CHEMUNG FINANCIAL CORP
Form 10-Q
November 01, 2017

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

FORM 10-Q

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

For Quarterly period ended September 30, 2017
Or

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

Commission File No.
000-13888
CHEMUNG FINANCIAL CORPORATION
(Exact name of registrant as specified in its charter)

New York	16-1237038
(State or other jurisdiction of incorporation or organization)	I.R.S. Employer Identification No.
One Chemung Canal Plaza, Elmira, NY	14901
(Address of principal executive offices)	(Zip Code)

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

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

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

Large accelerated filer	[ ]	Non-accelerated filer	[ ]
Accelerated filer	[X]	Smaller reporting company	[ ]
		Emerging growth company	[ ]

If an emerging growth company, indicate by check mark 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. [ ]

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act):
YES: NO: X

The number of shares of the registrant's common stock, $.01 par value, outstanding on October 31, 2017 was 4,740,401.

CHEMUNG FINANCIAL CORPORATION AND SUBSIDIARIES

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GLOSSARY OF ABBREVIATIONS AND TERMS

To assist the reader the Corporation has provided the following list of commonly used abbreviations and terms included in the Notes to the Unaudited Consolidated Financial Statements and Management's Discussion and Analysis of Financial Condition and Results of Operations.

Abbreviations	
ALCO	Asset-Liability Committee
ASU	Accounting Standards Update
Bank	Chemung Canal Trust Company
Basel III	The Third Basel Accord of the Basel Committee on Banking Supervision
Board of Directors	Board of Directors of Chemung Financial Corporation
CDARS	Certificate of Deposit Account Registry Service
CDO	Collateralized Debt Obligation
CECL	Current expected credit loss
CFS	CFS Group, Inc.
Corporation	Chemung Financial Corporation
CRM	Chemung Risk Management, Inc.
Dodd-Frank Act	The Dodd-Frank Wall Street Reform and Consumer Protection Act
EPS	Earnings per share
Exchange Act	Securities Exchange Act of 1934
FASB	Financial Accounting Standards Board
FDIC	Federal Deposit Insurance Corporation
FHLBNY	Federal Home Loan Bank of New York
FRB	Board of Governors of the Federal Reserve System
FRBNY	Federal Reserve Bank of New York
Freddie Mac	Federal Home Loan Mortgage Corporation
GAAP	U.S. Generally Accepted Accounting Principles
ICS	Insured Cash Sweep Service
IFRS	International Financial Reporting Standards
MD&A	Management's Discussion and Analysis of Financial Condition and Results of Operations
NAICS	North American Industry Classification System
N/M	Not meaningful
OPEB	Other postemployment benefits
OREO	Other real estate owned
OTTI	Other-than-temporary impairment
PCI	Purchased credit impaired
ROA	Return on average assets
ROE	Return on average equity
RWA	Risk-weighted assets
SBA	Small Business Administration
SEC	Securities and Exchange Commission
Securities Act	Securities Act of 1933
TDRs	Troubled debt restructurings
WMG	Wealth Management Group

Terms	
Allowance for loan losses to total loans	Represents period-end allowance for loan losses divided by retained loans.

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Assets under administration	Represents assets that are beneficially owned by clients and all investment decisions pertaining to these assets are also made by clients.
Assets under management	Represents assets that are managed on behalf of clients.
Basel III	A comprehensive set of reform measures designed to improve the regulation, supervision, and risk management within the banking sector. The reforms require banks to maintain proper leverage ratios and meet certain capital requirements.
Benefit obligation	Refers to the projected benefit obligation for pension plans and the accumulated postretirement benefit obligation for OPEB plans.
Capital Bank	Division of Chemung Canal Trust Company located in the “Capital Region” of New York State and includes the counties of Albany and Saratoga.
CDARS	Product involving a network of financial institutions that exchange certificates of deposits among members in order to ensure FDIC insurance coverage on customer deposits above the single institution limit. Using a sophisticated matching system, funds are exchanged on a dollar-for-dollar basis, so that the equivalent of an original deposit comes back to the originating institution.
Captive insurance company	A company that provides risk-mitigation services for its parent company.
Collateralized debt obligation	A structured financial product that pools together cash flow-generating assets, such as mortgages, bonds, and loans.
Collateralized mortgage obligations	A type of mortgage-backed security with principal repayments organized according to their maturities and into different classes based on risk. The mortgages serve as collateral and are organized into classes based on their risk profile.
Dodd-Frank Act	The Dodd-Frank Act was enacted on July 21, 2010 and significantly changed the bank regulatory landscape and has impacted and will continue to impact the lending, deposit, investment, trading and operating activities of financial institutions and their holding companies. The Dodd-Frank Act requires various federal agencies to adopt a broad range of new rules and regulations, and to prepare various studies and reports for Congress.
Fully taxable equivalent basis	Income from tax-exempt loans and investment securities that have been increased by an amount equivalent to the taxes that would have been paid if this income were taxable at statutory rates; the corresponding income tax impact related to tax-exempt items is recorded within income tax expense.
GAAP	Accounting principles generally accepted in the United States of America.
Holding company	Consists of the operations for Chemung Financial Corporation (parent only).
ICS	Product involving a network of financial institutions that exchange interest-bearing money market deposits among members in order to ensure FDIC insurance coverage on customer deposits above the single institution limit. Using a sophisticated matching system, funds are exchanged on a dollar-for-dollar basis, so that the equivalent of an original deposit comes back to the originating institution.
Loans held for sale	Residential real estate loans originated for sale on the secondary market with maturities from 15-30 years.
Long term lease obligation	An obligation extending beyond the current year, which is related to a long term capital lease that is considered to have the economic characteristics of asset ownership.
Mortgage-backed securities	A type of asset-backed security that is secured by a collection of mortgages.
Municipal clients	A political unit, such as a city, town, or village, incorporated for local self-government.
N/A	Data is not applicable or available for the period presented.
N/M	Not meaningful.
Non-GAAP	A calculation not made according to GAAP.

Obligations of state and political subdivisions	An obligation that is guaranteed by the full faith and credit of a state or political subdivision that has the power to tax.
Obligations of U.S. Government	A federally guaranteed obligation backed by the full power of the U.S. government, including Treasury bills, Treasury notes and Treasury bonds.
Obligations of U.S. Government sponsored enterprise obligations	Obligations of agencies originally established or chartered by the U.S. government to serve public purposes as specified by the U.S. Congress; these obligations are not explicitly guaranteed as to the timely payment of principal and interest by the full faith and credit of the U.S. government.

OREO	Represents real property owned by the Corporation, which is not directly related to its business and is most frequently the result of a foreclosure on real property.
OTTI	Impairment charge taken on a security whose fair value has fallen below the carrying value on the balance sheet and whose value is not expected to recover through the holding period of the security.
PCI loans	Represents loans that were acquired in the Fort Orange Financial Corp. transaction and deemed to be credit-impaired on the acquisition date in accordance with the guidance of FASB.
Political subdivision	A county, city, town, or other municipal corporation, a public authority, or a publicly-owned entity that is an instrumentality of a state or a municipal corporation.
Pre-provision profit/(loss)	Represents total net revenue less noninterest expense, before income tax expense (benefit). The Corporation believes that this financial measure is useful in assessing the ability of a bank to generate income in excess of its provision for credit losses.
RWA	Risk-weighted assets consist of on- and off-balance sheet assets that are assigned to one of several broad risk categories and weighted by factors representing their risk and potential for default. On-balance sheet assets are risk-weighted based on the perceived credit risk associated with the obligor or counterparty, the nature of any collateral, and the guarantor, if any. Off-balance sheet assets such as lending-related commitments, guarantees, derivatives and other applicable off-balance sheet positions are risk-weighted by multiplying the contractual amount by the appropriate credit conversion factor to determine the on-balance sheet credit equivalent amount, which is then risk-weighted based on the same factors used for on-balance sheet assets. Risk-weighted assets also incorporate a measure for market risk related to applicable trading assets-debt and equity instruments. The resulting risk-weighted values for each of the risk categories are then aggregated to determine total risk-weighted assets.
SBA loan pools	Business loans partially guaranteed by the SBA.
Securities sold under agreements to repurchase	Sale of securities together with an agreement for the seller to buy back the securities at a later date.
TDR	A TDR is deemed to occur when the Corporation modifies the original terms of a loan agreement by granting a concession to a borrower that is experiencing financial difficulty.
Trust preferred securities	A hybrid security with characteristics of both subordinated debt and preferred stock which allows for early redemption by the issuer, makes fixed or variable payments, and matures at face value.
Unaudited	Financial statements and information that have not been subjected to auditing procedures sufficient to permit an independent certified public accountant to express an opinion.
WMG	Provides services as executor and trustee under wills and agreements, and guardian, custodian, trustee and agent for pension, profit-sharing and other employee benefit trusts, as well as various investment, financial planning, pension, estate planning and employee benefit administration services.

CHEMUNG FINANCIAL CORPORATION AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
(UNAUDITED)

(in thousands, except share and per share data)	September 30, 2017	December 31, 2016
ASSETS		
Cash and due from financial institutions	$ 34,572	$ 28,205
Interest-bearing deposits in other financial institutions	21,806	45,957
Total cash and cash equivalents	56,378	74,162
Trading assets, at fair value	909	774
Securities available for sale, at estimated fair value	312,226	303,402
Securities held to maturity, estimated fair value of $3,861 at September 30, 2017 and $4,912 at December 31, 2016	3,865	4,705
FHLBNY and FRBNY Stock, at cost	3,497	4,041
Loans, net of deferred loan fees	1,288,813	1,200,290
Allowance for loan losses	(15,694)	(14,253)
Loans, net	1,273,119	1,186,037
Loans held for sale	1,246	412
Premises and equipment, net	27,366	28,923
Goodwill	21,824	21,824
Other intangible assets, net	2,292	2,945
Bank-owned life insurance	2,964	2,912
Accrued interest receivable and other assets	25,996	27,042
Total assets	$ 1,731,682	$ 1,657,179
LIABILITIES AND SHAREHOLDERS' EQUITY		
Deposits:		
Non-interest-bearing	$ 449,841	$ 417,812
Interest-bearing	1,087,177	1,038,531
Total deposits	1,537,018	1,456,343
Securities sold under agreements to repurchase	10,000	27,606
FHLBNY term advances	9,009	9,093
Long term capital lease obligation	4,568	4,722
Dividends payable	1,232	1,225
Accrued interest payable and other liabilities	15,578	14,442
Total liabilities	1,577,405	1,513,431
Shareholders' equity:		
Common stock, $0.01 par value per share, 10,000,000 shares authorized; 5,310,076 issued at September 30, 2017 and December 31, 2016	53	53
Additional paid-in capital	46,089	45,603
Retained earnings	130,006	124,111

Treasury stock, at cost; 571,115 shares at September 30, 2017 and 597,843 shares at December 31, 2016	(14,596)	(15,265)
Accumulated other comprehensive loss	(7,275)	(10,754)
Total shareholders' equity	154,277	143,748
Total liabilities and shareholders' equity	$ 1,731,682	$ 1,657,179

See accompanying notes to unaudited consolidated financial statements.

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
(in thousands, except per share data)	2017	2016	2017	2016
Interest and dividend income:				
Loans, including fees	$13,709	$12,487	$39,025	$37,054
Taxable securities	1,369	1,225	4,189	3,943
Tax exempt securities	322	228	836	722
Interest-bearing deposits	97	85	445	180
Total interest and dividend income	15,497	14,025	44,495	41,899
Interest expense:				
Deposits	545	561	1,632	1,607
Securities sold under agreements to repurchase	95	214	383	636
Borrowed funds	94	210	273	623
Total interest expense	734	985	2,288	2,866
Net interest income	14,763	13,040	42,207	39,033
Provision for loan losses	1,289	1,050	2,750	2,033
Net interest income after provision for loan losses	13,474	11,990	39,457	37,000
Non-interest income:				
WMG fee income	2,147	2,027	6,525	6,240
Service charges on deposit accounts	1,269	1,361	3,678	3,781
Interchange revenue from debit card transactions	925	1,203	2,809	3,035
Net gains on securities transactions	—	75	12	983
Net gains on sales of loans held for sale	71	115	193	273
Net gains (losses) on sales of other real estate owned	30	10	38	(6)
Income from bank-owned life insurance	17	19	52	55
Other	707	625	1,728	1,891
Total non-interest income	5,166	5,435	15,035	16,252
Non-interest expenses:				
Salaries and wages	5,480	5,355	16,177	15,720
Pension and other employee benefits	992	1,573	3,417	4,894
Net occupancy expenses	1,476	1,503	4,784	5,287
Furniture and equipment expenses	657	685	2,119	2,286
Data processing expense	1,667	1,624	4,858	5,058
Professional services	452	502	1,169	1,418
Legal accruals and settlements	—	—	850	1,200
Amortization of intangible assets	214	245	653	748
Marketing and advertising expenses	213	101	580	648
Other real estate owned expenses	4	41	35	150
FDIC insurance	312	324	946	895
Loan expense	165	162	447	462
Other	1,644	1,356	4,618	4,283
Total non-interest expenses	13,276	13,471	40,653	43,049
Income before income tax expense	5,364	3,954	13,839	10,203

Income tax expense	1,710	1,209	4,250	3,130
Net income	$3,654	$2,745	9,589	$7,073
Weighted average shares outstanding	4,802	4,765	4,796	4,758
Basic and diluted earnings per share	$0.76	$0.58	$2.00	$1.49

See accompanying notes to unaudited consolidated financial statements.
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CHEMUNG FINANCIAL CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
(UNAUDITED)

	Three Months Ended September 30,		Nine Months Ended September 30,	
(in thousands)	2017	2016	2017	2016
Net income	$3,654	$2,745	$9,589	$7,073
Other comprehensive income (loss):				
Unrealized holding gains (losses) on securities available for sale	(522)	(733)	5,498	4,899
Reclassification adjustment for gains realized in net income	—	(75)	(12)	(983)
Net unrealized gains (losses)	(522)	(808)	5,486	3,916
Tax effect	(198)	(305)	2,069	1,477
Net of tax amount	(324)	(503)	3,417	2,439
Change in funded status of defined benefit pension plan and other benefit plans:				
Reclassification adjustment for amortization of prior service costs	(55)	(22)	(165)	(67)
Reclassification adjustment for amortization of net actuarial loss	88	396	264	1,188
Total before tax effect	33	374	99	1,121
Tax effect	12	141	37	423
Net of tax amount	21	233	62	698
Total other comprehensive income (loss)	(303)	(270)	3,479	3,137
Comprehensive income	$3,351	$2,475	$13,068	$10,210

See accompanying notes to unaudited consolidated financial statements.

