## DIVISION OF BANKING SUPERVISION AND REGULATION BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

Elmira
Savings Bank
The People's Bank

20<sup>th</sup> Street and Constitution Avenue, N.W. Washington, DC 20551

#### **FORM 10-K**

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

For the fiscal year ended December 31, 2013

NEW YORK (State or other jurisdiction of incorporation or organization)			VINGS BANK gistrant as specified in it	s Charter)	16-0422120 (IRS Employer ID Number)
Address of Principal Exc Registrant's telephone r		area code:	333 East V (607) 735-	Vater Street, Elm 8660	ira, NY 14901
Securities registered pu Securities registered pu				ommon Stock (\$ <sup>2</sup>	1.00 par value)
Indicate by check mark YES [ ] NO [X]	if the registrant is	a well-known s	easoned issuer, as	defined in Rule	105 of Securities Act:
	ct of 1934 during	the preceding	12 months (or suc	ch shorter period	ction 13 or 15(d) of the d that the registrant was t 90 days:
Indicate the number of date.	shares outstandir	ng of each of th	ne issuer's classes	of common stoc	k, as of the last practical
date.	\$1.00 par value (	Common Stock		2,682,086 share utstanding March 18, 20	
Indicate by check mark Exchange Act: YES[]		s not required t	o file reports pursu	ant to Section 1	3 or Section 15(d) of the
any, every interactive d	ata file to be subreeding 12 months	nitted and post	ed pursuant to Rule	e 405 of Regulat	n its corporate website, if ion S-T (§232.405 of this as required to submit and
	contained, to the b	pest of Registra	nt's knowledge, in	definitive proxy of	ion S-K is not contained or information statements
	ompany. See def	finitions of "acc			r, a non-accelerated filer, er" and "smaller reporting
Large Accelerated Filer	Accelerate	d Filer	Non-Accelerated Filer _	Smaller Repo	rting Company <u>X</u>
Indicate by check mark	whether the regi	strant is a shel YES[] No		ned in Rule 12b	-2 of the Exchange Act):
					une 30, 2013 was \$51.8 ne Registrant's Common
Otook.	DOCUM	ENTS INCORP	ORATED BY REFE	ERENCE	

Documents
Definitive Proxy Statement for the April 22, 2014
Annual Meeting of Shareholders

Part of 10-K into which incorporated

Part III

## ANNUAL REPORT FOR 2013 ON FORM 10-K ELMIRA SAVINGS BANK

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#### PART I

#### Item 1 - Business

## **Forward-Looking Statements**

This Form 10-K contains forward-looking statements, which can be identified by the use of such words as estimate, project, believe, intend, anticipate, plan, seek, expect, and similar expressions. These forward-looking statements include:

- Statements of our goals, intentions and expectations;
- Statements regarding our business plans, prospects, growth and operating strategies;
- Statements regarding the asset quality of our loan and investment portfolios; and
- Estimates of our risks and future costs and benefits.

These forward-looking statements are subject to significant risks, assumptions, and uncertainties, including among other things, the following important factors that could affect the actual outcome of future events:

- Significantly increased competition among depository and other financial institutions;
- Changes in the interest rate environment that reduce our margins or reduce the fair value of financial instruments:
- General economic conditions, either nationally or in our market areas, that are worse than expected;
- Adverse changes in the securities markets;
- Legislative or regulatory changes that adversely affect our business:
- Our ability to enter new markets successfully and capitalize on growth opportunities;
- Changes in consumer spending, borrowing and saving habits;
- Changes in accounting policies and practices, as may be adopted by the Financial Accounting Standards Board; and
- Changes in our organization, compensation and benefit plans.

The Company cautions readers not to place undue reliance on any forward-looking statements, which speak only as of the date made, and advises readers that various factors, including those described above, could affect the Company's financial performance and could cause the Company's actual results or circumstances for future periods to differ materially from those anticipated or projected.

Except as required by law, the Company does not undertake, and specifically disclaims any obligation, to publicly release any revisions to any forward-looking statements to reflect the occurrence of anticipated or unanticipated events or circumstances after the date of such statements.

#### General

Elmira Savings Bank ("Bank") was organized in 1869 as a New York chartered mutual savings bank under the name of Southern Tier Savings Bank. In 1890, the Bank's name was changed to The Elmira Savings Bank. In 1983, the Bank converted from a state charter to a federally chartered mutual savings bank. In March 1985, the Bank became a stock savings bank with its

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	ct of 1934 during	the preceding	12 months (or suc	ch shorter period	ction 13 or 15(d) of the d that the registrant was t 90 days:
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Part III

first stock offering. As of January 1, 2012, the Bank converted from a federally chartered savings bank to a New York State chartered savings bank. The Bank conducts its business through twelve full-service offices located in Chemung, Tompkins, Cayuga, and Steuben Counties, New York, one limited service office located in Tompkins County, New York, one limited service office located in Broome County, New York, one limited service office located in Cortland County, New York, and one cashless branch in Schuyler County, New York. The main office is located at 333 East Water Street, Elmira, New York.

The Bank has two subsidiaries: ESB Realty Corp. and ESB Advisory Services, Inc. ESB Realty Corp. operates as a real estate investment trust. The Bank offers financial services products and financial planning advisory services through its wholly-owned subsidiary, ESB Advisory Services, Inc.

The Bank is engaged primarily in the business of attracting deposits from the general public and originating mortgage loans secured by first and second liens on one-to-four family residences; consumer loans on automobiles; general consumer loans; commercial real estate loans; and commercial loans. The Bank offers a wide variety of services to its individual and commercial customers.

The Bank's deposits are insured by the Federal Deposit Insurance Corporation ("FDIC"). The Bank is chartered by the New York State Department of Financial Services ("NYSDFS") and is thus subject to regulation and examination by both regulatory agencies. The Bank is a member bank of the Federal Reserve System and therefore, the Federal Reserve Board ("FRB") serves as its primary federal regulator. The Bank is also a member of the Federal Home Loan Bank System.

