and wages, \$0.2 million in acquisition expenses and \$0.2 million in data processing costs. These items were primarily offset by decreases of \$0.1 million in other real estate owned expenses and \$0.1 million in amortization of intangible assets. The increase in salaries and wages was due primarily to compensation related to merit increases and incentive plans.

### Income Taxes

Income tax expense for the nine months ended September 30, 2013 totaled \$3.5 million, a decrease of \$0.9 million, compared with \$4.4 million for the same period in the prior year. Income tax expense reflects an effective tax rate of 32.4% for the nine months ended September 30, 2013 compared with 33.1% for the same period in the prior year. The decrease in the effective tax rate was due primarily to an increase in the relative percentage of tax exempt income to pre-tax income.

### Comparison of Three Months Ended September 30, 2013 and 2012

#### Net Income

Net income for the three months ended September 30, 2013 was \$2.2 million, a decrease of \$0.6 million, or 23.1%, compared with \$2.8 million for the three months ended September 30, 2012. Earnings per share for the three months ended September 30, 2013 was \$0.47 compared with \$0.61 for the three months ended September 30, 2012. Return on average assets and return on average equity for the three months ended September 30, 2013 were 0.67% and 6.45%, respectively, compared with 0.89% and 7.92%, respectively, for the same period in the prior year.

The decrease in net income for the three months ended September 30, 2013 was due primarily to a decline of \$0.3 million in net interest income and increases of \$0.6 million in the provision for loan losses and \$0.5 million in non-interest expense. These items were partially offset by an increase of \$0.4 million in non-interest income and a reduction of \$0.4 million in income taxes.

#### Net Interest Income

Net interest income for the three months ended September 30, 2013 totaled \$11.5 million, a decrease of \$0.3 million, or 2.3%, compared with \$11.8 million for the same period in the prior year. Net interest margin was 3.84% for the three months ended September 30, 2013 compared with 4.04% for the same period in the prior year. The decline in net interest income was due primarily to a 29 basis point decrease in the yield on interest-earning assets, partially offset by a 12 basis point decline in the cost of funds and an increase of \$29.5 million in average earning assets. The decline in net interest margin was primarily due to yields on interest-earning assets decreasing at a faster rate than the cost of interest-bearing liabilities. The decrease in yield on interest-earning assets was attributable to a 52 basis point decrease in yield on loans, a result of loans continuing to reprice at current historically low market rates.





## Average Consolidated Balance Sheet and Interest Analysis

The following table sets forth certain information related to the Corporation's average consolidated balance sheets and its consolidated statements of income for the three month periods ended September 30, 2013 and 2012. The table also reflects the average yield on assets and average cost of liabilities for the three month periods ended September 30, 2013 and 2012. For the purpose of the table below, non-accruing loans are included in the daily average loan amounts outstanding. Daily balances were used for average balance computations. Investment securities are stated at amortized cost. No tax equivalent adjustments have been made in calculating yields on obligations of states and political subdivisions.

## Average Consolidated Balance Sheet and Interest Analysis (continued)

(in thousands of dollars)	Three Months Ended September 30, 2013			Three Months Ended September 30, 2012		
	Average Balance	Interest	Yield/ Rate	Average Balance	Interest	Yield/ Rate
<b>Assets</b>						
<b>Earning assets:</b>						
Loans	\$ 950,657	\$ 11,245	4.69%	\$ 867,972	\$ 11,374	5.21%
Taxable securities	195,337	1,003	2.04%	208,000	1,306	2.50%
Tax-exempt securities	39,470	258	2.60%	46,811	300	2.55%
Interest-bearing deposits	4,514	3	0.25%	37,696	35	0.36%
<b>Total earning assets</b>	<b>1,189,978</b>	<b>12,509</b>	<b>4.17%</b>	<b>1,160,479</b>	<b>13,015</b>	<b>4.46%</b>
<b>Non-earning assets:</b>						
Cash and due from banks	23,512			24,823		
Premises and equipment, net	25,006			24,585		
Other assets	46,465			49,482		
Allowance for loan losses	(11,300)			(10,534)		
AFS valuation allowance	9,916			13,813		
<b>Total</b>	<b>\$ 1,283,577</b>			<b>\$ 1,262,648</b>		
<b>Liabilities and Shareholders' Equity</b>						
<b>Interest-bearing liabilities:</b>						
Interest-bearing demand deposits	\$ 88,854	22	0.10%	\$ 92,703	25	0.11%
Savings and insured money market deposits	455,818	205	0.18%	415,368	207	0.20%
Time deposits	226,278	345	0.61%	252,826	528	0.83%
	66,889	420	2.50%	65,039	465	2.85%