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

(in thousands, except share and per share data)	Common Stock	Additional Paid-in Capital	Retained Earnings	Treasury Stock	Accumulated Other Comprehensive Loss	Total
Balances at January 1, 2016	$ 53	$ 45,537	$ 118,973	$ (16,379)	$ (10,942)	$ 137,242
Net income	—	—	7,073	—	—	7,073
Other comprehensive income	—	—	—	—	3,137	3,137
Restricted stock awards	—	145	—	—	—	145
Restricted stock units for directors' deferred compensation plan	—	72	—	—	—	72
Cash dividends declared ($0.78 per share)	—	—	(3,664)	—	—	(3,664)
Distribution of 9,532 shares of treasury stock for directors' compensation	—	19	—	243	—	262
Distribution of 7,661 shares of treasury stock for employee compensation	—	15	—	195	—	210
Distribution of 3,740 shares of treasury stock for deferred directors’ compensation	—	(92)	—	95	—	3
Sale of 11,857 shares of treasury stock (a)	—	28	—	304	—	332
Balances at September 30, 2016	$ 53	$ 45,724	$ 122,382	$ (15,542)	$ (7,805)	$ 144,812
Balances at January 1, 2017	$ 53	$ 45,603	$ 124,111	$ (15,265)	$ (10,754)	$ 143,748
Net income	—	—	9,589	—	—	9,589
Other comprehensive income	—	—	—	—	3,479	3,479
Restricted stock awards	—	162	—	—	—	162
Restricted stock units for directors' deferred compensation plan	—	72	—	—	—	72
Cash dividends declared ($0.78 per share)	—	—	(3,694)	—	—	(3,694)
Distribution of 7,880 shares of treasury stock for directors' compensation	—	68	—	201	—	269
Distribution of 5,861 shares of treasury stock for employee compensation	—	50	—	150	—	200
Distribution of 2,438 shares of treasury stock for deferred directors’ compensation	—	(51)	—	62	—	11
Sale of 11,688 shares of treasury stock (a)	—	142	—	299	—	441
Forfeiture of 1,139 shares of restricted stock awards	—	43	—	(43)	—	—
Balances at September 30, 2017	$ 53	$ 46,089	$ 130,006	$ (14,596)	$ (7,275)	$ 154,277

(a) All treasury stock sales were completed at the prevailing market price with the Chemung Canal Trust Company Profit Sharing, Savings, and Investment Plan which is a defined contribution plan sponsored by the Bank.

See accompanying notes to unaudited consolidated financial statements.

CHEMUNG FINANCIAL CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
(UNAUDITED)

(in thousands)	Nine Months Ended September 30,	
CASH FLOWS FROM OPERATING ACTIVITIES:	2017	2016
Net income	$9,589	$7,073
Adjustments to reconcile net income to net cash provided by operating activities:		
Amortization of intangible assets	653	748
Provision for loan losses	2,750	2,033
Net losses on disposal of fixed assets	15	—
Depreciation and amortization of fixed assets	2,820	3,285
Amortization of premiums on securities, net	1,098	1,365
Gains on sales of loans held for sale, net	(193)	(273)
Proceeds from sales of loans held for sale	9,655	12,854
Loans originated and held for sale	(10,296)	(11,624)
Net gains on trading assets	(96)	(53)
Proceeds from sales of trading assets	20	99
Net gains on securities transactions	(12)	(983)
Net (gains) losses on sales of other real estate owned	(38)	6
Purchase of trading assets	(59)	(65)
Expense related to restricted stock units for directors' deferred compensation plan	72	72
Expense related to employee stock compensation	200	210
Expense related to employee restricted stock awards	162	145
Income from bank-owned life insurance	(52)	(55)
Decrease in other assets and accrued interest receivable	888	2,250
Decrease in accrued interest payable	(26)	(8)
Increase (decrease) in other liabilities	(565)	2,702
Net cash provided by operating activities	16,585	19,781
CASH FLOWS FROM INVESTING ACTIVITIES:		
Proceeds from sales and calls of securities available for sale	1,620	36,130
Proceeds from maturities and principal collected on securities available for sale	35,262	56,661
Proceeds from maturities and principal collected on securities held to maturity	2,807	2,797
Purchases of securities available for sale	(41,306)	(47,696)
Purchases of securities held to maturity	(1,967)	(2,735)
Purchase of FHLBNY and FRBNY stock	(1,708)	(5,458)
Redemption of FHLBNY and FRBNY stock	2,252	5,764
Proceeds from sale of equipment	16	—
Purchases of premises and equipment	(1,294)	(937)
Proceeds from sales of other real estate owned	383	1,499
Net increase in loans	(90,019)	(49,243)
Net cash (used in) provided by investing activities	(93,954)	(3,218)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Net increase in demand deposits, interest-bearing demand accounts, savings accounts, and insured money market accounts	98,599	126,309
Net decrease in time deposits	(17,924)	(17,660)
Net increase (decrease) in securities sold under agreements to repurchase	(17,606)	1,549

Net change in FHLBNY overnight advances, net	—	(13,900)
Repayments of FHLBNY long term advances	(84)	(82)
Payments made on capital leases	(154)	(136)
Sale of treasury stock	441	332
Cash dividends paid	(3,687)	(3,656)
Net cash provided by financing activities	59,585	92,756
Net increase (decrease) in cash and cash equivalents	(17,784)	109,319
Cash and cash equivalents, beginning of period	74,162	26,185
Cash and cash equivalents, end of period	$56,378	$135,504

(continued)

See accompanying notes to unaudited consolidated financial statements.

CHEMUNG FINANCIAL CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS, CONTINUED
(UNAUDITED)

(in thousands)	Nine Months Ended September 30,	
Supplemental disclosure of cash flow information:	2017	2016
Cash paid for:		
Interest	$2,314	$2,874
Income taxes	$4,050	$2,680
Supplemental disclosure of non-cash activity:		
Transfer of loans to other real estate owned	$187	$342
Dividends declared, not yet paid	$1,232	$1,222
Distribution of treasury stock for directors' compensation	$269	$262
Distribution of treasury stock for deferred directors' compensation	$11	$3
Assets acquired through long term capital lease obligations	$—	$2,035

See accompanying notes to unaudited consolidated financial statements.

CHEMUNG FINANCIAL CORPORATION AND SUBSIDIARIES
NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Organization

The Corporation, through its wholly-owned subsidiaries, the Bank and CFS, provides a wide range of banking, financing, fiduciary and other financial services to its clients. The Corporation and the Bank are subject to the regulations of certain federal and state agencies and undergo periodic examinations by those regulatory authorities.

CRM, a wholly-owned subsidiary of the Corporation, which was formed and began operations on May 31, 2016, is a Nevada-based captive insurance company which insures against certain risks unique to the operations of the Corporation and its subsidiaries and for which insurance may not be currently available or economically feasible in today's insurance marketplace. CRM pools resources with several other similar insurance company subsidiaries of financial institutions to spread a limited amount of risk among themselves. CRM is subject to regulations of the State of Nevada and undergoes periodic examinations by the Nevada Division of Insurance.

Basis of Presentation

The accompanying unaudited consolidated financial statements have been prepared in conformity with GAAP for interim financial information and pursuant to the requirements for reporting on Form 10-Q and Article 10 of Regulation S-X of the Exchange Act. These financial statements include the accounts of the Corporation and its subsidiaries, and all significant intercompany balances and transactions are eliminated in consolidation. Amounts in the prior periods' consolidated financial statements are reclassified whenever necessary to conform to the current period's presentation.

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions based on available information. These estimates and assumptions affect the amounts reported in the financial statements and disclosures provided, and actual results could differ. In the opinion of management, all adjustments (consisting of normal recurring adjustments) and disclosures necessary for the fair presentation of the accompanying consolidated financial statements have been included. The unconsolidated financial statements should be read in conjunction with the Corporation's 2016 Annual Report on Form 10-K for the year ended December 31, 2016. The results of operations for any interim periods are not necessarily indicative of the results which may be expected for the entire year.

Recent Accounting Pronouncements

In May 2014, the FASB issued ASU 2014-09, an amendment to Revenue from Contracts with Customers (Topic 606). The objective of this amendment is to clarify the principles for recognizing revenue and to develop a common revenue standard for U.S. GAAP and IFRS. This update affects any entity that either enters into contracts with customers to transfer goods or services or enters into contracts for the transfer of non-financial assets unless those contracts are in the scope of other standards. In August 2015, the FASB issued ASU 2015-14 to defer for one year the effective date of the new revenue standard. The requirements are effective for annual periods and interim periods within fiscal years beginning after December 15, 2017. During 2016, the FASB issued further implementation guidance regarding revenue recognition. This additional guidance included clarification on certain principal versus agent considerations within the implementation of the guidance as well as clarification related to identifying performance obligations and licensing, assessing collectability, presenting sales taxes, measuring non-cash consideration, and certain transition matters. The Corporation intends to adopt the new revenue guidance as of January 1, 2018 and does not expect a significant change upon adoption of the standard, as the new standard will not materially change the way the Corporation currently records revenue for its WMG and fee income from mortgage servicing fees, financial guarantees, and deposit related fees.

In January 2016, the FASB issued ASU 2016-01, an amendment to Recognition and Measurement of Financial Assets and Financial Liabilities (Subtopic 825-10). The objectives of the ASU are to (1) require equity investments to be measured at fair value, with changes in fair value recognized in net income, (2) simplify the impairment assessment of equity investments without readily determinable fair values, (3) eliminate the requirement to disclose methods and significant assumptions used to estimate fair value for financial instruments measured at amortized cost on the balance sheet, (4) require the use of the exit price notion when measuring the fair value of financial instruments, and (5) clarify the need for a valuation allowance on a deferred tax asset related to available-for-sale securities in combination with the entity's other deferred tax assets. The amendments in this ASU are effective for public business entities for annual periods, and interim periods within those annual periods, beginning after December 15, 2017. The Corporation intends to adopt the new guidance as of January 1, 2018 and believes the ASU will not have a material impact on its consolidated financial statements, as the Corporation's equity investment portfolio is less than $1.0 million as of September 30, 2017.

In February 2016, the FASB issued ASU 2016-02, Leases (Topic 842). ASU 2016-02 requires companies that lease valuable assets to recognize on their balance sheets the assets and liabilities generated by contracts longer than a year. The amendments in this update are effective for annual periods, and interim periods within those annual periods, beginning after December 15, 2018, though early adoption is permitted. The Corporation intends to adopt the new lease guidance as of January 1, 2019 and is currently evaluating the impact that adoption of these updates will have on its consolidated financial statements. Currently, the Corporation believes the implementation of this ASU will create a right of use asset of less than $8.0 million for the Corporation's 15 leased facilities and a related capital obligation of the same amount as of January 1, 2019.

In March 2016, the FASB issued ASU 2016-09, Compensation - Stock Compensation (Topic 718): Improvements to Employee Share-Based Payment Accounting. The objectives of the ASU are to simplify accounting for a stock payment's tax consequences and amend how excess tax benefits and a business's payments to cover the tax bills for the shares' recipients should be classified. The amendments allow companies to estimate the number of stock awards they expect to vest, and they revise the withholding requirements for classifying stock awards as equity. The amendments in this ASU became effective for public companies for fiscal years beginning after December 15, 2016, though early adoption was permitted. The adoption of ASU 2016-09 did not have a significant impact on the Corporation's consolidated financial statements.

In June 2016, the FASB issued ASU 2016-13, Financial Instruments - Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments. The objective of the ASU 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 by replacing 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 form credit loss estimates. The amendments in this ASU are effective for public companies for fiscal years beginning after December 15, 2019, though entities may adopt the amendments earlier for fiscal year beginning after December 15, 2018. The Corporation is currently evaluating the impact of the adoption of this guidance on its consolidated financial statements. The Corporation anticipates that the adoption of the CECL model will result in an increase to the Corporation's allowance for loan losses. The Corporation has established a committee to oversee the implementation of CECL. This committee is currently assessing the data and system requirements necessary for adoption. The Corporation plans to run its current incurred loss model and a CECL model concurrently for 12 months prior to the adoption of this guidance on January 1, 2020.

