

EVANS BANCORP INC
Form 10-Q
August 03, 2017

United States

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

For quarterly period ended June 30, 2017

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

For the transition period from _____ to _____

Commission file number 001-35021

EVANS BANCORP, INC.

(Exact name of registrant as specified in its charter)

New York 16-1332767

(State or other jurisdiction of (I.R.S. Employer
incorporation or organization) Identification No.)

One Grimsby Drive, Hamburg, NY 14075

(Address of principal executive offices) (Zip Code)

(716) 926-2000

(Registrant's telephone number, including area code)

Not Applicable

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

since last report)

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

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

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

Large accelerated filer

Accelerated filer

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

Smaller reporting company

Emerging growth company

If an emerging growth company, indicate by checkmark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

Edgar Filing: EVANS BANCORP INC - Form 10-Q

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

Yes No

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date: Common Stock, \$.50 par value, 4,774,967 shares as of August 3, 2017

Table of Contents

INDEX

EVANS BANCORP, INC. AND SUBSIDIARIES

| PART 1. FINANCIAL INFORMATION | PAGE |
|---|------|
| <u>Financial Statements</u> | |
| 1. | |
| <u>Unaudited Consolidated Balance Sheets – June 30, 2017 and December 31, 2016</u> | 1 |
| <u>Unaudited Consolidated Statements of Income – Three months ended June 30, 2017 and 2016</u> | 2 |
| <u>Unaudited Consolidated Statements of Income – Six months ended June 30, 2017 and 2016</u> | 3 |
| <u>Unaudited Consolidated Statements of Comprehensive Income – Three months ended June 30, 2017 and 2016</u> | 4 |
| <u>Unaudited Consolidated Statements of Comprehensive Income – Six months ended June 30, 2017 and 2016</u> | 5 |
| <u>Unaudited Consolidated Statements of Changes in Stockholders' Equity – Six months ended June 30, 2017 and 2016</u> | 6 |
| <u>Unaudited Consolidated Statements of Cash Flows - Six months ended June 30, 2017 and 2016</u> | 7 |
| <u>Notes to Unaudited Consolidated Financial Statements</u> | 9 |
| <u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u> | 37 |
| 2. | |
| <u>Quantitative and Qualitative Disclosures About Market Risk</u> | 46 |
| 3. | |
| <u>Controls and Procedures</u> | 47 |
| 4. | |
| PART II. OTHER INFORMATION | |

| | |
|--|----|
| <u>Legal Proceedings</u> | 48 |
| 1. | |
| <u>Unregistered Sales of Equity Securities and Use of Proceeds</u> | 48 |
| 2. | |
| <u>Exhibits</u> | 48 |
| 6. | |
| <u>Signatures</u> | 49 |

Table of Contents

PART I - FINANCIAL INFORMATION
ITEM 1 - FINANCIAL STATEMENTS
EVANS BANCORP, INC. AND SUBSIDIARIES
UNAUDITED CONSOLIDATED BALANCE SHEETS
JUNE 30, 2017 AND DECEMBER 31, 2016
(in thousands, except share and per share amounts)

| | June 30, 2017 | December 31, 2016 |
|---|---------------------|-------------------------|
| ASSETS | | |
| Cash and due from banks | \$ 13,869 | \$ 12,503 |
| Interest-bearing deposits at banks | 1,776 | 581 |
| Securities: | | |
| Available for sale, at fair value (amortized cost: \$141,510 at June 30, 2017; \$95,810 at December 31, 2016) | 141,225 | 95,222 |
| Held to maturity, at amortized cost (fair value: \$1,357 at June 30, 2017; \$1,959 at December 31, 2016) | 1,372 | 1,983 |
| Federal Home Loan Bank common stock, at cost | 1,727 | 2,185 |
| Federal Reserve Bank common stock, at cost | 1,908 | 1,546 |
| Loans, net of allowance for loan losses of \$14,178 at June 30, 2017 and \$13,916 at December 31, 2016 | 962,315 | 928,596 |
| Properties and equipment, net of accumulated depreciation of \$17,641 at June 30, 2017 and \$17,012 at December 31, 2016 | 10,960 | 11,310 |
| Goodwill and intangible assets | 8,609 | 8,406 |
| Bank-owned life insurance | 21,805 | 21,534 |
| Other assets | 17,280 | 16,843 |
| TOTAL ASSETS | \$ 1,182,846 | \$ 1,100,709 |
| LIABILITIES AND STOCKHOLDERS' EQUITY | | |
| LIABILITIES | | |
| Deposits: | | |
| Demand | \$ 207,348 | \$ 201,741 |
| NOW | 99,131 | 88,632 |
| Savings | 547,760 | 508,652 |
| Time | 164,817 | 140,949 |
| Total deposits | 1,019,056 | 939,974 |
| Securities sold under agreement to repurchase | 9,481 | 10,159 |
| Other borrowings | 14,600 | 28,200 |
| Other liabilities | 12,816 | 14,298 |
| Junior subordinated debentures | 11,330 | 11,330 |
| Total liabilities | 1,067,283 | 1,003,961 |
| CONTINGENT LIABILITIES AND COMMITMENTS | | |

STOCKHOLDERS' EQUITY:

| | | |
|---|---------------------|---------------------|
| Common stock, \$.50 par value, 10,000,000 shares authorized; 4,773,496 and 4,302,504 shares issued at June 30, 2017 and December 31, 2016, respectively, and 4,773,005 and 4,300,634 outstanding at June 30, 2017 and December 31, 2016, respectively | 2,389 | 2,153 |
| Capital surplus | 58,822 | 44,389 |
| Treasury stock, at cost, 491 and 1,870 shares at June 30, 2017 and December 31, 2016, respectively | - | - |
| Retained earnings | 56,492 | 52,630 |
| Accumulated other comprehensive loss, net of tax | (2,140) | (2,424) |
| Total stockholders' equity | 115,563 | 96,748 |
| TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY | \$ 1,182,846 | \$ 1,100,709 |

See Notes to Unaudited Consolidated Financial Statements

Table of Contents

PART I - FINANCIAL INFORMATION
ITEM 1 - FINANCIAL STATEMENTS
EVANS BANCORP, INC. AND SUBSIDIARIES
UNAUDITED CONSOLIDATED STATEMENTS OF INCOME
THREE MONTHS ENDED JUNE 30, 2017 AND 2016
(in thousands, except share and per share amounts)

| | Three Months Ended June 30, | |
|--|--------------------------------|----------|
| | 2017 | 2016 |
| INTEREST INCOME | | |
| Loans | \$ 10,646 | \$ 8,878 |
| Interest-bearing deposits at banks | 43 | 33 |
| Securities: | | |
| Taxable | 563 | 561 |
| Non-taxable | 210 | 222 |
| Total interest income | 11,462 | 9,694 |
| INTEREST EXPENSE | | |
| Deposits | 1,190 | 1,036 |
| Other borrowings | 50 | 51 |
| Junior subordinated debentures | 104 | 91 |
| Total interest expense | 1,344 | 1,178 |
| NET INTEREST INCOME | 10,118 | 8,516 |
| PROVISION (CREDIT) FOR LOAN LOSSES | 410 | (376) |
| NET INTEREST INCOME AFTER PROVISION FOR LOAN LOSSES | 9,708 | 8,892 |
| NON-INTEREST INCOME | | |
| Deposit service charges | 428 | 403 |
| Insurance service and fees | 1,912 | 1,572 |
| Gain on loans sold | 52 | 29 |
| Bank-owned life insurance | 142 | 141 |
| Loss on tax credit investment | (919) | (2,139) |
| Refundable state historic tax credit | 647 | 1,508 |
| Interchange fee income | 379 | 340 |
| Other | 448 | 426 |
| Total non-interest income | 3,089 | 2,280 |
| NON-INTEREST EXPENSE | | |
| Salaries and employee benefits | 6,030 | 5,467 |
| Occupancy | 775 | 740 |
| Advertising and public relations | 216 | 190 |
| Professional services | 550 | 656 |
| Technology and communications | 804 | 551 |
| Amortization of intangibles | 28 | - |
| FDIC insurance | 129 | 182 |

Edgar Filing: EVANS BANCORP INC - Form 10-Q

| | | |
|---|-----------|-----------|
| Other | 785 | 933 |
| Total non-interest expense | 9,317 | 8,719 |
| INCOME BEFORE INCOME TAXES | 3,480 | 2,453 |
| INCOME TAX PROVISION | 862 | 450 |
| NET INCOME | \$ 2,618 | \$ 2,003 |
| | | |
| Net income per common share-basic | \$ 0.55 | \$ 0.47 |
| Net income per common share-diluted | \$ 0.54 | \$ 0.46 |
| Cash dividends per common share | \$ - | \$ - |
| Weighted average number of common shares outstanding | 4,764,080 | 4,284,180 |
| Weighted average number of diluted shares outstanding | 4,880,454 | 4,346,599 |

See Notes to Unaudited Consolidated Financial Statements

2

Table of Contents

PART I - FINANCIAL INFORMATION
ITEM 1 - FINANCIAL STATEMENTS
EVANS BANCORP, INC. AND SUBSIDIARIES
UNAUDITED CONSOLIDATED STATEMENTS OF INCOME
SIX MONTHS ENDED JUNE 30, 2017 AND 2016
(in thousands, except share and per share amounts)

| | Six Months Ended June 30, | |
|--|---------------------------|-----------|
| | 2017 | 2016 |
| INTEREST INCOME | | |
| Loans | \$ 20,892 | \$ 17,608 |
| Interest-bearing deposits at banks | 55 | 44 |
| Securities: | | |
| Taxable | 999 | 938 |
| Non-taxable | 434 | 460 |
| Total interest income | 22,380 | 19,050 |
| INTEREST EXPENSE | | |
| Deposits | 2,306 | 1,995 |
| Other borrowings | 108 | 101 |
| Junior subordinated debentures | 204 | 178 |
| Total interest expense | 2,618 | 2,274 |
| NET INTEREST INCOME | 19,762 | 16,776 |
| (CREDIT) PROVISION FOR LOAN LOSSES | (25) | (168) |
| NET INTEREST INCOME AFTER PROVISION FOR LOAN LOSSES | 19,787 | 16,944 |
| NON-INTEREST INCOME | | |
| Deposit service charges | 818 | 846 |
| Insurance service and fees | 4,080 | 3,320 |
| Gain on loans sold | 70 | 44 |
| Bank-owned life insurance | 272 | 277 |
| Loss on tax credit investment | (919) | (2,139) |
| Refundable state historic tax credit | 647 | 1,508 |
| Interchange fee income | 723 | 658 |
| Other | 920 | 760 |
| Total non-interest income | 6,611 | 5,274 |
| NON-INTEREST EXPENSE | | |
| Salaries and employee benefits | 11,746 | 10,981 |
| Occupancy | 1,550 | 1,439 |
| Advertising and public relations | 406 | 475 |
| Professional services | 1,152 | 1,236 |
| Technology and communications | 1,411 | 1,149 |
| Amortization of intangibles | 56 | - |
| FDIC insurance | 356 | 341 |
| Other | 1,695 | 1,626 |

Edgar Filing: EVANS BANCORP INC - Form 10-Q

| | | |
|---|-----------|-----------|
| Total non-interest expense | 18,372 | 17,247 |
| INCOME BEFORE INCOME TAXES | 8,026 | 4,971 |
| INCOME TAX PROVISION | 2,262 | 1,254 |
| NET INCOME | \$ 5,764 | \$ 3,717 |
| | | |
| Net income per common share-basic | \$ 1.23 | \$ 0.87 |
| Net income per common share-diluted | \$ 1.20 | \$ 0.86 |
| Cash dividends per common share | \$ 0.40 | \$ 0.38 |
| Weighted average number of common shares outstanding | 4,699,447 | 4,273,645 |
| Weighted average number of diluted shares outstanding | 4,819,375 | 4,337,299 |

See Notes to Unaudited Consolidated Financial Statements

Table of Contents

PART I - FINANCIAL INFORMATION
 ITEM 1 - FINANCIAL STATEMENTS
 EVANS BANCORP, INC. AND SUBSIDIARIES
 UNAUDITED STATEMENTS OF CONSOLIDATED COMPREHENSIVE INCOME
 THREE MONTHS ENDED JUNE 30, 2017 AND 2016

(in thousands)

| | Three Months Ended June 30, | |
|--|-----------------------------|----------|
| | 2017 | 2016 |
| NET INCOME | \$ 2,618 | \$ 2,003 |
| OTHER COMPREHENSIVE INCOME, NET OF TAX: | | |
| Unrealized gain on available-for-sale securities | 3 | 260 |
| Defined benefit pension plans: | | |
| Amortization of prior service cost | 5 | 5 |
| Amortization of actuarial loss | 26 | 35 |
| Total | 31 | 40 |
| OTHER COMPREHENSIVE INCOME, NET OF TAX | 34 | 300 |
| COMPREHENSIVE INCOME | \$ 2,652 | \$ 2,303 |

See Notes to Unaudited Consolidated Financial Statements

Table of Contents

PART I - FINANCIAL INFORMATION
 ITEM 1 - FINANCIAL STATEMENTS
 EVANS BANCORP, INC. AND SUBSIDIARIES
 UNAUDITED STATEMENTS OF CONSOLIDATED COMPREHENSIVE INCOME
 SIX MONTHS ENDED JUNE 30, 2017 AND 2016

(in thousands)

| | Six Months Ended June 30, | |
|--|---------------------------|----------|
| | 2017 | 2016 |
| NET INCOME | \$ 5,764 | \$ 3,717 |
| OTHER COMPREHENSIVE INCOME, NET OF TAX: | | |
| Unrealized gain on available-for-sale securities | 190 | 909 |
| Defined benefit pension plans: | | |
| Amortization of prior service cost | 15 | 10 |
| Amortization of actuarial loss | 79 | 70 |
| Total | 94 | 80 |
| OTHER COMPREHENSIVE INCOME, NET OF TAX | 284 | 989 |
| COMPREHENSIVE INCOME | \$ 6,048 | \$ 4,706 |

See Notes to Unaudited Consolidated Financial Statements

Table of Contents

PART I - FINANCIAL INFORMATION

ITEM 1 - FINANCIAL STATEMENTS

EVANS BANCORP, INC. AND

SUBSIDIARIES

UNAUDITED CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS'

EQUITY

SIX MONTHS ENDED JUNE 30, 2017 AND 2016

(in thousands, except share and per share amounts)

| | Common Stock | Capital Surplus | Retained Earnings | Accumulated Other Comprehensive Income (Loss) | Treasury Stock | Total |
|---|-----------------|--------------------|----------------------|--|-------------------|-----------|
| Balance, December 31, 2015 | \$ 2,132 | \$ 43,318 | \$ 47,616 | \$ (1,810) | \$ - | \$ 91,256 |
| Net Income | | | 3,717 | | | 3,717 |
| Other comprehensive income | | | | 989 | | 989 |
| Cash dividends (\$0.38 per common share) | | | (1,626) | | | (1,626) |
| Stock compensation expense | | 270 | | | | 270 |
| Excess tax benefit from stock-based compensation | | 15 | | | | 15 |
| Repurchased 3,280 shares in treasury stock | | | | | (80) | (80) |
| Issued 19,093 restricted shares | 10 | (10) | | | | - |
| Issued 5,270 shares under Dividend Reinvestment Plan | 3 | 129 | | | | 132 |
| Issued 5,166 shares in Employee Stock Purchase Plan | 2 | 106 | | | | 108 |
| Issued 490 shares in stock option exercise | | 8 | | | | 8 |
| Reissued 3,021 restricted shares, net of forfeitures | | | | | | - |
| Balance, June 30, 2016 | \$ 2,147 | \$ 43,836 | \$ 49,707 | \$ (821) | \$ (80) | \$ 94,789 |
| Balance, December 31, 2016 | \$ 2,153 | \$ 44,389 | \$ 52,630 | \$ (2,424) | \$ - | \$ 96,748 |
| Net Income | | | 5,764 | | | 5,764 |
| Other comprehensive income | | | | 284 | | 284 |
| Cash dividends (\$0.40 per common share) | | | (1,902) | | | (1,902) |
| Stock compensation expense | | 295 | | | | 295 |
| Issued 440,000 shares in stock offering | 220 | 13,922 | | | | 14,142 |
| Issued 16,283 restricted shares | 8 | (8) | | | | - |
| Issued 3,253 shares under Dividend Reinvestment Plan | 2 | 124 | | | | 126 |
| Issued 3,713 shares in Employee Stock Purchase Plan | 2 | 124 | | | | 126 |
| | 4 | 111 | | | | 115 |

| | | | | | | | |
|--|----------|-----------|-----------|------------|------|------------|-------|
| Issued 7,743 shares in stock option exercises | | | | | | | |
| Repurchased 9,218 shares in treasury stock | | | | | | (342) | (342) |
| Reissued 10,597 shares in stock option exercises, net of forfeitures | | (135) | | | | 342 | 207 |
| Balance, June 30, 2017 | \$ 2,389 | \$ 58,822 | \$ 56,492 | \$ (2,140) | \$ - | \$ 115,563 | |

