

EVANS BANCORP INC  
Form 10-K  
March 09, 2015  
UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K

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

For the fiscal year ended: December 31, 2014

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission file number: 001-35021

EVANS BANCORP, INC.

(Exact name of registrant as specified in its charter)

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

16-1332767  
(I.R.S. Employer Identification No.)

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

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

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

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

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

None  
(Title of Class)

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

Yes    No

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

Yes    No

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 checkmark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes     No

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

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

Large accelerated filer      Accelerated filer  
Non-accelerated filer      Smaller reporting company   
(do not check if a smaller  
reporting company)

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

Yes      No

On June 30, 2014, the aggregate market value of the registrant's common stock held by non-affiliates was approximately \$64.7 million, based upon the closing sale price of a share of the registrant's common stock on the NYSE MKT LLC.

As of February 27, 2015, 4,212,608 shares of the registrant's common stock were outstanding.

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DOCUMENTS INCORPORATED BY REFERENCE

Portions of the registrant's Proxy Statement relating to the registrant's 2015 Annual Meeting of Shareholders, to be held on April 30, 2015, which will be subsequently filed with the Securities and Exchange Commission within 120 days after the end of the fiscal year to which this Report relates, are incorporated by reference into Part III of this Annual Report on Form 10-K where indicated.

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PART I

FORWARD LOOKING STATEMENTS

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

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

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

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Item 1. BUSINESS

EVANS BANCORP, INC.

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

At December 31, 2014, the Company had consolidated total assets of \$846.8 million, deposits of \$707.6 million and stockholders’ equity of \$85.8 million.

The Company’s primary business is the operation of its subsidiaries. It does not engage in any other substantial business activities. The Company has two direct wholly-owned subsidiaries: (1) Evans Bank, N.A. (the “Bank”), which provides a full range of banking services to consumer and commercial customers in Western New York; and (2) Evans National Financial Services, LLC (“ENFS”), which owns 100% of the membership interests in The Evans Agency, LLC (“TEA”), which sells various premium-based insurance policies on a commission basis. At December 31, 2014, the Bank represented 99.0% and ENFS represented 1.0% of the consolidated assets of the Company. Further discussion of our segments is included in Note 18 to the Company’s Consolidated Financial Statements included under Item 8 of this Annual Report on Form 10-K.

Evans Bank

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

At December 31, 2014, the Bank had total assets of \$837.9 million, investment securities of \$100.1 million, net loans of \$683.1 million, deposits of \$707.6 million and stockholders’ equity of \$77.3 million, compared to total assets of

\$824.0 million, investment securities of \$104.9 million, net loans of \$635.5 million, deposits of \$713.8 million and stockholders' equity of \$71.7 million at December 31, 2013. The Bank offers deposit products, which include checking and NOW accounts, savings accounts, and certificates of deposit, as its principal source of funding. The Bank's deposits are insured up to the maximum permitted by the Bank Insurance Fund (the "Insurance Fund") of the Federal Deposit Insurance Corporation ("FDIC"). The Bank offers a variety of loan products to its customers, including commercial and consumer loans and commercial and residential mortgage loans.

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

The Evans Agency, LLC

TEA, a property and casualty insurance agency, is a wholly-owned subsidiary of ENFS. TEA is headquartered in Hamburg, NY, with offices located throughout Western New York. TEA is a full-service insurance agency offering personal, commercial and financial services products. For the year ended December 31, 2014, TEA had total revenue of \$6.5 million.

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

## Other Subsidiaries

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

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

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

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

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

Evans National Leasing, Inc. ("ENL"). ENL, a wholly-owned subsidiary of the Bank, provided direct financing leasing of commercial small-ticket general business equipment to companies located throughout the contiguous 48 United States. The Company exited the leasing business in 2009 and is currently servicing the leasing portfolio through to maturity.

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

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

#### MARKET AREA

The Company's primary market area is Erie County, Niagara County, northern Chautauqua County and northwestern Cattaraugus County, NY. This primary market area is the area where the Bank principally receives deposits and makes loans and TEA sells insurance.

#### MARKET RISK

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

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### COMPETITION

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

As an approximate indication of the Company's competitive position, in Erie County, NY, where 13 of the Company's banking offices are located, the Bank had the sixth most deposits according to the FDIC's annual deposit market share report as of June 30, 2014 with 1.8% of the total market's deposits of \$36.3 billion. By comparison, the market leaders, M&T Bank and First Niagara Financial Group, have 76.7% of the county's deposits combined. The Company attempts to be generally competitive with all financial institutions in its service area with respect to interest rates paid on time and savings deposits, service charges on deposit accounts, and interest rates charged on loans.

### SUPERVISION AND REGULATION

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

#### Bank Holding Company Regulation (BHCA)

As a financial holding company registered under the BHCA, the Company and its non-banking subsidiaries are subject to regulation and supervision under the BHCA by the FRB. The FRB requires periodic reports from the

Company, and is authorized by the BHCA to make regular examinations of the Company and its subsidiaries. Under Regulation Y, a bank holding company must serve as a source of financial and managerial strength for its subsidiary banks and must not conduct its operations in an unsafe or unsound manner.

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

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

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

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

## Supervision and Regulation of Bank Subsidiaries

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

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

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

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

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

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

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

Under the Financial Institutions Reform, Recovery and Enforcement Act of 1989, a depository institution insured by the FDIC can be held liable for any loss incurred by, or reasonably expected to be incurred by, the FDIC in connection with: (i) the default of a commonly controlled FDIC-insured depository institution, or (ii) any assistance provided by the FDIC to a commonly controlled FDIC-insured institution in danger of default. "Default" is defined generally as the appointment of a conservator or receiver, and "in danger of default" is defined generally as the existence of certain conditions indicating that, in the opinion of the appropriate banking agency, a "default" is likely to occur in the absence of regulatory assistance.

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

and unsound banking practices or which constitute violations of laws or regulations, and can assess civil money penalties for certain activities conducted on a knowing and reckless basis, if those activities caused a substantial loss to a depository institution.

Dividends paid by the Bank have been the Company's primary source of operating funds and are expected to be for the foreseeable future. Capital adequacy requirements serve to limit the amount of dividends that may be paid by the Bank. Under OCC regulations, the Bank may not pay a dividend, without prior OCC approval, if the total amount of all dividends declared during the calendar year, including the proposed dividend, exceed the sum of its retained net income to date during the calendar year and its retained net income over the preceding two years. As of December 31, 2014, approximately \$16.1 million was available for the payment of dividends without prior OCC approval. The Bank's ability to pay dividends is also subject to the Bank being in compliance with regulatory capital requirements. As indicated below, at December 31, 2014, the Bank was in compliance with these requirements.

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

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

## Capital Adequacy

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

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

Institutions not meeting these criteria, as well as institutions with supervisory, financial or operational weaknesses, along with those experiencing or anticipating significant growth, are expected to maintain a Tier 1 capital to total adjusted average assets ratio equal to at least 4%. As reflected in the following table, the risk-based capital ratios and leverage ratios of the Company and the Bank as of December 31, 2014 and 2013 exceeded the required capital ratios for classification as "well capitalized," the highest classification under the regulatory capital guidelines.

## Capital Components and Ratios

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December 31, 2014  
(dollars in thousands)

	Company		Bank		Minimum for Capital Adequacy Purposes		Minimum to be Well Capitalized Under Prompt Corrective Action Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio	Amount	Ratio
Total Risk-Based Capital (to Risk Weighted Assets)	\$ 98,782	14.9 %	\$ 98,317	14.9 %	\$ 53,227	8.0 %	\$ 66,533	10.0 %
Tier I Capital (to Risk Weighted Assets)	\$ 90,473	13.6 %	\$ 90,021	13.7 %	\$ 26,613	4.0 %	\$ 39,920	6.0 %
Tier I Capital (to Average Assets)	\$ 90,473	10.8 %	\$ 90,021	10.8 %	\$ 33,726	4.0 %	\$ 42,157	5.0 %

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December 31, 2013  
(dollars in thousands)

	Company		Bank		Minimum for Capital Adequacy Purposes		Minimum to be Well Capitalized Under Prompt Corrective Action Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio	Amount	Ratio
Total Risk-Based Capital (to Risk Weighted Assets)	\$ 92,789	14.9 %	\$ 86,757	13.9 %	\$ 49,864	8.0 %	\$ 62,330	10.0 %
Tier I Capital (to Risk Weighted Assets)	\$ 85,044	13.6 %	\$ 78,932	12.7 %	\$ 24,932	4.0 %	\$ 37,398	6.0 %
Tier I Capital (to Average Assets)	\$ 85,044	10.4 %	\$ 78,932	9.6 %	\$ 32,823	4.0 %	\$ 41,029	5.0 %

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

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

Under the implementing regulations adopted by the federal banking agencies, a bank holding company or bank is considered "well capitalized" if it has: (i) a total risk-based capital ratio of 10% or greater; (ii) a Tier 1 risk-based capital ratio of 6% or greater; and (iii) a leverage ratio of 5% or greater; and is not subject to any order or written directive to

meet and maintain a specific capital level for a capital measure. An “adequately capitalized” bank holding company or bank is defined as one that has: (i) a total risk-based capital ratio of 8% or greater; (ii) a Tier 1 risk-based capital ratio of 4% or greater; and (iii) a leverage ratio of 4% or greater (or 3% or greater in the case of a bank with a composite CAMELS rating of (1)). A bank holding company or bank is considered (A) “undercapitalized” if it has: (i) a total risk-based capital ratio of less than 8%; (ii) a Tier 1 risk-based capital ratio of less than 4%; or (iii) a leverage ratio of less than 4% (or 3% in the case of a bank with a composite CAMELS rating of (1)); (B) “significantly undercapitalized” if it has: (i) a total risk-based capital ratio of less than 6%; or (ii) a Tier 1 risk-based capital ratio of less than 3%; or (iii) a leverage ratio of less than 3%; and (C) “critically undercapitalized” if it has a ratio of tangible equity to total assets equal to or less than 2%. The FRB may reclassify a “well capitalized” bank holding company or bank as “adequately capitalized” or subject an “adequately capitalized” or “undercapitalized” institution to the supervisory actions applicable to the next lower capital category if it determines that the bank holding company or bank is in an unsafe or unsound condition or deems the bank holding company or bank to be engaged in an unsafe or unsound practice and not to have corrected the deficiency. As of December 31, 2014, the Company and the Bank met the definition of “well capitalized” institutions.

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

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

Dodd-Frank Wall Street Reform and Consumer Protection Act

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

- I. The creation of a new oversight regulator, the Financial Stability Oversight Council. The council of regulators monitors the financial system for systemic risk and will determine which entities pose significant systemic risk and should be subject to greater federal regulation and oversight.
- II. The Collins Amendment, which requires the federal banking agencies to establish minimum leverage capital and risk-based capital requirements for insured depository institutions, depository institution holding companies and non-bank financial companies supervised by the FRB (also known as systemically significant financial institutions). The Collins Amendment provides that certain hybrid financial instruments, such as trust preferred

securities, issued on or after May 19, 2010, will be excluded from Tier 1 capital. For certain large depository institution holding companies (greater than \$15 billion in assets), hybrid financial instruments issued before May 19, 2010 must be phased out of Tier 1 capital over a three-year period beginning January 1, 2013. The Company was well below this threshold at December 31, 2014. At December 31, 2014, the Company had \$11.3 million in trust preferred securities included in Tier 1 capital.