#### **Market Area**

The Bank's market areas are in Elmira, New York, and Ithaca, New York, and include the surrounding communities in the southern tier and central New York region. The Bank's Elmira market area is characterized by a stable population, moderate household incomes, and a stable and diverse industrial and service corporation base. Education plays a significant role in the economy in the Bank's Ithaca market area with Cornell University and Ithaca College being two of the area's major employers. The Ithaca market area is also marked by moderate population growth and a low rate of unemployment, relative to other areas of New York State.

#### Competition

The Bank faces intense competition in its market areas both in attracting deposits and originating loans. This competition comes primarily from commercial banks, credit unions, brokerage companies, consumer finance companies and mortgage companies. Within the Bank's market areas there are many competing banking institutions, including some substantially larger than the Bank.

The Bank competes for loans primarily on the basis of the quality of service provided to borrowers, types of loans originated, loan fees, and loan rates. The Bank competes for deposits based on the convenience of its branch locations and operating hours, quality of service, the scope of services provided, and interest rates paid on deposits.

### Regulation

The operations of the Bank and all savings institutions are significantly affected by prevailing economic conditions as well as government economic policies and regulations concerning monetary and fiscal policy, taxes, housing, financial institutions, regulatory burdens on bank products, and regulatory policy on competitors of the savings industry.

The Bank is chartered by the NYSDFS. The primary federal regulatory authority for the Bank is the FRB. The FRB and the NYSDFS set regulations on the types of loans and investments the Bank is allowed to make and hold, the types of deposit products the Bank can offer, and the activities the Bank can participate in.

#### Insurance of Deposit Accounts

Deposits of the Bank are insured by the FDIC up to statutory and regulatory limits, therefore, the Bank is subject to regulation, supervision and reporting requirements of the FDIC. The FDIC has adopted a regulation that defines and sets the minimum requirements for capital adequacy. Under this regulation, the Bank is required to maintain capital ratios similar to those required by other federal financial regulatory agencies.

The Dodd-Frank Act permanently increased the maximum amount of deposit insurance for banks, savings institutions and credit unions to \$250,000 per depositor per insured institution. The deposits of the Bank are insured up to regulatory limits by the FDIC. The Federal Deposit Insurance Reform Act of 2005 gave the FDIC increased flexibility in assessing premiums on banks and savings associations, including the Bank, to pay for deposit insurance and in managing its deposit insurance reserves. The FDIC currently maintains a risk-based assessment system under which assessment rates vary based on the level of risk posed by institutions to the Deposit Insurance Fund ("DIF"). On February 8, 2011, the FDIC issued new rules that took effect April 1, 2011 to change the way the FDIC differentiates risk and sets appropriate assessment rates.

On February 9, 2011, the FDIC adopted a final rule as required by the Dodd-Frank Act which redefined the deposit insurance assessment base as average consolidated total assets minus average tangible equity, which led to a decrease in FDIC assessment expenses for the Bank. FDIC assessment expenses for the Bank totaled \$334,000 in 2011, \$276,000 in 2012, and \$306,000 in 2013.

In addition, all institutions with deposits insured by the Federal Deposit Insurance Corporation are required to pay assessments to fund interest payments on bonds issued by the Financing Corporation, a mixed-ownership government corporation established to recapitalize the predecessor to the DIF. These assessments will continue until the Financing Corporation bonds mature in 2019.

The FDIC may terminate the deposit insurance of any insured depository institution, including the Bank, if it determines after a hearing that the institution has engaged or is engaging in unsafe or unsound practices, is in an unsafe or unsound condition to continue operations, or has violated any applicable law, regulation, order or any condition imposed by an agreement with the FDIC. It also may suspend deposit insurance temporarily during the hearing process for the permanent termination of insurance, if the institution has no tangible capital. If insurance of accounts is terminated, the accounts at the institution at the time of the termination, less subsequent withdrawals, shall continue to be insured for a period of six months to two years, as

determined by the FDIC. Management is not aware of any existing circumstances which could result in termination of the Bank's deposit insurance.

### Other Legislation

Sarbanes-Oxley Act

The Sarbanes-Oxley Act addresses, among other issues, corporate governance, auditor independence and auditing standards, executive compensation, insider loans, whistleblower protection, and enhanced and timely disclosure of corporate information. The Securities and Exchange Commission ("SEC") has adopted or proposed several implementation rules, and the National Association of Securities Dealers ("NASD") has proposed corporate governance rules that have been presented to the SEC for review and approval. The proposed changes are intended to allow stockholders to monitor more effectively the performance of companies and management.

As directed by section 302(a) of the Sarbanes-Oxley Act, the Company's Chief Executive Officer and Chief Financial Officer are each required to certify that the Company's quarterly and annual reports do not contain any untrue statement of a material fact. This requirement has several parts, including certification that these officers are responsible for establishing, maintaining and regularly evaluating the effectiveness of the Company's internal controls; that they have made certain disclosures to the Company's auditors and the Audit Committee of the Board of Directors about the Company's internal controls; and that they have included information in the Company's quarterly and annual reports about their evaluation and whether there have been significant changes in the Company's internal controls or in other factors that could significantly affect internal controls subsequent to the evaluation.

In response to the Sarbanes-Oxley Act of 2002, the Bank has established a Corporate Governance Committee, designated a financial expert on the Board of Directors, adopted a bank-wide Code of Ethical Conduct, Chief Financial Officer Code of Conduct, Director and Executive Officer Code of Conduct, and has adopted a Whistleblower policy and procedures.

#### Dodd-Frank Wall Street Reform and Consumer Protection Act

On July 21, 2010, the President signed into law the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act"). The financial reform and consumer protection act imposes new restrictions and an expanded framework of regulatory oversight for financial institutions, including depository institutions.

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. The federal agencies are given significant discretion in drafting such rules and regulations, and consequently, many of the details and much of the impact of the Dodd-Frank Act may not be known for months or years.

The Dodd-Frank Act broadened the base for FDIC insurance assessments. Assessments are now based on the average consolidated total assets less tangible equity capital of a financial institution. The Dodd-Frank Act also permanently increased the maximum amount of deposit insurance for banks, savings institutions and credit unions to \$250,000 per depositor.