See Notes to Unaudited Consolidated Financial Statements

Table of Contents

PART I - FINANCIAL INFORMATION
ITEM 1 - FINANCIAL STATEMENTS
EVANS BANCORP, INC. AND SUBSIDIARIES
UNAUDITED CONSOLIDATED STATEMENTS OF CASH FLOWS
SIX MONTHS ENDED JUNE 30, 2017 AND 2016
(in thousands)

| | Six Months Ended | |
|--|------------------|-----------|
| | June 30, | |
| | 2017 | 2016 |
| OPERATING ACTIVITIES: | | |
| Interest received | \$ 22,329 | \$ 18,778 |
| Fees received | 6,538 | 5,554 |
| Interest paid | (2,587) | (2,249) |
| Cash paid to employees and vendors | (18,748) | (16,429) |
| Cash contributed to pension plan | (1,000) | (140) |
| Income taxes paid | (1,635) | (279) |
| Proceeds from sale of loans held for resale | 5,376 | 3,514 |
| Originations of loans held for resale | (5,532) | (3,477) |
| Net cash provided by operating activities | 4,741 | 5,272 |
| INVESTING ACTIVITIES: | | |
| Available for sales securities: | | |
| Purchases | (52,697) | (25,953) |
| Proceeds from maturities, calls, and payments | 6,905 | 15,005 |
| Held to maturity securities: | | |
| Purchases | (35) | - |
| Proceeds from maturities, calls, and payments | 646 | 95 |
| Additions to properties and equipment | (264) | (1,119) |
| Purchase of tax credit investment | (811) | (703) |
| Insurance agency acquisitions | (275) | - |
| Net increase in loans | (32,925) | (78,823) |
| Net cash used in investing activities | (79,456) | (91,498) |
| FINANCING ACTIVITIES: | | |
| Proceeds from (repayments of) short-term borrowings, net | (14,278) | 9,690 |
| Net increase in deposits | 79,082 | 66,903 |
| Dividends paid | (1,902) | (1,626) |
| Repurchase of treasury stock | (342) | (80) |
| Issuance of common stock | 14,509 | 248 |
| Reissuance of treasury stock | 207 | - |
| Net cash provided by financing activities | 77,276 | 75,135 |

Edgar Filing: EVANS BANCORP INC - Form 10-Q

| | | |
|--|-------|----------|
| Net increase (decrease) in cash and cash equivalents | 2,561 | (11,091) |
|--|-------|----------|

CASH AND CASH EQUIVALENTS:

| | | |
|---------------------|--------|--------|
| Beginning of period | 13,084 | 22,621 |
|---------------------|--------|--------|

| | | |
|---------------|-----------|-----------|
| End of period | \$ 15,645 | \$ 11,530 |
|---------------|-----------|-----------|

See Notes to Unaudited Consolidated Financial Statements

(continued)

7

Table of Contents

PART I - FINANCIAL INFORMATION
 ITEM 1 - FINANCIAL STATEMENTS
 EVANS BANCORP, INC. AND SUBSIDIARIES
 UNAUDITED CONSOLIDATED STATEMENTS OF CASH FLOWS
 SIX MONTHS ENDED JUNE 30, 2017 AND 2016
 (in thousands)

| | Six Months Ended June 30, | |
|---|------------------------------|-----------------|
| | 2017 | 2016 |
| RECONCILIATION OF NET INCOME TO NET CASH PROVIDED BY OPERATING ACTIVITIES: | | |
| Net income | \$ 5,764 | \$ 3,717 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| Depreciation and amortization | 875 | 647 |
| Deferred tax expense | 589 | 125 |
| Provision (credit) for loan losses | (25) | (168) |
| Loss on tax credit investment | 919 | 2,139 |
| Refundable state historic tax credit | (647) | (1,508) |
| Gain on loans sold | (70) | (44) |
| Stock compensation expense | 295 | 270 |
| Proceeds from sale of loans held for resale | 5,376 | 3,514 |
| Originations of loans held for resale | (5,532) | (3,477) |
| Changes in assets and liabilities affecting cash flow: | | |
| Other assets | (1,145) | (1,001) |
| Other liabilities | (1,658) | 1,058 |
| NET CASH PROVIDED BY OPERATING ACTIVITIES | \$ 4,741 | \$ 5,272 |

See Notes to Unaudited Consolidated Financial Statements

Table of Contents

PART 1 – FINANCIAL INFORMATION

ITEM 1 – FINANCIAL STATEMENTS

EVANS BANCORP, INC. AND SUBSIDIARIES

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

THREE AND SIX MONTH PERIODS ENDED JUNE 30, 2017 AND 2016

1. ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

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

The results of operations for the three and six month periods ended June 30, 2017 are not necessarily indicative of the results to be expected for the full year. The accompanying unaudited consolidated financial statements should be read in conjunction with the Audited Consolidated Financial Statements and the Notes thereto included in our Annual Report on Form 10-K for the year ended December 31, 2016 (“10-K”). The Company’s significant accounting policies are disclosed in Note 1 to the 10-K.

Table of Contents

2. SECURITIES

The amortized cost of securities and their approximate fair value at June 30, 2017 and December 31, 2016 were as follows:

| | June 30, 2017 (in thousands) | | | |
|---|---------------------------------|---------------------|------------|---------------|
| | Amortized Cost | Unrealized Gains | Losses | Fair Value |
| Available for Sale: | | | | |
| Debt securities: | | | | |
| U.S. government agencies | \$ 26,633 | \$ 73 | \$ (248) | \$ 26,458 |
| States and political subdivisions | 32,531 | 478 | (35) | 32,974 |
| Total debt securities | \$ 59,164 | \$ 551 | \$ (283) | \$ 59,432 |
| Mortgage-backed securities: | | | | |
| FNMA | \$ 29,039 | \$ 118 | \$ (221) | \$ 28,936 |
| FHLMC | 13,234 | 29 | (95) | 13,168 |
| GNMA | 2,363 | 27 | (19) | 2,371 |
| SBA | 10,681 | 18 | (53) | 10,646 |
| CMO | 27,029 | 62 | (419) | 26,672 |
| Total mortgage-backed securities | \$ 82,346 | \$ 254 | \$ (807) | \$ 81,793 |
| Total securities designated as available for sale | \$ 141,510 | \$ 805 | \$ (1,090) | \$ 141,225 |
| Held to Maturity: | | | | |
| Debt securities | | | | |
| States and political subdivisions | \$ 1,372 | \$ 7 | \$ (22) | \$ 1,357 |
| Total securities designated as held to maturity | \$ 1,372 | \$ 7 | \$ (22) | \$ 1,357 |

December 31, 2016

Edgar Filing: EVANS BANCORP INC - Form 10-Q

(in thousands)

| | Amortized Cost | Unrealized Gains | Unrealized Losses | Fair Value |
|---|-------------------|---------------------|----------------------|---------------|
| Available for Sale: | | | | |
| Debt securities: | | | | |
| U.S. government agencies | \$ 12,958 | \$ 67 | \$ (153) | \$ 12,872 |
| States and political subdivisions | 34,952 | 356 | (166) | 35,142 |
| Total debt securities | \$ 47,910 | \$ 423 | \$ (319) | \$ 48,014 |
| Mortgage-backed securities: | | | | |
| FNMA | \$ 14,694 | \$ 96 | \$ (230) | \$ 14,560 |
| FHLMC | 3,544 | 32 | (51) | 3,525 |
| GNMA | 2,535 | 19 | (21) | 2,533 |
| CMO | 27,127 | 67 | (604) | 26,590 |
| Total mortgage-backed securities | \$ 47,900 | \$ 214 | \$ (906) | \$ 47,208 |
| Total securities designated as available for sale | \$ 95,810 | \$ 637 | \$ (1,225) | \$ 95,222 |
| Held to Maturity: | | | | |
| Debt securities | | | | |
| States and political subdivisions | \$ 1,983 | \$ 5 | \$ (29) | \$ 1,959 |
| Total securities designated as held to maturity | \$ 1,983 | \$ 5 | \$ (29) | \$ 1,959 |

Table of Contents

Available for sale securities with a total fair value of \$125 million and \$87 million at June 30, 2017 and December 31, 2016, respectively, were pledged as collateral to secure public deposits and for other purposes required or permitted by law.

The scheduled maturities of debt and mortgage-backed securities at June 30, 2017 and December 31, 2016 are summarized below. All maturity amounts are contractual maturities. Actual maturities may differ from contractual maturities because certain issuers have the right to call or prepay obligations with or without call premiums.

| | June 30, 2017 | | December 31, 2016 | |
|--|-------------------|-------------------------|-------------------|-------------------------|
| | Amortized cost | Estimated fair value | Amortized cost | Estimated fair value |
| | (in thousands) | | (in thousands) | |
| Debt securities available for sale: | | | | |
| Due in one year or less | \$ 4,283 | \$ 4,294 | \$ 2,869 | \$ 2,876 |
| Due after one year through five years | 28,103 | 28,330 | 30,171 | 30,214 |
| Due after five years through ten years | 20,722 | 20,773 | 12,166 | 12,133 |
| Due after ten years | 6,056 | 6,035 | 2,704 | 2,791 |
| | 59,164 | 59,432 | 47,910 | 48,014 |
| Mortgage-backed securities available for sale | | | | |
| | 82,346 | 81,793 | 47,900 | 47,208 |
| Total available for sale securities | \$ 141,510 | \$ 141,225 | \$ 95,810 | \$ 95,222 |
| Debt securities held to maturity: | | | | |
| Due in one year or less | \$ 174 | \$ 173 | \$ 780 | \$ 778 |
| Due after one year through five years | 284 | 280 | 289 | 283 |
| Due after five years through ten years | 814 | 810 | 814 | 805 |
| Due after ten years | 100 | 94 | 100 | 93 |
| | 1,372 | 1,357 | 1,983 | 1,959 |
| Total held to maturity securities | \$ 1,372 | \$ 1,357 | \$ 1,983 | \$ 1,959 |

Contractual maturities of the Company's mortgage-backed securities generally exceed ten years; however, the effective lives may be significantly shorter due to prepayments of the underlying loans and due to the nature of these securities. The duration of the investment securities portfolio increased from 3.4 years at December 31, 2016 to 3.7

years at June 30, 2017.

Information regarding unrealized losses within the Company's available for sale securities at June 30, 2017 and December 31, 2016 is summarized below. The securities are primarily U.S. government-guaranteed agency securities or municipal securities. All unrealized losses are considered temporary and are related to market interest rate fluctuations.

11

Table of Contents

June 30, 2017

| | Less than 12 months | | 12 months or longer | | Total | |
|---------------------------------------|---------------------|-------------------|---------------------|-------------------|------------|-------------------|
| | Fair Value | Unrealized Losses | Fair Value | Unrealized Losses | Fair Value | Unrealized Losses |
| | (in thousands) | | | | | |
| Available for Sale: | | | | | | |
| Debt securities: | | | | | | |
| U.S. government agencies | \$ 16,662 | \$ (248) | \$ - | \$ - | \$ 16,662 | \$ (248) |
| States and political subdivisions | 4,550 | (18) | 731 | (17) | 5,281 | (35) |
| Total debt securities | \$ 21,212 | \$ (266) | \$ 731 | \$ (17) | \$ 21,943 | \$ (283) |
| Mortgage-backed securities: | | | | | | |
| FNMA | \$ 18,145 | \$ (221) | \$ - | \$ - | \$ 18,145 | \$ (221) |
| FHLMC | 11,587 | (59) | 881 | (36) | 12,468 | (95) |
| GNMA | 1,030 | (17) | 297 | (2) | 1,327 | (19) |
| SBA | 6,571 | (53) | - | - | 6,571 | (53) |
| CMO | 12,065 | (132) | 9,294 | (287) | 21,359 | (419) |
| Total mortgage-backed securities | \$ 49,398 | \$ (482) | \$ 10,472 | \$ (325) | \$ 59,870 | \$ (807) |
| Held to Maturity: | | | | | | |
| Debt securities: | | | | | | |
| States and political subdivisions | \$ 265 | \$ (1) | \$ 642 | \$ (21) | \$ 907 | \$ (22) |
| Total temporarily impaired securities | \$ 70,875 | \$ (749) | \$ 11,845 | \$ (363) | \$ 82,720 | \$ (1,112) |

December 31, 2016

| | Less than 12 months | | 12 months or longer | | Total | |
|--|---------------------|-------------------|---------------------|-------------------|------------|-------------------|
| | Fair Value | Unrealized Losses | Fair Value | Unrealized Losses | Fair Value | Unrealized Losses |
| | (in thousands) | | | | | |

Edgar Filing: EVANS BANCORP INC - Form 10-Q

Available for Sale:

Debt securities:

| | | | | | | |
|-----------------------------------|-----------|----------|--------|---------|-----------|----------|
| U.S. government agencies | \$ 6,847 | \$ (153) | \$ - | \$ - | \$ 6,847 | \$ (153) |
| States and political subdivisions | 16,895 | (146) | 731 | (20) | 17,626 | (166) |
| Total debt securities | \$ 23,742 | \$ (299) | \$ 731 | \$ (20) | \$ 24,473 | \$ (319) |

Mortgage-backed securities:

| | | | | | | |
|----------------------------------|-----------|----------|----------|---------|-----------|----------|
| FNMA | \$ 9,577 | \$ (230) | \$ - | \$ - | \$ 9,577 | \$ (230) |
| FHLMC | 1,728 | (8) | 988 | (43) | 2,716 | (51) |
| GNMA | 1,046 | (17) | 309 | (4) | 1,355 | (21) |
| CMO | 19,745 | (569) | 1,166 | (35) | 20,911 | (604) |
| Total mortgage-backed securities | \$ 32,096 | \$ (824) | \$ 2,463 | \$ (82) | \$ 34,559 | \$ (906) |

Held to Maturity:

Debt securities:

| | | | | | | |
|-----------------------------------|--------|--------|--------|---------|----------|---------|
| States and political subdivisions | \$ 863 | \$ (3) | \$ 706 | \$ (26) | \$ 1,569 | \$ (29) |
|-----------------------------------|--------|--------|--------|---------|----------|---------|

Total temporarily impaired

| | | | | | | |
|------------|-----------|------------|----------|----------|-----------|------------|
| securities | \$ 56,701 | \$ (1,126) | \$ 3,900 | \$ (128) | \$ 60,601 | \$ (1,254) |
|------------|-----------|------------|----------|----------|-----------|------------|

Table of Contents

Management has assessed the securities available for sale in an unrealized loss position at June 30, 2017 and December 31, 2016 and determined the decline in fair value below amortized cost to be temporary. In making this determination, management considered the period of time the securities were in a loss position, the percentage decline in comparison to the securities' amortized cost, and the financial condition of the issuer (primarily government or government-sponsored enterprises). In addition, management does not intend to sell these securities and it is not more likely than not that the Company will be required to sell these securities before recovery of their amortized cost. Management believes the decline in fair value is primarily related to market interest rate fluctuations and not to the credit deterioration of the individual issuers.