Federal Home Loan  
Bank  
advances and  
securities sold  
under agreements  
repurchase

Total interest-bearing liabilities	837,839	992	0.47%	825,936	1,225	0.59%
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Non-interest-bearing  
liabilities:

Demand deposits	299,603			294,612		
Other liabilities	12,180			9,914		
Total liabilities	1,149,622			1,130,462		
Shareholders' equity	133,955			132,186		
Total	\$ 1,283,577			\$ 1,262,648		
Net interest income		\$ 11,517			\$ 11,790	
Net interest rate spread(1)			3.70%			3.87%
Net interest margin(2)			3.84%			4.04%

(1) Net interest rate spread is the difference in the yield received on earning assets less the rate paid on interest-bearing liabilities.

(2) Net interest margin is the ratio of net interest income divided by average earning assets

## Changes Due to Volume and Rate

Net interest income can be analyzed in terms of the impact of changes in rates and volumes. The following table illustrates the extent to which changes in interest rates and in the volume of average interest-earning assets and interest-bearing liabilities have affected the Corporation's interest income and interest expense during the three month periods ended September 30, 2013 and September 30, 2012. Information is provided in each category with respect to (i) changes attributable to changes in volume (changes in volume multiplied by prior rate); (ii) changes attributable to changes in rates (changes in rates multiplied by prior volume); and (iii) the net changes. For purposes of this table, changes that are not due solely to volume or rate changes have been allocated to these categories based on the respective percentage changes in average volume and rate. Due to the numerous simultaneous volume and rate changes during the periods analyzed, it is not possible to precisely allocate changes between volume and rates. In addition, average earning assets include non-accrual loans and no tax equivalent adjustments were made.

Three Months Ended  
September 30, 2013 vs. 2012  
Increase/(Decrease)

(in thousands of dollars)	Total Change	Due to Volume	Due to Rate
Interest and dividends earned on:			
Loans	\$ (129)	\$ 1,048	\$ (1,177)
Taxable investment securities	(303)	(75)	(228)
Tax-exempt investment securities	(42)	(47)	5
Interest-bearing deposits	(32)	(24)	(8)
<b>Total earning assets</b>	<b>\$ (506 )</b>	<b>\$ 902</b>	<b>\$ (1,408 )</b>
Interest paid on:			
Interest-bearing demand deposits	\$ (3)	\$ (1)	\$ (2)
Savings and insured money market deposits	(2)	19	(21)
Time Deposits	(183)	(51)	(132)
FHLB advances and securities sold under agreements to repurchase	(45)	13	(58)
<b>Total interest-bearing liabilities</b>	<b>\$ (233 )</b>	<b>\$ (20)</b>	<b>\$ (213)</b>
<b>Net interest income</b>	<b>\$ (273)</b>	<b>\$ 922</b>	<b>\$ (1,195)</b>

## Provision for Loan Losses

The provision for loan losses for the three months ended September 30, 2013 totaled \$0.9 million compared with \$0.2 million for the three months ended September 30, 2012. The increase in the provision for loan losses was due primarily to one commercial and industrial loan, loan portfolio growth and higher net charge-offs.