In August 2016, the FASB issued ASU 2016-15, Statement of Cash Flows (Topic 230): Classification of Certain Cash Receipts and Cash Payments. The objective of the ASU is to reduce the existing diversity in practice relating to eight specific cash flow issues: (1) debt prepayment or debt extinguishment costs, (2) settlement of zero-coupon debt instruments or other debt instruments with coupon interest rates that are insignificant in relation to the effective interest rate of the borrowing, (3) contingent consideration payments made after a business combination, (4) proceeds from the settlement of insurance claims, (5) proceeds from the settlement of corporate-owned life insurance policies, including bank-owned life insurance policies, (6) distributions received from equity method investees, (7) beneficial interests in securitization transactions, and (8) separately identifiable cash flows and application of the predominance principal. The amendments in this ASU are effective for public companies for fiscal years beginning after December 15, 2017 and interim periods within those fiscal years, though early adoption is permitted. The adoption of the ASU is not expected to have a significant impact on the Corporation's consolidated financial statements.

In January 2017, the FASB issued ASU 2017-04, Intangibles - Goodwill and Other (Topic 350): Simplifying the Test for Goodwill Impairment. The objective of the ASU is to simplify the manner in which an entity is required to test goodwill for impairment by eliminating Step 2 from the goodwill impairment test. Additionally, the ASU removes the requirement for any reporting unit with a zero or negative carrying amount to perform a qualitative assessment and, if it fails such qualitative test, to perform Step 2 of the goodwill impairment test. The amendments in this ASU are effective for annual, or any interim, goodwill impairment tests in fiscal years beginning after December 15, 2019. The adoption of the ASU is not expected to have a significant impact on the Corporation's consolidated financial statements.

In March 2017, the FASB issued ASU 2017-07, Compensation - Retirement Benefits (Topic 715) - Improving the Presentation of Net Periodic Cost and Net Periodic Postretirement Benefit Cost. The objective of the ASU is to improve guidance related to the presentation of defined benefit costs in the income statement. Specifically, the ASU requires that an employer report the service cost component in the same line item(s) as other compensation costs arising from services rendered by the pertinent employees during the period. The other components of net benefit cost are required to be presented in the income statement separately from the service cost component and outside a subtotal of income from operations, if one is presented. Additionally, the ASU allows only the service cost component to be eligible for capitalization, when applicable. The amendments in this ASU are effective for annual periods beginning after December 15, 2017, including interim periods within those annual periods. The adoption of the ASU is not expected to have a significant impact on the Corporation's consolidated financial statements.

In March 2017, the FASB issued ASU 2017-08, Receivables - Nonrefundable Fees and Other Costs (Subtopic 310-20): Premium Amortization on Purchased Callable Debt Securities. The objective of the ASU is to align the amortization period of premiums and discounts to expectations incorporated in market pricing on the underlying securities. The amendment requires that the premium be amortized to the earliest call date, but does not require an accounting change for securities held at a discount; the discount continues to be amortized to maturity. The amendments in this ASU are effective for fiscal years, and for interim periods within those fiscal years, beginning after December 15, 2018. The adoption of the ASU is not expected to have a significant impact on the Corporation's consolidated financial statements.

NOTE 2 EARNING PER COMMON SHARE (shares in thousands)

Basic earnings per share is net income divided by the weighted average number of common shares outstanding during the period. Issuable shares, including those related to directors’ restricted stock units and directors’ stock compensation, are considered outstanding and are included in the computation of basic earnings per share. All outstanding unvested share based payment awards that contain rights to non-forfeitable dividends are considered participating securities for this calculation. Restricted stock awards are grants of participating securities and are considered outstanding at grant date. Earnings per share information is adjusted to present comparative results for stock splits and stock dividends that occur. Earnings per share were computed by dividing net income by 4,802 and 4,765 weighted average shares outstanding for the three-month periods ended September 30, 2017 and 2016, respectively. Earnings per share were computed by dividing net income by 4,796 and 4,758 weighted average shares outstanding for the nine-month periods ended September 30, 2017 and 2016, respectively. There were no common stock equivalents during the three and nine-month periods ended September 30, 2017 or 2016.

NOTE 3 SECURITIES

Amortized cost and estimated fair value of securities available for sale are as follows (in thousands):

	September 30, 2017			
	Amortized Cost	Unrealized Gains	Unrealized Losses	Estimated Fair Value
Obligations of U.S. Government and U.S. Government sponsored enterprises	$15,494	$ 90	$ —	$15,584
Mortgage-backed securities, residential	239,074	480	2,893	236,661
Obligations of states and political subdivisions	54,144	612	28	54,728
Corporate bonds and notes	249	—	7	242

SBA loan pools	4,513	2	30	4,485
Corporate stocks	265	261	—	526
Total	$313,739	$ 1,445	$ 2,958	$312,226

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	December 31, 2016			
	Amortized Cost	Unrealized Gains	Unrealized Losses	Estimated Fair Value
Obligations of U.S. Government and U.S. Government sponsored enterprises	$17,300	$ 155	$ —	$17,455
Mortgage-backed securities, residential	253,156	202	7,492	245,866
Obligations of states and political subdivisions	38,843	209	312	38,740
Corporate bonds and notes	249	1	—	250
SBA loan pools	568	3	1	570
Corporate stocks	285	236	—	521
Total	$310,401	$ 806	$ 7,805	$303,402

Amortized cost and estimated fair value of securities held to maturity are as follows (in thousands):

	September 30, 2017			
	Amortized Cost	Unrealized Gains	Unrealized Losses	Estimated Fair Value
Obligations of states and political subdivisions	$2,030	$ —	$ —	$ 2,030
Time deposits with other financial institutions	1,835	1	5	1,831
Total	$3,865	$ 1	$ 5	$ 3,861

	December 31, 2016			
	Amortized Cost	Unrealized Gains	Unrealized Losses	Estimated Fair Value
Obligations of states and political subdivisions	$3,725	$ 206	$ —	$ 3,931
Time deposits with other financial institutions	980	1	—	981
Total	$4,705	$ 207	$ —	$ 4,912

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

	September 30, 2017			
	Available for Sale		Held to Maturity	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
Within one year	$13,067	$13,135	$753	$751
After one, but within five years	26,063	26,328	2,841	2,839
After five, but within ten years	29,621	29,944	271	271
After ten years	1,136	1,147	—	—
	69,887	70,554	3,865	3,861
Mortgage-backed securities, residential	239,074	236,661	—	—
SBA loan pools	4,513	4,485	—	—
Total	$313,474	$311,700	$3,865	$3,861

The proceeds from sales and calls of securities resulting in gains or losses for the three months ended September 30, 2017 and 2016 are listed below (in thousands):

	2017	2016
Proceeds	$545	$20,709
Gross gains	—	75
Tax expense	—	28

The proceeds from sales and calls of securities resulting in gains or losses for the nine months ended September 30, 2017 and 2016 are listed below (in thousands):

	2017	2016
Proceeds	$1,620	$36,130
Gross gains	12	983
Tax expense	4	371

The following tables summarize the investment securities available for sale with unrealized losses at September 30, 2017 and December 31, 2016 by aggregated major security type and length of time in a continuous unrealized loss position (in thousands):

	Less than 12 months		12 months or longer		Total	
September 30, 2017	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Mortgage-backed securities, residential	$121,345	$ 1,022	$57,638	$ 1,871	$178,983	$ 2,893
Obligations of states and political subdivisions	4,080	19	281	9	4,361	28
Corporate bonds and notes	242	7	—	—	242	7
SBA loan pools	3,970	30	—	—	3,970	30
Total temporarily impaired securities	$129,637	$ 1,078	$57,919	$ 1,880	$187,556	$ 2,958

	Less than 12 months		12 months or longer		Total	
December 31, 2016	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Mortgage-backed securities, residential	$233,843	$ 7,492	$—	$ —	$233,843	$ 7,492
Obligations of states and political subdivisions	25,724	312	—	—	25,724	312
SBA loan pools	—	—	225	1	225	1
Total temporarily impaired securities	$259,567	$ 7,804	$225	$ 1	$259,792	$ 7,805

Other-Than-Temporary Impairment

As of September 30, 2017, the majority of the Corporation's unrealized losses in the investment securities portfolio related to mortgage-backed securities. At September 30, 2017, all of the unrealized losses related to mortgage-backed securities were issued by U.S. government sponsored entities, Fannie Mae and Freddie Mac. Because the decline in fair value is attributable to changes in interest rates and not credit quality, and because it is not likely that the Corporation will be required to sell these securities before their anticipated recovery, the Corporation does not consider these securities to be other-than-temporarily impaired at September 30, 2017.

NOTE 4 LOANS AND ALLOWANCE FOR LOAN LOSSES

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

	September 30, 2017	December 31, 2016
Commercial and agricultural:		
Commercial and industrial	$188,341	$176,201
Agricultural	448	360
Commercial mortgages:		
Construction	57,704	46,387
Commercial mortgages, other	580,061	522,269
Residential mortgages	197,210	198,493
Consumer loans:		
Credit cards	1,444	1,476
Home equity lines and loans	98,492	98,590
Indirect consumer loans	147,426	139,572
Direct consumer loans	17,687	16,942
Total loans, net of deferred origination fees and costs	$1,288,813	$1,200,290
Interest receivable on loans	3,448	3,192
Total recorded investment in loans	$1,292,261	$1,203,482

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

The following tables present the activity in the allowance for loan losses by portfolio segment for the three and nine-month periods ended September 30, 2017 and 2016 (in thousands):

	Three Months Ended September 30, 2017				
Allowance for loan losses	Commercial and Agricultural	Commercial Mortgages	Residential Mortgages	Consumer Loans	Total
Beginning balance	$1,883	$ 7,778	$ 1,517	$ 3,926	$15,104
Charge-offs	(89)	(154)	(133)	(440)	(816)
Recoveries	34	1	—	82	117
Net recoveries (charge-offs)	(55)	(153)	(133)	(358)	(699)
Provision	99	758	12	420	1,289
Ending balance	$1,927	$ 8,383	$ 1,396	$ 3,988	$15,694

	Three Months Ended September 30, 2016				
Allowance for loan losses	Commercial and Agricultural	Commercial Mortgages	Residential Mortgages	Consumer Loans	Total
Beginning balance	$1,771	$ 7,754	$ 1,504	$ 3,639	$14,668
Charge-offs	(104)	(52)	(7)	(280)	(443)
Recoveries	15	1	—	34	50
Net recoveries (charge-offs)	(89)	(51)	(7)	(246)	(393)
Provision	101	520	50	379	1,050
Ending balance	$1,783	$ 8,223	$ 1,547	$ 3,772	$15,325

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	Nine Months Ended September 30, 2017				
Allowance for loan losses	Commercial and Agricultural	Commercial Mortgages	Residential Mortgages	Consumer Loans	Total
Beginning balance:	$1,589	$ 7,270	$ 1,523	$ 3,871	$14,253
Charge-offs:	(96)	(154)	(193)	(1,265)	(1,708)
Recoveries:	95	4	30	270	399
Net recoveries (charge-offs)	(1)	(150)	(163)	(995)	(1,309)
Provision	339	1,263	36	1,112	2,750
Ending balance	$1,927	$ 8,383	$ 1,396	$ 3,988	$15,694

	Nine Months Ended September 30, 2016				
Allowance for loan losses	Commercial and Agricultural	Commercial Mortgages	Residential Mortgages	Consumer Loans	Total
Beginning balance:	$1,831	$ 7,112	$ 1,464	$ 3,853	$14,260
Charge-offs:	(121)	(52)	(65)	(995)	(1,233)
Recoveries:	65	10	—	190	265
Net recoveries (charge-offs)	(56)	(42)	(65)	(805)	(968)
Provision	8	1,153	148	724	2,033
Ending balance	$1,783	$ 8,223	$ 1,547	$ 3,772	$15,325

The following tables present the balance in the allowance for loan losses and the recorded investment in loans by portfolio segment and based on impairment method as of September 30, 2017 and December 31, 2016 (in thousands):

	September 30, 2017				
Allowance for loan losses:	Commercial and Agricultural	Commercial Mortgages	Residential Mortgages	Consumer Loans	Total
Ending allowance balance attributable to loans:					
Individually evaluated for impairment	$159	$ 1,009	$ —	$ —	$1,168
Collectively evaluated for impairment	1,768	7,345	1,396	3,988	14,497
Loans acquired with deteriorated credit quality	—	29	—	—	29
Total ending allowance balance	$1,927	$ 8,383	$ 1,396	$ 3,988	$15,694

	December 31, 2016				
Allowance for loan losses:	Commercial and Agricultural	Commercial Mortgages	Residential Mortgages	Consumer Loans	Total
Ending allowance balance attributable to loans:					
Individually evaluated for impairment	$—	$ 735	$ —	$ 141	$876
Collectively evaluated for impairment	1,589	6,476	1,498	3,730	13,293
Loans acquired with deteriorated credit quality	—	59	25	—	84
Total ending allowance balance	$1,589	$ 7,270	$ 1,523	$ 3,871	$14,253

	September 30, 2017				
Loans:	Commercial and Agricultural	Commercial Mortgages	Residential Mortgages	Consumer Loans	Total
Loans individually evaluated for impairment	$1,133	$ 9,458	$ 434	$67	$11,092
Loans collectively evaluated for impairment	188,170	629,211	197,267	265,689	1,280,337
Loans acquired with deteriorated credit quality	—	832	—	—	832
Total ending loans balance	$189,303	$ 639,501	$ 197,701	$265,756	$1,292,261

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Loans:	December 31, 2016 Commercial and Agricultural	Commercial Mortgages	Residential Mortgages	Consumer Loans	Total
Loans individually evaluated for impairment	$693	$ 10,382	$ 396	$455	$11,926
Loans collectively evaluated for impairment	176,334	558,451	198,474	256,879	1,190,138
Loans acquired with deteriorated credit quality	—	1,323	95	—	1,418
Total ending loans balance	$177,027	$ 570,156	$ 198,965	$257,334	$1,203,482