- III. The Durbin Amendment, which provided that interchange fees that a card issuer or payment network receives or charges for debit transactions will now be regulated by the FRB and must be “reasonable and proportional” to the cost incurred by the card issuer in authorizing, clearing and settling the transaction. The pricing provisions of the Durbin Amendment apply to card issuing financial institutions with more than \$10 billion in assets. The Durbin Amendment also prohibits all issuers and networks from restricting the number of networks over which electronic debit transactions may be processed to less than two unaffiliated networks, and prohibits issuers and networks from inhibiting a merchant’s ability to direct the routing of the electronic debit transaction

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over any network that the issuer has enabled to process them. Although the Bank is exempt from the pricing provisions of the Durbin Amendment, it may be impacted by this provision if it has to match the reduced rates being offered by larger competitors. Such a result could have a material adverse effect on the Company's results of operations and cash flows.

- IV. A number of deposit insurance reforms, which have generally benefitted the Bank. First, the Dodd-Frank Act redefined the deposit insurance assessment base to reflect consolidated total assets less average tangible equity. The result is that larger financial institutions, which have more assets leveraged with non-deposit wholesale funds, have paid a greater percentage of the aggregate insurance assessment, while smaller banks (such as the Bank) have paid less than they would have under the prior rules. The Dodd-Frank Act also increased the minimum reserve ratio of the Deposit Insurance Fund from 1.15% to 1.35%, but exempted institutions with assets less than \$10 billion from funding the cost of the increase. The title also permanently increased deposit insurance coverage to \$250,000 per account (subject to certain limitations).
- V. A permanent exemption from the provisions of Section 404(b) of the Sarbanes-Oxley Act ("SOX"), which requires that public companies receive an opinion from their external auditors as to the effectiveness of their internal control over financial reporting, for companies with a public market capitalization under \$75 million. As a smaller reporting company, the Company qualifies for this exemption. However, the Audit Committee of the Board of Directors and the Company's management have decided to continue to voluntarily comply with SOX 404(b) as they believe it is in the best interest of the Company and its shareholders.
- VI. Establishment of the Consumer Financial Protection Bureau (the "CFPB"), an independent agency with the authority to prohibit practices that it finds to be unfair, deceptive, or abusive, in addition to requiring certain disclosures.
- VII. The imposition of new regulations on mortgage loan originators, including the imposition of new disclosure requirements and appraisal reforms, such as: the creation of a mortgage originator duty of care; the establishment of certain underwriting requirements designed to ensure that at the time of origination the consumer has a reasonable ability to repay the loan; the creation of document requirements intended to eliminate "no document" and "low document" loans; the prohibition of steering incentives for mortgage originators; a prohibition on yield spread premiums and prepayment penalties in some cases; and a provision that allows borrowers to assert as a foreclosure defense a contention that the lender violated the anti-steering restrictions or the reasonable repayment requirements.
- VIII. In December 2013, five federal agencies (including the FRB and the OCC) adopted a final regulation implementing the "Volcker Rule" provision of the Dodd-Frank Act. The Volcker Rule generally prohibits insured banks and their affiliates from proprietary trading or from acquiring or retaining any equity, partnership or other ownership interest in, sponsoring or having certain other relationships with a hedge fund or a private equity fund, subject to certain exceptions. Although we are continuing to evaluate the impact of the Volcker Rule, we do not currently anticipate that it will have a material effect on the operations of the Company or the Bank, as we generally do not engage in the activities prohibited by the Volcker Rule.

Basel III

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

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

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

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

The final rules also increase the required capital for certain categories of assets, including higher-risk construction real estate loans and certain exposures related to securitizations, but retain the historical approach to capital requirements for residential mortgages under prior general risk-based capital rules.

In addition, the final rule includes certain exemptions to address concerns about the regulatory burden on community banks. For example, as indicated above, banking organizations with less than \$15 billion in consolidated assets as of December 31, 2009 are permitted to include in Tier 1 capital trust preferred securities and cumulative perpetual preferred stock issued and included in Tier 1 capital prior to May 19, 2010 on a permanent basis, without any phase out (subject to a limit of 25% of Tier 1 capital). Community banks may also elect on a one time basis in their March 31, 2015 quarterly filings to opt-out of the onerous requirement to include most accumulated other comprehensive income (“AOCI”) components in the calculation of common equity Tier 1 capital and, in effect, retain the AOCI treatment under the current capital rules. Under the final rule, the Company will make a one-time, permanent election to continue to exclude AOCI from capital.

The new minimum capital ratios became effective for us on January 1, 2015 and will be fully phased-in on January 1, 2019. Management believes that, as of December 31, 2014, the Company and the Bank would have met all capital adequacy requirements under the Basel III Capital Rules on a fully phased-in basis as if such requirements had been in effect on that date.

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

## Regulation of Insurance Agency Subsidiary

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

## Monetary Policy and Economic Control

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

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Consumer Laws and Regulations

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

EMPLOYEES

As of December 31, 2014, the Company had no direct employees. As of December 31, 2014, the following table summarizes the employment rosters of the Company’s subsidiaries using full-time equivalent employees (“FTE”):

	2014	2013	2012	2011	2010
Bank	201	196	183	186	164
ENL	-	-	2	2	4
TEA	46	41	49	50	52
FCS	4	4	4	4	4
	251	241	238	242	224

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

AVAILABLE INFORMATION

The Company's Annual Report on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K and amendments to those reports filed or furnished by the Company pursuant to Section 13(a) or 15(d) of the Exchange

Act are available without charge on the Company's website, [www.evansbancorp.com](http://www.evansbancorp.com) - SEC filings section, as soon as reasonably practicable after they are electronically filed with or furnished to the SEC. The Company is providing the address to its Internet site solely for the information of investors. The Company does not intend its Internet address to be an active link or to otherwise incorporate the contents of the website into this Annual Report on Form 10-K or into any other report filed with or furnished to the SEC.

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Item 1A.RISK FACTORS

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

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

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

Economic conditions in the United States continued to improve in 2014 following the deep recession of 2007 through 2009. Overall, during 2014, the business environment showed signs of modest improvement, which included national and state unemployment rates dropping from 6.7% and 7.1%, respectively, as of December 31, 2013 to 5.6% and 5.8%, respectively, as of December 31, 2014. Although conditions in Western New York and the United States remain positive, a slowdown of the economic conditions in other parts of the world, particularly Europe and China, may begin to affect the United States economically. Such conditions could materially adversely affect the credit quality of the Company's loans and leases, and therefore, the Company's results of operations and financial condition.

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

At December 31, 2014, the Company's portfolio of commercial real estate loans totaled \$404.2 million, or 58.1% of total loans and leases outstanding, and the Company's portfolio of commercial and industrial ("C&I") loans totaled \$129.5 million, or 18.6% of total loans and leases outstanding. The Company plans to continue to emphasize the origination of commercial loans as they generally earn a higher rate of interest than other loan products offered by the Bank. Commercial loans generally expose a lender to greater risk of non-payment and loss than one-to four-family residential mortgage loans because repayment of commercial real estate and C&I loans often depends on the successful operations and the income stream of the borrowers. Commercial mortgages are collateralized by real property while C&I loans are typically secured by business assets such as equipment and accounts receivable. Such loans typically involve larger loan balances to single borrowers or groups of related borrowers compared to one-to four-family residential mortgage loans. Also, many of the Company's commercial borrowers have more than one commercial real estate or C&I loan outstanding with the Company. Consequently, an adverse development with respect to one loan or one credit relationship can expose the Company to a significantly greater risk of loss compared to an adverse development with respect to a one-to four-family residential mortgage loan. Commercial real estate

loans in non-accrual status at December 31, 2014 were \$3.2 million, compared with \$8.9 million at December 31, 2013. C&I loans in non-accrual status at December 31, 2014 were \$5.5 million, compared with \$3.0 million at December 31, 2013. Increases in the delinquency levels of commercial real estate and C&I loans could result in an increase in non-performing loans and the provision for loan and lease losses, which could have a material adverse effect on our results of operations and financial condition.

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

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

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

The Company maintains an allowance for loan and lease losses in order to capture the probable losses inherent in its loan and lease portfolio. There is a risk that the Company may experience significant loan and lease losses which could exceed the allowance for loan and lease losses. In determining the amount of the Company's recorded allowance, the Company makes various assumptions and judgments about the collectability of its loan and lease portfolio, including the creditworthiness of its borrowers, the effect of changes in the local economy on the value of the real estate and other assets serving as collateral for the repayment of loans, the effects on the Company's loan and lease portfolio of current economic indicators and their probable impact on borrowers, and the Company's loan quality reviews. The emphasis on the origination of commercial real estate and C&I loans is a significant factor in evaluating an allowance for loan and lease losses. As the Company continues to increase the amount of these loans in the portfolio, additional or increased provisions for loan and lease losses may be necessary and would adversely affect the results of operations. In addition, bank regulators periodically review the Company's loan and lease portfolio and credit underwriting procedures, as well as its allowance for loan and lease losses, and may require the Company to increase its provision for loan and lease losses or recognize further loan and lease charge-offs. At December 31, 2014, the Company had a gross loan portfolio of approximately \$695.7 million and the allowance for loan and lease losses was approximately \$12.5 million, which represented 1.80% of the total amount of gross loans and leases. If the Company's assumptions and judgments prove to be incorrect or bank regulators require the Company to increase its provision for loan and lease losses or recognize further loan and lease charge-offs, the Company may have to increase its allowance for loan and lease losses or loan and lease charge-offs which could have an adverse effect on the Company's operating results and financial condition. There can be no assurances that the Company's allowance for loan and lease losses will be adequate to protect the Company against loan and lease losses that it may incur.

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

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

Changes in interest rates also affect the value of the Company's interest-earning assets, and in particular, the Company's securities portfolio. Generally, the value of securities fluctuates inversely with changes in interest rates. At December 31, 2014, the Company's securities available for sale totaled \$95.5 million. Net unrealized gains on securities available for sale, net of tax, amounted to \$0.9 million and are reported as a separate component of stockholders' equity. Decreases in the fair value of securities available for sale, therefore, could have an adverse effect

on stockholders' equity or earnings.

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

Consistent with its statutory mandate to foster maximum employment and price stability, the Federal Open Market Committee (the "Fed") had practiced policy accommodation by purchasing additional agency mortgage-backed securities throughout 2012 and 2013. During 2014, the Fed discontinued its purchase of agency mortgage-backed securities ("MBS") based on improvement in the labor market. At its December 2014 meeting, the Fed indicated it will continue to maintain its targeted federal funds rate near zero. The length of this accommodating policy will be dependent on the Fed's projected long term inflation rate goal of 2%.

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

The Fed's current accommodative stance has resulted in extraordinarily low interest rates during the past five years and played a part in compressing the Company's net interest margin from 4.16% in 2010 to 3.99% in 2011, 3.84% in 2012 and 3.74% in 2013. However, in 2014, as the Fed discontinued its MBS purchase program and as labor conditions continued to improve, the Company benefited from an increase in longer term rates as the market's expectation of increasing rates prevailed. The Company's net interest margin for 2014 was 4.01%. Compression of the Company's net interest margin could reoccur as a result of the Fed's accommodative monetary policy, which could have a material adverse effect on the Company's results of operations and financial condition.