The Dodd-Frank Act requires publicly traded companies to give stockholders a non-binding vote on executive compensation and so-called "golden parachute" payments, and allow greater

access by shareholders to the company's proxy material by authorizing the SEC to promulgate rules that would allow stockholders to nominate their own candidates using a company's proxy materials.

The Dodd-Frank Act created a new Consumer Financial Protection Bureau with broad powers to supervise and enforce consumer protection laws. The Consumer Financial Protection Bureau has broad rule-making authority for a wide range of consumer protection laws that apply to all banks and savings institutions, including the authority to prohibit "unfair, deceptive or abusive" acts and practices. The Consumer Financial Protection Bureau has examination and enforcement authority over all banks and savings institutions with more than \$10 billion in assets. Banks and savings institutions with \$10 billion or less in assets, such as the Bank, will continue to be examined for compliance with the consumer laws by their primary bank regulators. The Dodd-Frank Act also weakens the federal preemption rules that have been applicable for national banks and federal savings associations, and gives state attorneys general the ability to enforce federal consumer protection laws.

It is difficult to predict at this time what specific impact the Dodd-Frank Act and the yet to be written implementing rules and regulations will have on community banks. However, it is likely that at a minimum the implementation of these rules and regulations would increase our operating and compliance costs.

## **Employees**

At March 18, 2014, the Bank had 124 employees, 10 of whom were part-time.

#### Item 1A - Risk Factors

## Changes in Market Interest Rates could Adversely Affect our Results of Operations and Financial Condition

Our results of operations and financial condition are significantly affected by changes in interest rates. Our results of operations are substantially dependent on our net interest income, which is the difference between the interest income earned on our interest-earning assets and the interest expense paid on our interest-bearing liabilities. Because as a general matter our interest-bearing liabilities reprice or mature more quickly than our interest-earning assets, an increase in interest rates generally would result in a decrease in our average interest rate spread and net interest income.

Changes in interest rates also affect the value of our interest-earning assets, and in particular, our securities portfolio. Generally, the value of debt securities fluctuates inversely with changes in interest rates. Changes in the unrealized gains and losses on our securities available-for-sale could have an adverse effect on stockholders' equity.

We are also subject to reinvestment risk relating to interest rate movements. Changes in interest rates can affect the average life of loans and mortgage-related securities. Decreases in interest rates can result in prepayments of loans and mortgage-related securities, as borrowers refinance to reduce borrowing costs. Under these circumstances, we are subject to reinvestment risk to the extent that we are unable to reinvest such prepayments at rates that are comparable to the rates on existing loans or securities.

## Our Commercial Real Estate, Commercial and Consumer Loans Expose us to Increased Lending Risks

Commercial real estate, commercial and industrial and consumer loans expose a lender to a greater risk of loss than one-to-four-family residential loans. Commercial real estate and commercial and industrial loans typically involve larger loan balances to single borrowers or groups of related borrowers compared to one-to-four-family residential loans. Consequently, an adverse development with respect to one loan or one credit relationship can expose us to a significantly greater risk of loss compared to an adverse development with respect to one residential mortgage loan. Similarly, consumer loans generally have a higher credit risk than residential loans due to the loan being unsecured or secured by rapidly depreciable assets. See the *Loan Portfolio* section of this Form 10-K.

## If our Allowance for Loan Losses is not Sufficient to Cover Actual Loan Losses, our Earnings could Decrease

Our loan customers may not repay their loans according to their terms, and the collateral securing the payment of these loans may be insufficient to pay any remaining loan balance. We may experience significant loan losses, which could have a material adverse effect on our operating results. We make various assumptions and judgments about the collectibility of our loan portfolio, including the creditworthiness of our borrowers and the value of the real estate and other assets serving as collateral for the repayment of many of our loans. In determining the amount of the allowance for loan losses, we rely on an allowance valuation model that considers a review of loans, our experience and our evaluation of economic conditions. If our assumptions prove to be incorrect, our allowance for loan losses may not be sufficient to cover losses inherent in our loan portfolio, resulting in additions to our allowance. Material additions to our allowance would materially decrease our net income.

In addition, bank regulators periodically review our allowance for loan losses and may require us to increase our provision for loan losses or recognize further loan charge-offs. Any increase in our allowance for loan losses or loan charge-offs as required by these regulatory authorities could have a material adverse effect on our results of operations and financial condition. See the *Allowance for Loan Losses* section of this Form 10-K.

## Our Local Economy has Limited Growth Potential and this may Hurt our Ability to Generate Profits and Grow our Business

The success of our business depends on our ability to generate profits and grow our franchise. Our Ithaca, New York, market area has experienced moderate population growth and low unemployment in recent years. However, our Elmira, New York, market area in the southern tier of New York has experienced a decline in population, reflecting a decrease in the manufacturing sector, and the loss of major employers during the past decade. Moreover, economic and population growth in the southern tier of New York is expected to be limited for the foreseeable future. The relatively weak economy will make it more difficult for us to grow our earnings and to generate internal asset growth.

# If Economic Conditions Deteriorate, our Results of Operations and Financial Condition could be Adversely Impacted as Borrowers' Ability to Repay Loans Declines and the Value of the Collateral Securing our Loans Decreases

Our financial results may be adversely affected by further deterioration of economic conditions, including decreases in real estate values, adverse employment conditions, the monetary and fiscal policies of the federal government and other significant external events. Because we have a significant amount of real estate loans, decreases in real estate values could adversely affect the value of property used as collateral. Deterioration in the economy may also have a negative effect on the ability of our borrowers to make timely repayments of their loans, which would have an adverse impact on our earnings.

In addition, substantially all of our loans are to individuals and businesses in Chemung, Schuyler, Steuben, Tompkins, Cortland, and Cayuga Counties, New York. Consequently, any decline in the economy of these market areas could have an adverse impact on our earnings.