#### Non-Interest Income

Non-interest income for the three months ended September 30, 2013 totaled \$4.4 million, an increase of \$0.4 million, or 9.0%, compared with \$4.0 million for the same period in the prior year. The increase was due primarily to increases of \$0.1 million in Wealth Management fee income, \$0.1 million in service charges on deposit accounts and \$0.1 million in net gain on sales of other real estate owned.

#### Non-Interest Expense

Non-interest expense for the three months ended September 30, 2013 totaled \$11.8 million, an increase of \$0.5 million, or 4.2%, compared with \$11.3 million for the same period in the prior year. The decrease was due primarily to increases of \$0.2 million in data processing costs and \$0.2 million in acquisition expenses.

## Income Taxes

Income tax expense for the three months ended September 30, 2013 totaled \$1.0 million, a decrease of \$0.4 million, compared with \$1.4 million for the same period in the prior year. Income tax expense reflects an effective tax rate of 31.5% for the three months ended September 30, 2013 compared with 32.8% for the same period in the prior year. The decrease in the effective tax rate was due primarily to an increase in the relative percentage of tax exempt income to pre-tax income.

## Liquidity and Capital Resources

Liquidity management involves the ability to meet the cash flow requirements of deposit clients, borrowers, and the operating, investing, and financing activities of the Corporation. The Corporation uses a variety of resources to meet its liquidity needs. These include short term investments, cash flow from lending and investing activities, core deposit growth and non-core funding sources, such as time deposits of \$100,000 or more, securities sold under agreements to repurchase and other borrowings.

The Corporation is a member of the FHLB, which allows it to access borrowings that enhance management's ability to satisfy future liquidity needs. Based on available collateral and current advances outstanding, the Corporation was eligible to borrow up to a total of \$53.9 million and \$104.5 million at September 30, 2013 and December 31, 2012, respectively. The Corporation also had a total of \$28.0 million of unsecured lines of credit with four different financial institutions, all of which was available at September 30, 2013 and December 31, 2012.

During the nine months ended September 30, 2013, cash and cash equivalents decreased slightly. The major uses of cash included purchases of securities totaling \$76.1 million and a net increase of \$74.1 million in loans. These items were partially offset by proceeds from sales, maturities, calls and principal reductions on securities totaling \$52.1 million, net increases of \$47.9 million in borrowings and \$43.7 million in deposits, and \$14.9 million provided by operating activities.

As of September 30, 2013, the Bank's Tier I leverage ratio, Tier I and total risk-based capital ratios were 8.57%, 10.71% and 12.19%, respectively. All of the ratios were in excess of those required to be considered well-capitalized under regulatory capital standards.

During the nine months ended September 30, 2013, the Corporation declared cash dividends totaling \$0.78 per share compared with \$0.75 per share for the same period in the prior year.

## Interest Rate Risk

Management considers interest rate risk to be the most significant market risk for the Corporation. Market risk is the risk of loss from adverse changes in market prices and rates. Interest rate risk is the exposure to adverse changes in the net income of the Corporation as a result of changes in interest rates.

The Corporation's primary earnings source is net interest income, which is affected by changes in the level of interest rates, the relationship between rates, the impact of interest rate fluctuations on asset prepayments, the level and composition of deposits and liabilities, and credit quality of earning assets.



The Corporation's objectives in its asset and liability management are to maintain a strong, stable net interest margin, to utilize its capital effectively without taking undue risks, to maintain adequate liquidity, and to reduce vulnerability of its operations to changes in interest rates. The Corporation's Asset/Liability Committee ("ALCO") has the strategic responsibility for setting the policy guidelines on acceptable exposure to interest rate risk. These guidelines contain specific measures and limits regarding the risks, which are monitored on a regular basis. The ALCO is made up of the president and chief executive officer, the chief financial officer, the asset liability management officer, and other officers representing key functions.