The following table presents loans individually evaluated for impairment recognized by class of loans as of September 30, 2017 and December 31, 2016 (in thousands):

	September 30, 2017			December 31, 2016		
With no related allowance recorded:	Unpaid Principal Balance	Recorded Investment	Allowance for Loan Losses Allocated	Unpaid Principal Balance	Recorded Investment	Allowance for Loan Losses Allocated
Commercial and agricultural:						
Commercial and industrial	$714	$ 719	$ —	$690	$ 693	$ —
Commercial mortgages:						
Construction	395	396	—	277	278	—
Commercial mortgages, other	4,274	4,277	—	8,792	7,857	—
Residential mortgages	457	434	—	395	396	—
Consumer loans:						
Home equity lines and loans	66	67	—	93	95	—
With an allowance recorded:						
Commercial and agricultural:						
Commercial and industrial	413	414	159	—	—	—
Commercial mortgages:						
Commercial mortgages, other	5,875	4,785	1,009	2,245	2,247	735
Consumer loans:						
Home equity lines and loans	—	—	—	360	360	141
Total	$12,194	$ 11,092	$ 1,168	$12,852	$ 11,926	$ 876

The following table presents the average recorded investment and interest income of loans individually evaluated for impairment recognized by class of loans as of the three and nine-month periods ended September 30, 2017 and 2016 (in thousands):

	Three Months Ended September 30, 2017		Three Months Ended September 30, 2016		Nine Months Ended September 30, 2017		Nine Months Ended September 30, 2016	
With no related allowance recorded:	Average Recorded Investment	Interest Income Recognized (1)	Average Recorded Investment	Interest Income Recognized (1)	Average Recorded Investment	Interest Income Recognized (1)	Average Recorded Investment	Interest Income Recognized (1)
Commercial and agricultural:								
Commercial and industrial	$661	$ 8	$900	$ 10	$666	$ 24	$1,083	$ 33
Commercial mortgages:								
Construction	974	3	310	4	946	9	329	11
Commercial mortgages, other	4,946	5	6,124	60	5,973	73	6,760	181
Residential mortgages	439	2	443	2	416	6	358	3
Consumer loans:								
Home equity lines & loans	68	1	101	1	76	2	104	4
With an allowance recorded:								
Commercial and agricultural:								
Commercial and industrial	291	3	45	1	145	4	29	4
Commercial mortgages:								
Commercial mortgages, other	4,721	4	5,151	1	3,989	10	4,998	4
Consumer loans:								
Home equity lines and loans	—	—	360	—	180	—	362	—
Total	$12,100	$ 26	$13,434	$ 79	$12,391	$ 128	$14,023	$ 240

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

The following tables present the recorded investment in non-accrual and loans past due 90 days or more and still accruing by class of loans as of September 30, 2017 and December 31, 2016 (in thousands):

	Non-accrual		Loans Past Due 90 Days or More and Still Accruing	
	September 30, 2017	December 31, 2016	September 30, 2017	December 31, 2016
Commercial and agricultural:				
Commercial and industrial	$150	$ —	$2	$ 2
Commercial mortgages:				
Construction	159	19	—	—
Commercial mortgages, other	8,473	5,454	—	—
Residential mortgages	3,210	4,201	—	—
Consumer loans:				
Credit cards	—	—	19	11
Home equity lines and loans	1,178	1,670	—	—
Indirect consumer loans	837	654	—	—
Direct consumer loans	21	45	—	—
Total	$14,028	$ 12,043	$21	$ 13

The following tables present the aging of the recorded investment in loans as of September 30, 2017 and December 31, 2016 (in thousands):

	September 30, 2017						
	30 - 59 Days Past Due	60 - 89 Days Past Due	90 Days or More Past Due	Total Past Due	Loans Acquired with Deteriorated Credit Quality	Loans Not Past Due	Total
Commercial and agricultural:							
Commercial and industrial	$217	$17	$2	$236	$ —	$188,617	$188,853
Agricultural	—	—	—	—	—	450	450
Commercial mortgages:							
Construction	—	—	—	—	—	57,861	57,861
Commercial mortgages, other	4,218	—	2,572	6,790	832	574,018	581,640
Residential mortgages	1,122	695	1,714	3,531	—	194,170	197,701
Consumer loans:							
Credit cards	6	2	19	27	—	1,417	1,444
Home equity lines and loans	220	99	846	1,165	—	97,598	98,763
Indirect consumer loans	2,084	325	501	2,910	—	144,880	147,790
Direct consumer loans	112	21	8	141	—	17,618	17,759
Total	$7,979	$1,159	$5,662	$14,800	$ 832	$1,276,629	$1,292,261

	December 31, 2016						
	30 - 59 Days Past Due	60 - 89 Days Past Due	90 Days or More Past Due	Total Past Due	Loans Acquired with Deteriorated Credit Quality	Loans Not Past Due	Total
Commercial and agricultural:							
Commercial and industrial	$160	$7	$2	$169	$ —	$176,497	$176,666
Agricultural	—	—	—	—	—	361	361
Commercial mortgages:							
Construction	—	1,177	—	1,177	—	45,333	46,510
Commercial mortgages, other	652	4,460	2,412	7,524	1,323	514,799	523,646
Residential mortgages	2,100	436	2,383	4,919	95	193,951	198,965
Consumer loans:							
Credit cards	3	9	11	23	—	1,453	1,476
Home equity lines and loans	227	—	1,149	1,376	—	97,477	98,853
Indirect consumer loans	1,773	287	542	2,602	—	137,391	139,993
Direct consumer loans	54	7	22	83	—	16,929	17,012
Total	$4,969	$6,383	$6,521	$17,873	$ 1,418	$1,184,191	$1,203,482

Troubled Debt Restructurings:

A modification of a loan may result in classification as a TDR when a borrower is experiencing financial difficulty and the modification constitutes a concession. The Corporation offers various types of modifications which may involve a change in the schedule of payments, a reduction in the interest rate, an extension of the maturity date, extending the maturity date at an interest rate lower than the current market rate for new debt with similar risk, requesting additional collateral, releasing collateral for consideration, substituting or adding a new borrower or guarantor, a permanent reduction of the recorded investment in the loan or a permanent reduction of the interest on the loan.

As of September 30, 2017 and December 31, 2016, the Corporation has a recorded investment in TDRs of $9.2 million and $10.2 million, respectively. There were specific reserves of $1.0 million and $0.9 million allocated for TDRs at September 30, 2017 and December 31, 2016, respectively. As of September 30, 2017, TDRs totaling $2.0 million were accruing interest under the modified terms and $7.2 million were on non-accrual status. As of December 31, 2016, TDRs totaling $5.8 million were accruing interest under the modified terms and $4.4 million were on non-accrual status. The Corporation had committed no additional amounts as of both September 30, 2017 and December 31, 2016, to customers with outstanding loans that are classified as TDRs.

During the three-month periods ended September 30, 2017 and 2016, the terms of certain loans were modified as TDRs. The modification of the terms of two commercial & industrial term loans during the three months ended September 30, 2017 included a reduction of the scheduled amortized payments for greater than a three month period, the release of collateral related to one of the loans and the extension of a maturity date. During the three months ended September 30, 2016, no loans were modified as TDRs.

During the nine months ended September 30, 2017 and 2016, the terms of certain loans were modified as TDRs. In addition to the modifications noted above, the modification of the terms of two commercial & industrial term loans and one line of credit during the nine months ended September 30, 2017 included consolidating the loans into one commercial & industrial loan, extending the maturity date by approximately two years and lowering the monthly payment. An additional piece of equipment was taken as collateral but was not considered to be of greater value than the concessions given. The modification of the terms of a commercial mortgage loan during the nine months ended September 30, 2017 included a reduction of the scheduled amortized payments of the loan for greater than a three month period. The modification of the terms of a residential mortgage loan during the nine months ended September 30, 2017 included an extension of the maturity date by approximately five years and a postponement of the scheduled amortized past due payments to the end of the loan.

The modification of the terms of a residential mortgage loan during the nine months ended September 30, 2016 included an extension of the maturity date by thirteen years at a stated interest rate lower than the current market rate for new debt with similar risk and a corresponding reduction of the scheduled amortization payments of the loan due to the longer term. The modification of the terms of five commercial real estate loans and one residential home equity loan during the nine months ended September 30, 2016 included consolidating the loans into one commercial real estate loan and extending the maturity date at a stated interest rate lower than the current market rate for new debt with similar risk. The modification of the terms of a residential mortgage loan performed during the nine months ended September 30, 2016 included a reduction in the stated interest rate for three years and a corresponding reduction of the scheduled amortized payments of the loan due to the lower interest rate. Additionally, $4 thousand of interest and past due escrow payments were capitalized on the restructured loan.

The following table presents loans by class modified as TDRs that occurred during the three months ended September 30, 2017 (dollars in thousands):

September 30, 2017	Number of Loans	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment
Troubled debt restructurings:			
Commercial and agricultural:			
Commercial and industrial	2	$ 506	$ 506
Total	2	$ 506	$ 506

The TDRs described above increased the allowance for loan losses by $0.1 million and resulted in no charge-offs during the three month period ended September 30, 2017.

There were no loans modified as TDRs during the three months ended September 30, 2016.

The following tables presents loans by class modified as TDRs that occurred during the nine months ended September 30, 2017 and 2016 (dollars in thousands):

September 30, 2017	Number of Loans	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment
Troubled debt restructurings:			
Commercial and agricultural:			
Commercial and industrial	3	$ 677	$ 677
Commercial mortgages:			

Commercial mortgages	1	166	166
Residential mortgages	1	105	105
Total	5	$ 948	$ 948

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September 30, 2016	Number of Loans	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment
Troubled debt restructurings:			
Commercial mortgages:			
Commercial mortgages	5	$ 312	$ 310
Residential mortgages	2	295	307
Consumer loans:			
Home equity lines and loans	1	74	74
Total	8	$ 681	$ 691

The TDRs described above increased the allowance for loan losses by $0.2 million and resulted in no charge-offs during the nine months ended September 30, 2017. The TDRs described above did not increase the allowance for loan losses and resulted in no charge-offs during the nine months ended September 30, 2016.

A loan is considered to be in payment default once it is 90 days contractually past due under the modified terms. There were no payment defaults on any loans previously modified as TDRs within twelve months following the modification during the three and nine month periods ended September 30, 2017.

There were no payment defaults on any loans previously modified as TDRs within twelve months following the modification during the three months ended September 30, 2016. The following table presents loans by class modified as TDRs for which there was a payment default within twelve months following the modification during the nine months ended September 30, 2016:

	Number of Loans	Recorded Investment
Commercial mortgages:		
Commercial mortgages	2	$ 2,100
Total	2	$ 2,100

The TDRs that subsequently defaulted described above did not increase the allowance for loan losses and resulted in no charge offs during the nine months ended September 30, 2016.

Credit Quality Indicators

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

For the retail loans, which include residential mortgages, indirect and direct consumer loans, home equity lines and loans, and credit cards, once a loan is properly approved and closed, the Corporation evaluates credit quality based upon loan repayment.

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

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

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

Doubtful – Loans classified as doubtful have all the weaknesses inherent in those classified as substandard, with the added characteristic that the weaknesses make collection or liquidation in full, on the basis of currently existing facts, conditions, and values, highly questionable and improbable.

Commercial loans not meeting the criteria above to be considered criticized or classified are considered to be pass rated loans. Loans listed as not rated are included in groups of homogeneous loans performing under terms of the loan notes. Based on the analyses performed as of September 30, 2017 and December 31, 2016, the risk category of the recorded investment of loans by class of loans is as follows (in thousands):

	September 30, 2017						
	Not Rated	Pass	Special Mention	Substandard	Doubtful	Loans acquired with deteriorated credit quality	Total
Commercial and agricultural:							
Commercial and industrial	$—	$181,457	$5,390	$ 2,006	$ —	$ —	$188,853
Agricultural	—	450	—		—	—	450
Commercial mortgages:							
Construction	—	57,702	—	159	—	—	57,861
Commercial mortgages	—	557,371	7,048	14,990	1,399	832	581,640
Residential mortgages	194,491	—	—	3,210	—	—	197,701
Consumer loans:							
Credit cards	1,444	—	—	—	—	—	1,444
Home equity lines and loans	97,585	—	—	1,178	—	—	98,763
Indirect consumer loans	146,953	—	—	837	—	—	147,790
Direct consumer loans	17,738	—	—	21	—	—	17,759
Total	$458,211	$796,980	$12,438	$ 22,401	$ 1,399	$ 832	$1,292,261

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	December 31, 2016						
	Not Rated	Pass	Special Mention	Substandard	Doubtful	Loans acquired with deteriorated credit quality	Total
Commercial and agricultural:							
Commercial and industrial	$—	$172,873	$2,277	$ 1,516	$ —	$ —	$176,666
Agricultural	—	361	—	—	—	—	361
Commercial mortgages:							
Construction	—	45,055	259	1,196	—	—	46,510
Commercial mortgages	—	496,723	8,574	15,566	1,460	1,323	523,646
Residential mortgages	194,669	—	—	4,201	—	95	198,965
Consumer loans:							
Credit cards	1,476	—	—	—	—	—	1,476
Home equity lines and loans	97,183	—	—	1,670	—	—	98,853
Indirect consumer loans	139,339	—	—	654	—	—	139,993
Direct consumer loans	16,967	—	—	45	—	—	17,012
Total	$449,634	$715,012	$11,110	$ 24,848	$ 1,460	$ 1,418	$1,203,482