#### Strong Competition within our Market Area may Limit our Growth and Profitability

Competition in the banking and financial services industry is intense. The southern tier and central New York regions have a high concentration of financial institutions, including large money center and regional banks, community banks, and credit unions. Some of our competitors offer products and services that we currently do not offer, such as private banking. Some of these competitors have substantially greater resources and lending limits than we do and may offer certain services that we do not or cannot provide. Price competition for loans and deposits might result in us earning less on our loans and paying more on our deposits, which reduces net interest income. We expect competition to increase in the future as a result of legislative, regulatory and technological changes and the continuing trend of consolidation in the financial services industry. Our profitability depends upon our continued ability to successfully compete in our market areas.

## We may have Difficulty Managing our Growth, which may Divert Resources and Limit our Ability to Successfully Expand our Operations

We have incurred substantial expenses to build our management team and personnel, develop our delivery systems, and establish our infrastructure to support future growth. Our future success will depend on the ability of our officers and key employees to continue to implement and improve our operational, financial and management controls, reporting systems, and procedures, and to manage a growing number of client relationships. We may not be able to successfully implement improvements to our management information and control systems in an efficient or timely manner, and we may discover deficiencies in our existing systems and controls. Thus, we cannot assure you that our growth strategy will not place a strain on our administrative and operational infrastructure or require us to incur additional expenditures beyond current projections to support our recent and future growth.

## A Breach of Information Security could Negatively Affect our Earnings

Increasingly, we depend upon data processing, communication, and information exchange on a variety of computing platforms and networks, and over the Internet. We cannot be certain all our systems are entirely free from vulnerability to attack, despite safeguards we have instituted. In addition, we rely on the services of a variety of vendors to meet our data processing and communication needs. If information security is breached, information can be lost or

misappropriated, resulting in financial loss or costs to the Bank or damages to others. These costs or losses could materially exceed the amount of insurance coverage, if any, which would adversely affect our earnings.

## We Operate in a Highly Regulated Environment and we may be Adversely Affected by Changes in Laws or Monetary Policy

We are subject to extensive regulation, supervision, and examination by the NYSDFS, our chartering authority, as well as the FRB, our primary federal regulator. Such regulation and supervision govern the activities in which an institution may engage and are intended primarily for the protection of the depositors. Regulatory authorities have extensive discretion in connection with their supervisory and enforcement activities, including the imposition of restrictions on the operating of an institution, the classification of assets by the institution, and the adequacy of an institution's allowance for loan losses. Financial institution regulation has been the subject of significant legislation in recent years and may be the subject of further significant legislation in the future, none of which is in the control of the Bank. Any change in such regulation and oversight, whether in the form of regulatory policy, regulations, or legislation, could have a material impact on the Bank's financial condition, results of operations, or liquidity. Further, federal monetary policy, particularly as implemented through the Federal Reserve System, significantly affects short-term interest rates and credit conditions, and any unfavorable change in these conditions could have a material effect on the Bank's financial condition, results of operations, or liquidity.

## The Soundness of Other Financial Services Institutions May Adversely Affect our Credit Risk

We rely on other financial services institutions through trading, clearing, counterparty, and other relationships. We maintain limits and monitor concentration levels of our counterparties as specified in our internal policies. Our reliance on other financial services institutions exposes us to credit risk in the event of default by these institutions or counterparties. These losses could adversely affect our results of operations and financial condition.

#### Increases in FDIC Insurance Premiums May Cause our Earnings to Decrease

In 2008 and 2009, higher levels of bank failures drastically depleted the deposit insurance fund. In May 2009, the FDIC adopted a final rule levying a five basis point special assessment on each insured depository institution's assets minus Tier 1 capital as of June 30, 2009. We recorded an expense of \$238,000 during 2009, to reflect the special assessment. The FDIC also issued a final rule pursuant to which all insured depository institutions were required to prepay on December 30, 2009 their estimated assessments for the fourth quarter of 2009, and for all of 2010, 2011 and 2012. We prepaid \$1.9 million of our assessments on December 30, 2009, based on our deposits and assessment rate as of September 30, 2009. In June 2013, the FDIC's insurance fund position enabled the FDIC to refund the unamortized portion of the 2009 prepayments, including a refund of \$706,000 to the Bank. However, should the FDIC deposit insurance fund position in the future require the FDIC to increase premiums, these actions could significantly increase our noninterest expense in future years as long as the increased premiums are in place.

## Changes in the Value of the Bank's Investment Securities Portfolio Could Negatively Affect our Earnings

Under accounting principles generally accepted in the United States, the Bank is required to review its investment portfolio periodically for the presence of other-than-temporary-impairment of its securities, taking into consideration current market conditions, the extent and nature of the change in fair value, issuer rating changes and trends, as well as other factors. Adverse developments with respect to one or more of the foregoing factors could require the Bank to deem particular securities to be other-than-temporarily-impaired, with the reduction in the value recognized as a charge against the Bank's respective earnings as it relates to the credit portion of the impairment.

### A Substantial Decline in the Value of our Federal Home Loan Bank ("FHLB") of New York Common Stock May Adversely Affect our Financial Condition

We own common stock of FHLB of New York in order to qualify for membership in the FHLB system, which enables us to borrow funds under the FHLB of New York's advance program. The carrying value and fair market value of our FHLB of New York common stock was \$8.7 million as of December 31, 2013.

In recent periods, published reports indicated that certain member banks of the FHLB system may have been subject to asset quality risks that could have resulted in materially lower regulatory capital levels. In an extreme situation, it is possible that the capitalization of a FHLB, including FHLB of New York, could be substantially diminished or reduced to zero. Consequently, given that there is no market for our FHLB of New York common stock, we believe that there is a risk that our investment could be deemed other than temporarily impaired at some time in the future. If this occurs, it may adversely affect our results of operations and financial condition. If the capitalization of FHLB of New York is substantially diminished and if it further reduces or suspends its dividend, our liquidity may be adversely impaired if we are not able to obtain an alternative source of funding.