Interest rate risk is the risk that net interest income will fluctuate as a result of a change in interest rates. It is the assumption of interest rate risk, along with credit risk, that drives the net interest margin of a financial institution. For that reason, the ALCO has established tolerance limits based upon a 200-basis point change in interest rates. At September 30, 2013, it is estimated that an immediate 200-basis point decrease in interest rates would negatively impact the next 12 months net interest income by 9.36% and an immediate 200-basis point increase would negatively impact the next 12 months net interest income by 10.33%. Both are within the Corporation's policy guideline of 15%. Given the overall low level of current interest rates and the unlikely event of a 200-basis point decline from this point, management additionally modeled an immediate 100-basis point decline and an immediate 300-basis point increase in interest rates. When applied, it is estimated these scenarios would result in negative impacts to net interest income of 4.10% and 15.44%, respectively.

A related component of interest rate risk is the expectation that the market value of the Corporation's capital account will fluctuate with changes in interest rates. This component is a direct corollary to the earnings-impact component: an institution exposed to earnings erosion is also exposed to shrinkage in market value. At September 30, 2013, it is estimated that an immediate 200-basis point decrease in interest rates would negatively impact the market value of the Corporation's capital account by 4.80% and an immediate 200-basis point increase in interest rates would negatively impact the market value by 6.01%. Both are within the Corporation's policy guideline of 15%. Management also modeled the impact to the market value of the Corporation's capital with an immediate 100-basis point decline and an immediate 300-basis point increase in interest rates, based on the current interest rate environment. When applied, it is estimated these scenarios would result in negative impacts to the market value of the Corporation's capital of 2.79% and 9.44%, respectively. Both are within the Corporation's policy guideline of 15%.

Management does recognize the need for certain hedging strategies during periods of anticipated higher fluctuations in interest rates and the Funds Management Policy provides for limited use of certain derivatives in asset liability management. These strategies were not employed during the nine months ended September 30, 2013.

#### Pending Acquisition

On July 10, 2013, the Bank, the wholly-owned banking subsidiary of the Corporation entered into a Purchase and Assumption Agreement with Bank of America, National Association ("BOA") pursuant to which the Bank agreed to acquire certain assets and assume certain liabilities of six BOA branch offices located in Auburn, Cortland, Ithaca and Seneca Falls, New York. Subject to the terms of the Purchase Agreement, the Bank will acquire approximately \$261.0 million in deposits and \$1.6 million in loans, for a purchase price equal to the sum of a deposit premium of 1.5% based on the 30-day average balances prior to the close of the transaction, the aggregate net book value of all assets and accrued interest on the loans acquired. The Bank will not receive any loans that are past due 30 days or more on the closing date. The deposits acquired will initially be used to fund the purchase of investment securities of varying maturities. The maturities and cash flows of these securities will be structured



to provide funding for the anticipated deployment into new commercial and consumer loans originated in the near future. The transaction will close in the fourth quarter of 2013. Additional information concerning this transaction was included in the Corporation's Current Report on Form 8-K filed with the SEC on July 12, 2013.

ITEM 3: QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Information required by this Item is set forth herein in Management's Discussion and Analysis of Financial Condition and Results of Operations under the heading "Interest Rate Risk."

ITEM 4: CONTROLS AND PROCEDURES

The Corporation's management, with the participation of our President and Chief Executive Officer, who is the Corporation's principal executive officer, and our Chief Financial Officer and Treasurer, who is the Corporation's principal financial officer, has evaluated the effectiveness of the Corporation's disclosure controls and procedures as of September 30, 2013 pursuant to Rule 13a-15 of the Securities Exchange Act of 1934, as amended. Based upon that evaluation, the principal executive officer and principal financial officer have concluded that the Corporation's disclosure controls and procedures are effective as of September 30, 2013. In addition, there have been no changes in the Corporation's internal control over financial reporting during the most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, the Corporation's internal control over financial reporting.