The Company has not recorded any other-than-temporary impairment ("OTTI") charges as of June 30, 2017 and did not record any OTTI charges during 2016. The credit worthiness of the Company's portfolio is largely reliant on the ability of U.S. government sponsored agencies such as FHLB, Federal National Mortgage Association ("FNMA"), Government National Mortgage Association ("GNMA"), and Federal Home Loan Mortgage Corporation ("FHLMC"), and municipalities throughout New York State to meet their obligations. In addition, dysfunctional markets could materially alter the liquidity, interest rate, and pricing risk of the portfolio. The stable past performance is not a guarantee for similar performance of the Company's securities portfolio in future periods.

3. FAIR VALUE MEASUREMENTS

Fair value is defined in ASC Topic 820 "Fair Value Measurements" as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date.

There are three levels of inputs to fair value measurements:

Level 1 inputs are quoted prices for identical instruments in active markets;

Level 2 inputs are inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly or indirectly; and

Level 3 inputs are unobservable inputs.

Observable market data should be used when available.

FINANCIAL INSTRUMENTS MEASURED AT FAIR VALUE ON A RECURRING BASIS

The following table presents, for each of the fair-value hierarchy levels as defined in this footnote, those financial instruments which are measured at fair value on a recurring basis as of June 30, 2017 and December 31, 2016, respectively:

| (in thousands) | Level 1 | Level 2 | Level 3 | Fair Value |
|-----------------------------------|---------|-----------|---------|------------|
| June 30, 2017 | | | | |
| Securities available-for-sale: | | | | |
| U.S. government agencies | \$ - | \$ 26,458 | \$ - | \$ 26,458 |
| States and political subdivisions | - | 32,974 | - | 32,974 |
| Mortgage-backed securities | - | 81,793 | - | 81,793 |
| Mortgage servicing rights | - | - | 555 | 555 |
| December 31, 2016 | | | | |
| Securities available-for-sale: | | | | |
| U.S. government agencies | \$ - | \$ 12,872 | \$ - | \$ 12,872 |
| States and political subdivisions | - | 35,142 | - | 35,142 |
| Mortgage-backed securities | - | 47,208 | - | 47,208 |
| Mortgage servicing rights | - | - | 527 | 527 |

Table of Contents

Securities available for sale

Fair values for securities are determined using independent pricing services and market-participating brokers. The Company's independent pricing service utilizes evaluated pricing models that vary by asset class and incorporate available trade, bid and other market information for structured securities, cash flow and, when available, loan performance data. Because many fixed income securities do not trade on a daily basis, the evaluated pricing applications apply information as applicable through processes, such as benchmarking of like securities, sector groupings, and matrix pricing, to prepare evaluations. In addition, model processes, such as the Option Adjusted Spread model, are used to assess interest rate impact and develop prepayment scenarios. The models and the process take into account market convention. For each asset class, a team of evaluators gathers information from market sources and integrates relevant credit information, perceived market movements and sector news into the evaluated pricing applications and models. The company's service provider may occasionally determine that it does 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 in the market value of its security portfolio. Individual changes in valuations are reviewed for consistency with general interest rate movements and any known credit concerns for specific securities. Additionally, on an annual basis, the Company has its entire security portfolio priced by a second pricing service to determine consistency with another market evaluator. If, during the Company's review or when comparing with another servicer, a material difference between pricing evaluations were to exist, the Company would submit an inquiry to the service provider regarding the data used to value a particular security. If the Company determines it has market information that would support a different valuation than the initial evaluation it can submit a challenge for a change to that security's valuation.

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

Mortgage servicing rights

Mortgage servicing rights ("MSRs") do not trade in an active, open market with readily observable prices. Accordingly, the Company obtains the fair value of the MSRs using a third-party pricing provider. The provider determines the fair value by discounting projected net servicing cash flows of the remaining servicing portfolio. The valuation model used by the provider considers market loan prepayment predictions and other economic factors which management considers to be significant unobservable inputs. The fair value of MSRs is mostly affected by changes in mortgage interest rates since rate changes cause the loan prepayment acceleration factors to increase or decrease. Management

has a sufficient understanding of the third party service's valuation models, assumptions and inputs used in determining the fair value of MSRs to enable management to maintain an appropriate system of internal control. Mortgage servicing rights are classified within Level 3 of the fair value hierarchy as the valuation is model driven and primarily based on unobservable inputs.

The following table summarizes the changes in fair value for mortgage servicing rights during the three month periods ended June 30, 2017 and 2016, respectively:

| (in thousands) | Three months ended June 30, | |
|-------------------------------------|--------------------------------|--------|
| | 2017 | 2016 |
| Mortgage servicing rights -April 1 | \$ 564 | \$ 496 |
| Losses included in earnings | (32) | (56) |
| Additions from loan sales | 23 | 26 |
| Mortgage servicing rights - June 30 | \$ 555 | \$ 466 |

Table of Contents

| (in thousands) | Six months ended June 30, | |
|---------------------------------------|------------------------------|--------|
| | 2017 | 2016 |
| Mortgage servicing rights - January 1 | \$ 527 | \$ 557 |
| Losses included in earnings | (21) | (125) |
| Additions from loan sales | 49 | 34 |
| Mortgage servicing rights - June 30 | \$ 555 | \$ 466 |

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

| | June 30, 2017 | | December 31, 2016 | |
|-----------------------|---------------|--|-------------------|--|
| Servicing fees | 0.25 % | | 0.25 % | |
| Discount rate | 9.52 % | | 9.52 % | |
| Prepayment rate (CPR) | 8.57 % | | 8.12 % | |

FINANCIAL INSTRUMENTS MEASURED AT FAIR VALUE ON A NONRECURRING BASIS

The Company is required, on a nonrecurring basis, to adjust the carrying value of certain assets or provide valuation allowances related to certain assets using fair value measurements. The following table presents for each of the fair-value hierarchy levels as defined in this footnote, those financial instruments which are measured at fair value on a nonrecurring basis at June 30, 2017 and December 31, 2016:

| (in thousands) | Level 1 | Level 2 | Level 3 | Fair Value |
|-------------------------------------|---------|---------|-----------|------------|
| June 30, 2017 | | | | |
| Collateral dependent impaired loans | \$ - | \$ - | \$ 17,575 | \$ 17,575 |
| December 31, 2016 | | | | |
| Collateral dependent impaired loans | \$ - | \$ - | \$ 13,114 | \$ 13,114 |

Collateral dependent impaired loans

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

The Company has an appraisal policy in which appraisals are obtained upon a commercial loan being downgraded on the Company'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 commercial loans are either graded a 6 or 7 on the internal loan rating scale. For consumer loans, the Company obtains appraisals when a loan becomes 90 days past due or is determined to be impaired, whichever occurs first. Subsequent to the downgrade or reaching 90 days past due, if the loan remains outstanding and impaired for at least one year more, management may require another follow-up appraisal. Between receipts of updated appraisals, if necessary, management may perform an internal valuation based on any known changing conditions in the marketplace such as sales of similar properties, a change in the condition of the collateral, or feedback from local appraisers. Impaired loans had a gross value of \$19.5 million, with an allowance for loan loss of \$1.9 million, at June 30, 2017 compared with \$15.1 million and \$2.0 million, respectively, at December 31, 2016.

Table of Contents

FAIR VALUE OF FINANCIAL INSTRUMENTS

At each of June 30, 2017 and December 31, 2016, the estimated fair values of the Company's financial instruments, including those that are not measured and reported at fair value on a recurring basis or nonrecurring basis, were as follows:

| | June 30, 2017 | | December 31, 2016 | |
|---|--------------------|---------------|--------------------|---------------|
| | Carrying Amount | Fair Value | Carrying Amount | Fair Value |
| | (in thousands) | | (in thousands) | |
| Financial assets: | | | | |
| Level 1: | | | | |
| Cash and cash equivalents | \$ 15,645 | \$ 15,645 | \$ 13,084 | \$ 13,084 |
| Level 2: | | | | |
| Available for sale securities | 141,225 | 141,225 | 95,222 | 95,222 |
| FHLB and FRB stock | 3,635 | 3,635 | 3,731 | 3,731 |
| Level 3: | | | | |
| Held to maturity securities | 1,372 | 1,357 | 1,983 | 1,959 |
| Loans, net | 962,315 | 951,510 | 928,596 | 945,998 |
| Mortgage servicing rights | 555 | 555 | 527 | 527 |
| Financial liabilities: | | | | |
| Level 1: | | | | |
| Demand deposits | \$ 207,348 | \$ 207,348 | \$ 201,741 | \$ 201,741 |
| NOW deposits | 99,131 | 99,131 | 88,632 | 88,632 |
| Savings deposits | 547,760 | 547,760 | 508,652 | 508,652 |
| Level 2: | | | | |
| Securities sold under agreement to repurchase | 9,481 | 9,481 | 10,159 | 10,159 |
| Other borrowed funds | 14,600 | 14,548 | 28,200 | 28,152 |
| Junior subordinated debentures | 11,330 | 11,330 | 11,330 | 11,330 |
| Level 3: | | | | |
| Time deposits | 164,817 | 165,934 | 140,949 | 141,758 |

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

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

FHLB and FRB stock. The carrying value of Federal Home Loan Bank ("FHLB") and Federal Reserve Bank ("FRB") stock, which are non-marketable equity investments, approximate fair value.

As a member of the FHLB System, the Bank is required to hold stock in FHLBNY. The Company regularly evaluates investments in FHLBNY for impairment, considering liquidity, operating performance, capital position, stock repurchase and dividend history. As of June 30, 2017, the Bank's investment in FHLBNY stock was not impaired.

The Bank, as a member of the FRB system, is currently required to purchase and hold shares of capital stock in the FRB in an amount equal to 6% of its capital and surplus. Based on the current capital adequacy and liquidity position of the FRB, management believes there is no impairment in the Company's investment at June 30, 2017.

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

Table of Contents

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

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

Junior Subordinated Debentures. There is no active market for the Company’s debentures and there have been no issuances of similar instruments in recent years. The Company looked at a market bond index to estimate a discount margin to value the debentures. The discount margin was very similar to the spread to LIBOR established at the issuance of the debentures. As a result, the Company determined that the fair value of the adjustable-rate debentures approximates their face amount.

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

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

Table of Contents

4. LOANS AND THE ALLOWANCE FOR LOAN LOSSES

Loan Portfolio Composition

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

| | June 30, 2017 | December 31, 2016 |
|-------------------------------------|------------------|----------------------|
| Mortgage loans on real estate: | (in thousands) | |
| Residential mortgages | \$ 123,734 | \$ 118,542 |
| Commercial and multi-family | 477,216 | 462,385 |
| Construction-Residential | 2,433 | 2,540 |
| Construction-Commercial | 96,640 | 93,240 |
| Home equities | 66,144 | 66,234 |
| Total real estate loans | 766,167 | 742,941 |
| Commercial and industrial loans | 207,769 | 197,371 |
| Consumer and other loans | 1,502 | 1,417 |
| Net deferred loan origination costs | 1,055 | 783 |
| Total gross loans | 976,493 | 942,512 |
| Allowance for loan losses | (14,178) | (13,916) |
| Loans, net | \$ 962,315 | \$ 928,596 |

The Bank sells certain fixed rate residential mortgages to FNMA while maintaining the servicing rights for those mortgages. In the three month period ended June 30, 2017, the Bank sold mortgages to FNMA totaling \$2.5 million, compared with \$2.6 million in the three month period ended June 30, 2016. During the six month periods ended June 30, 2017 and 2016, the Bank sold \$5.3 million and \$3.5 million, respectively, to FNMA. At June 30, 2017, the Bank had a loan servicing portfolio principal balance of \$77 million upon which it earned servicing fees, compared with \$76 million at December 31, 2016. The value of the mortgage servicing rights for that portfolio was \$0.6 million at June 30, 2017 and \$0.5 million at December 31, 2016. At June 30, 2017 there were \$0.5 million in residential mortgages

held for sale compared with \$0.3 million at December 31, 2016. The Company has never been contacted by FNMA to repurchase any loans due to improper documentation or fraud.

As noted in Note 1, these financial statements should be read in conjunction with the Audited Consolidated Financial Statements and the Notes thereto included in our Annual Report on Form 10-K for the year ended December 31, 2016. Disclosures related to the basis for accounting for loans, the method for recognizing interest income on loans, the policy for placing loans on nonaccrual status and the subsequent recording of payments and resuming accrual of interest, the policy for determining past due status, a description of the Company's accounting policies and methodology used to estimate the allowance for loan losses, the policy for charging-off loans, the accounting policies for impaired loans, and more descriptive information on the Company's credit risk ratings are all contained in the Notes to the Audited Consolidated Financial Statements in the Company's Annual Report on Form 10-K for the year ended December 31, 2016. Unless otherwise noted in this Form 10-Q, the policies and methodology described in the Annual Report for the year ended December 31, 2016 are consistent with those utilized by the Company in the three and six month periods ended June 30, 2017.

Table of Contents

Credit Quality Indicators

The Bank monitors the credit risk in its loan portfolio by reviewing certain credit quality indicators (“CQI”). The primary CQI for its commercial mortgage and commercial and industrial (“C&I”) portfolios is the individual loan’s credit risk rating. The following list provides a description of the credit risk ratings that are used internally by the Bank when assessing the adequacy of its allowance for loan losses:

- 1-3-Pass
- 4-Watch
- 5-O.A.E.M. (Other Assets Especially Mentioned) or Special Mention
- 6-Substandard
- 7-Doubtful
- 8-Loss

The Company’s consumer loans, including residential mortgages and home equities, are not individually risk rated or reviewed in the Company’s loan review process. Unlike commercial customers, consumer loan customers are not required to provide the Company with updated financial information. Consumer loans also carry smaller balances. Given the lack of updated information after the initial underwriting of the loan and small size of individual loans, the Company uses delinquency status as the primary credit quality indicator for consumer loans. However, once a consumer loan is identified as impaired, it is individually evaluated for impairment.

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

June 30, 2017
(in thousands)

| Corporate Credit Exposure – By Credit Rating | Commercial Real Estate Construction | Commercial and Multi-Family Mortgages | Total Commercial Real Estate | Commercial and Industrial |
|--|---|--|------------------------------------|---------------------------------|
| 1-3 | \$ 75,063 | \$ 374,031 | \$ 449,094 | \$ 139,594 |
| 4 | 17,398 | 81,436 | 98,834 | 55,030 |

Edgar Filing: EVANS BANCORP INC - Form 10-Q

| | | | | |
|-------|-----------|------------|------------|------------|
| 5 | - | 12,187 | 12,187 | 7,136 |
| 6 | 4,179 | 9,562 | 13,741 | 5,254 |
| 7 | - | - | - | 755 |
| Total | \$ 96,640 | \$ 477,216 | \$ 573,856 | \$ 207,769 |

December 31, 2016
(in thousands)

| Corporate Credit Exposure – By Credit Rating | Commercial Real Estate Construction | Commercial and Multi-Family Mortgages | Total Commercial Real Estate | Commercial and Industrial |
|--|---|--|------------------------------------|---------------------------------|
| 1-3 | \$ 82,520 | \$ 372,235 | \$ 454,755 | \$ 121,414 |
| 4 | 6,541 | 73,655 | 80,196 | 59,117 |
| 5 | - | 12,506 | 12,506 | 12,623 |
| 6 | 4,179 | 3,989 | 8,168 | 3,404 |
| 7 | - | - | - | 813 |
| Total | \$ 93,240 | \$ 462,385 | \$ 555,625 | \$ 197,371 |

Table of Contents

Past Due Loans

The following tables provide an analysis of the age of the recorded investment in loans that are past due as of the dates indicated:

June 30, 2017
(in thousands)

| | 30-59 days | 60-89 days | 90+ days | Total Past Due | Current Balance | Total Balance | 90+ Days Accruing | Non-accruing Loans |
|---------------------------|---------------|---------------|-----------|----------------------|--------------------|------------------|----------------------|-----------------------|
| Commercial and industrial | \$ 3,054 | \$ 602 | \$ 1,743 | \$ 5,399 | \$ 202,370 | \$ 207,769 | \$ 2 | \$ 2,651 |
| Residential real estate: | | | | | | | | |
| Residential | - | 90 | 735 | 825 | 122,909 | 123,734 | - | 1,003 |
| Construction | - | - | - | - | 2,433 | 2,433 | - | - |
| Commercial real estate: | | | | | | | | |
| Commercial | 3,576 | 1,417 | 3,119 | 8,112 | 469,104 | 477,216 | 1,288 | 3,110 |
| Construction | 4,044 | 61 | 4,643 | 8,748 | 87,892 | 96,640 | 464 | 4,179 |
| Home equities | 699 | 7 | 580 | 1,286 | 64,858 | 66,144 | - | 1,194 |
| Consumer and other | 23 | - | - | 23 | 1,479 | 1,502 | - | 10 |
| Total Loans | \$ 11,396 | \$ 2,177 | \$ 10,820 | \$ 24,393 | \$ 951,045 | \$ 975,438 | \$ 1,754 | \$ 12,147 |

Note: Loan balances do not include \$1.1 million in net deferred loan origination costs as of June 30, 2017.