## Changes in the Value of Goodwill and Other Intangible Assets Could Negatively Affect our Earnings

Under accounting standards, the Company is not required to amortize goodwill but rather must evaluate goodwill for impairment at least annually. If deemed impaired at any point in the future, an impairment charge representing all or a portion of goodwill will be recorded to current earnings in the period in which the impairment occurred. The capitalized value of other intangible assets is amortized to earnings over their estimated lives. Other intangible assets are also subject to periodic impairment reviews. If these assets are deemed impaired at any point in the future, an impairment charge will be recorded to current earnings in the period in which the impairment occurred. See also Note 9 of the Notes to Consolidated Financial Statements.

#### Integration of Acquisitions

The Bank periodically reviews potential acquisition opportunities involving other financial institutions and financial services companies. The Bank seeks merger or acquisition partners that are culturally similar, present long-term growth opportunities, and have the potential for improved profitability through economies of scale or expanded services. Risks associated with acquisitions include potential exposure to asset quality issues of the acquired entity, the difficulty and expense of integrating the operations and personnel of the acquired entity,

potential disruption to the business of the acquired entity, potential diversion of management time and attention from other matters, and impairment of relationships with, and the possible loss of, key employees and customers of the acquired entity. Failure to realize expected revenue increases, cost savings, and/or other projected benefits from an acquisition could have a material adverse effect on the Bank's financial condition and results of operations.

#### Biggert-Waters Flood Insurance Act Could Negatively Affect our Earnings

In 2012, the Biggert-Waters Flood Insurance Act (the "Act") became law. The Act was designed to strengthen the National Flood Insurance Program by phasing out the federal government's subsidization of portions of the cost of flood insurance policies. Recent changes resulting from the Act have included: (1) phase-in of increased flood insurance rates for some properties, generally with an increase of 25% per year for 4 years until full-risk rates are reached; and (2) elimination of grandfathering of original flood-risk ratings, so that effective in 2014, all buildings will be rated using the latest flood zone maps. For primary residences that have never flooded and whose insurance policy has never lapsed, the government-funded subsidy will continue; however, the full-risk rate will apply immediately if a flood insurance policy lapses or if a property located in a flood zone is newly purchased.

Unless the Act is revised or repealed, reductions in collateral values associated with properties located in flood zones that secure some of the Bank's residential and commercial loans could occur, and some borrowers may become unable or unwilling to make their loan payments as a result of the increased costs of flood insurance. These potential results of the Act's provisions could have an adverse effect on the Bank's financial condition, results of operations, or liquidity.

#### New York State Taxation

During 2008, New York State revised legislation that phases out the exclusion of dividends paid by a real estate investment trust ("REIT") to a bank when the taxable assets of the bank's combined reporting group exceed \$8 billion. In 2011, 2012, and 2013, we are entitled to exclude from taxation 60% of our REIT's taxable income.

In January 2014, the New York State governor proposed tax reform legislation which would eliminate the Bank's ability to exclude the REIT's taxable income after January 1, 2015. The legislation is not yet final. If it becomes effective as currently proposed, or if future state tax legislation is proposed regarding the disallowance of the exclusion for dividends paid by our REIT, it may have a negative impact on our earnings.

## Item 2 – Properties

The Bank has a main office, including administrative offices, twelve full-service branch offices, two loan centers, one cashless branch, and other properties. At December 31, 2013, management believes the Bank's existing properties are adequate for the conduct of its business. The following table sets forth certain information relating to the Bank's offices and other properties at December 31, 2013:

				Lease	
	Year	Owned	Lease	Renewal	Net Book
Location	Opened	or Leased	Expiration	Option	Value (000's)
Main Office					)
333 E. Water Street, Elmira, NY	1975	Owned			1,941
Horseheads Branch					
Grand Central Avenue, Horseheads, NY	1969	Owned			288
West Elmira Branch					
West Church Street, Elmira, NY	1977	Owned			143
Southport Branch					
Pennsylvania Avenue, Elmira, NY	1980	Owned			237
Big Flats Branch					
971 County Route 64, Elmira, NY	2012	Owned			1,893
Elmira Heights Branch					
2075 Lake Road, Elmira Heights, NY	2012	Owned			140
Corning Branch					
19 E. Market Street - Suite 101, Corning, NY 14830	2006	Owned			398
Erwin Branch					
404 S. Hamilton Street, Painted Post, NY 14870	2013	Leased	2015	Yes	0
Commons Branch					
301 East State Street, Ithaca, NY 14850	2007	Leased	2016	Yes	1
Ithaca Loan Center					
301 East State Street, Ithaca, NY 14850	2009	Leased	2016	Yes	17
Vestal Loan Office					
3439 Vestal Parkway, Vestal, NY 13850	2013	Leased	2018	Yes	0
Moravia Branch					
142 Main Street, Moravia, NY	2007	Owned			278
South Meadow Branch					
702 South Meadow Street, Ithaca, NY	2007	Leased	2017	Yes	256
Triphammer Branch					
2300 North Triphammer Road, Ithaca, NY	2007	Leased	2017	Yes	0
Montour Falls LPO Office					
401 West Main St., Suite 110, Montour Falls, NY, 14865	2009	Leased	2014	Yes	0
Cortland Office					
77 South West Street, Homer, NY 13077	2010	Leased	2014	Yes	2
Arnot Mall ATM					
Rt. 17 & Chambers Road, Big Flats, NY	2012	Leased	2014	Yes	1
Multiple-Use Building					
311, 313, 315 East Water Street, Elmira, NY		Owned			458
Building lots held for possible future use - Division Street /					
Lackawanna Avenue & Fisherville Rd. Elmira NY & E. Fourth					
Street / Magee Street, Watkins Glen, NY		Owned			1,029
Parking Lot					470
100-106 Lake Street, Elmira, NY		Owned			172

## Item 3 - Legal Proceedings

There are no material pending legal proceedings, other than ordinary routine litigation incidental to the business, to which the Company or its subsidiary is a party or of which any of their property is the subject.

## **Item 4 – Mine Safety Disclosures**

Not applicable.