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

Financial services institutions are interrelated as a result of counterparty relationships. The Company has exposure to many different industries and counterparties, and routinely executes transactions with counterparties in the financial services industry. As a result, defaults by, or even rumors or questions about, one or more financial services institutions, or the financial services industry generally, could lead to losses or defaults by us or by other institutions and impact our business. Many of these transactions expose us to credit risk in the event of default of our counterparty or customer. In addition, our credit risk may be further increased when the collateral held by us cannot be relied upon or is liquidated at prices not sufficient to recover the full amount of the financial instrument exposure due to us. Any such losses could materially and adversely affect our results of operations.

The most important counterparty for the Company, in terms of liquidity, is the Federal Home Loan Bank of New York ("FHLBNY"). The Company uses FHLBNY as its primary source of borrowed overnight funds and also has several long-term advances with FHLBNY. At December 31, 2014, the Company had a total of \$13.7 million in borrowed funds with FHLBNY. The Company has placed sufficient collateral in the form of commercial and residential real estate loans at FHLBNY. As a member of the Federal Home Loan Bank System, the Bank is required to hold stock in FHLBNY. The Bank held FHLBNY stock with a fair value of \$1.4 million as of December 31, 2014. The Bank's FHLBNY stock average yield in 2014 was 4.4%.

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

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

Bank.

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

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

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

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

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

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

The impending capital requirement changes from Basel III discussed in Item 1 could have a material adverse impact on the Company. Even though the Bank exceeds current and proposed minimum regulatory capital levels, adverse changes to residential mortgage risk weights, new requirements for common equity capital, the inclusion of accumulated other comprehensive income in regulatory capital, along with the adoption of new capital conservation buffers, over time could cause the Bank to fail to meet minimum regulatory requirements. These positions are subject to volatility due to changes in interest rates and credit spreads. The current positive balance is a product of the continued ultra low interest rate environment, which could change in the future. Rapid increases in interest rates and credit spreads could reverse the gain position and force the Company's accumulated other comprehensive income to become negative and have an adverse impact on the Bank's regulatory capital. Although there is a phase-in period in the proposed rules, other challenges such as the ultra-low interest rate environment, fragile economic recovery, possible recession, and further constraints on profitability by regulators could impact the Bank's ability to meet the new regulatory minimums once the phase-in periods have ended.

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

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

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

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

Loss of Key Employees May Disrupt Relationships with Certain Customers

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

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

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

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

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

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

The Company operates in diverse markets and relies on the ability of its employees and systems to process a high number of transactions. Operational risk is the risk of loss resulting from the Company's operations, including but not limited to, the risk of fraud by employees or persons outside of the Company, the execution of unauthorized transactions by employees, errors relating to transaction processing and technology, breaches of the internal control system and compliance requirements, and business continuation and disaster recovery. This risk of loss also includes the potential legal actions that could arise as a result of an operational deficiency or as a result of noncompliance with applicable regulatory standards, adverse business decisions or their implementation, and customer attrition due to potential negative publicity. In the event of a breakdown in the internal control system, improper operation of systems or improper employee actions, the Company could suffer financial loss, face regulatory action and suffer damage to its reputation.

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

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

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

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

### Environmental Factors May Create Liability

In the course of its business, the Bank has acquired and may acquire in the future, property securing loans that are in default. There is a risk that the Bank could be required to investigate and clean-up hazardous or toxic substances or chemical releases at such properties after acquisition by the Bank in a foreclosure action, and that the Bank may be held liable to a governmental entity or third parties for property damage, personal injury and investigation and clean-up costs incurred by such parties in connection with such contamination. In addition, the owner or former owners of contaminated sites may be subject to common law claims by third parties based on damages and costs resulting from environmental contamination emanating from such property. To date, the Bank has not been required to perform any investigation or clean-up activities, nor has it been subject to any environmental claims. There can be no assurance, however, that this will remain the case in the future.

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

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

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Damage to our Reputation Could Adversely Impact our Business

Our business reputation is important to our success. Our ability to attract and retain customers, investors, employees and advisors may depend upon external perceptions of our Company. Damage to our reputation could cause significant harm to our business and prospects and may arise from numerous sources, including litigation or regulatory actions, failing to deliver minimum standards of service and quality, compliance failures, unethical behavior and the misconduct of employees, advisors and counterparties. Negative perceptions or publicity regarding these matters could damage our reputation among existing and potential customers, investors, employees and advisors. Adverse developments with respect to our industry may also, by association, negatively impact our reputation or result in greater regulatory or legislative scrutiny or litigation against us. Preserving and enhancing our reputation also depends on maintaining systems and procedures that address known risks and regulatory requirements, as well as our ability to identify and mitigate additional risks that arise due to changes in our businesses and the marketplaces in which we operate, the regulatory environment and client expectations. If any of these developments has a material effect on our reputation, our business could suffer.

Item 1B.UNRESOLVED STAFF COMMENTS

None.

Item 2.PROPERTIES

At December 31, 2014, the Bank conducted its business from its administrative office and 13 branch offices. The Bank's administrative office is located at One Grimsby Drive in Hamburg, NY. The administrative office facility is 26,000 square feet and is owned by the Bank. This facility is occupied by the Office of the President and Chief Executive Officer of the Company, as well as the Administrative and Loan Divisions of the Bank. The Bank also owns a building on Sunset Drive in Hamburg, NY that houses its Operations Center.

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

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

The Company owned \$10.2 million in properties and equipment, net of depreciation at December 31, 2014, compared with \$11.2 million at December 31, 2013.

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Item 3.LEGAL PROCEEDINGS

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

Additionally, as previously reported, on September 2, 2014, the Office of the Attorney General for the State of New York (the "NYAG") filed a formal complaint in the U.S. District Court for the Western District of New York against the Company and the Bank regarding residential lending practices. The complaint seeks unspecified monetary damages and injunctive relief.

The Company and the Bank believe that they have meritorious defenses to the NYAG's claims, deny any wrongdoing, and will defend against the NYAG's allegations. However, the outcome of this action may not be assured. If this action is decided unfavorably to the Company and the Bank, we could be required to pay a civil penalty and make other expenditures. Despite management's views of the merits of this litigation, or the reasonableness of our estimates and reserves, our financial statements could nonetheless be materially affected by an adverse judgment.

Under applicable accounting guidance, we accrue for litigation and claims where the potential loss from any claim or legal proceeding is considered probable and a range of possible losses can be estimated. Accordingly, based on the advice of counsel and management review of the existing facts and circumstances, we recorded a reserve relating to the NYAG investigation totaling \$1 million in the second quarter of 2014. Legal proceedings are subject to uncertainties, and the outcomes are difficult to predict. Because of such uncertainties, accruals are based only on the best information available at the time. As additional information becomes available, we will reassess the potential liability related to this investigation and may revise this estimate.

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

Item 4.MINE SAFETY DISCLOSURES

Not applicable.

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PART II

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

STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES

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

The following table shows, for the periods indicated, the high and low sales prices per share of the Company's common stock for fiscal 2014 and 2013 as reported on the NYSE MKT.

QUARTER	2014		2013	
	High	Low	High	Low
FIRST	\$ 24.50	\$ 21.00	\$ 18.29	\$ 15.50
SECOND	\$ 23.70	\$ 22.50	\$ 18.15	\$ 17.20
THIRD	\$ 23.52	\$ 22.92	\$ 19.87	\$ 17.57
FOURTH	\$ 25.01	\$ 22.80	\$ 21.20	\$ 19.75

Holders. The approximate number of holders of record of the Company's common stock as of February 27, 2015 was 1,271.

Cash Dividends. The Company paid the following cash dividends on shares of the Company's common stock during fiscal 2014 and 2013:

- A cash dividend of \$0.26 per share on October 9, 2013 to holders of record on September 18, 2013.
- A cash dividend of \$0.31 per share on April 8, 2014 to holders of record on March 18, 2014.
- A cash dividend of \$0.34 per share on October 7, 2014 to holders of record on September 16, 2014.

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

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

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## PERFORMANCE GRAPH

The following Performance Graph compares the Company's cumulative total stockholder return on its common stock for a five-year period (December 31, 2009 to December 31, 2014) with the cumulative total return of the NYSE MKT Composite Index and the NASDAQ Bank Index. The comparison for each of the periods assumes that \$100 was invested on December 31, 2009 in each of the Company's common stock and the stocks included in the NYSE MKT Composite Index and NASDAQ Bank Index, and that all dividends were reinvested without commissions. This table does not forecast future performance of the Company's stock.

## Compare 5-Year Cumulative Total Return Among

Evans Bancorp, Inc.,

NYSE MKT Composite Index and NASDAQ Bank Index

Index	Period Ending					
	12/31/09	12/31/10	12/31/11	12/31/12	12/31/13	12/31/14
Evans Bancorp, Inc.	100.00	129.29	111.42	151.48	209.05	247.65
NYSE MKT - Composite Index	100.00	125.60	133.49	142.32	151.80	157.50
NASDAQ Bank	100.00	114.16	102.17	121.26	171.86	180.31

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

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Purchases of Equity Securities by the Issuer and Affiliated Purchasers. In March 2013, the Company announced it had been authorized by its Board of Directors to purchase up to 100,000 shares of the Company's outstanding common stock. The Company repurchased 59,800 shares pursuant to this repurchase program during 2014. During the fourth quarter of 2014, the Company did not purchase any shares of its common stock.

## Issuer Purchases of Equity Securities

Period	Total Number of Shares Purchased	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs	Maximum Number of Shares that may yet be Purchased Under the Plans or Programs
October 2014:				
October 1, 2014 - October 31, 2014	-	\$ -	-	27,168
November 2014:				
November 1, 2014 - November 30, 2014	-	\$ -	-	27,168
December 2014:				
December 1, 2014 - December 31, 2014	-	\$ -	-	27,168
Total:	-	\$ -	-	27,168

(1)

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## Item 6.SELECTED FINANCIAL DATA

	As of and for the year ended December 31,										
	2014		2013		2012		2011		2010		
	(in thousands, except for per share data)										
<b>Balance Sheet Data</b>											
Assets	\$	846,809	\$	833,498	\$	809,676	\$	740,902	\$	671,523	
Interest-earning assets		785,302		767,629		750,287		682,140		611,141	
Investment securities		100,057		104,880		95,807		103,783		89,562	
Loans and leases, net		683,131		635,493		573,163		571,910		517,554	
Deposits		707,635		706,612		678,992		616,203		544,457	
Borrowings		38,808		33,681		42,441		42,340		52,226	
Stockholders' equity		85,788		80,712		74,828		68,988		63,064	
<b>Income Statement Data</b>											
Net interest income	\$	31,099	\$	28,347	\$	27,780	\$	25,988	\$	24,495	
Non-interest income		10,273		12,161		12,823		12,432		12,633	
Non-interest expense		31,252		29,380		28,792		27,241		26,107	
Net income		8,187		7,857		8,132		6,112		4,840	
<b>Per Share Data</b>											
Earnings per share - basic	\$	1.95	\$	1.88	\$	1.96	\$	1.49	\$	1.34	
Earnings per share - diluted		1.92		1.85		1.95		1.49		1.34	
Cash dividends		0.65		0.26		0.68		0.40		0.40	
Book value		20.41		19.18		17.94		16.72		15.45	
<b>Performance Ratios</b>											
Return on average assets		0.98	%	0.96	%	1.04	%	0.86	%	0.75	%
Return on average equity		9.84	%	10.06	%	11.20	%	9.17	%	8.35	%
Net interest margin		4.01	%	3.74	%	3.84	%	3.99	%	4.16	%
Efficiency ratio *		70.83	%	71.98	%	70.05	%	69.68	%	67.90	%
Dividend payout ratio		33.33	%	13.83	%	34.69	%	26.85	%	29.85	%
<b>Capital Ratios</b>											
Tier 1 capital to average assets		10.84	%	10.36	%	9.69	%	9.71	%	9.93	%
Equity to assets		10.13	%	9.68	%	9.24	%	9.31	%	9.39	%
<b>Asset Quality Ratios</b>											
Total non-performing assets to total assets		1.25	%	1.65	%	1.02	%	2.05	%	2.07	%

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Total non-performing loans and leases to total loans and leases	1.52	%	2.12	%	1.41	%	2.60	%	2.64	%
Net charge-offs (recoveries) to average loans and leases	0.03	%	(0.04)	%	0.29	%	0.26	%	0.10	%
Allowance for loan and lease losses to total loans and leases	1.80	%	1.78	%	1.67	%	1.97	%	1.97	%

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

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

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

OVERVIEW

This discussion is intended to compare the performance of the Company for the years ended December 31, 2014, 2013 and 2012. The review of the information presented should be read in conjunction with Part I, Item 1: "Business" and Part II, Item 6: "Selected Financial Data" and Item 8: "Financial Statements and Supplementary Data" of this Annual Report on Form 10-K.