Table of Contents

December 31, 2016
(in thousands)

| | 30-59 days | 60-89 days | 90+ days | Total Past Due | Current Balance | Total Balance | 90+ Days Accruing | Non-accruing Loans |
|---------------------------|---------------|---------------|-------------|----------------------|--------------------|------------------|-------------------------|-----------------------|
| Commercial and industrial | \$ 6,772 | \$ 2,966 | \$ 1,150 | \$ 10,888 | \$ 186,483 | \$ 197,371 | \$ - | \$ 3,106 |
| Residential real estate: | | | | | | | | |
| Residential | 868 | 123 | 567 | 1,558 | 116,984 | 118,542 | - | 862 |
| Construction | - | - | - | - | 2,540 | 2,540 | - | - |
| Commercial real estate: | | | | | | | | |
| Commercial | 6,319 | 1,522 | 2,357 | 10,198 | 452,187 | 462,385 | 483 | 1,874 |
| Construction | 257 | - | 4,417 | 4,674 | 88,566 | 93,240 | 239 | 4,178 |
| Home equities | 481 | 119 | 679 | 1,279 | 64,955 | 66,234 | - | 1,261 |
| Consumer and other | 15 | 10 | 5 | 30 | 1,387 | 1,417 | - | 17 |
| Total Loans | \$ 14,712 | \$ 4,740 | \$ 9,175 | \$ 28,627 | \$ 913,102 | \$ 941,729 | \$ 722 | \$ 11,298 |

Note: Loan balances do not include \$783 thousand in net deferred loan origination costs as of December 31, 2016.

Table of Contents

Allowance for loan losses

The following tables present the activity in the allowance for loan losses according to portfolio segment for the six month periods ended June 30, 2017 and 2016:

June 30, 2017

| (in thousands) | Commercial and Industrial | Commercial Real Estate Mortgages* | Consumer and Other | Residential Mortgages* | Home Equities | Total |
|---------------------------------------|---------------------------------|---|-----------------------|---------------------------|------------------|------------|
| Allowance for loan losses: | | | | | | |
| Beginning balance | \$ 4,813 | \$ 7,890 | \$ 96 | \$ 769 | \$ 348 | \$ 13,916 |
| Charge-offs | (33) | - | (33) | - | - | (66) |
| Recoveries | 331 | - | 21 | - | 1 | 353 |
| Provision (Credit) | (141) | 9 | 20 | 63 | 24 | (25) |
| Ending balance | \$ 4,970 | \$ 7,899 | \$ 104 | \$ 832 | \$ 373 | \$ 14,178 |
| Allowance for loan losses: | | | | | | |
| Ending balance: | | | | | | |
| Individually evaluated for impairment | \$ 681 | \$ 1,189 | \$ 42 | \$ 1 | \$ 2 | \$ 1,915 |
| Collectively evaluated for impairment | 4,289 | 6,710 | 62 | 831 | 371 | 12,263 |
| Total | \$ 4,970 | \$ 7,899 | \$ 104 | \$ 832 | \$ 373 | \$ 14,178 |
| Loans: | | | | | | |
| Ending balance: | | | | | | |
| Individually evaluated for impairment | \$ 2,665 | \$ 12,298 | \$ 42 | \$ 2,834 | \$ 1,651 | \$ 19,490 |
| Collectively evaluated for impairment | 205,104 | 561,558 | 1,460 | 123,333 | 64,493 | 955,948 |
| Total | \$ 207,769 | \$ 573,856 | \$ 1,502 | \$ 126,167 | \$ 66,144 | \$ 975,438 |

* Includes construction loans

Note: Loan balances do not include \$1.1 million in net deferred loan origination costs as of June 30, 2017.

22

Table of Contents

June 30, 2016

| (in thousands) | Commercial and Industrial | Commercial Real Estate Mortgages* | Consumer and Other | Residential Mortgages* | Home Equities | Total |
|---------------------------------------|---------------------------------|---|-----------------------|---------------------------|------------------|------------|
| Allowance for loan losses: | | | | | | |
| Beginning balance | \$ 4,383 | \$ 7,135 | \$ 85 | \$ 909 | \$ 371 | \$ 12,883 |
| Charge-offs | (33) | - | (23) | - | - | (56) |
| Recoveries | 55 | 51 | 7 | - | 1 | 114 |
| Provision (Credit) | (210) | 122 | 32 | (146) | 34 | (168) |
| Ending balance | \$ 4,195 | \$ 7,308 | \$ 101 | \$ 763 | \$ 406 | \$ 12,773 |
| Allowance for loan losses: | | | | | | |
| Ending balance: | | | | | | |
| Individually evaluated for impairment | \$ 324 | \$ 1,128 | \$ 40 | \$ 3 | \$ 18 | \$ 1,513 |
| Collectively evaluated for impairment | 3,871 | 6,180 | 61 | 760 | 388 | 11,260 |
| Total | \$ 4,195 | \$ 7,308 | \$ 101 | \$ 763 | \$ 406 | \$ 12,773 |
| Loans: | | | | | | |
| Ending balance: | | | | | | |
| Individually evaluated for impairment | \$ 4,985 | \$ 9,261 | \$ 40 | \$ 2,461 | \$ 1,614 | \$ 18,361 |
| Collectively evaluated for impairment | 174,225 | 490,138 | 1,407 | 106,476 | 61,928 | 834,174 |
| Total | \$ 179,210 | \$ 499,399 | \$ 1,447 | \$ 108,937 | \$ 63,542 | \$ 852,535 |

* Includes construction loans

Note: Loan balances do not include \$771 thousand in net deferred loan origination costs as of June 30, 2016.

Table of Contents

The following tables present the activity in the allowance for loan losses according to portfolio segment for the three month periods ended June 30, 2017 and 2016:

June 30, 2017

| (\$ in thousands) | Commercial and Industrial | Commercial Real Estate Mortgages* | Consumer and Other | Residential Mortgages* | Home Equities | Total |
|----------------------------|---------------------------|-----------------------------------|--------------------|------------------------|---------------|-----------|
| Allowance for loan losses: | | | | | | |
| Beginning balance | \$ 3,963 | \$ 8,198 | \$ 135 | \$ 919 | \$ 364 | \$ 13,579 |
| Charge-offs | - | - | (5) | - | - | (5) |
| Recoveries | 184 | - | 9 | - | 1 | 194 |
| Provision (Credit) | 823 | (299) | (35) | (87) | 8 | 410 |
| Ending balance | \$ 4,970 | \$ 7,899 | \$ 104 | \$ 832 | \$ 373 | \$ 14,178 |

June 30, 2016

| (\$ in thousands) | Commercial and Industrial | Commercial Real Estate Mortgages* | Consumer and Other | Residential Mortgages* | Home Equities | Total |
|----------------------------|---------------------------|-----------------------------------|--------------------|------------------------|---------------|-----------|
| Allowance for loan losses: | | | | | | |
| Beginning balance | \$ 4,580 | \$ 7,442 | \$ 93 | \$ 696 | \$ 308 | \$ 13,119 |
| Charge-offs | (20) | - | (16) | - | - | (36) |
| Recoveries | 48 | 13 | 4 | - | 1 | 66 |
| Provision (Credit) | (413) | (147) | 20 | 67 | 97 | (376) |
| Ending balance | \$ 4,195 | \$ 7,308 | \$ 101 | \$ 763 | \$ 406 | \$ 12,773 |

*Includes construction loans

Table of Contents

Impaired Loans

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

| | At June 30, 2017 | | | | | |
|-------------------------------------|------------------------|--------------------------------|----------------------|-----------------------------------|--------------------------------|----------------------------------|
| | Recorded Investment | Unpaid Principal Balance | Related Allowance | Average Recorded Investment | Interest Income Foregone | Interest Income Recognized |
| With no related allowance recorded: | (in thousands) | | | | | |
| Commercial and industrial | \$ 203 | \$ 251 | \$ - | \$ 216 | \$ 11 | \$ 1 |
| Residential real estate: | | | | | | |
| Residential | 2,668 | 2,758 | - | 2,610 | 20 | 38 |
| Construction | - | - | - | - | - | - |
| Commercial real estate: | | | | | | |
| Commercial | 2,371 | 2,461 | - | 2,473 | 66 | 21 |
| Construction | - | - | - | - | - | - |
| Home equities | 1,633 | 1,733 | - | 1,672 | 32 | 10 |
| Consumer and other | - | - | - | - | - | - |
| Total impaired loans | \$ 6,875 | \$ 7,203 | \$ - | \$ 6,971 | \$ 129 | \$ 70 |

| | At June 30, 2017 | | | | | |
|------------------------------------|------------------------|--------------------------------|----------------------|-----------------------------------|--------------------------------|----------------------------------|
| | Recorded Investment | Unpaid Principal Balance | Related Allowance | Average Recorded Investment | Interest Income Foregone | Interest Income Recognized |
| With a related allowance recorded: | (in thousands) | | | | | |
| | \$ 2,462 | \$ 2,715 | \$ 681 | \$ 2,522 | \$ 78 | \$ 6 |

| | | | | | | |
|---|-----------|-----------|----------|-----------|--------|--------|
| Commercial and industrial Residential real estate: | | | | | | |
| Residential | 166 | 169 | 1 | 167 | 4 | 1 |
| Construction | - | - | - | - | - | - |
| Commercial real estate: | | | | | | |
| Commercial | 5,748 | 5,777 | 360 | 5,795 | 27 | 108 |
| Construction | 4,179 | 4,201 | 829 | 4,179 | 104 | - |
| Home equities | 18 | 19 | 2 | 17 | 1 | - |
| Consumer and other | 42 | 61 | 42 | 39 | 1 | 1 |
| Total impaired loans | \$ 12,615 | \$ 12,942 | \$ 1,915 | \$ 12,719 | \$ 215 | \$ 116 |

Table of Contents

| | At June 30, 2017 | | | | | |
|------------------------------|--|--------------------------------|----------------------|-----------------------------------|--------------------------------|----------------------------------|
| | Recorded Investment (in thousands) | Unpaid Principal Balance | Related Allowance | Average Recorded Investment | Interest Income Foregone | Interest Income Recognized |
| Total: | | | | | | |
| Commercial and industrial | \$ 2,665 | \$ 2,966 | \$ 681 | \$ 2,738 | \$ 89 | \$ 7 |
| Residential real estate: | | | | | | |
| Residential | 2,834 | 2,927 | 1 | 2,777 | 24 | 39 |
| Construction | - | - | - | - | - | - |
| Commercial real estate: | | | | | | |
| Commercial | 8,119 | 8,238 | 360 | 8,268 | 93 | 129 |
| Construction | 4,179 | 4,201 | 829 | 4,179 | 104 | - |
| Home equities | 1,651 | 1,752 | 2 | 1,689 | 33 | 10 |
| Consumer and other | 42 | 61 | 42 | 39 | 1 | 1 |
| Total impaired loans | \$ 19,490 | \$ 20,145 | \$ 1,915 | \$ 19,690 | \$ 344 | \$ 186 |

| | At December 31, 2016 | | | | | |
|---|--|--------------------------------|----------------------|-----------------------------------|--------------------------------|----------------------------------|
| | Recorded Investment (in thousands) | Unpaid Principal Balance | Related Allowance | Average Recorded Investment | Interest Income Foregone | Interest Income Recognized |
| With no related allowance recorded: | | | | | | |
| Commercial and industrial | \$ 1,304 | \$ 1,604 | \$ - | \$ 1,455 | \$ 125 | \$ 51 |
| Residential real estate: | | | | | | |
| Residential | 2,513 | 2,720 | - | 2,542 | 39 | 78 |
| Construction | - | - | - | - | - | - |
| Commercial real estate: | | | | | | |
| Commercial | 2,123 | 2,168 | - | 2,181 | 33 | 89 |

Edgar Filing: EVANS BANCORP INC - Form 10-Q

| | | | | | | |
|----------------------|----------|----------|------|----------|--------|--------|
| Construction | 257 | 257 | - | 404 | 2 | 28 |
| Home equities | 1,559 | 1,621 | - | 1,606 | 51 | 30 |
| Consumer and other | - | - | - | - | - | - |
| Total impaired loans | \$ 7,756 | \$ 8,370 | \$ - | \$ 8,188 | \$ 250 | \$ 276 |

26

Table of Contents

| | At December 31, 2016 | | | | | |
|------------------------------------|----------------------|-----------|-----------|----------|----------|----------|
| | Recorded | Unpaid | Related | Average | Interest | Interest |
| | Investment | Principal | Allowance | Recorded | Income | Income |
| | (in thousands) | | | | | |
| With a related allowance recorded: | | | | | | |
| Commercial and industrial | \$ 1,844 | \$ 1,913 | \$ 492 | \$ 1,898 | \$ 62 | \$ 53 |
| Residential real estate: | | | | | | |
| Residential | 71 | 72 | 1 | 72 | 2 | 1 |
| Construction | - | - | - | - | - | - |
| Commercial real estate: | | | | | | |
| Commercial | 1,054 | 1,083 | 296 | 1,062 | 50 | - |
| Construction | 4,179 | 4,201 | 1,175 | 4,180 | 194 | - |
| Home equities | 194 | 206 | 20 | 195 | 9 | 1 |
| Consumer and other | 43 | 68 | 43 | 45 | 3 | 3 |
| Total impaired loans | \$ 7,385 | \$ 7,543 | \$ 2,027 | \$ 7,452 | \$ 320 | \$ 58 |

| | At December 31, 2016 | | | | | |
|---------------------------|----------------------|-----------|-----------|----------|----------|----------|
| | Recorded | Unpaid | Related | Average | Interest | Interest |
| | Investment | Principal | Allowance | Recorded | Income | Income |
| | (in thousands) | | | | | |
| Total: | | | | | | |
| Commercial and industrial | \$ 3,148 | \$ 3,517 | \$ 492 | \$ 3,353 | \$ 187 | \$ 104 |
| Residential real estate: | | | | | | |
| Residential | 2,584 | 2,792 | 1 | 2,614 | 41 | 79 |
| Construction | - | - | - | - | - | - |
| Commercial real estate: | | | | | | |
| Commercial | 3,177 | 3,251 | 296 | 3,243 | 83 | 89 |
| Construction | 4,436 | 4,458 | 1,175 | 4,584 | 196 | 28 |
| Home equities | 1,753 | 1,827 | 20 | 1,801 | 60 | 31 |
| Consumer and other | 43 | 68 | 43 | 45 | 3 | 3 |

Consumer and
other
Total impaired
loans

\$ 15,141

\$ 15,913

\$ 2,027

\$ 15,640

\$ 570

\$ 334

27

Table of Contents

Troubled debt restructurings

The Company had \$9.0 million and \$5.1 million in loans that were restructured in a troubled debt restructuring (“TDR”) at June 30, 2017 and December 31, 2016, respectively. Of those balances, \$1.7 million and \$1.2 million were in non-accrual status at June 30, 2017 and December 31, 2016, respectively. Any TDR that is placed on non-accrual is not reverted back to accruing status until the borrower makes timely payments as contracted for at least six months and future collection under the revised terms is probable. All of the Company’s restructurings were allowed in an effort to maximize its ability to collect on loans where borrowers were experiencing financial difficulty.