The Corporation considers the performance of the loan portfolio and its impact on the allowance for loan losses. For residential and consumer loan classes, the Corporation also evaluates credit quality based on the aging status of the loan, which was previously presented, and by payment activity. The following table presents the recorded investment in residential and consumer loans based on payment activity as of September 30, 2017 and December 31, 2016 (in thousands):

	September 30, 2017				
		Consumer Loans			
	Residential Mortgages	Credit Card	Home Equity Lines and Loans	Indirect Consumer Loans	Other Direct Consumer Loans
Performing	$194,491	$1,444	$97,585	$146,953	$ 17,738
Non-Performing	3,210	—	1,178	837	21
	$197,701	$1,444	$98,763	$147,790	$ 17,759

	December 31, 2016				
		Consumer Loans			
	Residential Mortgages	Credit Card	Home Equity Lines and Loans	Indirect Consumer Loans	Other Direct Consumer Loans
Performing	$194,764	$1,476	$97,183	$139,339	$ 16,967
Non-Performing	4,201	—	1,670	654	45
	$198,965	$1,476	$98,853	$139,993	$ 17,012

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

The table below summarizes the changes in total contractually required principal and interest cash payments, management's estimate of expected total cash payments and carrying value of the PCI loans from July 1, 2017 to September 30, 2017 and July 1, 2016 to September 30, 2016 (in thousands):

Three Months Ended September 30, 2017	Balance at June 30, 2017	Income Accretion	All Other Adjustments	Balance at September 30, 2017
Contractually required principal and interest	$ 1,167	$ —	$ (165)	$ 1,002
Contractual cash flows not expected to be collected (nonaccretable discount)	(33)	—	(33)	(66)
Cash flows expected to be collected	1,134	—	(198)	936
Interest component of expected cash flows (accretable yield)	(128)	11	13	(104)
Carrying amount of loans acquired with deteriorating credit quality	$ 1,006	$ 11	$ (185)	$ 832

Three Months Ended September 30, 2016	Balance at June 30, 2016	Income Accretion	All Other Adjustments	Balance at September 30, 2016
Contractually required principal and interest	$ 2,492	$ —	$ (60)	$ 2,432
Contractual cash flows not expected to be collected (nonaccretable discount)	(374)	—	(33)	(407)
Cash flows expected to be collected	2,118	—	(93)	2,025
Interest component of expected cash flows (accretable yield)	(243)	26	30	(187)
Carrying amount of loans acquired with deteriorating credit quality	$ 1,875	$ 26	$ (63)	$ 1,838

For those purchased credit impaired loans disclosed above, the Corporation decreased the allowance for loan losses by $1 thousand during the three months ended September 30, 2017 and did not increase or decrease the allowance for loan losses during the three months ended September 30, 2016. The Corporation reversed $1 thousand of the allowance for loan losses during the three months ended September 30, 2017. The Corporation did not reverse any allowance for loan losses during the three months ended September 30, 2016.

The tables below summarizes the changes in total contractually required principal and interest cash payments, management's estimate of expected total cash payments and carrying value of the PCI loans from January 1, 2017 to September 30, 2017 and January 1, 2016 to September 30, 2016 (in thousands):

Nine Months Ended September 30, 2017	Balance at December 31, 2016	Income Accretion	All Other Adjustments	Balance at September 30, 2017
Contractually required principal and interest	$ 1,940	$ —	$ (938)	$ 1,002
Contractual cash flows not expected to be collected (nonaccretable discount)	(352)	—	286	(66)
Cash flows expected to be collected	1,588	—	(652)	936
Interest component of expected cash flows (accretable yield)	(170)	51	15	(104)
Carrying amount of loans acquired with deteriorating credit quality	$ 1,418	$ 51	$ (637)	$ 832

Nine Months Ended September 30, 2016	Balance at December 31, 2015	Income Accretion	All Other Adjustments	Balance at September 30, 2016
Contractually required principal and interest	$ 2,912	$ —	$ (480)	$ 2,432
Contractual cash flows not expected to be collected (nonaccretable discount)	(506)	—	99	(407)
Cash flows expected to be collected	2,406	—	(381)	2,025
Interest component of expected cash flows (accretable yield)	(311)	96	28	(187)
Carrying amount of loans acquired with deteriorating credit quality	$ 2,095	$ 96	$ (353)	$ 1,838

For those purchased credit impaired loans disclosed above, the Corporation decreased the allowance for loan losses by $55 thousand and $15 thousand during the nine months ended September 30, 2017 and 2016, respectively. The Corporation reversed $30 thousand of the allowance for losses during the nine months ended September 30, 2017. The Corporation did not reverse any allowance for loan losses during the nine months ended September 30, 2016.

NOTE 5 FAIR VALUE

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

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

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

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

The Corporation used the following methods and significant assumptions to estimate fair value on a recurring basis:

Investment Securities: The fair values of securities available for sale are usually determined by obtaining quoted prices on nationally recognized securities exchanges (Level 1 inputs), or matrix pricing, which is a mathematical technique widely used to value debt securities without relying exclusively on quoted prices for the specific securities but rather by relying on the securities' relationship to other benchmark quoted securities (Level 2 inputs). For securities where quoted prices or market prices of similar securities are not available, fair values are calculated using discounted cash flows or other market indicators (Level 3 inputs).

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

Derivatives: The fair values of interest rate swaps are based on valuation models using observable market data as of the measurement date (Level 2 inputs). Derivatives are traded in an over-the-counter market where quoted market prices are not always available. Therefore, the fair values of derivatives are determined using quantitative models that utilize multiple market inputs. The inputs will vary based on the type of derivative, but could include interest rates, prices, and indices to generate continuous yield or pricing curves, prepayment rates, and volatility factors to value the position. The Corporation also incorporates credit valuation adjustments to appropriately reflect both its own nonperformance risk and the respective counter-party's nonperformance risk in the fair value measurements. In adjusting the fair value of its derivative contracts for the effect of nonperformance risk, the Corporation has considered the impact of any applicable credit enhancements, such as collateral postings. Although the Corporation has determined that the majority of the inputs used to value its derivatives fall within Level 2 of the fair value hierarchy, the credit valuation adjustments associated with its derivatives utilize credit default rate assumptions (Level 3 inputs).

The fair values of credit risk participations are based on credit default rate assumptions (Level 3 inputs).

Assets and liabilities measured at fair value on a recurring basis are summarized below (in thousands):

		Fair Value Measurement at September 30, 2017 Using		
Financial Assets:	Fair Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Obligations of U.S. Government and U.S. Government sponsored enterprises	$15,584	$—	$ 15,584	$ —
Mortgage-backed securities, residential	236,661	—	236,661	—
Obligations of states and political subdivisions	54,728	—	54,728	—
Corporate bonds and notes	242	—	242	—
SBA loan pools	4,485	—	4,485	—
Corporate stocks	526	194	332	—
Total available for sale securities	$312,226	$194	$ 312,032	$ —

Trading assets	$909	$909	$ —	$ —
Derivative assets	670	—	670	—
Financial Liabilities:				
Derivative liabilities	$741	$—	$ 670	$ 71

During the three months ended September 30, 2017, the Corporation transferred corporate bonds with a fair market value of $242 thousand from Level 3 to Level 2 due to the availability of pricing in secondary markets.

Financial Assets:	Fair Value	Fair Value Measurement at December 31, 2016 Using Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Obligations of U.S. Government and U.S. Government sponsored enterprises	$17,455	$—	$ 17,455	$ —
Mortgage-backed securities, residential	245,866	—	245,866	—
Obligations of states and political subdivisions	38,740	—	38,740	—
Corporate bonds and notes	250	—	—	250
SBA loan pools	570	—	570	—
Corporate stocks	521	170	351	—
Total available for sale securities	$303,402	$170	$ 302,982	$ 250
Trading assets	$774	$774	$ —	$ —
Derivative assets	693	—	693	—
Financial Liabilities:				
Derivative liabilities	$761	$—	$ 693	$ 68

There were no transfers between Level 1 and Level 2 during the three and nine-month periods ended September 30, 2017. During the year ended December 31, 2016, the Corporation transferred corporate stocks with a fair market value of $158 thousand at the date of transfer (and $103 thousand at December 31, 2016) from Level 2 to Level 1 due to the corporation's stock becoming publicly listed.

The table below presents a reconciliation of all assets and liabilities measured at fair value on a recurring basis using significant unobservable inputs (Level 3) for the three-month periods ended September 30, 2017 and September 30, 2016 (in thousands):

	Assets (Liabilities) Corporate Bonds and Notes		Derivative Liabilities	
	2017	2016	2017	2016
Balance of recurring Level 3 assets at July 1	$252	$256	$(71)	$(120)
Derivative instruments entered into	—	—	—	—
Total gains or losses for the period:				
Included in earnings - other non-interest income	—	—	—	26
Included in other comprehensive income	(10)	(1)	—	—
Transfers out of Level 3	(242)	—	—	—
Balance of recurring Level 3 assets at September 30	$—	$255	$(71)	$(94)

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The table below presents a reconciliation of all assets and liabilities measured at fair value on a recurring basis using significant unobservable inputs (Level 3) for the nine month periods ended September 30, 2017 and September 30, 2016 (in thousands):

	Assets (Liabilities)			
	Corporate Bonds and Notes		Derivative Liabilities	
	2017	2016	2017	2016
Balance of recurring Level 3 assets at January 1	$250	$248	$(68)	$(48)
Derivative instruments entered into	—	—	(1)	(25)
Total gains or losses for the period:				
Included in earnings - other non-interest income	—	—	(2)	(21)
Included in other comprehensive income	(8)	7	—	—
Transfers out of Level 3	(242)	—	—	—
Balance of recurring Level 3 assets at September 30	$—	$255	$(71)	$(94)

The following table presents information related to Level 3 recurring fair value measurements at September 30, 2017 and December 31, 2016 (in thousands):

Description	Fair Value at September 30, 2017	Valuation Technique	Unobservable Inputs	Range [Weighted Average] at September 30, 2017
Derivative liabilities	$ 71	Historical trend	Credit default rate	5.15% - 5.15% [5.15%]

Description	Fair Value at December 31, 2016	Valuation Technique	Unobservable Inputs	Range [Weighted Average] at December 31, 2016
Corporate bonds and notes	$ 250	Discounted cash flow	Credit spread	1.73% - 1.73% [1.73%]
Derivative liabilities	$ 68	Historical trend	Credit default rate	4.92% - 4.92% [4.92%]

The Corporation used the following methods and significant assumptions to estimate fair value on a non-recurring basis:

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

OREO: Assets acquired through or instead of loan foreclosures are initially recorded at fair value less costs to sell when acquired, establishing a new cost basis. These assets are subsequently accounted for at lower of cost or fair value less estimated costs to sell. Fair value is commonly based on recent real estate appraisals. These appraisals may utilize a single valuation approach or a combination of approaches including comparable sales and the income approach. Adjustments are routinely made in the appraisal process by independent appraisers to adjust for differences between the comparable sales and income data available. Such adjustments are usually significant and typically result in a Level 3 classification of the inputs for determining fair value. Assets in which the Corporation has accepted a purchase offer are classified as Level 2.

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

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

		Fair Value Measurement at September 30, 2017 Using		
Financial Assets:	Fair Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Impaired Loans:				
Commercial and agricultural:				
Commercial and industrial	$85	$ —	$ —	$ 85
Commercial mortgages:				
Commercial mortgages, other	3,157	—	—	3,157
Total impaired loans	$3,242	$ —	$ —	$ 3,242
Other real estate owned:				
Residential mortgages	$179	$ —	$ —	$ 179
Total other real estate owned, net	$179	$ —	$ —	$ 179

		Fair Value Measurement at December 31, 2016 Using		
Financial Assets:	Fair Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Impaired Loans:				
Commercial mortgages:				
Commercial mortgages, other	$2,631	$ —	$ —	$ 2,631
Consumer loans:				
Home equity lines and loans	219	—	—	219

Total impaired loans	$2,850	$ —	$ —	$ 2,850
Other real estate owned:				
Residential mortgages	$344	$ —	$ —	$ 344
Total other real estate owned, net	$344	$ —	$ —	$ 344

The following tables presents information related to Level 3 non-recurring fair value measurement at September 30, 2017 and December 31, 2016 (in thousands):

Description	Fair Value at September 30, 2017	Valuation Technique	Unobservable Inputs	Range [Weighted Average] at September 30, 2017
Impaired loans:				
Commercial and agricultural:				
Commercial and industrial	$ 85	Sales comparison	Discount to appraised value	36.07%-36.07% [36.07%]
Commercial mortgages:				
Commercial mortgages, other	707	Sales comparison	Discount to appraised value	10.00% - 44.52% [20.34%]
	2,450	Income approach	Capitalization rate	9.00% - 10.00% [9.52%]
	$ 3,242			
OREO:				
Residential mortgages	$ 179	Sales comparison	Discount to appraised value	17.28% - 27.97% [20.73%]
	$ 179			

Description	Fair Value at December 31, 2016	Valuation Technique	Unobservable Inputs	Range [Weighted Average] at December 31, 2016
Impaired loans:				
Commercial mortgages:				
Commercial mortgages, other	$ 2,631	Income approach	Capitalization rate	9.00% - 10.00% [9.52%]
Consumer loans:				
Home equity lines and loans	219	Sales comparison	Discount to appraised value	22.98% - 22.98% [22.98%]
	$ 2,850			
OREO:				
Residential mortgages	$ 344	Sales comparison	Discount to appraised value	20.80% - 48.17% [30.50%]
	$ 344			

FAIR VALUE OF FINANCIAL INSTRUMENTS

The following methods and assumptions were used to estimate the fair value of each class of financial instruments not already discussed:

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

For those short-term instruments that generally mature in 90 days or less, the carrying value approximates fair value of which non-interest-bearing deposits are classified as Level 1 and interest-bearing deposits with the FHLBNY and

FRBNY are classified as Level 1.