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

Summary

In 2014, the Company experienced strong core earnings results moderated by a \$1.0 million litigation expense. The Company's goal is to continue to grow to increase market share and achieve scale while improving profitability and returning value to shareholders. Net income in 2014 was \$8.2 million, a 4.2% increase from 2013 net income of \$7.9 million, and a slight 0.7% increase from 2012 net income of \$8.1 million. The Company's net interest income in 2014 was \$31.1 million, or 9.7%, higher than 2013 of \$28.3 million, and 12.0% higher than 2012 net interest income. The strong core earnings in the recent three years demonstrate the solid growth in the Company's commercial loan portfolio and demand deposit balances, as evidenced by a net interest margin of 4.01%, 3.74%, and 3.84% in 2014, 2013, and 2012, respectively. As of December 31, 2014, average net loans and lease balances of \$657.5 million increased \$60.7 million, or 10.2%, from \$596.8 million at December 31, 2013. The Company's record core earnings in 2014 were tempered by a \$1.0 million litigation expense, due to a formal complaint filed against the Company by the Office of the Attorney General for the State of New York, further described in Item 3 of Part I of this Annual Report on Form 10-K.

The Company's performance in 2014 was also marked by stringent cost control and strategic investments in community-based projects. Excluding the \$1.0 million litigation expense recognized in 2014, non-interest expenses increased 3.0%, as compared with a 2.0% increase in 2013. One of the Company's goals includes continuous improvement operational efficiency and cost control. As a result of tax credit investments in community-based projects in 2014 and 2013, the Company realized losses of \$2.6 million and \$1.6 million, respectively. The losses in

both periods were offset by corresponding tax credit benefits of \$3.0 million and \$1.8 million in 2014 and 2013, respectively. The Company's income tax provision for 2014 was \$1.0 million, or 59.3%, lower than income tax provision of \$1.7 million in 2013, and \$3.0 million, or 81.2%, lower than income tax provision of \$3.7 million in 2012.

## Strategy

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

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

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The Company's strategies are designed to direct tactical investment decisions supporting its financial objectives. While the Company intends to focus its efforts on the pursuit of these strategies, there can be no assurance that the Company will successfully implement these strategies or that the strategies will produce the desired results. The Company's most significant revenue source continues to be net interest income, defined as total interest income less interest expense. Net interest income accounted for approximately 75% of total revenue in 2014. To produce net interest income and consistent earnings growth over the long-term, the Company must generate loan and deposit growth at acceptable margins within its market area. To generate and grow loans and deposits, the Company must focus on a number of areas including, but not limited to, opportunistic branch expansion, sales practices, customer and employee satisfaction and retention, competition, evolving customer behavior, technology, product innovation, interest rates, credit performance of its customers and vendor relationships.

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

While the Company reviews and manages all customer units, it has focused increased efforts on targeted segments in its community such as (1) smaller businesses with smaller credit needs but rich in deposits and other service needs; (2) middle market commercial businesses; (3) commercial real estate lending; and (4) retail customers. The overarching goal is to cross-sell between our insurance, financial services and banking lines of business to deepen our relationships with all of our customers. The Company believes that these efforts resulted in growth in the commercial loan portfolio and core deposits during fiscal 2014 and 2013.

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

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

## APPLICATION OF CRITICAL ACCOUNTING ESTIMATES

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

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

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

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

### Allowance for Loan and Lease Losses

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

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

The analysis of the allowance for loan and lease losses is composed of two components: specific credit allocation and general portfolio allocation. The specific credit allocation includes a detailed review of each impaired loan and an allocation is made based on this analysis. Factors may include the appraisal value of the collateral, the age of the appraisal, the type of collateral, the performance of the loan to date, the performance of the borrower's business based on financial statements, and legal judgments involving the borrower. The Company has an appraisal policy in which appraisals are obtained upon a loan being downgraded on the Company's internal loan rating scale to a 5 (special mention) or a 6 (substandard) depending on the amount of the loan, the type of loan and the type of collateral. All impaired loans are either graded a 6 or 7 on the internal loan rating scale, unless the loan was otherwise classified as impaired due to a troubled debt restructuring and is currently performing. Subsequent to the downgrade, if the loan remains outstanding and impaired for at least one year more, management may require another follow-up

appraisal. Between receipts of updated appraisals, if necessary, management may perform an internal valuation based on any known changing conditions in the marketplace such as sales of similar properties, a change in the condition of the collateral, or feedback from local appraisers. The general portfolio allocation consists of an assigned reserve percentage based on the historical loss experience, the loss emergence period, and other quantitative and qualitative factors of the loan category.

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

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

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

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

## Goodwill and Intangible Assets

The amount of goodwill reflected in the Company's Consolidated Financial Statements is required to be tested by management for impairment on at least an annual basis. The test for impairment of goodwill in an identified reporting unit is considered a critical accounting estimate because it requires judgment on the part of management and the use of estimates related to the growth assumptions and market multiples used in the valuation model. As of December 31, 2014, TEA had \$8.1 million in goodwill. The banking reporting unit does not have any goodwill. All of the goodwill at TEA stems from the acquisition of various insurance agencies, not the purchase of diverse companies in which goodwill was subjectively allocated to different reporting units. Therefore, total market capitalization reconciliation was not performed because not all of the reporting units had goodwill. As a result, such an analysis would not be meaningful.

Management valued TEA, the reporting unit with goodwill, using cash flow modeling and earnings multiple techniques. When using the cash flow models, management considered historical information, the operating budget for 2015, economic and insurance market cycles, and strategic goals in projecting net income and cash flows for the next five years. The fair value calculated substantially exceeded the book value of TEA. The value based on a multiple to earnings before interest, taxes, depreciation, and amortization ("EBITDA") was higher, a result of conservative growth assumptions used by the Company in the cash flow model as well as an implied control premium in the multiple. The multiple used was based on historical industry data and consistent with the previous year's assumption.

While the fair values determined in the impairment tests were substantially higher than the carrying value for TEA, the risk of a future impairment charge still exists. Management used growth rates that are achievable over the long run through both soft and hard insurance cycles. As experienced producers focused on retaining their maturing portfolios of business, TEA experienced a slight decrease in revenue of 1.1% in 2014 compared with 2013.

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

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RECENT ACCOUNTING PRONOUNCEMENTS AND DEVELOPMENTS

Note 1 to the Company's Consolidated Financial Statements included in Item 8 of this Annual Report on Form 10-K discusses new accounting policies adopted by the Company during fiscal 2014. Below are accounting policies recently issued or proposed but not yet required to be adopted. To the extent management believes the adoption of new accounting standards materially affects the Company's financial condition, results of operations, or liquidity, the impacts are discussed below.

Accounting Standards Update ("ASU") 2014-04, Reclassification of Collateralized Mortgage Loans upon a Troubled Debt Restructuring. The objective of this proposed ASU is to clarify when an in substance repossession or foreclosure occurs, that is, when a creditor should be considered to have received physical possession of residential real estate property collateralizing a consumer mortgage loan, such that all or a portion of the loan should be derecognized and the real estate property recognized. The main provisions would also require additional disclosures regarding the amount of foreclosed residential real estate property held by the creditor and the recorded investments of consumer mortgage loans that are in the process of foreclosure at each interim and annual reporting period. This ASU becomes effective for the Company in fiscal years and interim periods within those years, beginning after December 15, 2014. The Company has not early adopted this guidance and does not expect this guidance to have a significant impact on its financial statements.

ASU 2014-09, Revenue from Contracts with Customers. The objective of this proposed ASU is to require entities to recognize the amount of revenue to which it expects to be entitled for the transfer of promised goods or services to customers. This ASU will replace most existing revenue recognition guidance under U.S. GAAP when it becomes effective. The amendments in this ASU are effective for annual reporting periods beginning after December 15, 2016, including interim periods within that reporting period. Early application is not permitted. The standard allows an entity to apply the amendments in the ASU using either the retrospective or cumulative effect transition method. The Company has not yet selected a transition method nor has it determined the effect of the standard on its ongoing financial reporting.

RESULTS OF OPERATIONS FOR THE YEARS ENDED DECEMBER 31, 2014 AND DECEMBER 31, 2013

Net Income

Net income of \$8.2 million in 2014 consisted of \$7.0 million related to the Company's banking activities and \$1.2 million in net income related to the Company's insurance agency activities. The total net income of \$8.2 million was a 4.2% increase from \$7.9 million in 2013. Earnings per diluted share for 2014 of \$1.92 showed an increase of 3.8%

from \$1.85 per diluted share for 2013.

#### Net Interest Income

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

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

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## AVERAGE BALANCE SHEET INFORMATION

The following table presents the significant categories of the assets and liabilities of the Bank, interest income and interest expense, and the corresponding yields earned and rates paid in 2014, 2013 and 2012. The assets and liabilities are presented as daily averages. The average loan balances include both performing and non-performing loans. Interest income on loans does not include interest on loans for which the Bank has ceased to accrue interest. Securities are stated at fair value. Interest and yield are not presented on a tax-equivalent basis.