The reserve for a TDR is based upon the present value of the future expected cash flows discounted at the loan’s original effective interest rate or upon the fair value of the collateral less costs to sell, if the loan is deemed collateral dependent. This reserve methodology is used because all TDR loans are considered impaired. As of June 30, 2017, there were no commitments to lend additional funds to debtors owing on loans whose terms have been modified in TDRs.

The following tables summarize the loans that were classified as troubled debt restructurings as of the dates indicated:

| | June 30, 2017 | | | |
|-----------------------------------|----------------|-------------|----------|-------------------|
| | (in thousands) | | | |
| | Total | Nonaccruing | Accruing | Related Allowance |
| Commercial and industrial | \$ 692 | \$ 679 | \$ 13 | \$ 135 |
| Residential real estate: | | | | |
| Residential | 2,065 | 233 | 1,832 | - |
| Construction | - | - | - | - |
| Commercial real estate: | | | | |
| Commercial and multi-family | 5,593 | 583 | 5,010 | 150 |
| Construction | - | - | - | - |
| Home equities | 630 | 174 | 456 | - |
| Consumer and other | 32 | - | 32 | 32 |
| Total troubled restructured loans | \$ 9,012 | \$ 1,669 | \$ 7,343 | \$ 317 |

December 31, 2016

(in thousands)

| | Total | Nonaccruing | Accruing | Related Allowance |
|--|-------|-------------|----------|-------------------|
|--|-------|-------------|----------|-------------------|

Edgar Filing: EVANS BANCORP INC - Form 10-Q

| | | | | |
|-----------------------------------|----------|----------|----------|--------|
| Commercial and industrial | \$ 574 | \$ 532 | \$ 42 | \$ 147 |
| Residential real estate: | | | | |
| Residential | 1,949 | 227 | 1,722 | - |
| Construction | - | - | - | - |
| Commercial real estate: | | | | |
| Commercial and multi-family | 1,617 | 313 | 1,304 | - |
| Construction | 257 | - | 257 | - |
| Home equities | 667 | 175 | 492 | 1 |
| Consumer and other | 26 | - | 26 | 26 |
| Total troubled restructured loans | \$ 5,090 | \$ 1,247 | \$ 3,843 | \$ 174 |

The Company's TDRs have various agreements that involve deferral of principal payments, or interest-only payments, for a period (usually 12 months or less) to allow the customer time to improve cash flow or sell the property. Other common concessions leading to the designation of a TDR are lines of credit that are termed-out and/or extensions of maturities at rates that are less than the prevailing market rates given the risk profile of the borrower.

Table of Contents

The following tables show the data for TDR activity by the type of concession granted to the borrower for the three month and six periods ended June 30, 2017 and 2016:

| Troubled Debt Restructurings by Type of Concession | Three months ended June 30, 2017 (Recorded Investment in thousands) | | | Three months ended June 30, 2016 (Recorded Investment in thousands) | | |
|--|--|--|---|--|--|---|
| | Number of Contracts | Pre-Modification Outstanding Recorded Investment | Post-Modification Outstanding Recorded Investment | Number of Contracts | Pre-Modification Outstanding Recorded Investment | Post-Modification Outstanding Recorded Investment |
| Commercial and Industrial | - | \$ - | \$ - | - | \$ - | \$ - |
| Residential Real Estate & Construction | - | - | - | - | - | - |
| Commercial Real Estate & Construction | - | - | - | - | - | - |
| Home Equities: | | | | | | |
| Extension of maturity and interest rate reduction | 1 | 20 | 20 | - | - | - |
| Consumer and other loans | - | - | - | - | - | - |

| Troubled Debt Restructurings by Type of Concession | Six months ended June 30, 2017 (Recorded Investment in thousands) | | | Six months ended June 30, 2016 (Recorded Investment in thousands) | | |
|--|--|--|---|--|--|---|
| | Number of Contracts | Pre-Modification Outstanding Recorded Investment | Post-Modification Outstanding Recorded Investment | Number of Contracts | Pre-Modification Outstanding Recorded Investment | Post-Modification Outstanding Recorded Investment |
| | | | | | | |

| | | | | | | |
|---|---|-------|-------|---|-------|-------|
| Commercial and Industrial: | | | | | | |
| Extension of maturity | - | \$ - | \$ - | 1 | \$ 24 | \$ 24 |
| Term-out line of credit | 1 | 180 | 180 | 1 | 20 | 20 |
| Residential Real Estate & Construction: | | | | | | |
| Extension of maturity | - | - | - | 1 | 95 | 95 |
| Commercial Real Estate & Construction: | | | | | | |
| Extension of maturity | 3 | 5,073 | 5,073 | - | - | - |
| Home Equities: | | | | | | |
| Extension of maturity and interest rate reduction | 1 | 20 | 20 | - | - | - |
| Consumer loans | - | - | - | - | - | - |

Table of Contents

The general practice of the Bank is to work with borrowers so that they are able to repay their loan in full. If a borrower continues to be delinquent or cannot meet the terms of a TDR and the loan is determined to be uncollectible, the loan will be charged-off. There were no loans which were classified as TDRs during the previous 12 months which defaulted during each of the three month and six month periods ended June 30, 2017 and 2016, respectively.

5. COMMON EQUITY AND EARNINGS PER SHARE DATA

The common stock per share information is based upon the weighted average number of shares outstanding during each period. For the three and six month periods ended June 30, 2017, the Company had an average of 116,374 and 119,928 dilutive shares outstanding, respectively. The Company had an average of 62,419 and 63,654 dilutive shares outstanding for the three and six months periods ended June 30, 2016, respectively.

Potential common shares that would have the effect of increasing diluted earnings per share are considered to be anti-dilutive and not included in calculating diluted earnings per share. For the three and six month periods ended June 30, 2017, there was an average of 23,020 and 24,005 potentially anti-dilutive shares outstanding, respectively, that were not included in calculating diluted earnings per share because their effect was anti-dilutive. For both the three and sixth month periods ended June 30, 2016, there were an average of 83,960 potentially anti-dilutive shares outstanding, respectively.

The Company issued 440,000 shares of common stock at \$35.00 per share (including shares issued upon partial exercise of the underwriters' allotment option in connection with the offering) in a registered common stock offering in January 2017. The offering netted \$14 million in additional capital after expenses.

Table of Contents

6. OTHER COMPREHENSIVE INCOME

The following tables summarize the changes in the components of accumulated other comprehensive income (loss) during the three and six month periods ended June 30, 2017 and 2016:

| | Balance at March 31, 2017 (in thousands) | Net Change | Balance at June 30, 2017 |
|---|---|---------------|--------------------------------|
| Net unrealized (loss) gain on investment securities | \$ (178) | \$ 3 | \$ (175) |
| Net defined benefit pension plan adjustments | (1,996) | 31 | (1,965) |
| Total | \$ (2,174) | \$ 34 | \$ (2,140) |

| | Balance at March 31, 2016 (in thousands) | Net Change | Balance at June 30, 2016 |
|--|---|---------------|--------------------------------|
| Net unrealized gain on investment securities | \$ 1,124 | \$ 260 | \$ 1,384 |
| Net defined benefit pension plan adjustments | (2,245) | 40 | (2,205) |
| Total | \$ (1,121) | \$ 300 | \$ (821) |

| | Balance at December 31, 2016 (in thousands) | Net Change | Balance at June 30, 2017 |
|---|---|---------------|--------------------------------|
| Net unrealized (loss) gain on investment securities | \$ (365) | \$ 190 | \$ (175) |
| Net defined benefit pension plan adjustments | (2,059) | 94 | (1,965) |
| Total | \$ (2,424) | \$ 284 | \$ (2,140) |

| | Balance at December 31, 2015 (in thousands) | Net Change | Balance at June 30, 2016 |
|--|---|---------------|--------------------------------|
| Net unrealized gain on investment securities | \$ 475 | \$ 909 | \$ 1,384 |
| Net defined benefit pension plan adjustments | (2,285) | 80 | (2,205) |
| Total | \$ (1,810) | \$ 989 | \$ (821) |

Table of Contents

| | Three months ended June 30, 2017 (in thousands) | | | Three months ended June 30, 2016 (in thousands) | | |
|---|---|------------------------|----------------------|---|------------------------|----------------------|
| | Income Tax | | Net-of-Tax Amount | Income Tax | | Net-of-Tax Amount |
| | Before-Tax Amount | (Provision) Benefit | | Before-Tax Amount | (Provision) Benefit | |
| Unrealized gain on investment securities: | | | | | | |
| Unrealized gain on investment securities | \$ 7 | \$ (4) | \$ 3 | \$ 419 | \$ (159) | \$ 260 |
| Defined benefit pension plan adjustments: | | | | | | |
| Reclassifications from accumulated other comprehensive income for gains | | | | | | |
| Amortization of prior service cost (a) | \$ 8 | \$ (3) | \$ 5 | \$ 8 | \$ (3) | \$ 5 |
| Amortization of actuarial loss (a) | 43 | (17) | 26 | 56 | (21) | 35 |
| Net change | 51 | (20) | 31 | 64 | (24) | 40 |
| Other Comprehensive Income | \$ 58 | \$ (24) | \$ 34 | \$ 483 | \$ (183) | \$ 300 |

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

| | Six months ended June 30, 2017 (in thousands) | | | Six months ended June 30, 2016 (in thousands) | | |
|---|--|----------------------------|----------------------|--|------------------------|----------------------|
| | Income Tax | | Net-of-Tax Amount | Income Tax | | Net-of-Tax Amount |
| | Before-Tax Amount | (Provision) Benefit (b) | | Before-Tax Amount | (Provision) Benefit | |
| Unrealized gain on investment securities: | | | | | | |
| Unrealized gain on investment securities | \$ 303 | \$ (113) | \$ 190 | \$ 1,465 | \$ (556) | \$ 909 |

Defined benefit pension plan

adjustments:

Reclassifications from accumulated other
comprehensive income for gains

| | | | | | | |
|--|--------|----------|--------|----------|----------|--------|
| Amortization of prior service cost (a) | \$ 16 | \$ (1) | \$ 15 | \$ 16 | \$ (6) | \$ 10 |
| Amortization of actuarial loss (a) | 86 | (7) | 79 | 112 | (42) | 70 |
| Net change | 102 | (8) | 94 | 128 | (48) | 80 |
| Other Comprehensive Income | \$ 405 | \$ (121) | \$ 284 | \$ 1,593 | \$ (604) | \$ 989 |

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

(b) Tax benefit includes impact of re-valuation of deferred tax asset due to increase in marginal federal income tax rate from 34% to 35%.

Table of Contents

7. SEGMENT INFORMATION

The Company is comprised of two primary business segments, banking and insurance agency activities. The following tables set forth information regarding these segments for the three and six month periods ended June 30, 2017 and 2016.

| | Three months ended June 30, 2017 | | |
|--|---|--------------------------------|-----------|
| | Banking Activities (in thousands) | Insurance Agency Activities | Total |
| Net interest income (expense) | \$ 10,144 | \$ (26) | \$ 10,118 |
| Provision for loan losses | 410 | - | 410 |
| Net interest income (expense) after provision for loan losses | 9,734 | (26) | 9,708 |
| Non-interest income | 1,177 | - | 1,177 |
| Insurance service and fees | 96 | 1,816 | 1,912 |
| Amortization expense | - | 28 | 28 |
| Non-interest expense | 7,874 | 1,415 | 9,289 |
| Income before income taxes | 3,133 | 347 | 3,480 |
| Income tax provision | 729 | 133 | 862 |
| Net income | \$ 2,404 | \$ 214 | \$ 2,618 |

| | Three months ended June 30, 2016 | | |
|--|---|--------------------------------|-------|
| | Banking Activities (in thousands) | Insurance Agency Activities | Total |

Edgar Filing: EVANS BANCORP INC - Form 10-Q

| | | | |
|--|----------|---------|----------|
| Net interest income (expense) | \$ 8,549 | \$ (33) | \$ 8,516 |
| (Credit) provision for loan losses | (376) | - | (376) |
| Net interest income (expense) after provision for loan losses | 8,925 | (33) | 8,892 |
| Non-interest income | 708 | - | 708 |
| Insurance service and fees | 116 | 1,456 | 1,572 |
| Non-interest expense | 7,551 | 1,168 | 8,719 |
| Income before income taxes | 2,198 | 255 | 2,453 |
| Income tax provision | 352 | 98 | 450 |
| Net income | \$ 1,846 | \$ 157 | \$ 2,003 |

33

Table of Contents

| | Six months ended June 30, 2017 | | |
|--|---|--------------------------------|-----------|
| | Banking Activities (in thousands) | Insurance Agency Activities | Total |
| Net interest income (expense) | \$ 19,814 | \$ (52) | \$ 19,762 |
| (Credit) provision for loan losses | (25) | - | (25) |
| Net interest income (expense) after provision for loan losses | 19,839 | (52) | 19,787 |
| Non-interest income | 2,531 | - | 2,531 |
| Insurance service and fees | 205 | 3,875 | 4,080 |
| Amortization expense | - | 56 | 56 |
| Non-interest expense | 15,521 | 2,795 | 18,316 |
| Income before income taxes | 7,054 | 972 | 8,026 |
| Income tax provision | 1,888 | 374 | 2,262 |
| Net income | \$ 5,166 | \$ 598 | \$ 5,764 |

| | Six months ended June 30, 2016 | | |
|--|---|--------------------------------|-----------|
| | Banking Activities (in thousands) | Insurance Agency Activities | Total |
| Net interest income (expense) | \$ 16,840 | \$ (64) | \$ 16,776 |
| (Credit) provision for loan losses | (168) | - | (168) |
| Net interest income (expense) after provision for loan losses | 17,008 | (64) | 16,944 |
| Non-interest income | 1,954 | - | 1,954 |
| Insurance service and fees | 232 | 3,088 | 3,320 |
| Non-interest expense | 14,878 | 2,369 | 17,247 |
| Income before income taxes | 4,316 | 655 | 4,971 |
| Income tax provision | 1,002 | 252 | 1,254 |
| Net income | \$ 3,314 | \$ 403 | \$ 3,717 |

8. CONTINGENT LIABILITIES AND COMMITMENTS

The unaudited consolidated financial statements do not reflect various commitments and contingent liabilities, which arise in the normal course of business, and which involve elements of credit risk, interest rate risk and liquidity risk. These commitments and contingent liabilities consist of commitments to extend credit and standby letters of credit. A summary of the Bank's commitments and contingent liabilities is as follows:

| | June 30, 2017 (in thousands) | December 31, 2016 |
|------------------------------|------------------------------------|-------------------------|
| Commitments to extend credit | \$ 226,240 | \$ 217,581 |
| Standby letters of credit | 2,891 | 3,736 |
| Total | \$ 229,131 | \$ 221,317 |

Table of Contents

Commitments to extend credit and standby letters of credit include some exposure to credit loss in the event of nonperformance by the customer. The Bank's credit policies and procedures for credit commitments and financial guarantees are the same as those for extensions of credit that are recorded on the Company's unaudited consolidated balance sheets. Because these instruments have fixed maturity dates, and because they may expire without being drawn upon, they do not necessarily represent cash requirements of the Bank. The Bank did not incur any losses on its commitments and did not record a reserve for its commitments during the first six months of 2017 or during 2016.