Securities Held to Maturity

For securities where quoted prices or market prices of similar securities are not available, fair values are calculated using discounted cash flows or other market indicators (Level 3 inputs).

FHLBNY and FRBNY Stock

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

Loans, Net

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

Loans Held for Sale

Certain mortgage loans are originated with the intent to sell. Loans held for sale are recorded at the lower of cost or market and are classified as Level 2.

Deposits

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

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

Securities Sold Under Agreements to Repurchase

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

FHLBNY Overnight Advances and FHLBNY Term Advances

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

Accrued Interest Receivable and Payable

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

The carrying amounts and estimated fair values of other financial instruments, at September 30, 2017 and December 31, 2016, are as follows (in thousands):

	September 30, 2017				
Financial assets:	Carrying Amount	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Estimated Fair Value (1)
Cash and due from financial institutions	$34,572	$34,572	$ —	$ —	$34,572
Interest-bearing deposits in other financial institutions	21,806	21,806	—	—	21,806
Trading assets	909	909	—	—	909
Securities available for sale	312,226	194	312,032	—	312,226
Securities held to maturity	3,865	—	1,831	2,030	3,861
FHLBNY and FRBNY stock	3,497	—	—	—	N/A
Loans, net	1,273,119	—	—	1,277,896	1,277,896
Loans held for sale	1,246	—	1,246	—	1,246
Accrued interest receivable	4,516	2	1,050	3,464	4,516
Derivative assets	670	—	670	—	670
Financial liabilities:					
Deposits:					
Demand, savings, and insured money market accounts	$1,410,836	$1,410,836	$ —	$ —	$1,410,836
Time deposits	126,182	—	126,445	—	126,445
Securities sold under agreements to repurchase	10,000	—	10,117	—	10,117
FHLBNY term advances	9,009	—	9,030	—	9,030
Accrued interest payable	184	21	163	—	184
Derivative liabilities	741	—	670	71	741

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

	December 31, 2016				
Financial assets:	Carrying Amount	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Estimated Fair Value (1)
Cash and due from financial institutions	$28,205	$28,205	$ —	$ —	$28,205
Interest-bearing deposits in other financial institutions	45,957	45,957	—	—	45,957
Trading assets	774	774	—	—	774
Securities available for sale	303,402	170	302,982	250	303,402
Securities held to maturity	4,705	—	981	3,931	4,912
FHLBNY and FRBNY stock	4,041	—	—	—	N/A
Loans, net	1,186,037	—	—	1,205,814	1,205,814
Loans held for sale	412	—	412	—	412
Accrued interest receivable	4,000	9	784	3,207	4,000
Derivative assets	693	—	693	—	693
Financial liabilities:					
Deposits:					
Demand, savings, and insured money market accounts	$1,312,237	$1,312,237	$ —	$ —	$1,312,237
Time deposits	144,106	—	144,460	—	144,460
Securities sold under agreements to repurchase	27,606	—	27,880	—	27,880
FHLBNY term advances	9,093	—	9,189	—	9,189
Accrued interest payable	210	25	185	—	210
Derivative liabilities	761	—	693	68	761

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

NOTE 6 GOODWILL AND INTANGIBLE ASSETS

The changes in goodwill included in the core banking segment during the periods ended September 30, 2017 and 2016 were as follows (in thousands):

	2017	2016
Beginning of year	$21,824	$21,824
Acquired goodwill	—	—
Ending balance September 30,	$21,824	$21,824

Acquired intangible assets were as follows at September 30, 2017 and December 31, 2016 (in thousands):

	At September 30, 2017		At December 31, 2016	
	Balance Acquired	Accumulated Amortization	Balance Acquired	Accumulated Amortization
Core deposit intangibles	$5,975	$ 5,077	$5,975	$ 4,689

Other customer relationship intangibles	5,633	4,239	5,633	3,974
Total	$11,608	$ 9,316	$11,608	$ 8,663

Aggregate amortization expense was $0.2 million for both of the three month periods ended September 30, 2017 and 2016. Aggregate amortization expense was $0.7 million for both of the nine month periods ended September 30, 2017 and 2016.

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The remaining estimated aggregate amortization expense at September 30, 2017 is listed below (in thousands):

Year	Estimated Expense
2017	$ 207
2018	734
2019	609
2020	484
2021	258
Total	$ 2,292

NOTE 7 SECURITIES SOLD UNDER AGREEMENTS TO REPURCHASE

A summary of securities sold under agreements to repurchase as of September 30, 2017 and December 31, 2016 is as follows (in thousands):

	September 30, 2017				
	Overnight and Continuous	Up to 1 Year	1 - 3 Years	3+ Years	Total
Mortgage-backed securities, residential	$ —	$ 12,536	$ —	$ —	$ 12,536
Excess collateral held	—	(2,536)	—	—	(2,536)
Gross amount of recognized liabilities for repurchase agreements	$ —	$ 10,000	$ —	$ —	$ 10,000

	December 31, 2016				
	Overnight and Continuous	Up to 1 Year	1 - 3 Years	3+ Years	Total
Obligations of U.S. Government and U.S. Government sponsored enterprises	$ —	$ 1,276	$ —	$ —	$ 1,276
Mortgage-backed securities, residential	13,092	9,664	14,244	—	37,000
Total	13,092	10,940	14,244	—	38,276
Excess collateral held	(5,486)	(940)	(4,244)	—	(10,670)
Gross amount of recognized liabilities for repurchase agreements	$ 7,606	$ 10,000	$ 10,000	$ —	$ 27,606

The Corporation enters into sales of securities under agreements to repurchase and the amounts received under these agreements represent borrowings and are reflected as a liability in the consolidated balance sheets. The securities underlying these agreements are included in investment securities in the consolidated balance sheets.

The Corporation has no control over the market value of the securities which fluctuate due to market conditions, however, the Corporation is obligated to promptly transfer additional securities if the market value of the securities falls below the repurchase agreement price. The Corporation manages this risk by utilizing highly marketable and easily priced securities, monitoring these securities for significant changes in market valuation routinely, and maintaining an unpledged securities portfolio believed to be sufficient to cover a decline in the market value of the securities sold under agreements to repurchase.

NOTE 8 ACCUMULATED OTHER COMPREHENSIVE LOSS

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

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

	Unrealized Gains and Losses on Securities Available for Sale	Defined Benefit and Other Benefit Plans	Total
Balance at July 1, 2017	$ (615)	$(6,357)	$(6,972)
Other comprehensive income before reclassification	(324)	—	(324)
Amounts reclassified from accumulated other comprehensive income	—	21	21
Net current period other comprehensive income (loss)	(324)	21	(303)
Balance at September 30, 2017	$ (939)	$(6,336)	$(7,275)

	Unrealized Gains and Losses on Securities Available for Sale	Defined Benefit and Other Benefit Plans	Total
Balance at July 1, 2016	$ 3,152	$(10,687)	$(7,535)
Other comprehensive loss before reclassification	(456)	—	(456)
Amounts reclassified from accumulated other comprehensive income	(47)	233	186
Net current period other comprehensive income (loss)	(503)	233	(270)
Balance at September 30, 2016	$ 2,649	$(10,454)	$(7,805)

	Unrealized Gains and Losses on Securities Available for Sale	Defined Benefit and Other Benefit Plans	Total
Balance at January 1, 2017	$ (4,356)	$(6,398)	$(10,754)
Other comprehensive income before reclassification	3,425	—	3,425
Amounts reclassified from accumulated other comprehensive income	(8)	62	54
Net current period other comprehensive gain	3,417	62	3,479
Balance at September 30, 2017	$ (939)	$(6,336)	$(7,275)

	Unrealized Gains and Losses on Securities Available for Sale	Defined Benefit and Other Benefit Plans	Total
Balance at January 1, 2016	$ 210	$(11,152)	$(10,942)
Other comprehensive income before reclassification	3,051	—	3,051
Amounts reclassified from accumulated other comprehensive income	(612)	698	86
Net current period other comprehensive gain (loss)	2,439	698	3,137
Balance at September 30, 2016	$ 2,649	$(10,454)	$(7,805)

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The following is the reclassification out of accumulated other comprehensive income for the periods indicated (in thousands):

Details about Accumulated Other Comprehensive Income Components	Three Months Ended September 30, 2017	2016	Affected Line Item in the Statement Where Net Income is Presented
Unrealized gains and losses on securities available for sale:			
Realized gains on securities available for sale	$—	$(75)	Net gains (losses) on securities transactions
Tax effect	—	28	Income tax expense
Net of tax	—	(47)	
Amortization of defined pension plan and other benefit plan items:			
Prior service costs (a)	(55)	(22)	Pension and other employee benefits
Actuarial losses (a)	88	396	Pension and other employee benefits
Tax effect	(12)	(141)	Income tax expense
Net of tax	21	233	
Total reclassification for the period, net of tax	$21	$186	

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

Details about Accumulated Other Comprehensive Income Components	Nine Months Ended September 30, 2017	2016	Affected Line Item in the Statement Where Net Income is Presented
Unrealized gains and losses on securities available for sale:			
Realized gains on securities available for sale	$(12)	$(983)	Net gains (losses) on securities transactions
Tax effect	4	371	Income tax expense
Net of tax	(8)	(612)	
Amortization of defined pension plan and other benefit plan items:			
Prior service costs (a)	(165)	(67)	Pension and other employee benefits
Actuarial losses (a)	264	1,188	Pension and other employee benefits
Tax effect	(37)	(423)	Income tax expense
Net of tax	62	698	
Total reclassification for the period, net of tax	$54	$86	

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

NOTE 9 COMMITMENTS AND CONTINGENCIES

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

The following table lists the contractual amounts of financial instruments with off-balance sheet risk at September 30, 2017 and December 31, 2016 (in thousands):

	September 30, 2017		December 31, 2016	
	Fixed Rate	Variable Rate	Fixed Rate	Variable Rate
Commitments to make loans	$21,664	$26,834	$38,246	$33,189
Unused lines of credit	1,870	202,020	610	208,124
Standby letters of credit	—	14,490	—	14,241

On March 23, 2016, the Bank received a summons and complaint for an action brought in the State of New York Supreme Court for the County of Tompkins, regarding its lease of 202 East State Street, Ithaca, NY. The owner of the leased premises has alleged that the Bank has breached its contract and is requesting a judgment declaring that the term of the lease runs through December 31, 2025 or a judgment in his favor in the amount of $4.0 million. On July 25, 2016, the Corporation received Notice of Entry of the decision and order of the New York Supreme Court for the County of Tompkins, against the Bank. The Court granted, in part, partial summary judgment in favor of the plaintiff - on the issue of liability only- for anticipatory breach and breach of contract. The fraud claims were dismissed, and summary judgment was denied on the plaintiff’s trespass claims. The Court set the matter down for an inquest on damages at a later date, with the original claim by the plaintiff seeking $4.0 million in damages. The Corporation established a legal reserve of $1.2 million in connection with this case during the second quarter of 2016.

Subsequent to an appeal of the lower court determination, which was perfected in the Appellate Division, Third Department of State Supreme Court, on June 29, 2017, the Bank received Notice of Entry of the decision and Order of that Court which affirmed the lower court’s decision in favor of the plaintiff with damages to be determined at a later proceeding. The Bank established an additional legal reserve in the amount of $850 thousand, in connection with this case, during the second quarter of 2017. The Bank’s total reserve with respect to this matter now stands at $2.3 million, including $0.2 million accrued for related expenses not yet paid. A motion to the Appellate Division for reargument or permission for leave to appeal to the Court of Appeals has been filed and a determination on that is pending.

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

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

The components of net periodic expense for the Corporation's pension and other benefit plans for the periods indicated are as follows (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2017	2016	2017	2016
Qualified Pension Plan				
Service cost, benefits earned during the period	$—	$298	$—	$892
Interest cost on projected benefit obligation	403	470	1,209	1,410
Expected return on plan assets	(785)	(756)	(2,355)	(2,267)
Amortization of unrecognized transition obligation	—	—	—	—
Amortization of unrecognized prior service cost	—	1	—	5
Amortization of unrecognized net loss	58	383	174	1,150
Net periodic pension cost (benefit)	$(324)	$396	$(972)	$1,190
Supplemental Pension Plan				
Service cost, benefits earned during the period	$—	$11	$—	$32
Interest cost on projected benefit obligation	12	13	36	39
Expected return on plan assets	—	—	—	—
Amortization of unrecognized prior service cost	—	—	—	—
Amortization of unrecognized net loss	1	6	3	19
Net periodic supplemental pension cost	$13	$30	$39	$90
Postretirement Plan, Medical and Life				
Service cost, benefits earned during the period	$—	$11	$—	$35
Interest cost on projected benefit obligation	3	18	11	53
Expected return on plan assets	—	—	—	—
Amortization of unrecognized prior service cost	(55)	(23)	(165)	(72)
Amortization of unrecognized net loss	29	7	87	19
Net periodic postretirement, medical and life cost (benefit)	$(23)	$13	$(67)	$35

NOTE 11 SEGMENT REPORTING

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

Accounting policies for the segments are the same as those described in Note 1 of the Corporation's 2016 Annual Report on Form 10-K, which was filed with the SEC on March 8, 2017. Summarized financial information concerning the Corporation's reportable segments and the reconciliation to the Corporation's consolidated results are shown in the following table. Income taxes are allocated based on the separate taxable income of each entity and indirect overhead expenses are allocated based on reasonable and equitable allocations applicable to the reportable segment. CFS amounts are the primary differences between segment amounts and consolidated totals, and are reflected in the

Holding Company, CFS, and CRM column below, along with amounts to eliminate transactions between those segments (in thousands).