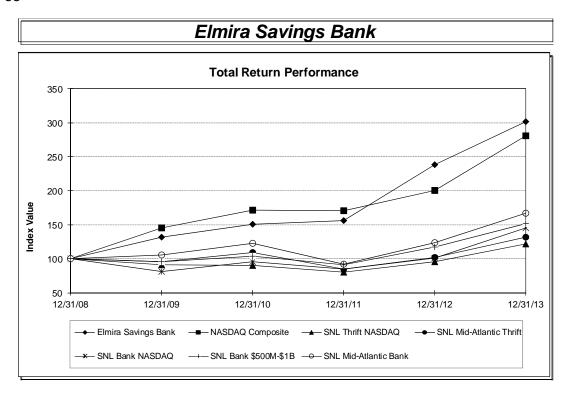
**PART II** 

## Item 5 – Market for Registrant's Common Equity and Related Shareholder Matters

The Bank's common stock was first offered in March 1985 and is now listed on the NASDAQ exchange. The table below summarizes the high and low market price for the Bank's stock during 2013 and 2012.

	201	2013		2
	High	Low	High	Low
1st Quarter	23.05	20.67	18.93	14.05
2nd Quarter	23.93	18.18	18.60	15.30
3rd Quarter	22.73	19.30	17.31	15.91
4th Quarter	28.45	20.15	21.50	16.80

The Bank had 451 holders of record of common stock at March 11, 2014, and the brokers currently making a market in the Bank's common stock are: Stifel Nicolaus; Spear, Leeds & Kellogg; Moors & Cabot; Baird Patrick; and Howe Barnes.



Information regarding securities authorized for issuance under equity compensation plans is provided in Part III "Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters" of this report.

Item 6 - Selected Financial Data

	At or for the years ended December 31,						
	(dollars in thousands, except per share data)						
Consolidated balance sheet data:	2013	2012	2011	2010	2009		
Total assets	\$514,325	\$536,936	\$523,358	\$499,839	\$498,983		
Securities available for sale	63,464	66,875	86,536	126,212	101,931		
Securities held to maturity	7,805	5,521	4,621	5,006	4,440		
Loans receivable	389,129	378,108	345,982	309,945	307,616		
Allowance for loan losses	3,834	3,740	3,299	2,909	3,139		
Goodwill	12,320	12,320	12,320	12,320	12,320		
Deposits	397,733	409,565	381,729	356,621	352,591		
Borrowings	56,500	54,000	70,019	81,093	87,162		
Shareholders' equity	54,025	66,909	64,615	56,451	54,546		
Consolidated income statement data:							
Interest income	\$20,253	\$20,985	\$22,100	\$22,688	\$25,141		
Interest expense	5,200	5,896	6,550	7,769	9,438		
Net interest income	15,053	15,089	15,550	14,919	15,703		
Provision for loan losses	315	463	668	515	592		
Noninterest income	5,557	6,050	4,727	4,593	4,638		
Noninterest expense	13,862	12,944	12,202	11,859	13,070		
Income before income tax	6,433	7,732	7,407	7,138	6,679		
Income tax expense	1,374	2,514	2,373	2,300	2,148		
Net income	5,059	5,218	5,034	4,838	4,531		
Net income attributable to noncontrolling interest	5	5	5	5	5		
Net income attributable to Elmira Savings Bank	5,054	5,213	5,029	4,833	4,526		
Preferred stock dividend and accretion of discount	1,215	1,609	1,764	1,451	1,410		
Income available to common shareholders	\$3,839	\$3,604	\$3,265	\$3,382	\$3,116		
Per share data:							
Basic earnings per share	\$1.47	\$1.44	\$1.32	\$1.37	\$1.28		
Diluted earnings per share	\$1.40	\$1.37	\$1.28	\$1.35	\$1.25		
Cash dividends declared per share	\$0.84	\$0.77	\$0.65	\$0.64	\$0.64		
Other data:							
Return on average assets	0.97%	0.99%	1.00%	0.97%	0.91%		
Return on average shareholders' equity	8.51%	7.92%	8.40%	8.62%	8.51%		
Shareholders' equity to assets at year-end	10.50%	12.46%	12.35%	11.29%	10.93%		
Dividend payout ratio	57.14%	53.16%	49.34%	45.71%	49.38%		
Number of offices	15	14	13	13	12		

Per share data has been restated to reflect a 10% stock dividend paid on December 27, 2013, a 5% stock dividend paid on December 28, 2012, and a 10% stock dividend paid on December 28, 2011.

## Item 7 – Management's Discussion and Analysis of Financial Condition and Results of Operations

Management's Discussion and Analysis ("MD&A") of Financial Condition and Results of Operations should be read in conjunction with the audited consolidated financial statements and notes.

#### General

The financial review which follows focuses on the factors affecting the financial condition of Elmira Savings Bank during the years ended December 31, 2013 and 2012 and the results of

operations for the three years ended December 31, 2013. The consolidated financial statements and related notes as of December 31, 2013 and 2012, and for each of the years in the three-year period ended December 31, 2013, should be read in conjunction with this review. All per share data has been restated to reflect a 10% stock dividend paid on December 27, 2013 and a 5% stock dividend paid on December 28, 2012.

Our results of operations are dependent primarily on net interest income, which is the difference between the income earned on our loans and securities and our cost of funds, consisting of the interest paid on deposits and borrowings. Results of operations are also affected by the provision for loan losses, securities and loan sale activities, loan servicing activities, service charges and fees collected on our deposit accounts.

Our noninterest expense primarily consists of salaries and employee benefits, occupancy and equipment expense, marketing expense, and technology expense. Results of operations are also significantly affected by general economic and competitive conditions, particularly changes in interest rates, government policies and the actions of regulatory authorities.

The Bank is chartered by the NYSDFS. The Bank's primary federal regulator is the FRB, and its customers' deposits are insured by the FDIC up to the maximum amount permitted by FDIC regulation. The Bank is subject to regulations and periodic examinations by both the NYSDFS and the FRB.

The Bank's common stock is traded on the NASDAQ exchange under the symbol ESBK. The table below summarizes the quoted market prices for the Bank's stock during 2013.