Certain lending commitments for construction residential mortgage loans are considered derivative instruments under the guidelines of GAAP. The changes in the fair value of these commitments, due to interest rate risk, are not recorded on the consolidated balance sheets as the fair value of these derivatives is not considered to be material.

9. NET PERIODIC BENEFIT COSTS

On January 31, 2008, the Bank froze its defined benefit pension plan. The plan covered substantially all Bank employees. The plan provides benefits that are based on the employees' compensation and years of service. Under the freeze, eligible employees will receive, at retirement, the benefits already earned through January 31, 2008, but have not accrued any additional benefits since then. As a result, service cost is no longer incurred.

The Bank uses an actuarial method of amortizing prior service cost and unrecognized net gains or losses which result from actual expense and assumptions being different than those that are projected. The amortization method the Bank used recognized the prior service cost and net gains or losses over the average remaining service period of active employees.

The Bank also maintains a nonqualified supplemental executive retirement plan covering certain members of the Company's senior management. The Bank uses an actuarial method of amortizing unrecognized net gains or losses which result from actual expense and assumptions being different than those that are projected. The amortization method the Bank uses recognizes the net gains or losses over the average remaining service period of active employees.

The Bank made a \$1 million contribution to the defined benefit pension plan during the first six months of 2017.

The following table presents the net periodic cost for the Bank's defined benefit pension plan and supplemental executive retirement plan for the three and six month periods ended June 30, 2017 and 2016:

| | Three months ended June 30, (in thousands) | | | |
|------------------------------------|---|-------|--|--------|
| | Pension Benefits | | Supplemental Executive Retirement Plan | |
| | 2017 | 2016 | 2017 | 2016 |
| Service cost | \$ - | \$ - | \$ 42 | \$ 47 |
| Interest cost | 54 | 55 | 34 | 36 |
| Expected return on plan assets | (68) | (66) | - | - |
| Amortization of prior service cost | - | - | 8 | 8 |
| Amortization of the net loss | 23 | 22 | 20 | 34 |
| Net periodic cost (benefit) | \$ 9 | \$ 11 | \$ 104 | \$ 125 |

Table of Contents

Six months ended June 30,
(in thousands)

| | Pension Benefits | | Supplemental Executive Retirement Plan | |
|------------------------------------|------------------|-------|--|--------|
| | 2017 | 2016 | 2017 | 2016 |
| Service cost | \$ - | \$ - | \$ 84 | \$ 94 |
| Interest cost | 108 | 110 | 68 | 72 |
| Expected return on plan assets | (137) | (131) | - | - |
| Amortization of prior service cost | - | - | 16 | 16 |
| Amortization of the net loss | 46 | 44 | 40 | 68 |
| Net periodic cost (benefit) | \$ 17 | \$ 23 | \$ 208 | \$ 250 |

10. INCOME TAXES

In the second quarter of 2017, the Company recognized the impact of its investment in a partnership that incurred expenses related to the rehabilitation of a certified historic structure located in New York State after a historic structure was placed in service. At the time a historic structure is placed in service, the Bank is eligible for a federal and New York State tax credit. The Company's accounting policies related to these investments and the resulting tax credits is detailed in Note 1 to the audited Consolidated Financial Statements on Form 10-K for the year ended December 31, 2016. The impact to the financial statements for the three and six month periods ended June 30, 2017 was a loss on the investment of \$0.9 million, the recording of the New York State tax credit of \$0.6 million in non-interest income, and a benefit in income tax expense of \$0.2 million. The impact for the three and six month periods ended June 30, 2016 was a loss on the investment of \$2.1 million, the recording of the New York State tax credit of \$1.5 million in non-interest income, and a benefit in income tax expense line of \$0.6 million.

11. RECENT ACCOUNTING PRONOUNCEMENTS

Accounting Standards Update (“ASU”) 2014-09, Revenue from Contracts with Customers. The objective of this 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, 2017, including interim periods within the reporting period. The Company does not expect the standard to have a material impact on the Company’s financial reporting.

ASU 2016-01, Recognition and Measurement of Financial Assets and Financial Liabilities. The main objective of this ASU is to enhance the reporting model for financial instruments to provide users of financial statements with more decision-useful information. The amendments in this ASU are effective for annual reporting periods beginning after December 15, 2017, including interim periods within those fiscal years. The ASU will not impact results of operations or the financial position of the Company, but will impact its fair value disclosures in the notes to the financial statements.

ASU 2016-02, Leases. The objective of this ASU is to increase transparency and comparability among organizations by recognizing lease assets and lease liabilities on the balance sheet and disclosing key information about leasing arrangements to meet that objective. The main difference between previous GAAP and this ASU is the recognition of lease assets and lease liabilities by lessees for those leases classified as operating leases under previous GAAP. Under this new guidance, a lessee should recognize in the statement of financial position a liability to make lease payments and a right-of-use asset representing its right to use the underlying asset for the lease term. The recognition, measurement, and presentation of expenses and cash flows arising from a lease by a lessee have not significantly changed from previous GAAP. Information about the Company’s operating lease obligations is disclosed in Note 16 to the Company’s Consolidated Financial Statements included in Item 8 of the Annual Report on Form 10-K for the year ended December 31, 2016. The amendments in this ASU are effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. The Company is currently evaluating the impact of the standard on its financial reporting.

Table of Contents

ASU 2016-09, Improvements to Employee Share-Based Payment Accounting. This ASU is part of the FASB's Simplification Initiative. The areas for simplification in this Update involve several aspects of the accounting for share-based payment transactions, including the income tax consequences, classification of awards as either equity or liabilities, and classification on the statement of cash flows. Some of the areas of simplification apply only to nonpublic entities. The standard was adopted effective January 1, 2017. One part of this ASU that impacted the Company was the elimination of the concept of a tax windfall pool. Previously, an entity determined for each award whether the difference between the deduction for tax purposes and the compensation cost recognized for financial reporting purposes resulted in either an excess benefit or a tax deficiency. Excess tax benefits were recognized in additional paid-in-capital; tax deficiencies were recognized either as an offset to accumulated excess tax benefits, if any, or in the income statement. Excess tax benefits were not recognized until the deduction reduced taxes payable. Under the new standard, all excess tax benefits and tax deficiencies are recognized as income tax expense or benefit in the income statement in the period in which they are incurred. The impact was a tax benefit of \$0.1 million and \$0.2 million for the three and six-month periods ended June 30, 2017, respectively.

In addition, the Company made the accounting policy election effective January 1, 2017 to account for forfeitures of stock awards when they occur rather than estimating the number of awards that are expected to vest. When stock awards are granted, the Company assumes that the service condition will be achieved when determining the initial amount of compensation cost recognized. The Company does not expect this election to have a material impact on its financial statements.

ASU 2016-13, Financial Instruments – Credit Losses: Measurement of Credit Losses on Financial Instruments. Current GAAP requires an “incurred loss” methodology for recognizing credit losses that delays recognition until it is probable a loss has been incurred. Both financial institutions and users of their financial statements expressed concern that current GAAP restricts the ability to record credit losses that are expected, but do not yet meet the “probable” threshold. The main objective of this ASU (commonly known as the Current Expected Credit Loss Impairment Model, or CECL, in the industry) is to provide financial statement users with more decision-useful information about the expected credit losses on financial instruments and other commitments to extend credit held by a reporting entity at each reporting date. To achieve this objective, the amendments in CECL replace the incurred loss impairment methodology in current GAAP with a methodology that reflects expected credit losses and requires consideration of a broader range of reasonable and supportable information to inform credit loss estimates. The amendments in CECL are effective for the Company for fiscal years beginning after December 15, 2019, including interim periods within those fiscal years. The FASB expects that an entity will be able to leverage its current systems and methods for recording the allowance for credit losses. However, many financial institutions, particularly community banks similar in size to the Company and industry groups like the American Bankers Association, have expressed concern about the impact of CECL. The life of loan loss concept presents complexities that can decrease capital, and add both volatility to ALLL estimates and additional costs. CECL may increase the ALLL, though many factors will determine the impact for each bank. Changes in expectations of future economic conditions play a large role in CECL and can significantly affect the credit loss estimate. While OCC estimates made in 2012 projected a 30% to 50% increase in the ALLL, more recent bank analyst projections were far lower. A challenge for the Company could be the operational impact. Costly new systems and process to track loan performance may need to be purchased or developed. Significant procedural challenges may be faced both in implementation and on an ongoing basis. The total impact of CECL to the Company's financial statements is unknown but may be material. Implementation of CECL will be a significant project for the Company through the projected implementation date of January 1, 2020.

ASU 2017-04, Simplifying the Test for Goodwill Impairment. The objective of this ASU is to simplify how an entity is required to test goodwill impairment by eliminating Step 2 from the goodwill impairment test. Step 2 measures a goodwill impairment loss by comparing the implied fair value of a reporting unit's goodwill with the carrying amount of that goodwill. Under the amendments in this ASU, an entity will perform its annual goodwill impairment test by comparing the fair value of a reporting unit with its carrying amount. An entity would recognize an impairment charge for the amount by which the carrying amount exceeds the reporting unit's fair value. The amendments in this ASU are effective for annual reporting periods beginning after December 15, 2019, including interim periods within those fiscal years. The Company does not expect the standard to have a material impact on the Company's financial reporting.

ITEM 2 - MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

This Quarterly Report on Form 10-Q 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," and similar expressions identify such forward-looking statements. These forward-looking statements include statements regarding the Company's business plans, prospects, growth and operating strategies, 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.

Table of Contents

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, monetary policy, 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; loan losses in excess of the Company's allowance for loan losses; changes in accounting pronouncements and practices, as adopted by financial institution regulatory agencies, the Financial Accounting Standards Board and the Public Company Accounting Oversight Board; the impact of such changes in accounting pronouncements and practices being greater than anticipated; the ability to realize the benefit of deferred tax assets; changes in tax policies, rates and regulations of federal, state and local tax authorities; 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 Quarterly Report on Form 10-Q, as well as in the Company's periodic reports filed with the SEC, in particular the "Risk Factors" discussed in Item 1A of the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2016. 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, except to the extent required by law.

APPLICATION OF CRITICAL ACCOUNTING ESTIMATES

The Company's Unaudited Consolidated Financial Statements included in this Quarterly Report on Form 10-Q are prepared in accordance with U.S. 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 Unaudited Consolidated Financial Statements and Notes. These estimates, assumptions, and judgments are based on information available as of the date of the Unaudited Consolidated Financial Statements. Accordingly, as this information changes, the Unaudited 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. 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. Refer to Note 3 – “Fair Value Measurements” to the Company’s Unaudited Consolidated Financial Statements included in Item 1 of this Quarterly Report on Form 10-Q for further detail on fair value measurement.

Significant accounting policies followed by the Company are presented in Note 1 – “Organization and Summary of Significant Accounting Policies” to the Audited Consolidated Financial Statements included in Item 8 in its Annual Report on Form 10-K for the year ended December 31, 2016. These policies, along with the disclosures presented in the other Notes to the Company's Audited Consolidated Financial Statements contained in its Annual Report on Form 10-K and in this financial review, provide information on how significant assets and liabilities are presented in the Company’s Unaudited Consolidated Financial Statements and how those values are determined.

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 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 Losses

The allowance for loan losses represents management’s estimate of probable losses in the Company’s loan portfolio. Determining the amount of the allowance for loan 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, estimated losses on pools of homogeneous loans 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

Table of Contents

Company's Unaudited Consolidated Balance Sheets. Note 1 to the Audited Consolidated Financial Statements included in Item 8 in the Company's Annual Report on Form 10-K for the year ended December 31, 2016 describes the methodology used to determine the allowance for loan losses.

Goodwill

The amount of goodwill reflected in the Company's Unaudited Consolidated Financial Statements is required to be tested by management for impairment on at least an annual basis. The test for impairment of goodwill on the 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. The goodwill impairment testing is performed annually as of December 31st. No impairment charges were incurred in the most recent test and the fair value of the tested reporting unit substantially exceeded its carrying value. There were no triggering events in the six month period ended June 30, 2017 that resulted in an interim impairment test.

ANALYSIS OF FINANCIAL CONDITION

Loan Activity

Total loans grew to \$976 million at June 30, 2017, a \$30 million or 3% increase from total loans of \$946 million at March 31, 2017 and a \$33 million or 4% increase from \$943 million at December 31, 2016.

Loans secured by real estate were \$766 million at June 30, 2017, reflecting a \$15 million or 2% increase from \$751 million at March 31, 2017 and a \$23 million or 3% increase from \$743 million at December 31, 2016. Commercial and multi-family real estate loans were \$477 million at June 30, 2017, \$13 million higher than the \$464 million balance at the end of the first quarter of 2017 and \$15 million higher than the balance of \$462 million at the end of 2016. Commercial real estate is the largest part of the Company's loan portfolio and has historically been the highest growth segment of the portfolio. The market for commercial real estate in the Company's footprint in Western New York has been strong over the past two years. The demand, along with the Company's proven track record in commercial real estate lending, led to strong growth at an annualized rate of 11% in the second quarter of 2017.

In the second quarter of 2017, residential mortgage originations were \$6 million compared with the previous quarter's originations of \$11 million and \$10 million in last year's second quarter. Residential mortgages sold in the second quarter of 2017 equated to approximately 39% of the residential mortgages originated by the Company during this quarter, as compared with 25% of residential mortgages originated during the first quarter of 2017 and 25% in the

second quarter of 2016. The Company originated \$17 million in residential mortgages in the first six months of 2017 and sold 31% of those loans, compared with \$15 million and 23%, respectively, in the first six months of 2016. Management decides to keep or sell residential mortgage loans at the time of origination based on interest rate risk management and the risk-adjusted return of alternative investment sources such as mortgage-backed securities.

The Company has also focused on growth opportunities in commercial and industrial (“C&I”) lending as a way to diversify its overall loan portfolio. The C&I portfolio grew to \$208 million at June 30, 2017, representing a \$16 million or 8% increase from \$192 million at March 31, 2017 and \$11 million or 6% higher than the \$197 million balance at December 31, 2016. Commercial loan demand rebounded in the second quarter after weaker commercial loan demand in late fourth quarter of 2016 and early first quarter of 2017. In addition, paydowns of outstanding balances on lines of credit contributed to the first quarter decrease in C&I loan balances.

Credit Quality of Loan Portfolio

Total non-performing loans, defined as accruing loans greater than 90 days past due and nonaccrual loans, totaled \$14 million, or 1.42% of total loans outstanding at June 30, 2017, compared with \$12 million, or 1.30% of total loans outstanding, as of March 31, 2017 and \$12 million, or 1.28% of total loans outstanding, as of December 31, 2016. The \$2 million increase in non-performing loans reflects two commercial loans that reached 90 days past due in the second quarter but remained in accruing status. Both loans are considered by management to be well secured and in the process of collection.

Troubled debt restructurings (“TDRs”) increased from \$5 million at December 31, 2016 to \$9 million at each of June 30, 2017 and March 31, 2017. The increase is attributable to a single commercial real estate loan of \$5 million that matured in the first quarter and was subsequently extended. While the borrower was considered by management to be financially troubled due to a high loan to collateral value ratio, the Company expects the borrower to pay the principal and interest of the restructured terms as contracted, and, therefore, the loan remains in accruing status.

Commercial credits graded as “special mention” and “substandard,” or the criticized loan portfolio, were \$39 million at June 30, 2017, a \$5 million increase from \$34 million at March 31, 2017 and \$1 million higher than the \$38 million in criticized loans at December 31, 2016. The increase in criticized loans in the recent quarter reflected several downgrades of commercial real estate and C&I loan relationships. The downgrades were for various reasons with no particular industry concentration. The decrease in criticized loans in

Table of Contents

the first quarter was in the C&I portfolio as one large loan relationship was upgraded to watch from special mention as the borrower demonstrated improved operating performance over a sustained period of time. The level of criticized loans can fluctuate as new information is constantly received on the Company's borrowers and their financial circumstances change over time. As noted in Note 4 to the Company's Unaudited Financial Statements included in Part I of this Quarterly Report on Form 10-Q, internal risk ratings are the credit quality indicators used by the Company's management to determine the appropriate allowance for loan losses for commercial credits. "Special mention" and "substandard" loans are weaker credits with a higher risk of loss categorized as "criticized" credits rather than "pass" or "watch" credits.