	Three months ended September 30, 2017			
	Core Banking	WMG	Holding Company, CFS, and CRM	Consolidated Totals
Interest and dividend income	$15,487	$—	$ 10	$ 15,497
Interest expense	734	—	—	734
Net interest income	14,753	—	10	14,763
Provision for loan losses	1,289	—	—	1,289
Net interest income after provision for loan losses	13,464	—	10	13,474
Other non-interest income	2,989	2,147	30	5,166
Legal accruals and settlements	—	—	—	—
Other non-interest expenses	11,651	1,370	255	13,276
Income (loss) before income tax expense (benefit)	4,802	777	(215)	5,364
Income tax expense (benefit)	1,457	295	(42)	1,710
Segment net income (loss)	$3,345	$482	$ (173)	$ 3,654

	Three months ended September 30, 2016			
	Core Banking	WMG	Holding Company, CFS, and CRM	Consolidated Totals
Interest and dividend income	$14,022	$—	$ 3	$ 14,025
Interest expense	985	—	—	985
Net interest income	13,037	—	3	13,040
Provision for loan losses	1,050	—	—	1,050
Net interest income after provision for loan losses	11,987	—	3	11,990
Other non-interest income	3,240	2,027	168	5,435
Legal accruals and settlements	—	—	—	—
Other non-interest expenses	11,888	1,293	290	13,471
Income (loss) before income tax expense (benefit)	3,339	734	(119)	3,954
Income tax expense (benefit)	974	277	(42)	1,209
Segment net income (loss)	$2,365	$457	$ (77)	$ 2,745

	Nine months ended September 30, 2017			
	Core Banking	WMG	Holding Company, CFS, and CRM	Consolidated Totals
Interest and dividend income	$44,478	$—	$ 17	$ 44,495
Interest expense	2,288	—	—	2,288
Net interest income	42,190	—	17	42,207
Provision for loan losses	2,750	—	—	2,750
Net interest income after provision for loan losses	39,440	—	17	39,457
Other non-interest income	8,228	6,525	282	15,035
Legal settlements	850	—	—	850
Other non-interest expenses	34,795	4,142	866	39,803
Income (loss) before income tax expense (benefit)	12,023	2,383	(567)	13,839
Income tax expense (benefit)	3,523	904	(177)	4,250
Segment net income (loss)	$8,500	$1,479	$ (390)	$ 9,589
Segment assets	$1,721,571	$4,112	$ 5,999	$ 1,731,682

	Nine months ended September 30, 2016			
	Core Banking	WMG	Holding Company, CFS, and CRM	Consolidated Totals
Interest and dividend income	$41,893	$—	$ 6	$ 41,899
Interest expense	2,866	—	—	2,866
Net interest income	39,027	—	6	39,033
Provision for loan losses	2,033	—	—	2,033
Net interest income after provision for loan losses	36,994	—	6	37,000
Other non-interest income	9,516	6,240	496	16,252
Legal accruals and settlements	1,200	—	—	1,200
Other non-interest expenses	36,605	4,251	993	41,849
Income (loss) before income tax expense (benefit)	8,705	1,989	(491)	10,203
Income tax expense (benefit)	2,591	751	(212)	3,130
Segment net income (loss)	$6,114	$1,238	$ (279)	$ 7,073
Segment assets	$1,721,739	$4,398	$ 2,728	$ 1,728,865

NOTE 12 STOCK COMPENSATION

Board of Directors' Stock Compensation

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

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

During January 2017 and 2016, 7,880 and 9,532 shares, respectively, were re-issued from treasury to fund the stock component of directors' compensation. An expense of $68 thousand and $65 thousand related to this compensation was recognized during the three-month periods ended September 30, 2017 and 2016, respectively. An expense of $222 thousand and $200 thousand related to this compensation was recognized during the nine month periods ended September 30, 2017 and 2016, respectively. This expense is accrued as shares are earned.

Restricted Stock Plan

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

A summary of restricted stock activity for the three month period ended September 30, 2017 is presented below:

	Shares	Weighted–Average Grant Date Fair Value
Nonvested at July 1, 2017	22,240	$ 29.96
Granted	—	—
Vested	—	—
Forfeited or cancelled	—	—
Nonvested at September 30, 2017	22,240	$ 29.96

A summary of restricted stock activity for the nine month period ended September 30, 2017 is presented below:

	Shares	Weighted–Average Grant Date Fair Value
Nonvested at January 1, 2017	23,794	$ 29.90
Granted	—	—
Vested	(415)	26.59
Forfeited or cancelled	(1,139)	29.97
Nonvested at September 30, 2017	22,240	$ 29.96

As of September 30, 2017, there was $504 thousand of total unrecognized compensation cost related to nonvested shares granted under the Plan. The cost is expected to be recognized over a weighted-average period of 3.21 years. The total fair value of shares vested was $16 thousand and $17 thousand for the nine month periods ended September 30, 2017 and 2016, respectively.

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

Introduction

The following is the MD&A of the Corporation in this Form 10-Q for the nine months ended September 30, 2017 and 2016. Reference should be made to the accompanying unaudited consolidated financial statements and footnotes, and the Corporation's 2016 Annual Report on Form 10-K, which was filed with the SEC on March 8, 2017, for an understanding of the following discussion and analysis. See the list of commonly used abbreviations and terms on pages 3–5.

The MD&A included in this Form 10-Q contains statements that are forward-looking within the meaning of the Private Securities Litigation Reform Act of 1995. These statements are based on the current beliefs and expectations of the Corporation's management and are subject to significant risks and uncertainties. Actual results may differ from those set forth in the forward-looking statements. For a discussion of those risks and uncertainties and the factors that could cause the Corporation's actual results to differ materially from those risks and uncertainties, see Forward-looking Statements below and Part I, Item 1A, Risk Factors, on pages 17–22 of the Corporation's 2016 Annual Report. For a discussion of use of non-GAAP financial measures, see pages 60–63 of the Corporation's 2016 Annual Report or pages 70-73 in this Form 10-Q.

The Corporation has been a financial holding company since 2000, the Bank was established in 1833, CFS in 2001, and CRM in 2016. Through the Bank and CFS, the Corporation provides a wide range of financial services, including demand, savings and time deposits, commercial, residential and consumer loans, interest rate swaps, letters of credit, wealth management services, employee benefit plans, insurance products, mutual funds and brokerage services. The Bank relies substantially on a foundation of locally generated deposits. The Corporation, on a stand-alone basis, has minimal results of operations. The Bank derives its income primarily from interest and fees on loans, interest income on investment securities, WMG fee income, and fees received in connection with deposit and other services. The Bank’s operating expenses are interest expense paid on deposits and borrowings, salaries and employee benefit plans, and general operating expenses. CRM is a Nevada-based captive insurance company which insures against certain risks unique to the operations of the Corporation and its subsidiaries and for which insurance may not be currently available or economically feasible in today's insurance marketplace. CRM pools resources with several other similar insurance company subsidiaries of financial institutions to spread a limited amount of risk among themselves.

Forward-looking Statements

This discussion contains forward-looking statements within the meaning of Section 27A of the Securities Act and Section 21E of the Exchange Act. The Corporation intends its forward-looking statements to be covered by the safe harbor provisions for forward-looking statements in these sections. All statements regarding the Corporation's expected financial position and operating results, the Corporation's business strategy, the Corporation's financial plans, forecasted demographic and economic trends relating to the Corporation's industry and similar matters are forward-looking statements. These statements can sometimes be identified by the Corporation's use of forward-looking words such as "may," "will," "anticipate," "estimate," "expect," or "intend." The Corporation cannot promise that its expectations in such forward-looking statements will turn out to be correct. The Corporation's actual results could be materially different from expectations because of various factors, including changes in economic conditions or interest rates, credit risk, difficulties in managing the Corporation’s growth, competition, changes in law or the regulatory environment, including the Dodd-Frank Act, and changes in general business and economic trends. Information concerning these and other factors can be found in the Corporation’s periodic filings with the SEC, including the discussion under the heading “Item 1A. Risk Factors” in the Corporation’s 2016 Annual Report on Form 10-K. These filings are available publicly on the SEC’s web site at http://www.sec.gov, on the Corporation's web site at http://www.chemungcanal.com or upon request from the Corporate Secretary at (607) 737-3746. Except as otherwise required by law, the Corporation undertakes no obligation to publicly update or revise its forward-looking statements, whether as a result of new information, future events or otherwise.

Consolidated Financial Highlights

	As of or for the Three Months Ended					As of or for the Nine Months Ended	
	Sept. 30,	June 30,	March 31,	Dec. 31,	Sept. 30,	Sept. 30,	Sept. 30,
(in thousands, except per share data)	2017	2017	2017	2016	2016	2017	2016
RESULTS OF OPERATIONS							
Interest income	$15,497	$14,684	$14,314	$14,269	$14,025	$44,495	$41,899
Interest expense	734	734	820	973	985	2,288	2,866
Net interest income	14,763	13,950	13,494	13,296	13,040	42,207	39,033
Provision for loan losses	1,289	421	1,040	404	1,050	2,750	2,033
Net interest income after provision for loan losses	13,474	13,529	12,454	12,892	11,990	39,457	37,000
Non-interest income	5,166	5,022	4,847	4,897	5,435	15,035	16,252
Non-interest expense	13,276	14,332	13,045	13,561	13,471	40,653	43,049
Income before income tax expense	5,364	4,219	4,256	4,228	3,954	13,839	10,203
Income tax expense	1,710	1,263	1,277	1,274	1,209	4,250	3,130
Net income	$3,654	$2,956	$2,979	$2,954	$2,745	$9,589	$7,073
Basic and diluted earnings per share	$0.76	$0.62	$0.62	$0.62	$0.58	$2.00	$1.49
Average basic and diluted shares outstanding	4,802	4,797	4,790	4,773	4,765	4,796	4,758
PERFORMANCE RATIOS							
Return on average assets	0.85 %	0.69 %	0.71 %	0.69 %	0.65 %	0.75 %	0.57 %
Return on average equity	9.46 %	7.90 %	8.24 %	8.20 %	7.55 %	8.54 %	6.62 %
Return on average tangible equity (a)	11.24 %	9.43 %	9.90 %	9.92 %	9.14 %	10.21 %	8.05 %
Efficiency ratio (a) (b)	64.83 %	69.28 %	69.25 %	72.63 %	71.28 %	67.72 %	75.03 %
	3.09 %	3.34 %	3.12 %	3.18 %	3.20 %	3.18 %	3.47 %

Non-interest expense to average assets														
Loans to deposits	83.85	%	82.14	%	79.93	%	82.42	%	80.62	%	83.85	%	80.62	%
YIELDS / RATES - Fully Taxable Equivalent														
Yield on loans	4.34	%	4.18	%	4.19	%	4.16	%	4.16	%	4.24	%	4.18	%
Yield on investments	2.16	%	2.01	%	2.00	%	1.75	%	1.73	%	2.05	%	1.86	%
Yield on interest-earning assets	3.86	%	3.65	%	3.66	%	3.57	%	3.58	%	3.72	%	3.63	%
Cost of interest-bearing deposits	0.20	%	0.20	%	0.20	%	0.21	%	0.21	%	0.20	%	0.21	%
Cost of borrowings	2.95	%	2.82	%	3.04	%	3.13	%	3.15	%	2.95	%	2.97	%
Cost of interest-bearing liabilities	0.27	%	0.26	%	0.30	%	0.35	%	0.36	%	0.27	%	0.35	%
Interest rate spread	3.59	%	3.39	%	3.36	%	3.22	%	3.22	%	3.45	%	3.28	%
Net interest margin, fully taxable equivalent	3.68	%	3.47	%	3.45	%	3.33	%	3.33	%	3.53	%	3.38	%
CAPITAL														
Total equity to total assets at end of period	8.91	%	8.84	%	8.54	%	8.67	%	8.38	%	8.91	%	8.38	%
Tangible equity to tangible assets at end of period (a)	7.62	%	7.53	%	7.23	%	7.29	%	7.03	%	7.62	%	7.03	%
Book value per share	$32.11		$31.67		$30.93		$30.07		$30.37		$32.11		$30.37	
Tangible book value per share	27.09		26.60		25.81		24.89		25.13		27.09		25.13	
Period-end market value per share	47.10		40.88		39.50		36.35		28.99		47.10		28.99	
Dividends declared per share	0.26		0.26		0.26		0.26		0.26		0.78		0.78	
AVERAGE BALANCES														
Loans and loans held for sale (c)	$1,259,919		$1,237,189		$1,215,445		$1,210,922		$1,199,367		$1,237,681		$1,189,105	

Earning assets	1,615,833	1,634,955	1,605,460	1,607,287	1,577,348	1,618,788	1,559,500
Total assets	1,707,111	1,723,664	1,694,199	1,699,059	1,674,492	1,708,360	1,656,313
Deposits	1,512,685	1,532,819	1,495,724	1,483,348	1,456,622	1,513,804	1,439,497
Total equity	153,244	150,155	146,642	143,388	144,631	150,038	142,745
Tangible equity (a)	129,024	125,720	121,988	118,502	119,504	125,603	117,372
ASSET QUALITY							
Net charge-offs	$699	$277	$333	$1,476	$393	$1,309	$968

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Non-performing loans (d)	14,028	15,208	12,914	12,043	12,903	14,028	12,903
Non-performing assets (e)	14,216	15,545	13,251	12,431	13,270	14,216	13,270
Allowance for loan losses	15,694	15,104	14,960	14,253	15,325	15,694	15,325
Annualized net charge-offs to average loans	0.22 %	0.09 %	0.11 %	0.48 %	0.13 %	0.14 %	0.11 %
Non-performing loans to total loans	1.09 %	1.21 %	1.05 %	1.00 %	1.06 %	1.09 %	1.06 %
Non-performing assets to total assets	0.82 %	0.90 %	0.76 %	0.75 %	0.77 %	0.82 %	0.77 %
Allowance for loan losses to total loans	1.22 %	1.21 %	1.21 %	1.19 %	1.26 %	1.22 %	1.26 %
Allowance for loan losses to non-performing loans	111.88 %	99.32 %	115.84 %	118.35 %	118.77 %	111.88 %	118.77 %

(a) See the GAAP to Non-GAAP reconciliations.
(b) Efficiency ratio is non-interest expense less merger and acquisition expenses less amortization of intangible assets less legal reserve divided by the total of fully taxable equivalent net interest income plus non-interest income less net gains on securities transactions.
(c) Loans and loans held for sale do not reflect the allowance for loan losses.
(d) Non-performing loans include non-accrual loans only.
(e) Non-performing assets include non-performing loans plus other real estate owned.