	2014			2013			2012		
	Average Outstanding Balance (dollars in thousands)	Interest Earned/ Paid (dollars in thousands)	Yield/ Rate %	Average Outstanding Balance (dollars in thousands)	Interest Earned/ Paid (dollars in thousands)	Yield/ Rate %	Average Outstanding Balance (dollars in thousands)	Interest Earned/ Paid (dollars in thousands)	Yield/ Rate %
<b>ASSETS</b>									
Interest-earning assets:									
Loans and leases, net	\$ 657,494	\$ 31,899	4.85 %	\$ 596,783	\$ 29,546	4.95 %	\$ 579,586	\$ 30,300	5.23 %
Taxable securities	71,508	1,816	2.54 %	63,890	1,666	2.61 %	67,679	1,870	2.76 %
Tax-exempt securities	32,766	967	2.95 %	35,255	1,060	3.01 %	34,104	1,153	3.38 %
Interest bearing deposits at banks	14,100	33	0.23 %	62,286	132	0.21 %	42,817	53	0.12 %
Total interest-earning assets	775,868	\$ 34,715	4.47 %	758,214	\$ 32,404	4.27 %	724,186	\$ 33,376	4.61 %
Non interest-earning assets:									
Cash and due from banks	12,365			14,481			11,634		
Premises and equipment, net	10,982			11,250			10,748		
Other assets	39,971			36,702			36,009		

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Total Assets	\$ 839,186			\$ 820,647			\$ 782,577		
<b>LIABILITIES &amp; STOCKHOLDERS' EQUITY</b>									
Interest-bearing liabilities:									
NOW	\$ 72,034	\$ 316	0.44 %	\$ 67,548	\$ 357	0.53 %	\$ 59,811	\$ 615	1.03 %
Regular savings	345,236	941	0.27 %	357,098	1,097	0.31 %	341,739	1,931	0.57 %
Muni-vest savings	33,011	70	0.21 %	26,052	60	0.23 %	24,937	79	0.32 %
Time deposits	111,521	1,730	1.55 %	111,165	1,782	1.60 %	109,508	1,921	1.75 %
Other borrowed funds	8,579	212	2.47 %	11,617	407	3.50 %	20,161	681	3.38 %
Junior subordinated debentures	11,330	322	2.84 %	11,330	325	2.87 %	11,331	348	3.07 %
Securities sold U/A to repurchase	13,956	26	0.19 %	14,767	29	0.20 %	10,009	22	0.22 %
Total interest-bearing liabilities	595,667	\$ 3,617	0.61 %	599,577	\$ 4,057	0.68 %	577,496	\$ 5,597	0.97 %
Noninterest-bearing liabilities:									
Demand deposits	148,827			131,041			119,805		
Other	11,529			11,955			12,381		
Total liabilities	\$ 756,023			\$ 742,573			\$ 709,682		
Stockholders' equity	83,163			78,074			72,895		
Total Liabilities and Equity	\$ 839,186			\$ 820,647			\$ 782,577		
Net interest earnings		\$ 31,098			\$ 28,347			\$ 27,779	
Net interest margin			4.01 %			3.74 %			3.84 %
Interest rate spread			3.86 %			3.59 %			3.64 %

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

	2014 Compared to 2013			2013 Compared to 2012		
	Increase (Decrease) Due to			Increase (Decrease) Due to		
	(in thousands)					
	Volume	Rate	Total	Volume	Rate	Total
Interest earned on:						
Loans	\$ 2,955	\$ (602)	\$ 2,353	\$ 884	\$ (1,638)	\$ (754)
Taxable securities	194	(44)	150	(100)	(104)	(204)
Tax-exempt securities	(74)	(19)	(93)	38	(131)	(93)
Federal funds sold	(112)	13	(99)	31	47	78
Total interest-earning assets	\$ 2,963	\$ (652)	\$ 2,311	\$ 853	\$ (1,826)	\$ (973)
Interest paid on:						
NOW accounts	\$ 14	\$ (55)	\$ (41)	\$ 75	\$ (333)	\$ (258)
Savings deposits	(36)	(120)	(156)	81	(915)	(834)
Muni-vest	15	(5)	10	4	(23)	(19)
Time deposits	6	(58)	(52)	29	(168)	(139)
Fed funds purchased & other borrowings	(73)	(129)	(202)	(88)	(202)	(290)
Total interest-bearing liabilities	\$ (74)	\$ (367)	\$ (441)	\$ 101	\$ (1,641)	\$ (1,540)

Net interest income increased by \$2.8 million, or 9.7%, to \$31.1 million in 2014 from \$28.3 million in 2013. As indicated in the preceding table, rates earned and paid on interest-earning assets and interest-bearing liabilities negatively impacted net interest income by \$0.3 million, while the volume on those respective assets and liabilities offset these changes in rates, resulting in a positive impact of \$2.9 million on net interest income.

The FRB has executed on a monetary policy designed to keep interest rates at all time lows for the past five years. The target overnight rate has been between 0.00% and 0.25% since the end of 2008. The FRB has also executed on other quantitative easing strategies, including the purchase of mortgage-backed securities, in an attempt to depress longer-term market interest rates. Although the Fed has stopped its asset purchases, its accommodation policy kept rates historically low during 2014. This interest rate environment resulted in lower interest yields earned on assets as well as lower rates paid on liabilities. Assets continue to re-price into lower yields as older loans and

securities mature, and new loans are originated and securities purchased at much lower yields than those they are replacing.

The Company has invested in adding to its commercial loan portfolio significantly in the past several years by adding several commercial loan officers while existing loan officers have successfully increased production. Total commercial loan portfolio balance, including commercial real estate and commercial and industrial loans, increased \$43.6 million, or 9.4%, from a \$465.6 million average balance in 2013 to a \$509.2 million average balance in 2014. Consumer loans increased 13.5% from a \$140.4 million average balance in 2013 to \$159.4 million in 2014.

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On the funding side, the Company has continued to be successful in attracting new deposit customers, with most of that success coming from growth in the commercial and retail demand deposit products. Due to customer preference for liquid deposits with long-term rates at all-time lows, the strong growth in the Company's demand deposit balances was marked by a \$17.8 million increase in average demand deposit balances during 2014 compared with 2013.

Net interest spread, or the difference between yield on interest-earning assets and rate on interest-bearing liabilities, increased to 3.86% in 2014, compared with 3.59% in 2013. The yield on interest-earning assets increased 20 basis points from 4.27% in 2013 to 4.47% in 2014, and the cost of interest-bearing liabilities decreased 7 basis points, from 0.68% in 2013 to 0.61% in 2014. Net interest spread increased as the yield curve, or the difference between long-term rates and short-term rates, widened throughout most of 2014. Banks traditionally benefit from a steep yield curve because the duration of interest-earning assets is typically longer than the duration of interest-bearing liabilities. In 2014, the Company's commercial loan growth at higher interest rates contributed to the widened net interest rate spread, while continuing to tighten pricing on the liability side. The Company also benefited from an increase in the proportion of higher yielding commercial loans to total interest-earning assets in 2014, when compared with 2013.

The Company's net interest margin increased from 3.74% in 2013 to 4.01% in 2014, reflecting the changes to the net interest spread. It should be noted that several factors could put additional pressure on the Company's net interest margin in the future, including further flattening of the yield curve and increased pricing competition for loans and deposits.

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

### Provision for Loan and Lease Losses

The Company's provision for loan and lease losses decreased \$0.3 million from \$1.5 million in 2013 to \$1.2 million in 2014. The overall decrease was a result of quantitative and qualitative improvements in the loan portfolio, somewhat offset by leasing recoveries from continued run-off of the leasing portfolio and the recognition of additional provision for previously covered loans under the FDIC loss sharing agreement in 2013. The decrease in the provision for loan losses relative to the quantitative and qualitative improvements in 2014 was driven mostly by the Company's low

historical losses and overall improvement in qualitative considerations such as the composition of the loan portfolio, favorable credit quality trends, and improvement in the general economic and business conditions in the Company's lending areas. As noted in Note 1 to the Consolidated Financial Statements included in Item 8 of this Annual Report on Form 10-K, the Company reserves a specific allocation on impaired loans and a higher percentage on criticized loans, or those loans risk rated 5 or higher. The Company had \$1.3 million in specific reserve credit allocation on impaired loans at December 31, 2014, compared with \$1.2 million at December 31, 2013. The slight increase was driven by the impairment of one criticized commercial loan relationship in 2014 that required a significant specific reserve, offset by other individually impaired commercial loans with specific reserves that had paid off during the year. At December 31, 2014, criticized loans (loans risk-rated 5 or higher) were down \$1.5 million to \$29.3 million, compared with \$30.8 million at December 31, 2013, mostly driven by one large commercial and multi-family relationship moved into a pass rated category and paid off, partially offset by another large commercial and industrial relationship which was classified as a criticized loan during 2014. Additionally, total loans collectively evaluated for impairment increased \$52.6 million to \$679.9 million in 2014, compared with \$627.3 million as of December 31, 2013.

The ratio of non-performing loans and leases to total loans and leases decreased from 2.12% at December 31, 2013 to 1.52% at December 31, 2014. The decrease is attributable to one large commercial and multi-family relationship that had demonstrated a period of performance and moved into accrual status in 2014. The positive trend in the ratio of non-performing loans and leases to total loans and leases over the past year is consistent with the historical trend from the years preceding 2013, from 2.64% at December 31, 2010 to 2.60% at December 31, 2011 and 1.41% at December 31, 2012. Trends in non-performing loans and charge-offs are good indicators of credit quality and provide context for the movement in

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the provision for loan and lease losses, and are presented and discussed in the next section. A description of how the allowance for loan and lease losses is determined along with tabular data depicting the key factors in calculating the allowance is set forth in Notes 1 and 3 of the Notes to Consolidated Financial Statements included in Part II, Item 8 of this Annual Report on Form 10-K.

## Non-accrual, Past Due and Restructured Loans and Leases

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

	At December 31,				
	2014	2013	2012	2011	2010
	(in thousands)				
Non-accruing loans and leases:					
Mortgage loans on real estate:					
Residential mortgages	\$ 1,296	\$ 1,376	\$ 1,443	\$ 1,048	\$ 742
Commercial and multi-family	3,162	8,873	4,309	6,858	5,724
Construction-residential	-	-	-	167	186
Construction-commercial	-	-	729	1,442	850
Home equities	415	447	618	946	256
Total mortgage loans on real estate	4,873	10,696	7,099	10,461	7,758
Direct financing leases	-	47	171	1,160	2,930
Commercial and industrial loans	5,500	2,970	914	2,180	2,203
Consumer installment loans	17	20	44	76	230
Other	-	-	-	-	-
Total non-accruing loans and leases	\$ 10,390	\$ 13,733	\$ 8,228	\$ 13,877	\$ 13,121
Accruing loans 90+ days past due	201	-	-	1,299	806
Total non-performing loans and leases	\$ 10,591	\$ 13,733	\$ 8,228	\$ 15,176	\$ 13,927

Total non-performing loans and leases to total assets	1.25	%	1.65	%	1.02	%	2.05	%	2.07	%
Total non-performing loans and leases to total loans and leases	1.52	%	2.12	%	1.41	%	2.60	%	2.64	%

Non-performing loans and leases decreased \$3.1 million from \$13.7 million at December 31, 2013 to \$10.6 million at December 31, 2014. The decrease in 2014 was driven by one large non-performing commercial and multi-family loan relationship with a demonstrated period of repayment performance, which was partially offset by one large commercial and industrial loan relationship which was moved into non-accrual status during the year.

Non-accruing loans and leases decreased \$3.3 million from \$13.7 million at December 31, 2013 to \$10.4 million at December 31, 2014. Accruing loans categorized as 90 days past due increased from \$0 to \$0.2 million from December 31, 2013 to December 31, 2014. The commercial and industrial loans portfolio represents the largest portion of non-accruing loans and leases. The decrease in non-accruing real estate loans since December 31, 2013 was due to one large commercial real estate loan relationship, totaling \$7.8 million at December 31, 2013, that moved into accrual status and paid off in 2014.

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The increase in non-accruing commercial and industrial loans since December 31, 2013 was due to a large commercial and industrial loan relationship, totaling \$5.2 million at December 31, 2014, moved into non-accrual during the year, partially off-set by a partial charge-off and pay-off of one large commercial loan, totaling \$2.4 million at December 31, 2013.