The Company maintains an allowance for loan losses that in management's judgment appropriately reflects losses inherent in the loan portfolio. The allowance for loan losses totaled \$14.2 million or 1.45% of total loans outstanding at June 30, 2017, compared with \$13.6 million or 1.44% of total loans outstanding as of March 31, 2017 and \$13.9 million or 1.48% of total loans outstanding at December 31, 2016. The Company recorded \$0.4 million in provision for loan losses in the second quarter after releasing \$0.4 million in allowance for loan losses during the 2017 first quarter. The fluctuation in provision for loan losses reflects the loan growth and criticized loan trends of the past two quarters. The net charge-off (recovery) ratio for the second quarter of 2017 was (0.08)% of average net loans, compared with a ratio of (0.04)% and (0.01)% in the first quarter of 2017 and second quarter of 2016, respectively.

Investing Activities

Total securities increased to \$143 million at June 30, 2017 from \$116 million at March 31, 2017 and \$97 million at December 31, 2016. Interest-bearing deposits at other banks, which consist of overnight funds kept at correspondent banks and the Federal Reserve, were \$2 million at June 30, 2017, compared with \$19 million at March 31, 2017 and \$1 million at December 31, 2016. A common equity issuance and seasonal municipal deposit inflows in the first quarter of 2017 increased liquidity, resulting in the increased investment securities and interest-bearing deposits at other banks. The Company has purchased investment securities to leverage the capital generated in the common equity issuance. While management plans to leverage the capital with loan growth over the long term, investment securities have been purchased to generate more immediate returns. Average investment securities and interest-bearing cash were 13% of average interest-earning assets in the second quarter of 2017, compared with 11% in the first three months of 2017.

The Company's highest concentration in its securities portfolio was in available for sale U.S. government sponsored mortgage-backed securities at 57% of total investment securities at June 30, 2017, compared with 55% at March 31, 2017 and 49% at December 31, 2016. The concentration in tax-advantaged debt securities issued by state and political subdivisions and U.S. government-sponsored agency bonds was 24% and 19%, respectively, of the total securities portfolio at June 30, 2017, compared with 31% and 14% at March 31, 2017 and 38% and 13% at December 31, 2016.

Management believes that the credit quality of the securities portfolio as a whole is strong, as the portfolio has no individual securities in a significant unrealized loss position. The total net unrealized loss position of the available-for-sale investment portfolio was \$0.3 million at each of June 30, 2017 and March 31, 2017, compared with

\$0.6 million at December 31, 2016.

The Company monitors extension and prepayment risk in the securities portfolio to limit potential exposures. The Company has no direct exposure to subprime mortgages, nor does the Company hold private mortgage-backed securities, credit default swaps, or FNMA or FHLMC preferred stock investments in its investment portfolio.

Funding Activities

Total deposits at June 30, 2017 were \$1.0 billion, a \$41 million or 4% increase from \$978 million at March 31, 2017 and a \$79 million or 8% increase from \$940 million at December 31, 2016. The growth in the first six months of 2017 reflected growth in savings deposits of \$39 million, time deposits of \$24 million, NOW deposits of \$10 million, and demand deposits of \$6 million. All of the savings deposit growth and half of the NOW deposit growth is attributable to municipal deposits. The Company hired a new director of government banking and has more aggressively pursued municipal deposits in 2017. The Company's most successful effort in attracting new retail deposits through the first six months of 2017 has been in time deposits as customers have returned to maturity deposits with increases in short-term interest rates. Due to the transactional nature of demand deposits, average balances are a useful metric to meaningfully measure sustained growth rates. Average demand deposits were \$205 million in the second quarter, a 5% increase from \$196 million in the first quarter of 2017 and 15% higher than the \$178 million average balance in the second quarter of 2016. Most of the Company's demand deposit growth over the past twelve months has been with commercial customers.

The Company had \$15 million in other borrowings at June 30, 2017, which consisted of a \$10 million long-term advance with the FHLB NY scheduled to mature in 2020 and \$5 million in overnight borrowings with the FHLB NY. Other borrowings were \$10 million at March 31, 2017 and \$28 million at December 31, 2016. The Company's use of its overnight line of credit with FHLB NY varies depending on its ability to fund investment and loan growth with core deposits along with the line usage's impact on interest rate risk.

Table of Contents

ANALYSIS OF RESULTS OF OPERATIONS

Average Balance Sheet

The following tables present the significant categories of the assets and liabilities of the Company, interest income and interest expense, and the corresponding yields earned and rates paid for the periods indicated. The assets and liabilities are presented as daily averages. The average loan balances include both performing and non-performing loans. Investments are included at book value. Yields are presented on a non-tax-equivalent basis.

| | Three months ended June 30, 2017 | | | Three months ended June 30, 2016 | | |
|---|---|--------------------------|----------------|---|--------------------------|----------------|
| | Average Outstanding Balance (dollars in thousands) | Interest Earned/ Paid | Yield/ Rate | Average Outstanding Balance (dollars in thousands) | Interest Earned/ Paid | Yield/ Rate |
| ASSETS | | | | | | |
| Interest-earning assets: | | | | | | |
| Loans, net | \$ 941,446 | \$ 10,646 | 4.54 % | \$ 801,115 | \$ 8,878 | 4.46 % |
| Taxable securities | 92,606 | 563 | 2.44 % | 76,817 | 561 | 2.94 % |
| Tax-exempt securities | 35,086 | 210 | 2.40 % | 38,793 | 222 | 2.30 % |
| Interest bearing deposits at banks | 16,840 | 43 | 1.02 % | 15,916 | 33 | 0.83 % |
| Total interest-earning assets | 1,085,978 | \$ 11,462 | 4.23 % | 932,641 | \$ 9,694 | 4.18 % |
| Non interest-earning assets: | | | | | | |
| Cash and due from banks | 13,545 | | | 12,001 | | |
| Premises and equipment, net | 11,021 | | | 11,310 | | |
| Other assets | 46,744 | | | 42,228 | | |
| Total Assets | \$ 1,157,288 | | | \$ 998,180 | | |
| LIABILITIES & STOCKHOLDERS' EQUITY | | | | | | |
| Interest-bearing liabilities: | | | | | | |
| NOW | \$ 97,422 | \$ 54 | 0.22 % | \$ 88,966 | \$ 78 | 0.35 % |
| Savings | 540,995 | 650 | 0.48 % | 473,791 | 606 | 0.51 % |
| Time deposits | 152,112 | 486 | 1.28 % | 114,545 | 352 | 1.24 % |
| Other borrowed funds | 10,329 | 44 | 1.71 % | 10,854 | 44 | 1.63 % |

Edgar Filing: EVANS BANCORP INC - Form 10-Q

| | | | | | | |
|------------------------------------|--------------|-----------|--------|------------|----------|--------|
| Junior subordinated debentures | 11,330 | 104 | 3.68 % | 11,330 | 91 | 3.23 % |
| Securities sold U/A to repurchase | 11,154 | 6 | 0.22 % | 13,847 | 7 | 0.20 % |
| Total interest-bearing liabilities | 823,342 | \$ 1,344 | 0.65 % | 713,333 | \$ 1,178 | 0.66 % |
| Noninterest-bearing liabilities: | | | | | | |
| Demand deposits | 205,361 | | | 178,106 | | |
| Other | 13,860 | | | 13,142 | | |
| Total liabilities | \$ 1,042,563 | | | \$ 904,581 | | |
| Stockholders' equity | 114,725 | | | 93,599 | | |
| Total Liabilities and Equity | \$ 1,157,288 | | | \$ 998,180 | | |
| Net interest earnings | | \$ 10,118 | | | \$ 8,516 | |
| Net interest margin | | | 3.74 % | | | 3.67 % |
| Interest rate spread | | | 3.58 % | | | 3.52 % |

41

Table of Contents

| | Six months ended June 30, 2017 | | | Six months ended June 30, 2016 | | |
|---|--------------------------------|-----------|--------|--------------------------------|-----------|--------|
| | Average | Interest | | Average | Interest | |
| | Outstanding | Earned/ | Yield/ | Outstanding | Earned/ | Yield/ |
| | Balance | Paid | Rate | Balance | Paid | Rate |
| | (dollars in thousands) | | | (dollars in thousands) | | |
| ASSETS | | | | | | |
| Interest-earning assets: | | | | | | |
| Loans, net | \$ 933,067 | \$ 20,892 | 4.52 % | \$ 786,862 | \$ 17,608 | 4.50 % |
| Taxable securities | 81,650 | 999 | 2.47 % | 70,809 | 938 | 2.66 % |
| Tax-exempt securities | 35,760 | 434 | 2.45 % | 38,547 | 460 | 2.40 % |
| Interest bearing deposits at banks | 11,425 | 55 | 0.97 % | 17,400 | 44 | 0.51 % |
| Total interest-earning assets | 1,061,902 | \$ 22,380 | 4.25 % | 913,618 | \$ 19,050 | 4.19 % |
| Non interest-earning assets: | | | | | | |
| Cash and due from banks | 13,143 | | | 12,368 | | |
| Premises and equipment, net | 11,126 | | | 11,201 | | |
| Other assets | 46,743 | | | 42,388 | | |
| Total Assets | \$ 1,132,914 | | | \$ 979,575 | | |
| LIABILITIES & STOCKHOLDERS' EQUITY | | | | | | |
| Interest-bearing liabilities: | | | | | | |
| NOW | \$ 95,761 | \$ 105 | 0.22 % | \$ 88,583 | \$ 163 | 0.37 % |
| Regular savings | 525,874 | 1,260 | 0.48 % | 460,551 | 1,137 | 0.50 % |
| Time deposits | 148,512 | 941 | 1.28 % | 111,751 | 695 | 1.25 % |
| Other borrowed funds | 12,910 | 97 | 1.52 % | 10,636 | 88 | 1.66 % |
| Junior subordinated debentures | 11,330 | 204 | 3.63 % | 11,330 | 178 | 3.16 % |
| Securities sold U/A to repurchase | 11,524 | 11 | 0.19 % | 13,169 | 13 | 0.20 % |
| Total interest-bearing liabilities | 805,911 | \$ 2,618 | 0.66 % | 696,020 | \$ 2,274 | 0.66 % |
| Noninterest-bearing liabilities: | | | | | | |
| Demand deposits | 200,890 | | | 177,091 | | |
| Other | 14,453 | | | 13,511 | | |
| Total liabilities | \$ 1,021,254 | | | \$ 886,622 | | |
| Stockholders' equity | 111,660 | | | 92,953 | | |
| Total Liabilities and Equity | \$ 1,132,914 | | | \$ 979,575 | | |

| | | |
|-----------------------|-----------|-----------|
| Net interest earnings | \$ 19,762 | \$ 16,776 |
| Net interest margin | 3.75 % | 3.69 % |
| Interest rate spread | 3.59 % | 3.53 % |

42

Table of Contents

Net Income

Net income was \$2.6 million, or \$0.54 per diluted share, in the second quarter of 2017, compared with \$3.1 million, or \$0.66 per diluted share, in the first quarter of 2017 and \$2.0 million, or \$0.46 per diluted share, in last year's second quarter. The increase over the prior year period reflects higher net interest income and non-interest income. The decrease in net income when compared with the first quarter of 2017 is primarily a result of higher provision for loan loss and non-interest expenses and lower non-interest income. Return on average equity was 9.13% for the second quarter of 2017 compared with 11.59% in the first quarter of 2017 and 8.56% in the second quarter of 2016.

The Company had net income of \$5.8 million, or \$1.20 per diluted share, in the first six months of 2017, a 55% increase from \$3.7 million, or \$0.86 per diluted share, in the comparable period of 2016. The increase reflected growth in net interest income and non-interest income. Return on average equity improved from 8.00% in the first half of 2016 to 10.32% in the six month period ended June 30, 2017.

Other Results of Operations – Quarterly Comparison

Net interest income increased \$0.5 million, or 5%, from the first quarter of 2017 and \$1.6 million, or 19%, from the prior-year second quarter to \$10.1 million in the second quarter of 2017. Average commercial loans, including both commercial real estate and C&I loans, were \$763 million in the second quarter, 2% higher than \$747 million in the trailing first quarter, and 19% higher than \$642 million in the 2016 second quarter. After the high volume of loan closings in the fourth quarter of 2016 somewhat muted commercial loan growth in the first quarter of 2017, stronger growth trends returned for the Company in the second quarter. The strong growth of average commercial loans was the primary driver of the improvement in net interest income in the second quarter of 2017 when compared with the comparative period in 2016. The Company also benefited in the second quarter from the recent increase in short-term interest rates after the Federal Reserve increased the federal funds rate for the third time in six months this past quarter.

Second quarter net interest margin of 3.74% decreased 3 basis points from the 2017 first quarter, but improved 7 basis points from the second quarter of 2016. The margin improvement from the prior year quarter stems from increased yields on interest-earning assets. Loan yields have benefited from variable loan re-pricing due to an increase in the prime rate as the Federal Reserve has increased its target rate by 75 basis points since late in 2016. The slight compression in net interest margin in the second quarter of 2017 when compared with the first quarter of 2017 is due to a shift in the interest-earning asset mix. After its common stock issuance in the first quarter of 2017, the Company increased its investment securities portfolio to leverage its capital. Average investment securities and interest-bearing cash were 13% of average interest-earning assets in the second quarter of 2017, compared with 11% in the first three months of 2017. Funding costs, particularly deposits, have held steady despite the increase in short-term interest rates. The cost of interest-bearing liabilities was 0.65% in the second quarter of 2017, compared with 0.66% in each of the first quarter of 2017 and second quarter of 2016.

The \$0.4 million provision for loan loss for the second quarter of 2017 reflects the strong loan growth in the quarter as well as an increase in criticized loans, somewhat offset by a sustained historically low charge-off ratio including \$0.2 million in net recoveries in the second quarter. The release of allowance for loan loss of \$0.4 million in each of the first quarter of 2017 and second quarter of 2016 resulted from decreases in criticized loans and the continued decline in historical loss factors in the reserve calculation, reflecting an improving economy and credit quality of the Company's loan portfolio. The first quarter of 2017 was also impacted by a slowdown in loan growth.

Non-interest income was \$3.1 million in the second quarter of 2017, a decrease from \$3.5 million in the first quarter of 2017, but an increase from \$2.3 million in the prior year second quarter. Each of the second quarters of 2017 and 2016 included the impact of a net reduction of noninterest income related to an investment in an historic rehabilitation tax credit. There was no comparable transaction in the first quarter of 2017.

Evans is actively engaged in the community by financing historic rehabilitation projects in Buffalo and enhances its yield by investing in related tax credits. When a project is completed, Evans begins to recognize tax benefits with a related reduction in the investment. In the second quarter of 2017, the Company recognized a net loss of \$0.1 million as a \$0.6 million refundable New York State tax credit was recorded in non-interest income and a corresponding \$0.2 million tax benefit was realized in income tax expense, offset by a \$0.9 million write-off on the investment in non-interest income. The write-off was contemplated when management priced the initial investment in the tax credit project. The Company expects an additional \$0.2 million tax benefit related to this project in the last half of 2017.

The net impact to non-interest income in the second quarter of 2017 from investing in historic tax credits was a reduction of \$0.3 million, compared with a reduction of \$0.6 million in last year's second quarter and no impact in the first quarter of 2017.