PART II. OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

For information related to this item, please see Note 9 to the Corporation's financial statements included herein.

ITEM 1A. MARKET RISK FACTORS

1A.

There have been no material changes in the risk factors set forth in the Corporation's Annual Report on Form 10-K for the year ended December 31, 2012, filed with the Securities and Exchange Commission on March 15, 2013.

ITEM 2. Unregistered Sales of Equity Securities and Use of Proceeds

(c) Issuer Purchases of Equity Securities (1)

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
7/1/13-7/30/13	-	\$ -	-	121,906
8/1/13-8/31/13	-	\$ -	-	121,906
9/1/13-9/30/13	-	\$ -	-	121,906
Quarter ended 9/30/13	-	\$ -	-	121,906

(1) On December 19, 2012, the Corporation's Board of Directors approved a stock repurchase plan authorizing the purchase of up to 125,000

shares of the Corporation's outstanding common stock. This plan replaces the plan approved on November 2009, which expired in November 2012. Purchases may be made from time to time on the open-market or in private negotiated transactions and will be at the discretion of management. As of September 30, 2013, a total of 3,094 shares had been purchased under this plan.

ITEMEXHIBITS

6.

The following exhibits are either filed with this Form 10-Q or are incorporated herein by reference. The Corporation's Securities Exchange Act File number is 000-13888.

3.1 Certificate of Incorporation of Chemung Financial Corporation dated December 20, 1984. (Filed as Exhibit 3.1 to Registrant's Form 10-K filed with the SEC on March 13, 2008 and incorporated herein by reference).

3.2 Certificate of Amendment to the Certificate of Incorporation of Chemung Financial Corporation, dated March 28, 1988. (Filed as Exhibit 3.2 to Registrant's Form 10-K filed with the SEC on March 13, 2008 and incorporated herein by reference).

3.3 Certificate of Amendment to the Certificate of Incorporation of Chemung Financial Corporation, dated May 13, 1998. (Filed as Exhibit 3.4 of the Registrant's Form 10-K for the year ended December 31, 2005 and incorporated herein by reference).

3.4 Amended and Restated Bylaws of the Registrant, as amended to May 16, 2012. (Filed as Exhibit 3.1 to the Registrant's Current Report on Form 8-K filed with the SEC on May 18, 2012 and incorporated herein by reference).

31.1 Certification of President and Chief Executive Officer of the Registrant pursuant to Rule 13a-14(a) under the Securities Exchange Act of 1934.\*

31.2 Certification of Chief Financial Officer and Treasurer of the Registrant pursuant to Rule 13a-14(a) under the Securities Exchange Act of 1934.\*

32.1 Certification of President and Chief Executive Officer of the Registrant pursuant to Rule 13a-14(b) under the Securities Exchange Act of 1934 and 18 U.S.C. §1350.\*

32.2 Certification of Chief Financial Officer and Treasurer of the Registrant pursuant to Rule 13a-14(b) under the Securities Exchange Act of 1934 and 18 U.S.C. §1350.\*

101.INS Instance Document\*

101.SCH XBRL Taxonomy Schema\*

101.CAL XBRL Taxonomy Calculation Linkbase\*

101.DEF XBRL Taxonomy Definition Linkbase\*

101.LAB XBRL Taxonomy Label Linkbase\*

101.PRE XBRL Taxonomy Presentation Linkbase\*

\* Filed herewith.



SIGNATURES

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

CHEMUNG FINANCIAL CORPORATION

DATED: November 7, 2013 By: /s/ Ronald M. Bentley  
Ronald M. Bentley, President and Chief Executive Officer  
(Principal Executive Officer)

DATED: November 7, 2013 By: /s/ Karl F. Krebs  
Karl F. Krebs, Chief Financial Officer and Treasurer  
(Principal Financial and Accounting Officer)

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