2013 Bid	High 26.81	Low 15.54
2013 Ask	High 29.81	Low 20.77

### 2013 Highlights

Total assets were \$514.3 million at December 31, 2013, which was \$22.6 million or 4.2% below December 31, 2012. Loans receivable increased by \$11.0 million and total investments, including FRB and FHLB stock, increased by \$112,000. The increase in loans is attributable to a \$14.5 million increase in real estate loans and a \$1.1 million increase in consumer loans, offset by a \$5.1 million decrease in business loans. Cash and cash equivalents decreased by \$32.7 million to \$7.6 million. Deposits decreased by \$11.8 million or 2.9% during the year. Borrowings increased by \$2.5 million or 4.6% during 2013.

The Bank's shareholders' equity decreased by \$12.9 million or 19.3% to \$54.0 million or a core capital ratio of 8.39% as of December 31, 2013.

Net income for the year ended December 31, 2013 was \$5.1 million which was \$159,000 or 3.1% lower than the same period in 2012. This decrease in net income is due to a \$493,000 decrease in noninterest income, a \$918,000 increase in noninterest expense, and a \$36,000

decrease in net interest income, partially offset by a \$148,000 decrease in the provision for loan losses and a \$1.1 million decrease in income tax expense.

Earnings per diluted share were \$1.40 for the year ended December 31, 2013, as compared to \$1.37 for the year ended December 31, 2012, an increase of 2.2%.

Net interest margin decreased by 9 basis points to 3.25% for the year ended December 31, 2013. Return on assets and return on equity were .97% and 8.51%, respectively, for the year ended 2013, compared to .99% and 7.92%, respectively, for the same period in 2012.

### **Critical Accounting Policies**

The accounting and reporting policies of Elmira Savings Bank conform to accounting principles generally accepted in the United States of America and reporting practices followed by the banking industry. Elmira Savings Bank utilizes the accrual method of accounting for financial reporting purposes.

We evaluate those accounting policies and estimates that we judge to be critical: those most important to the presentation of our financial condition and results of operations, and that require our most subjective and complex judgments. Accordingly, our accounting estimates relating to the adequacy of our allowance for loan losses, the valuation and other than temporary impairment analysis of our investment securities, the valuation of financial assets and liabilities measured at fair value, and the analysis of the carrying value of goodwill for impairment are deemed to be critical, as our judgments could have a material effect on our results of operations.

#### Allowance for Loan Losses

Elmira Savings Bank provision for loan losses charged or credited to operations is based upon management's evaluation of the loan portfolio. The allowance for loan losses is maintained at a level that management believes, to the best of its knowledge, is at a level at each reporting date, that is adequate based upon the estimated inherent risk of loss in the current loan portfolio. Management's judgment is based upon, but not limited to, periodic evaluation of the portfolio, past loss experience and current economic conditions. While management uses available information to recognize losses on loans, future additions to the allowance may be necessary based on changes in economic conditions. In addition, various regulatory agencies, as an integral part of their examination process, periodically review Elmira Savings Bank's allowance for loan losses. Such agencies may require Elmira Savings Bank to recognize additions to the allowance based on their judgments about information available to them at the time of their examinations. Further description of our methodology for evaluating our allowance for loan losses is included within the "Allowance for Loan Losses" section included in Note 1 to the Consolidated Financial Statements.

#### Securities

Fair value of our investment securities is based upon quoted market prices of identical securities, where available. If such quoted prices are not available, fair value is based upon valuation models that use cash flow, security structure, and other observable information.

Securities are evaluated on at least a quarterly basis and more frequently when economic or market conditions warrant such an evaluation to determine whether a decline in their value is other than temporary. Management considers the reasons underlying the decline, the magnitude and duration of the decline, and the Bank's intent to sell the security, and whether it is more likely than not that the Bank will not have to sell the security before recovery of its cost basis. If a decline in the fair value of a security, below its cost basis, is determined to be other than temporary, the cost basis of the security is reduced and a corresponding charge to earnings would be recognized.

#### Fair Values of Financial Instruments

Financial Accounting Standards Board ("FASB") Accounting Standards Codification ("ASC") Topic 820, "Fair Value Measurements and Disclosures," establishes a framework for measuring fair value. In accordance with FASB ASC Topic 820, Elmira Savings Bank groups financial assets and financial liabilities measured at a fair value in three levels based on the markets in which the assets and liabilities are traded and the reliability of the assumptions used to determine fair value.

Level 1 valuations are obtained from readily available pricing sources for market transactions involving identical assets or liabilities. Level 2 valuations are for instruments that trade in less active dealer or broker markets and incorporate values obtained for identical or comparable instruments. Level 3 valuations are derived from other valuation methodologies, including discounted cash flow models and similar techniques, and not based on market exchange, dealer, or broker traded transactions. Level 3 valuations incorporate certain assumptions and projections in determining the fair value assigned to each instrument.

#### Goodwill

Goodwill results from business acquisitions and represents the excess of the purchase price over the fair value of acquired tangible assets and liabilities and identifiable intangible assets. Goodwill is assessed at least annually for impairment, or more often if certain conditions or events occur, and any such impairment will be recognized in the period identified. In 2007 the Bank recorded goodwill in connection with the purchase of four branch offices located in central New York State. Further description of the methodology for assessing goodwill for impairment is included within the "Goodwill" section included in Note 1 to the Consolidated Financial Statements.

#### **Financial Condition**

Unless otherwise noted, the following discussion compares the Bank's financial condition at December 31, 2013 to December 31, 2012.

At December 31, 2013, the Bank had total consolidated assets of \$514.3 million, a decrease of \$22.6 million or 4.2% from the December 31, 2012 level of \$536.9 million. The Bank increased

its loans by \$11.0 million or 2.9%. The Bank experienced a decrease in deposits of \$11.8 million or 2.9% and an increase in total investments, including FRB and FHLB stock, of \$112,000 or .1%. The Bank experienced an increase in borrowings of \$2.5 million or 4.6%.