Non-accruing consumer real estate loans, including residential mortgages and home equity loans and lines of credit, decreased from \$1.8 million at December 31, 2013 to \$1.7 million at December 31, 2014. Historical losses in these portfolios have been relatively low as the Company has typically loaned at conservative loan-to-value ratios, resulting in fewer losses.

The Company had \$6.6 million in loans and leases that were restructured and deemed to be a troubled debt restructuring (“TDR”) at December 31, 2014 with \$1.9 million of those balances in non-accrual status. Any TDR that is placed on non-accrual is not returned to accruing status until the borrower makes timely payments as contracted for at least six months and future collection under the revised terms is probable. All of the restructurings were allowed in an effort to maximize the Company’s ability to collect on loans and leases where borrowers were experiencing financial difficulty. Modifications made to loans in a troubled debt restructuring did not have a material impact on the Company’s net income for the years ended December 31, 2014 and 2013. The reserve for a TDR is based upon the present value of the future expected cash flows discounted at the loan’s original effective rate or upon the fair value of the collateral less costs to sell, if the loan is deemed collateral dependent. This reserve methodology is used because all TDR loans are considered impaired.

The following table presents the Company’s TDR loans and leases as of December 31, 2014:

	December 31, 2014			
	(\$ in thousands)			
	Total	Nonaccruing	Accruing	Related Allowance
Commercial and industrial	\$ 492	\$ 274	\$ 218	\$ 173
Residential real estate:				
Residential	1,833	594	1,239	-
Construction	-	-	-	-
Commercial real estate:				
Commercial and multi family	2,428	847	1,581	33
Construction	1,074	-	1,074	-

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Home equities	728	233	495	-
Consumer loans	31	-	31	31
Other	-	-	-	-
Total troubled restructured loans and leases	\$ 6,586	\$ 1,948	\$ 4,638	\$ 237

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## Allowance for Loan and Lease Losses

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

## ANALYSIS OF THE ALLOWANCE FOR LOAN AND LEASE LOSSES

	2014	2013	2012	2011	2010
	(in thousands)				
BALANCE AT THE BEGINNING OF THE YEAR	\$ 11,503	\$ 9,732	\$ 11,495	\$ 10,424	\$ 6,971
CHARGE-OFFS:					
Residential mortgages	-	(39)	(12)	-	-
Commercial and multi-family	(57)	(460)	(900)	(189)	-
Construction-residential	-	-	-	-	-
Construction-commercial	-	-	-	-	(104)
Home equities	(2)	(128)	(114)	-	-
Direct financing leases	-	-	-	-	-
Commercial and industrial loans	(957)	(20)	(862)	(1,305)	(388)
Consumer installment loans	(46)	(64)	(32)	(2)	(4)
Other	-	-	-	(26)	(53)
TOTAL CHARGE-OFFS	(1,062)	(711)	(1,920)	(1,522)	(549)
RECOVERIES:					
Residential mortgages	18	2	1	-	-
Commercial and multi-family	58	444	15	57	-
Construction-residential	-	-	-	-	-
Construction-commercial	-	-	-	-	30
Home equities	-	1	6	2	1
Direct financing leases	173	242	-	-	-
Commercial and industrial loans	574	240	184	39	4
Consumer installment loans	40	13	19	1	-
Other	-	-	-	10	24
TOTAL RECOVERIES	863	942	225	109	59
NET (CHARGE-OFFS) RECOVERIES	(199)	231	(1,695)	(1,413)	(490)
PROVISION FOR LOAN AND LEASE LOSSES	1,229	1,540	(68)	2,484	3,943
BALANCE AT THE END OF YEAR	\$ 12,533	\$ 11,503	\$ 9,732	\$ 11,495	\$ 10,424

RATIO OF NET CHARGE-OFFS  
(RECOVERIES) TO AVERAGE  
NET LOANS AND LEASES  
OUTSTANDING

0.03	%	(0.04)	%	0.29	%	0.26	%	0.10	%
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RATIO OF ALLOWANCE FOR  
LOAN AND LEASE LOSSES TO  
TOTAL LOANS AND LEASES

1.80	%	1.78	%	1.67	%	1.97	%	1.97	%
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Net charge-offs (net recoveries) increased from (\$0.2) million in 2013 to \$0.2 million in 2014. The ratio of net charge-offs (net recoveries) to average net loans and leases outstanding correspondingly increased from (0.04)% at December 31, 2013 to 0.03% at December 31, 2014. The largest net charge-offs occurred in the commercial and industrial loan portfolio due to one commercial loan relationship that was partially charged-off and partially paid-off during the year. Excluding the \$0.5 million impact of this one commercial loan relationship, total net charge-offs (net recoveries) for 2014 would reflect a \$0.1 million increase in recoveries to (\$0.3) million in net recoveries for the year, as compared with (\$0.2) million in 2013.

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

	Balance at 12/31/2014 to:	Percent of loans in each category to:	Balance at 12/31/2013 to:	Percent of loans in each category to:	Balance at 12/31/2012 to:	Percent of loans in each category to:	Balance at 12/31/2011 to:	Percent of loans in each category to:	Balance at 12/31/2010 to:	Percent of loans in each category to:
Residential mortgages *	\$ 941	14.24 %	\$ 1,038	14.77 %	\$ 662	11.84 %	\$ 793	13.00 %	\$ 548	13.50 %
Commercial mortgages *	5,650	58.11 %	4,912	59.53 %	4,493	60.58 %	4,670	57.30 %	4,252	55.60 %
Home equities	819	8.62 %	878	8.85 %	746	9.68 %	768	9.40 %	540	10.10 %
Commercial loans	4,896	18.61 %	4,489	16.53 %	3,617	17.17 %	4,085	18.80 %	3,435	17.30 %
Consumer loans **	78	0.42 %	37	0.32 %	18	0.45 %	36	0.50 %	29	0.60 %
Direct financing leases	-	- %	-	- %	47	0.28 %	994	1.00 %	1,471	2.90 %
Unallocated	149	- %	149	- %	149	- %	149	- %	149	- %
	\$ 12,533	100.00 %	\$ 11,503	100.00 %	\$ 9,732	100.00 %	\$ 11,495	100.00 %	\$ 10,424	100.00 %

\* includes construction loans

\*\* includes other loans

The proportion of the allowance allocated to commercial mortgages comprises 45.1% of the allowance for loan and lease losses, and correspondingly, the commercial mortgage portfolio made up the largest proportion, or 58.1%, of the total loan and lease portfolio as of December 31, 2014, as compared with 42.7% of the allowance and 59.5% of the total loan and lease portfolio at December 31, 2013. The increase in the percentage of the allowance attributed to commercial mortgages was due to a \$25.3 million, or 6.8%, increase in commercial mortgages collectively evaluated in both the criticized and non-criticized commercial mortgage loan pools.

C&I loans comprise 39.1% of the allowance for loan and lease losses despite being only 18.6% of the loan and lease portfolio. Although the commercial mortgage portfolio experienced greater losses than the C&I loan portfolio in 2013, C&I loans experienced greater losses during the previous four years, as well as during 2014. Therefore, the percentage of the allowance attributable to C&I loans comprises a significant portion of the allowance.

Overall, the ratio of the allowance for loan and lease losses to total loans and leases increased slightly from 1.78% at December 31, 2013 to 1.80% on December 31, 2014. The increase is a reflection of an increase in the ratio of total specific reserves to total individually evaluated loans of 8.7% at December 31, 2014, compared with 8.0% as of December 31, 2013.

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The Company's coverage ratio of the allowance for loan and lease losses to non-performing loans and leases increased from 84% at December 31, 2013 to 118% at December 31, 2014, due to \$3.1 million decrease in non-performing loans and leases from \$13.7 million at December 31, 2013 to \$10.6 million at December 31, 2014.

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

Non-Interest Income

Total non-interest income decreased by \$1.9 million, or 15.5%, from 2013 to 2014. The primary factor driving the decrease was a \$2.6 million loss on a tax credit investment in 2014, as compared with a \$1.6 million loss on a tax credit investment in 2013. Additionally, a \$0.7 million one-time gain was realized from the termination of the FDIC loss sharing agreement in 2013. With the tax credit investments and corresponding tax credit benefit, the Company was able to reduce its overall tax provision in 2014 by \$3.0 million to \$0.7 million, or 59.3%, less than prior year tax provision of \$1.7 million, as described more below.

Gains from premiums on loans sold to FNMA increased \$0.2 million from 2013, as a result of the Company selling off more residential mortgages originated in a higher interest rate environment. In addition, income from bank-owned life insurance increased by \$0.1 million, or 13.0%, to \$0.6 million during 2014 due to additional purchases made in 2013, and interchange fee income increased \$0.1 million, 7.8%, to \$1.1 million in 2014. These increases were offset by decreases in bank service charges on deposits and insurance service and fee revenue. Bank charges on deposits decreased \$0.2 million, or 9.8%, from \$2.0 million at December 31, 2013 to \$1.8 million at December 31, 2014. This is attributable to a decrease in customer overdraft activity in deposits. Insurance service and fee revenue decreased \$0.1 million, or 1.1%, to \$7.1 million at December 31, 2014. TEA's revenue remains the largest component of non-interest income at 69.4% of total non-interest income. TEA is a source of diversification in the earnings of the Company and helps generate income not directly impacted by difficult credit or interest rate environments.

Non-Interest Expense

Total non-interest expense increased \$1.9 million, or 6.4%, from \$29.4 million in 2013 to \$31.3 million in 2014. The largest increase in non-interest expense was salaries and employee benefits, which increased \$1.1 million, or 6.1%, in comparison to 2013, and litigation expense, which increased \$1.0 million in comparison to 2013. The increase in salaries and employee benefits stems from merit increases, rising health care costs, and the addition of new employees

as a part of the Company's planned growth strategy. The \$1.0 million in litigation expense relates to an accrual for a legal matter with the New York Attorney General over the Bank's residential mortgage lending practices, as discussed in greater detail in Part I, Item 3 of this Annual Report on Form 10-K.

Advertising and public relations expenses increased \$0.1 million, or 10.3%, from prior year due to an increase in advertising campaigns and community involvement. A \$0.2 million, or 6.3%, increase in other expenses in 2014 was driven by an increase in Community Reinvestment Act loan closings and charitable contributions.

Technology and communications expense decreased \$0.2 million, or 11.9%, to \$1.1 million in 2014. The decrease was primarily attributable to technology cost savings as a result of building consolidations in late 2013 and renegotiation of a contract with a primary service provider.

In 2014, the Company benefited from the expiration of the amortization of intangibles related to its purchase of an insurance agency in 2008. Amortization expense declined from \$0.2 million in 2013 to \$0.1 million in 2014.

The efficiency ratio expresses the relationship of operating expenses to revenues. The Company's efficiency ratio, or non-interest operating expenses (exclusive of non-cash goodwill impairment and intangible amortization) divided by the sum of net interest income and non-interest income (exclusive of gains and losses from investment securities), was 70.83% in 2014, 71.98% in 2013, and 70.05% in 2012. The improvement in 2014 from 2013 is a result of the increase in Company's net interest margin in 2014.