In addition to analyzing the Corporation's results on a reported basis, management uses certain non-GAAP financial measures because it believes these non-GAAP financial measures provide information to investors about the underlying operational performance and trends of the Corporation and, therefore, facilitate a comparison of the Corporation with the performance of its competitors. Non-GAAP financial measures used by the Corporation may not be comparable to similarly named non-GAAP financial measures used by other companies. Refer to pages 70-73 for further explanation and reconciliation of the Corporation's use of non-GAAP measures.

Executive Summary

This executive summary of the MD&A includes selected information and may not contain all of the information that is important to readers of this Form 10-Q. For a complete description of the trends and uncertainties, as well as the risks and critical accounting estimates affecting the Corporation, this Form 10-Q should be read in its entirety.

The following table presents selected financial information for the periods indicated, and the dollar and percent change (in thousands, except per share and ratio data):

	Three Months Ended September 30,			
	2017	2016	Change	Percentage Change
Net interest income	$14,763	$13,040	$1,723	13.2 %
Non-interest income	5,166	5,435	(269)	(4.9)%
Non-interest expense	13,276	13,471	(195)	(1.4)%
Pre-provision income	6,653	5,004	1,649	33.0 %
Provision for loan losses	1,289	1,050	239	22.8 %
Income tax expense	1,710	1,209	501	41.4 %
Net income	$3,654	$2,745	$909	33.1 %
Basic and diluted earnings per share	$0.76	$0.58	$0.18	31.0 %
Selected financial ratios:				
Return on average assets	0.85 %	0.65 %		

Return on average equity	9.46	%	7.55	%
Net interest margin, fully taxable equivalent	3.68	%	3.33	%
Efficiency ratio	64.83	%	71.28	%
Non-interest expenses to average assets	3.09	%	3.20	%

Net income for the third quarter of 2017 was $3.7 million, or $0.76 per share, compared with a net income of $2.7 million, or $0.58 per share, for the same period in the prior year. Return on average equity for the quarter was 9.46%, compared with 7.55% for the prior year quarter. The increase in net income was driven by an increase in net interest income and a reduction in non-interest expense, offset by a decrease in non-interest income and increases in the provision for loan losses and income tax expense.

Net interest income
Net interest income increased $1.7 million, or 13.2%, compared with the same period in the prior year. The increase was due primarily to interest income from the commercial loan portfolio, taxable and tax exempt securities, and interest-bearing deposits and decreases in interest expense on deposits, securities sold under agreements to repurchase, and borrowed funds.

Non-interest income
Non-interest income decreased $0.3 million, or 4.9%, compared to the same period in the prior year. The decrease was due primarily to a decrease in interchange revenue from debit card transactions.

Non-interest expenses
Non-interest expenses decreased $0.2 million, or 1.4%, compared to the prior year quarter. The decrease was due primarily to a decrease in pension and other employee benefits, offset by increases in salaries and wages, marketing and advertising, and other non-interest expense. For the three months ended September 30, 2017, non-interest expense to average assets was 3.09%, compared with 3.20% for the same period in the prior year.

Provision for loan losses
The provision for loan losses increased $0.2 million, or 22.8%, compared to the same period in the prior year. The increase was due primarily to growth in the commercial mortgages and indirect consumer loan portfolios and additional reserves on problem assets previously identified during the three months ended September 30, 2017. Net charge-offs increased $0.3 million, compared with the same period in the prior year.

Income tax expense
Income tax expensed increased $0.5 million, or 41.4%, compared to the prior year quarter. The increase was due primarily to higher income before income tax expense, offset by an increase in the income generated by CCTC Funding Corp., a real estate investment trust subsidiary of the Bank, and a tax exclusion for insurance premiums within CRM.

The following table presents selected financial information for the periods indicated, and the dollar and percent change (in thousands, except per share and ratio data):

	Nine Months Ended September 30,			
	2017	2016	Change	Percentage Change
Net interest income	$42,207	$39,033	$3,174	8.1 %
Non-interest income	15,035	16,252	(1,217)	(7.5)%
Non-interest expense	40,653	43,049	(2,396)	(5.6)%
Pre-provision income	16,589	12,236	4,353	35.6 %
Provision for loan losses	2,750	2,033	717	35.3 %
Income tax expense	4,250	3,130	1,120	35.8 %
Net income	$9,589	$7,073	$2,516	35.6 %
Basic and diluted earnings per share	$2.00	$1.49	$0.51	34.2 %

Selected financial ratios:				
Return on average assets	0.75	%	0.57	%
Return on average equity	8.54	%	6.62	%
Net interest margin, fully taxable equivalent	3.53	%	3.38	%
Efficiency ratio	67.72	%	75.03	%
Non-interest expense to average assets	3.18	%	3.47	%

Net income for the nine months ended September 30, 2017 was $9.6 million, or $2.00 per share, compared with a net income of $7.1 million, or $1.49 per share, for the same period in the prior year. Return on average equity for the nine months ended September 30, 2017 was 8.54%, compared with 6.62% for the same period in the prior year. The increase in net income from the prior year was driven by an increase in net interest income and a reduction in non-interest expense, offset by a decrease in non-interest income and increases in the provision for loan losses and income tax expense.

Net interest income
Net interest income increased $3.2 million, or 8.1%, compared with the same period in the prior year. The increase was due primarily to interest income from the commercial loan portfolio, taxable and tax exempt securities, and interest-bearing deposits and decreases in interest expense on securities sold under agreements to repurchase and borrowed funds.

Non-interest income
Non-interest income decreased $1.2 million, or 7.5%, compared to the same period in the prior year. The decrease was due primarily to net gains on securities transactions during the first quarter of 2016 and decreases in service charges on deposit accounts, interchange revenue from debit card transactions, and other non-interest income, offset by an increase in WMG fee income.

Non-interest expenses
Non-interest expenses decreased $2.4 million, or 5.6%, compared to the same period in the prior year. The decrease was due primarily to decreases in pension and other employee benefits, net occupancy expense, furniture and equipment, data processing expense, professional services, legal accruals and settlements, marketing and advertising, and other real estate owned expense, offset by increases in salaries and wages and other non-interest expense. For the nine months ended September 30, 2017, non-interest expense to average assets was 3.18%, compared with 3.47% for the same period in the prior year.

Provision for loan losses
The provision for loan losses increased $0.7 million, or 35.3%, compared to the same period in the prior year. The increase was due primarily to growth in the commercial mortgages and indirect loan portfolios and additional reserves on problem assets previously identified during the nine months ended September 30, 2017. Net charge-offs increased $0.3 million, compared with the same period in the prior year.

Income tax expense
Income tax expensed increased $1.1 million, or 35.8%, compared to the same period in the prior year. The increase was due primarily to higher income before income tax expense, offset by an increase in the income generated by CCTC Funding Corp., a real estate investment trust subsidiary of the Bank, and a tax exclusion for insurance premiums within CRM.

Consolidated Results of Operations

The following section of the MD&A provides a comparative discussion of the Corporation's Consolidated Results of Operations on a reported basis for the three and nine months ended September 30, 2017 and 2016. For a discussion of the Critical Accounting Policies, Estimates and Risks and Uncertainties that affect the Consolidated Results of Operations, see page 69 of this Form 10-Q and pages 60 of the Corporation's 2016 Annual Report.

Net Interest Income

The following table presents net interest income for the periods indicated, and the dollar and percent change (in thousands):

	Three Months Ended September 30,			
	2017	2016	Change	Percentage Change
Interest and dividend income	$15,497	$14,025	$1,472	10.5 %
Interest expense	734	985	(251)	(25.5)%
Net interest income	$14,763	$13,040	$1,723	13.2 %

Net interest income, which is the difference between the interest income earned on interest-earning assets such as loans and securities, and the interest expense accrued on interest-bearing liabilities such as deposits and borrowings, is the largest contributor to the Corporation's earnings.

Net interest income for the three months ended September 30, 2017 totaled $14.8 million compared with $13.0 million for the same period in the prior year, an increase of $1.7 million, or 13.2%. Fully taxable equivalent net interest margin was 3.68% for the three months ended September 30, 2017 compared with 3.33% for the same period in the prior year. The increase in net interest income was due primarily to an increase of $38.5 million in interest-earning assets. The yield on interest-earning assets increased 28 basis points, while the cost of interest-bearing liabilities decreased nine basis points compared to the same period in the prior year. The increase in the yield on interest-earning assets can be mostly attributed to a 43 basis point increase in the yield on investments due to the reinvestment of maturing securities into higher yielding mortgage-backed and municipal securities, along with an 18 basis point increase in the yield on loans due to payoffs of nonaccrual loans and an increase in PRIME and LIBOR. The decline in the cost of interest-bearing liabilities can be attributed to a 20 basis point decline in the cost of borrowings due to the maturity of one $10.0 million FHLB term advance (4.60% rate) in December 2016 and one $10.0 million repurchase agreement (4.54% rate) in March 2017.

The following table presents net interest income for the periods indicated, and the dollar and percent change (in thousands):

	Nine Months Ended September 30,			
	2017	2016	Change	Percentage Change
Interest and dividend income	$44,495	$41,899	$2,596	6.2 %
Interest expense	2,288	2,866	(578)	(20.2)%
Net interest income	$42,207	$39,033	$3,174	8.1 %

Net interest income for the nine months ended September 30, 2017 totaled $42.2 million compared with $39.0 million for the same period in the prior year, an increase of $3.2 million, or 8.1%. Fully taxable equivalent net interest margin was 3.53% for the nine months ended September 30, 2017 compared with 3.38% for the same period in the prior year. The increase in net interest income was due primarily to an increase of $59.3 million in average interest-earning assets. The yield on interest-earning assets increased nine basis points, while the cost of interest-bearing liabilities decreased eight basis points compared to the same period in the prior year. The increase in the yield on interest-earning assets can be mostly attributed to a 19 basis point increase in the yield on investments due to the reinvestment of maturing securities into higher yielding mortgage-backed and municipal securities, along with an six basis point increase in the yield on loans due to payoffs of nonaccrual loans and an increase in PRIME and LIBOR. The decline in the cost of interest-bearing liabilities can be attributed to a two basis point decline in the cost of borrowings due to the maturity of one $10.0 million FHLB term advance (4.60% rate) in December 2016 and one $10.0 million repurchase agreement (4.54% rate) in March 2017.

Average Consolidated Balance Sheet and Interest Analysis

The following tables present certain information related to the Corporation's average consolidated balance sheets and its consolidated statements of income for the three and nine months ended September 30, 2017 and 2016. For the purpose of the table below, non-accruing loans are included in the daily average loan amounts outstanding. Daily balances were used for average balance computations. Investment securities are stated at amortized cost. Tax equivalent adjustments have been made in calculating yields on obligations of states and political subdivisions, tax-free commercial loans and dividends on equity investments.

AVERAGE CONSOLIDATED BALANCE SHEETS AND NET INTEREST INCOME ANALYSIS

(in thousands)	Three Months Ended September 30, 2017				Three Months Ended September 30, 2016			
	Average Balance	Interest	Yield/Rate		Average Balance	Interest	Yield/Rate	
Interest-earning assets:								
Commercial loans	$799,505	$9,037	4.48	%	$741,515	$7,967	4.27	%
Mortgage loans	199,396	1,963	3.91	%	197,292	1,950	3.93	%
Consumer loans	261,018	2,782	4.23	%	260,559	2,623	4.00	%
Taxable securities	271,529	1,371	2.00	%	268,388	1,225	1.82	%
Tax-exempt securities	57,127	467	3.24	%	43,692	329	3.00	%
Interest-bearing deposits	27,258	97	1.41	%	65,902	85	0.51	%
Total interest-earning assets	1,615,833	15,717	3.86	%	1,577,348	14,179	3.58	%
Non-earning assets:								
Cash and due from banks	26,036				27,420			
Premises and equipment, net	27,774				29,575			
Other assets	53,944				50,397			
Allowance for loan losses	(15,179)				(14,783)			
AFS valuation allowance	(1,297)				4,535			
Total assets	$1,707,111				$1,674,492			
Interest-bearing liabilities:								
Interest-bearing demand deposits	$138,364	$32	0.09	%	$122,030	$27	0.09	%
Savings and insured money market deposits	801,580	398	0.20	%	769,855	392	0.20	%
Time deposits	130,445	115	0.35	%	154,618	142	0.37	%
FHLBNY advances, securities sold under agreements to repurchase, and other debt	25,405	189	2.95	%	53,619	424	3.15	%
Total interest-bearing liabilities	1,095,794	734						