Insurance revenue decreased from the first quarter of 2017 due to seasonal profit sharing revenue, but increased 22% from last year's second quarter to \$1.9 million in the second quarter of 2017. Employee benefits revenue, a renewed focus for the Company after hiring several industry veterans, experienced significant growth in the quarter. The year-over-year increase was also driven by

Table of Contents

continued growth in commercial lines insurance commissions and personal lines revenue bolstered by incremental revenue from the two recent insurance agency acquisitions.

Second quarter non-interest expenses increased 7% from the prior-year period and 3% from the first quarter of 2017 to \$9.3 million. Salaries and benefits costs were \$6.0 million in the second quarter of 2017, an increase of 5% from the first quarter and 10% from last year's second quarter. The increase in salaries and benefits costs reflects strategic personnel hires to support the Company's continued growth as well as an increase in incentive compensation.

Technology and communications expenses increased to \$0.8 million in the second quarter of 2017 from \$0.6 million in each of the first quarter of 2017 and second quarter of 2016 after the Company changed its online banking platform in the second quarter of 2017. This was partially offset by a decrease in professional services expenses that were incurred in connection with significant technology projects, including the conversion to a new core banking system in 2016. Professional services costs were \$0.6 million in each of the second quarter of 2017 and first quarter of 2017, compared with \$0.7 million in the second quarter of 2016.

FDIC insurance expense decreased to \$0.1 million in the second quarter of 2017 as the Company's assessment calculation benefited from the increased capital ratios resulting from its common stock equity raise in the first quarter of 2017. FDIC insurance expense was \$0.2 million in each of the first quarter of 2017 and second quarter of 2016.

The Company's efficiency ratio in the second quarter of 2017 was relatively flat when compared with the first quarter at 68.9%, but lower than last year's second quarter ratio of 76.3%. The reduction in the efficiency ratio reflects the Company's increased revenue while managing expense growth.

Income tax expense was \$0.9 million, or an effective tax rate of 24.8%, for the second quarter of 2017, compared with \$1.4 million, or 30.8%, in the first quarter of 2017 and \$0.5 million, or 18.3%, in last year's second quarter. The effective tax rate for each of the second quarters of 2017 and 2016 reflects the benefit of the previously noted tax credit investment transactions.

Other Results of Operations – Year-to-Date Comparison

Net interest income was \$19.8 million for the first six months of 2017, a \$3.0 million or 18% increase from the first six months of 2016. The increase in net interest income is attributable to a \$148 million or 16% increase in average interest-earning assets and a 6 basis point increase in net interest margin. The increase in average interest-earning assets reflects average loan growth of \$146 million or 19% to \$933 million during the first half of 2017. Most of the growth was in commercial loans, including \$85 million in average commercial real estate loans and \$41 million in average C&I loans.

The Company's net interest margin increased 6 basis points from 3.69% in the first six months of 2016 to 3.75% in the first six months of 2017. The yield on average interest-earning assets increased 6 basis points from 4.19% to 4.25%. Average loan yields increased 2 basis points from 4.50% to 4.52%. The increase in the yield on interest-earning assets was more than the increase in average loan yields due to a shift in the mix of interest-earning assets. Average loans were 88% of total average interest-earnings assets in the first six months of 2017, compared with 86% in the first six months of the prior year. Loans have earned higher yields than investment securities and short-term interest-earning cash in 2017 and 2016. The cost of interest-bearing liabilities was 0.66% for each of the six month periods ended June 30, 2017 and 2016. While the average savings deposit rate has fallen from 0.50% in the first six months of 2016 to 0.48% in the first six months of 2017, time deposit rates increased from 1.25% to 1.28% in the same periods, respectively. With the rise in short-term interest rates in 2017, competitive time deposit rates increased in the market and promotional pricing of time deposits resulted in a slight increase in the Company's overall time deposit portfolio rate.

The Company released under \$0.1 million in allowance for loan losses in the six-month period ended June 30, 2017, compared with a release of \$0.2 million in the first six months of 2016. The release in 2017 is attributable to a sustained period of low charge-offs impacting historical loss rates in the reserve calculation and net recoveries in 2017 of \$0.3 million.

Non-interest income for the first six months of 2017 increased \$1.3 million from the prior year period to \$6.6 million. The increase was predominantly a result of increased insurance service and fee revenue and a lower reduction of income related to historic tax credit transactions. Insurance service and fee revenue, the largest component of non-interest income, was \$4.1 million for the six-month period ended June 30, 2017, a 23% increase from \$3.3 million in the comparable period of the prior year. Several business lines contributed to the increase, including profit sharing, commercial lines property and casualty commissions, personal lines property and casualty commissions, claims services revenue, and employee benefits revenue.

Also contributing to the increase in total non-interest income for the first six months of 2017 was the impact of historic tax credit transactions. The net impact of historic tax credit investments on non-interest income in the first half of 2017 was a reduction in income of \$0.3 million, compared with a reduction in income of \$0.6 million in the comparable period in 2016. The tax benefit from

Table of Contents

the transactions in income tax expense was \$0.2 million in the first six months of 2017 and \$0.6 million in the first six months of 2016.

Total non-interest expense increased to \$18.4 million in the first six months of 2017, 7% higher than the six-month period ended June 30, 2016. The increase was mostly attributable to an increase in salaries and employee benefits costs. Salaries and employee benefits costs were \$11.7 million for the first six months of 2017, a \$0.7 million or 7% increase from \$11.0 million in the prior year period. The year-over-year increase in salary and benefits expense reflects annual merit increases, personnel hires to support the Company's growth strategy, and higher incentive compensation. Technology and communications expenses increased \$0.3 million to \$1.4 million, reflecting additional expense related to the Company's conversion to a new online banking platform in the second quarter of 2017.

The Company's efficiency ratio for the first six months of 2017 was 68.7%, compared with 76.0% during the prior-year period. The improvement in the ratio reflects the increase in net interest income and non-interest income, partially offset by the increase in non-interest expenses.

An income tax expense of \$2.3 million was recorded for the six-month period ended June 30, 2017, compared with \$1.3 million in the first six months of 2016. The difference reflected the increase in taxable income in 2017 as well as the impact of historic tax credits. A benefit of \$0.2 million was recorded in the first six months of 2017, compared with \$0.6 million in the comparative period in 2016. The effective tax rate for the first six months of 2017 was 28.1%, compared with 25.2% in the comparable 2016 period. Excluding the impact of the historic tax credit and the write-off of the tax credit investment recognized in non-interest income, the current year-to-date effective tax rate was 30.1%, compared with 32.4% excluding the historic tax credit in the first six months of 2016. The lower rate reflects the fact that the six-month period ended June 30, 2017 has benefited from discreet tax deductions related to stock compensation.

CAPITAL

The Company consistently maintains regulatory capital ratios significantly above the federal "well capitalized" standard, including a Tier 1 leverage ratio of 10.57% at June 30, 2017, compared with 10.76% at March 31, 2017 and 9.49% at December 31, 2016. The increase from the end of 2016 reflects the impact of the Company's registered common stock offering in January 2017 which netted \$14 million in additional capital after expenses. The Company issued 440,000 shares of common stock at \$35.00 per share (including shares issued upon partial exercise of the underwriters' allotment option in connection with the offering). The offering was accretive to book value per share. Book value per share increased to \$24.21 at June 30, 2017, compared with \$23.64 at March 31, 2017, and \$22.50 at December 31, 2016.

On February 21, 2017, the Company declared a cash dividend of \$0.40 per share on the Company's outstanding common stock. The dividend was paid on April 4, 2017 to shareholders of record as of March 14, 2017. This semi-annual dividend represented a \$0.02, or 5%, increase from the previous semi-annual dividend paid on October 4, 2016.

LIQUIDITY

The Bank utilizes cash flows from the investment portfolio and federal funds sold balances to manage the liquidity requirements related to loan demand and deposit fluctuations. The Bank also has many borrowing options. The Company uses the Federal Home Loan Bank of New York ("FHLBNY") as its primary source of overnight funds and also has one long-term advance with FHLBNY. The Company had \$15 million in borrowed funds at FHLBNY at June 30, 2017, compared with \$10 million and \$28 million at March 31, 2017 and December 31, 2016, respectively. The Company has pledged sufficient collateral in the form of residential and commercial real estate loans at FHLBNY that meets FHLB collateral requirements. As a member of the FHLB, the Bank is able to borrow funds at competitive rates. Advances of up to \$185 million can be drawn on the FHLB via an Overnight Line of Credit Agreement between the Bank and the FHLB. An amount equal to 25% of the Bank's total assets could be borrowed through the advance programs under certain qualifying circumstances. The Bank also has the ability to purchase up to \$18 million in federal funds from its correspondent banks. By placing sufficient collateral in safekeeping at the Federal Reserve Bank, the Bank could borrow at the discount window. The Bank's liquidity needs also can be met by more aggressively pursuing time deposits, or accessing the brokered time deposit market, including the Certificate of Deposit Account Registry Service ("CDARS") network.

Cash flows from the Bank's investment portfolio are laddered, so that securities mature at regular intervals, to provide funds from principal and interest payments at various times as liquidity needs may arise. Contractual maturities are also laddered, with consideration as to the volatility of market prices. At June 30, 2017, approximately 3% of the Bank's securities had contractual maturity dates of one year or less and approximately 23% had maturity dates of five years or less. Additionally, mortgage-backed securities, which comprise 57% of the investment portfolio at June 30, 2017, provide consistent cash flows for the Bank.

Table of Contents

The Company's primary source of liquidity is dividends from the Bank. Additionally, the Company has access to capital markets as a funding source.

Management, on an ongoing basis, closely monitors the Company's liquidity position for compliance with internal policies and believes that available sources of liquidity are adequate to meet funding needs in the normal course of business. As part of that monitoring process, management calculates the 90-day liquidity each month by analyzing the cash needs of the Bank. Included in the calculation are liquid assets and potential liabilities. Management stresses the potential liabilities calculation to ensure a strong liquidity position. Included in the calculation are assumptions of some significant deposit run-off as well as funds needed for loan closings and investment purchases. In the Company's internal stress test at June 30, 2017, the Company had net short-term liquidity of \$199 million as compared with \$248 million at December 31, 2016. Available assets of \$138 million, divided by public and purchased funds of \$214 million, resulted in a long-term liquidity ratio of 64% at June 30, 2017, compared with 58% at December 31, 2016.

Management does not anticipate engaging in any activities, either currently or in the long term, for which adequate funding would not be available and which would therefore result in significant pressure on liquidity.

The Company believes that the Bank maintains a sufficient level of U.S. government and government agency securities and New York State municipal bonds that can be pledged as collateral for municipal deposits.

ITEM 3 - QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Additional information responsive to this Item is contained in the Liquidity section of Management's Discussion and Analysis of Financial Condition and Results of Operations, which information is incorporated herein by reference.

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

modeling technique described above with analysis of market values of the Bank's financial instruments and changes to such market values given changes in the interest rates.

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

Table of Contents

The following table demonstrates the possible impact of changes in interest rates on the Bank's net interest income over a 12-month period of time:

SENSITIVITY OF NET INTEREST INCOME TO CHANGES IN INTEREST RATES

| Changes in interest rates | Calculated increase in projected annual net interest income (in thousands) | |
|---------------------------|--|-------------------|
| | June 30, 2017 | December 31, 2016 |
| +200 basis points | \$ 1,236 | \$ 1,838 |
| +100 basis points | 2,368 | 2,590 |
| -100 basis points | (3,004) | NM |
| -200 basis points | NM | NM |

Many assumptions were utilized by management to calculate the impact that changes in interest rates may have on the Bank's net interest income. The more significant assumptions related to the rate of prepayments of mortgage-related assets, loan and deposit volumes and pricing, and deposit maturities. The Bank assumed immediate changes in rates including 200 basis point rate changes. In each of the 100 and 200 basis point rate reduction scenarios, the applicable rate changes may be limited to lesser amounts such that interest rates are not less than zero. The Company included the 100 basis point reduction scenario results in the preceding table in the second quarter of 2017 as this scenario offers more meaningful results now that the Federal Reserve has increased the federal funds rate 75 basis points since December 2016. The projected negative impact to net interest income in this scenario reflects the Company's asset sensitive position on its balance sheet. The assumptions in the Company's projections are inherently uncertain and, as a result, the Bank cannot precisely predict the impact of changes in interest rates on net interest income. Actual results may differ significantly due to the timing, magnitude, and frequency of interest rate changes in market conditions and interest rate differentials (spreads) between maturity/repricing categories, as well as any actions such as those previously described, which management may take to counter such changes. In light of the uncertainties and assumptions associated with the process, the amounts presented in the table and changes in such amounts are not considered significant to the Bank's projected net interest income.

ITEM 4 - CONTROLS AND PROCEDURES

DISCLOSURE CONTROLS AND PROCEDURES

The Company's management, with the participation of the Company's principal executive officer and principal financial officer, evaluated the effectiveness of the design and operation of the Company's disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act) as of June 30, 2017 (the end of the period covered by this Report). Based on that evaluation, the Company's principal executive and principal financial officers concluded that as of June 30, 2017 the Company's disclosure controls and procedures were effective.

CHANGES IN INTERNAL CONTROL OVER FINANCIAL REPORTING

No changes in the Company's internal control over financial reporting were identified in connection with the evaluation required by paragraph (d) of Rule 13a-15 or Rule 15d-15 under the Exchange Act that occurred during the fiscal quarter ended June 30, 2017 that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

Table of Contents

PART II - OTHER INFORMATION

ITEM 1 – LEGAL PROCEEDINGS

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

In the opinion of management, there are no 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 2 – UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

In the second quarter of 2017, the Company purchased shares of its common stock as follows:

Issuer Purchases of Equity Securities

| Period | Total Number of Shares Purchased (1) | Average Price Paid per Share | Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs (2) | Maximum Number of Shares that may yet be Purchased Under the Plans or Programs |
|-----------------------------------|--|---------------------------------------|--|--|
| April 2017: | | | | |
| April 1, 2017 - April 30, 2017 | - | \$ - | - | 15,212 |
| May 2017: | | | | |
| May 1, 2017 - May 31, 2017 | 10,424 | \$ 37.21 | 9,218 | 5,994 |
| June 2017: | | | | |
| June 1, 2017 - June 30, 2017 | - | \$ - | - | 5,994 |

Table of Contents

SIGNATURES

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

Evans Bancorp, Inc.

DATE

August 3, 2017

/s/ David J. Nasca
David J. Nasca
President and CEO
(Principal Executive Officer)

DATE

August 3, 2017

/s/ John B. Connerton
John B. Connerton
Treasurer
(Principal Financial Officer)

49

Table of Contents

EXHIBIT INDEX

Exhibit

| No. | Name |
|------|--|
| 31.1 | Certification of Principal Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002. |
| 31.2 | Certification of the Principal Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002. |
| 32.1 | Certification of Principal Executive Officer pursuant to 18 USC Section 1350 Chapter 63 of Title 18, United States Code, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. |
| 32.2 | Certification of Principal Financial Officer pursuant to 18 USC Section 1350 Chapter 63 of Title 18, United States Code, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. |
| 101 | The following materials from Evans Bancorp, Inc.'s Quarterly Report on Form 10-Q for the quarter ended June 30, 2017, formatted in XBRL (eXtensible Business Reporting Language): (i) Unaudited Consolidated Balance Sheets – June 30, 2017 and December 31, 2016; (ii) Unaudited Consolidated Statements of Income – Three months ended June 30, 2017 and 2016; (iii) Unaudited Consolidated Statements of Income – Six months ended June 30, 2017 and 2016; (iv) Unaudited Statements of Consolidated Comprehensive Income – Three months ended June 30, 2017 and 2016; (v) Unaudited Statements of Consolidated Comprehensive Income – Six months ended June 30, 2017 and 2016; (vi) Unaudited Consolidated Statements of Stockholders' Equity – Six months ended June 30, 2017 and 2016; (vii) Unaudited Consolidated Statements of Cash Flows – Six months ended June 30, 2017 and 2016; and (viii) Notes to Unaudited Consolidated Financial Statements. |