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Taxes

The provision for income taxes in 2014 was \$0.7 million on pre-tax income of \$8.9 million for an effective tax rate of 7.9%, compared with an effective tax rate of 18.1% in 2013. Both periods benefited from a tax credit due to investing in community projects which generated historic tax credits. In 2014, the project was larger and generated a \$3.0 million tax credit which was \$1.2 million greater than tax credit of \$1.8 million recognized in 2013. Excluding the impact of the historic tax credit and write-off of the tax credit investments recognized in non-interest income as of December 31, 2014 and 2013, the provision for income taxes would have been \$3.7 million and \$3.5 million, respectively, on pre-tax income of \$11.5 million and \$11.1 million, respectively, yielding an effective rate of 32.2% and 31.7%, respectively.

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

Net Income

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

Net Interest Income

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

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

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

Net interest spread, or the difference between yield on interest-earning assets and rate on interest-bearing liabilities, declined to 3.59% in 2013, compared with 3.64% in 2012. The yield on interest-earning assets decreased 34 basis points from 4.61% in 2012 to 4.27% in 2013, and the cost of interest-bearing liabilities decreased 29 basis points, from 0.97% in 2012 to 0.68% in 2013. Net interest spread decreased as the yield curve, or the difference between long-term rates and short-term rates, flattened throughout 2013. Banks traditionally benefit from a steep yield curve because the duration of interest-earnings assets is typically longer than the duration of interest-bearing liabilities. In addition, the Company's opportunities to re-price on the liability side during 2013 were not enough to make up for the steeper decrease in asset yields from re-pricing.

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## Provision for Loan and Lease Losses

The Company's provision for loan and lease losses increased \$1.6 million from (\$0.1) million in 2012 to \$1.5 million in 2013. The overall increase was a result of increases in impaired commercial loans, commercial loans classified as criticized loans, and the growth in the general loan portfolio, as well as recognition of provision for previously covered loans under the FDIC loss sharing agreement and continued run-off of the leasing portfolio. The increase in the provision for loan losses in 2013 was driven mostly by increases in loans, impaired commercial loans and commercial loans classified as criticized loans. As noted in Note 1 to the Consolidated Financial Statements included in Item 8 of this Annual Report on Form 10-K, the Company reserves a specific allocation on impaired loans and a higher percentage on criticized loans, or those loans risk rated 5 or higher. The Company had \$1.2 million in specific reserve credit allocation on impaired loans at December 31, 2013, compared with \$1.0 million at December 31, 2012. There was one criticized commercial loan relationship that became impaired in 2013 and required a significant specific reserve. At December 31, 2013, loans risk rated 5 or higher were up \$10.6 million to \$30.8 million, compared with \$20.2 million at December 31, 2012, mostly driven by one large commercial and multi-family relationship classified as a criticized loan during the year. Additionally, total loans collectively evaluated for impairment increased \$58.0 million to \$629.2 million in 2013, compared with \$571.2 million as of December 31, 2012. In addition, upon termination of the FDIC loss sharing agreement in 2013, the Company recognized \$0.6 million in provision on loans previously referred to as "covered" due to the FDIC guarantee governing those acquired loans. Termination of the loss sharing agreement with the FDIC eliminated the guarantee on the losses associated with the acquired portfolio, and required the Company to realize \$0.6 million provision on those loans previously covered under the FDIC guarantee. The Company's provision for lease losses benefitted from a negative provision of \$0.9 million in 2012, as the portfolio demonstrated improved performance, compared with a negative provision of \$0.1 million in 2013. As the leasing portfolio significantly declined and existing leases continued to perform in 2013, the benefit from additional releases in the provision for lease losses in the current year had been exhausted. The increases in the provision for loan and lease losses was partially offset by \$0.2 million in net recoveries in 2013, compared with net charge-offs of \$1.7 million in 2012.

The ratio of non-performing loans and leases to total loans and leases increased significantly from 1.41% at December 31, 2012 to 2.12% at December 31, 2013. The Company experienced a positive trend in the ratio of non-performing loans and leases to total loans and leases over the previous three years from 2.64% at December 31, 2010 to 2.60% at December 31, 2011 and 1.41% at December 31, 2012.

## Non-Interest Income

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

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

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Non-Interest Expense

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

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

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

FDIC insurance costs also increased \$0.1 million, or 10.6%, from 2012 due to an increase in the assessment from deposit growth.

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

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

The efficiency ratio expresses the relationship of operating expenses to revenues. The Company's efficiency ratio, or non-interest operating expenses (exclusive of non-cash goodwill impairment and intangible amortization) divided by the sum of net interest income and non-interest income (exclusive of gains and losses from investment securities), was 71.98% in 2013, an increase from 70.05% in 2012 and 69.68% in 2011. The increase was a product of the Company's declining net interest margin and investments in additional employees and infrastructure.

## FINANCIAL CONDITION

The Company had total assets of \$846.8 million at December 31, 2014, an increase of \$13.3 million, or 1.6%, from \$833.5 million at December 31, 2013. Net loans of \$683.1 million increased \$47.6 million, or 7.5%, from \$635.5 million at December 31, 2013. Securities decreased \$4.9 million or 4.8% in 2014, and deposits increased by \$1.0 million or 0.14%. Stockholders' equity increased \$5.1 million or 6.3% from 2013.

### Securities Activities

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

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

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In regard to municipal securities, the Company's general investment policy is that in-state securities must be rated at least Moody's Baa (or equivalent) at the time of purchase. The Company reviews the ratings report and municipality financial statements and prepares a pre-purchase analysis report before the purchase of any municipal securities. Out-of-state issues must be rated by Moody's at least Aa (or equivalent) at the time of purchase. The Company did not own any out-of-state municipal bonds at December 31, 2014 or December 31, 2013. Bonds rated below A are reviewed periodically to ensure their continued credit worthiness. While purchase of non-rated municipal securities is permitted, such purchases are limited to bonds issued by municipalities in the Company's general market area. Those municipalities are typically customers of the Bank whose financial situation is familiar to management. The financial statements of the issuers of non-rated securities are reviewed by the Bank and a credit file of the issuers is kept on each non-rated municipal security with relevant financial information.

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

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

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

Management believes that it has a sufficient understanding of the third party service's valuation models, assumptions and inputs used in determining the fair value of securities to enable management to maintain an appropriate system of internal control. On a quarterly basis the Company reviews changes, as submitted by our third-party pricing service provider, in the market value of its securities portfolio. Individual changes in valuations are reviewed for consistency with general interest rate movements and any known credit concerns for specific securities. Additionally, on an annual basis the Company has its entire securities portfolio priced by a second pricing service to determine consistency with another market evaluator. If, on the Company's review or in comparing with another servicer, a material difference between pricing evaluations were to exist, the Company may submit an inquiry to our third party pricing service provider regarding the data used to value a particular security. If the Company determines it has market information that would support a different valuation than our third-party pricing service provider's evaluation it can submit a challenge for a change to that security's valuation. There were no material differences in valuations noted in 2014 or 2013.

Securities and interest-bearing deposits at banks made up 15.3% of the Company's total average interest-earning assets in 2014 compared with 21.3% in 2013. These assets provide the Company with additional sources of liquidity and income and act as collateral for the Bank's municipal deposits. The Company's securities portfolio outstanding balances decreased 4.8% from \$102.0 million at December 31, 2013 to \$97.1 million at December 31, 2014, and the Company's interest-bearing deposits at banks also decreased from \$27.3 million to \$2.1 million over the same time period. The interest-bearing deposits are liquid interest-bearing cash accounts at correspondent banks. The \$25.1 million decrease in the Company's cash position

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was a result of the loan growth in 2014 and minimal growth in total deposits of \$1.0 million or 0.1% in 2014. With long-term rates at historic lows, the Company did not make significant investments from the limited liquidity in non-core assets such as long-term bonds. In 2014, \$9.0 million in FHLB borrowings matured, and were replaced by overnight borrowings with the FHLB. At December 31, 2014, the Company's concentration in U.S. government-sponsored agency bonds was 27.5% of the total securities balance versus 31.3% at December 31, 2013. Government-sponsored mortgage-backed securities made up 38.9% of the portfolio at December 31, 2014, compared with 35.1% of the portfolio at December 31, 2013, and tax-advantaged municipal bonds made up 32.0% of the portfolio at December 31, 2014 versus 31.2% of the portfolio at December 31, 2013.

As a member of both the Federal Reserve System and the FHLB, the Bank is required to hold stock in those entities. The Bank held \$1.4 million in FHLB stock as of December 31, 2014 and 2013, and \$1.5 million in FRB stock at December 31, 2014 and 2013.

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

The Company designates all securities at the time of purchase as either "held to maturity" or "available for sale." Securities designated as held to maturity are stated on the Company's Consolidated Balance Sheets included under Item 8 of this Annual Report on Form 10-K at amortized cost. Those designated as available for sale are reported at fair market value. At December 31, 2014, \$1.6 million in securities were designated as held to maturity. These bonds are primarily municipal investments that the Bank has made in its local market area.

The available for sale portfolio totaled \$95.5 million or approximately 98.4% of the Company's securities portfolio at December 31, 2014. Net unrealized gains and losses on available for sale securities resulted in a net unrealized gain of \$1.5 million at December 31, 2014, as compared with a net unrealized gain of \$0.3 million at December 31, 2013. Unrealized gains and losses on available-for-sale securities are reported, net of taxes, as a separate component of stockholders' equity. For the year ended December 31, 2014, the impact on stockholders' equity was a net unrealized gain, net of taxes, of approximately \$0.7 million.

Certain securities available for sale were in an unrealized loss position at December 31, 2014. Management has assessed those securities available for sale in an unrealized loss position at December 31, 2014 and determined the decline in fair value below amortized cost to be temporary. In making this determination, management considered the period of time the securities were in a loss position, the percentage decline in comparison to the securities amortized cost, the financial condition of the issuer (primarily government or government-sponsored enterprises) and the Company's ability and intent to hold these securities until their fair value recovers to their amortized cost. Management believes the decline in fair value is primarily related to market interest rate fluctuations and not to the credit deterioration of the individual issuer.

Income from securities held in the Bank's investment portfolio represented approximately 8.0% of total interest income of the Company in 2014 as compared with 8.8% in 2013 and 9.2% in 2012. At December 31, 2014, the Bank's securities portfolio of \$97.1 million consisted primarily of state and municipal securities, mortgage-backed securities issued by the Federal National Mortgage Association ("FNMA") and Federal Home Loan Mortgage Corp ("FHLMC"), and U.S. and federal agency obligations. The \$0.1 million and \$0.2 million decrease in investment securities income in 2014 and 2013, respectively, was a result of a significant decline in investment yields as sustained stimulus by the FRB continued to drive down bond yields to all-time lows. Taxable investment yields dropped from 2.61% in 2013 to 2.54% in 2014, and tax-exempt security yields fell from 3.01% in 2013 to 2.95% in 2014.

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

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The following table summarizes the Bank's securities with those designated as available for sale valued at fair value and securities designated as held to maturity at amortized cost as of December 31, 2014, 2013 and 2012:

	At December 31,		
	2014	2013	2012
	(in thousands)		
Available for Sale:			
Debt securities			
U.S. government agencies	\$ 26,717	\$ 31,992	\$ 28,332
States and local subdivisions	31,060	31,880	31,469
Total debt securities	\$ 57,777	\$ 63,872	\$ 59,801
Mortgage-backed securities			
FNMA	\$ 15,154	\$ 13,501	\$ 16,077
FHLMC	5,958	7,118	6,481
GNMA	6,130	7,573	8,013
CMO's	10,514	7,601	1,691
Total mortgage-backed securities	\$ 37,756	\$ 35,793	\$ 32,262
Total available for sale securities	\$ 95,533	\$ 99,665	\$ 92,063
Held to Maturity:			
Debt securities			
States and local subdivisions	\$ 1,599	\$ 2,384	\$ 3,744
Total held to maturity securities	\$ 1,599	\$ 2,384	\$ 3,744

The following table sets forth the contractual maturities and weighted average interest yields of the Bank's securities portfolio (yields on tax-exempt obligations are not presented on a tax-equivalent basis) as of December 31, 2014. Expected maturities will differ from contracted maturities since issuers may have the right to call or prepay obligations without penalties.

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	Maturing Within One Year		After One But Within Five Years		After Five But Within Ten Years		After Ten Years	
	Amount	Yield	Amount	Yield	Amount	Yield	Amount	Yield
	(dollars in thousands)							
Available for Sale:								
Debt Securities								
U.S. Government agencies	\$ 5,058	2.88 %	\$ 5,224	3.21 %	\$ 13,377	1.96 %	\$ 3,058	2.96 %
States and political subdivisions	3,198	3.87 %	17,373	3.37 %	7,212	3.61 %	3,277	4.24 %
Total debt securities	\$ 8,256	3.26 %	\$ 22,597	3.33 %	\$ 20,589	2.54 %	\$ 6,335	3.63 %
Mortgage-backed securities								
FNMA	\$ -	- %	\$ 451	5.00 %	\$ 6,718	3.55 %	\$ 7,986	3.48 %
FHLMC	-	- %	232	5.00 %	950	4.14 %	4,776	2.68 %
GNMA	-	- %	-	- %	-	- %	6,130	3.16 %
CMO's	-	- %	7	4.25 %	-	- %	10,506	1.91 %
Total mortgage-backed securities	\$ -	- %	\$ 690	4.99 %	\$ 7,668	3.62 %	\$ 29,398	2.72 %
Total available for sale	\$ 8,256	3.26 %	\$ 23,287	3.38 %	\$ 28,257	2.83 %	\$ 35,733	2.88 %
Held to Maturity:								
Debt Securities								
U.S. Government agencies	\$ -	- %	\$ -	- %	\$ -	- %	\$ -	- %
States and political subdivisions	478	1.78 %	77	3.35 %	932	2.91 %	112	2.80 %
Total held to maturity	\$ 478	1.78 %	\$ 77	3.35 %	\$ 932	2.91 %	\$ 112	2.80 %
Total securities	\$ 8,734	3.18 %	\$ 23,364	3.38 %	\$ 29,189	2.84 %	\$ 35,845	2.88 %

## LENDING AND LEASING ACTIVITIES

The Bank has a loan and lease policy which is approved by its Board of Directors on an annual basis. The loan and lease policy governs the conditions under which loans and leases may be made, addresses the lending authority of Bank officers, documentation requirements, appraisal policy, charge-off policies and desired portfolio mix. The

Bank's lending limit to any one borrower is subject to regulation by the OCC. The Bank continually monitors its loan portfolio to review compliance with new and existing regulations.

The Bank offers a variety of loan products to its customers, including residential and commercial real estate mortgage loans, commercial loans, and installment loans. The Bank primarily extends loans to customers located within the Western New York area. Interest income on loans and leases represented approximately 91.9% of the total interest income of the Company in 2014 and approximately 91.2% and 90.8% of total interest income in 2013 and 2012, respectively. The Bank's loan and lease portfolio, net of the allowances for loan and lease losses, totaled \$683.1 million and \$635.5 million at December 31, 2014 and December 31, 2013, respectively. The net loan and lease portfolio represented approximately 80.7% and 76.2% of the Company's total assets at December 31, 2014 and December 31, 2013, respectively.

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

	December 31,				
	2014	2013	2012	2011	2010
	(in thousands)				
Mortgage loans on real estate:					
Residential Mortgages	\$ 98,374	\$ 94,027	\$ 68,135	\$ 73,579	\$ 69,958
Commercial and multi-family	363,252	361,247	323,777	306,683	261,371
Construction-Residential	721	1,509	811	2,392	1,320
Construction-Commercial	40,986	23,902	28,941	27,887	32,332
Home equities	59,948	57,228	56,366	54,673	53,120
Total real estate loans	563,281	537,913	478,030	465,214	418,101
Direct financing leases	-	-	1,612	6,021	15,475
Commercial and industrial loans	129,456	106,952	99,951	109,513	91,445
Consumer loans	1,764	938	1,294	1,677	2,458
Other	404	323	1,342	586	252
Net deferred loan origination costs	759	870	666	394	247
Total gross loans and leases	695,664	646,996	582,895	583,405	527,978
Allowance for loan and lease losses	(12,533)	(11,503)	(9,732)	(11,495)	(10,424)
Loans and leases, net	\$ 683,131	\$ 635,493	\$ 573,163	\$ 571,910	\$ 517,554

## Real Estate Loans

Approximately 81.0% of the Bank's total loan and lease portfolio at December 31, 2014 consisted of real estate loans or loans collateralized by mortgages on real estate, including residential mortgages, commercial mortgages and other types of real estate loans. The Bank's real estate loan portfolio was \$563.3 million at December 31, 2014, compared with \$537.9 million at December 31, 2013. The real estate loan portfolio increased by approximately 4.7% in 2014

over 2013 compared with an increase of 12.5% in 2013 over 2012.

The Bank offers fixed rate residential mortgage loans with terms of 10 to 30 years with, typically, up to an 80% loan-to-value (“LTV”) ratio. Any loans with a greater than 80% LTV have private mortgage insurance. Fixed rate residential mortgage loans outstanding totaled \$90.8 million at December 31, 2014, which was approximately 13.1% of total loans and leases outstanding, compared with \$85.7 million and 13.2%, respectively, at December 31, 2013.

This balance did not include any construction residential mortgage loans, which are discussed below. The Bank has a contractual arrangement with FNMA, pursuant to which the Bank sells certain mortgage loans to FNMA and the Bank retains the servicing rights to those loans. The Bank determines with each origination of residential real estate loans which desired maturities, within the context of overall maturities in the loan portfolio, provide the appropriate mix to optimize the Bank’s ability to absorb the corresponding interest rate risk within the Company’s tolerance ranges.

In 2014, the Bank sold \$15.3 million in mortgages to FNMA under this arrangement, compared with \$0.8 million in mortgages sold in 2013. The rise in mortgages sold to FNMA was due to an increase in interest rates in 2014, which provided an opportunity to realize gains on sales to FNMA.

The Bank currently retains the servicing rights on \$71.6 million in mortgages sold to FNMA at December 31, 2014, compared with \$63.5 million in mortgages sold to FNMA at December 31, 2013. The Company has recorded a net servicing asset for such loans of \$0.5 million at December 31, 2014 and 2013. The value of the mortgage servicing rights remained the same, despite a 12.8% increase in the size of the servicing portfolio, due to the Company’s valuation model projecting higher

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prepayment speeds and additional assumption changes based on current attributes of recently originated loans in the servicing portfolio, such as decreased late charges and increased costs to service.

The Bank offers adjustable rate residential mortgage loans with terms of up to 30 years. Rates on these mortgage loans remain fixed for a predetermined time and are adjusted annually thereafter. The Bank's outstanding adjustable rate residential mortgage loans were \$6.5 million or 0.9% of total loans and leases outstanding at December 31, 2014 as compared with \$7.2 million or 1.1% at December 31, 2013. With rates on fixed rate mortgage products at all-time lows, there has been little demand for variable-rate products which has resulted in a decline in variable rate mortgage loan balances.

Overall, residential real estate loans increased \$4.3 million, or 4.6%, from \$94.0 million at December 31, 2013 to \$98.4 million at December 31, 2014.

The Bank also offers commercial mortgage loans with up to an 80% LTV ratio for up to 20 years on a variable and fixed rate basis. To the extent required, loans exceeding an 80% LTV are reported on an exception report to the Board of Directors. Many of these mortgage loans either mature or are subject to a rate call after three to five years. The Bank's outstanding commercial mortgage loans were \$363.3 million at December 31, 2014, which was 52.2% of total loans and leases outstanding, compared with \$361.2 million and 55.8% at December 31, 2013. The Company believes that the strong relationships with customers in the local community that have been fostered over the years with its loan officers resulted in sustained loan production in 2014. The balance at December 31, 2014 included \$117.4 million in fixed rate and \$245.9 million in variable rate commercial mortgage loans, which include interest rate calls.

The Bank also offers other types of loans collateralized by real estate, such as home equity loans. The Bank offers home equity loans at variable and fixed interest rates with terms of up to 15 years and up to an 85% combined LTV ratio. To the extent required, loans exceeding an 85% LTV ratio are reported on an exception report to the Board of Directors. At December 31, 2014, the real estate loan portfolio included \$59.9 million of home equity loans outstanding, which represented 8.6% of total loans and leases outstanding, compared with \$57.2 million and 8.8% at December 31, 2013, respectively. The total home equity portfolio included \$54.1 million in variable rate loans and \$5.8 million in fixed rate loans.

The Bank also offers both residential and commercial real estate construction loans at up to an 80% LTV ratio at fixed interest or adjustable interest rates and multiple maturities. At December 31, 2014, fixed rate real estate construction loans outstanding totaled \$3.2 million, or 0.5% of total loans and leases outstanding, and adjustable rate construction loans outstanding totaled \$38.5 million, or 5.5% of total loans and leases outstanding. At December 31, 2013, fixed rate real estate construction loans outstanding totaled \$3.2 million, or 0.5% of total loans and leases outstanding, and adjustable rate construction loans outstanding totaled \$22.2 million, or 3.4% of total loans and leases outstanding.

## Commercial and Industrial Loans

The Bank offers commercial and industrial (“C&I”) loans on a secured and unsecured basis, including lines of credit and term loans at fixed and variable interest rates and multiple maturities. The Bank’s C&I loan portfolio totaled \$129.5 million at December 31, 2014, compared with \$107.0 million at December 31, 2013, a 21.0% increase. The growth is attributable to an increased number of C&I loan officers and good results achieved through the Bank’s community-focused and relationship-based lending approach in the local market. Commercial loans represented 18.6% and 16.5% of the Bank’s total loans at December 31, 2014 and 2013, respectively.

Collateral for C&I loans, where applicable, may consist of inventory, receivables, equipment and other business assets. At December 31, 2014, 52.3% of the Bank’s C&I loans were at variable rates which are typically tied to the prime rate. The Company has a small number of loans that are tied to LIBOR.

## Consumer Loans

The Bank’s consumer installment loan portfolio totaled \$1.8 million and \$0.9 million at December 31, 2014 and 2013, respectively, representing 0.3% and 0.1% of the Bank’s total loans and leases outstanding at December 31, 2014 and 2013, respectively. Traditional installment loans are offered at fixed interest rates with various maturities of up to 60 months, on a secured and unsecured basis. This segment of the portfolio is done on an accommodation basis for customers. The Company does not actively try to grow the portfolio in a significant way.

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Other Loans

Other loans totaled \$0.4 million and \$0.3 million at December 31, 2014 and December 31, 2013, respectively. Other loans consisted primarily of overdrafts and loan clearing accounts.

Loan Maturities and Sensitivities of Loans to Changes in Interest Rates

The following table shows the maturities of commercial loans and real estate construction loans outstanding as of December 31, 2014 and the classification of such loans due after one year according to sensitivity to changes in interest rates.