Total earning assets were 91.9% of total assets at December 31, 2013 compared to 86.2% at December 31, 2012. The Bank's total cash and equivalents decreased by \$32.7 million to \$7.6 million. Securities, including FRB and FHLB stock and loans, net of allowance, represented 15.9% and 74.9%, respectively, of total assets at December 31, 2013, as compared to 15.2% and 69.7%, respectively, at December 31, 2012. Total liabilities decreased by \$9.7 million to \$460.3 million at December 31, 2013 from \$470.0 million at December 31, 2012. Total deposits decreased by \$11.8 million to \$397.7 million. For 2013, this decrease in deposits is due primarily to a decrease in time deposit accounts of \$14.8 million and noninterest-bearing accounts of \$1.6 million, offset by an increase in savings accounts of \$1.9 million, NOW accounts of \$1.6 million, and money market accounts of \$999,000. Total borrowings increased by \$2.5 million to \$56.5 million. Total deposits funded 77.3% of total assets at year-end 2013 in comparison to 76.3% at December 31, 2012. The percentage of total assets supported by borrowings increased to 11.0% at December 31, 2013 from 10.1% at the prior year-end.

Total shareholders' equity was \$54.0 million at December 31, 2013, a decrease of \$12.9 million, or 19.3% from December 31, 2012. This decrease is primarily attributable to the retirement of \$14.1 million of preferred stock in 2013, offset by net income for 2013 of \$5.1 million, less dividends paid of \$3.4 million.

#### **Loan Portfolio**

Loans receivable (after net unamortized loan origination costs and before the allowance for loan losses) at December 31, 2013 increased to \$389.1 million and were \$11.0 million or 2.9% higher than December 31, 2012 levels. The composition of the net increase in the loan portfolio consisted of a \$14.9 million increase in residential real estate loans, a \$3.9 million increase in commercial real estate loans, and a \$1.1 million increase in consumer loans, offset by a \$5.1 million decrease in commercial loans and a \$4.2 million decrease in construction loans. The increase in residential real estate loans reflects the Bank's focus on asset quality centered on improving the Bank's loan mix through growth in the residential loan portfolio.

At December 31, 2013, the Bank's loan portfolio before net unamortized loan costs and the allowance for loan losses consisted of the following: \$239.0 million of residential real estate loans; \$79.1 million of commercial real estate loans; \$5.5 million of construction loans; \$24.0 million of business loans; and \$39.3 million of consumer loans.

The following table sets forth the classification of the Bank's loan portfolio at December 31:

	2013		2012		2011		
		% of		% of		% of	
		Total		Total		Total	
(dollars in thousands)	\$ Outstanding	Loans	\$ Outstanding	Loans	\$ Outstanding	Loans	
Residential real estate loans	239,032	61.8	224,167	59.5	191,467	55.5	
Commercial real estate loans	79,135	20.4	75,230	20.0	68,548	19.9	
Construction loans	5,467	1.4	9,695	2.6	9,131	2.6	
Commercial loans	24,026	6.2	29,102	7.7	37,437	10.9	
Consumer loans	39,337	10.2	38,265	10.2	38,225	11.1	
	386,997	100.0	376,459	100.0	344,808	100.0	
	2010		2009				
		% of		% of			
		Total		Total			
(dollars in thousands)	\$ Outstanding	Loans	\$ Outstanding	Loans			
Residential real estate loans	169,185	54.7	147,859	48.1			

Consumer loan originations totaled \$17.4 million in 2013 compared to \$18.1 million in 2012. Residential real estate loan originations totaled \$129.6 million in 2013, a decrease of \$32.4 million from originations of \$162.0 million in 2012. Commercial loan and commercial real estate loan originations totaled \$18.4 million in 2013 versus \$22.2 million in 2012. Residential real estate originations for 2013 included \$67.4 million of loans originated for sale to the secondary market and \$79.6 million for 2012.

21.1

1.2

10.0

12.9

100.0

69,957

3,013

38,422

47,964

307,215

22.8

1.0

12.5

15.6

100.0

65,235

3,839

31,032

39,839

309,130

### **Nonperforming Assets**

Commercial real estate loans

Construction loans

Commercial loans

Consumer loans

As a matter of policy, the Bank discontinues accrual of interest when loan payments are 90 days or more past due (unless well secured and in the process of collection), or when by judgment of management, collectibility is uncertain. The following table sets forth certain information concerning the Bank's nonperforming loans, other real estate owned, and repossessed assets at the dates indicated:

	2013	2012	2011	2010	2009	
	(dollars in thousands)					
Nonaccrual loans	\$ 3,494	\$ 3,861	\$ 3,672	\$ 3,729	\$ 3,557	
Loans past due 90 days or more and still accruing						
Total nonperforming loans	3,494	3,861	3,672	3,729	3,557	
Other real estate owned	98	125	202	541	536	
Other repossessed assets			22	35		
Total nonperforming assets	\$ 3,592	\$ 3,986	\$ 3,896	\$ 4,305	\$ 4,093	
Nonperforming loans as a percentage of loans receivable, net	0.90%	1.02%	1.06%	1.20%	1.16%	
Nonperforming assets as a percentage of total assets	0.70%	0.74%	0.74%	0.86%	0.82%	

Impaired loans evaluated for specific allowance totaled \$3.1 million at December 31, 2013 and \$3.3 million at December 31, 2012. Impaired loans at December 31, 2013 had a related

allowance for loan losses of \$371,000. Impaired loans at December 31, 2012 had a related allowance for loan losses of \$369,000.

At December 31, 2013, loans more than 30 days delinquent, excluding nonaccrual loans, amounted to .26% of total loans receivable, net, as compared to .21% of total loans receivable, net at December 31, 2012.

At December 31, 2013, in addition to nonperforming loans, the Bank, through its internal loan review function, has identified ten commercial relationships totaling \$4.8 million, which it has classified as substandard which are still accruing. At December 31, 2012, the Bank had fourteen commercial relationships totaling \$5.6 million, which it had classified as substandard or doubtful which were still accruing. These loans remain in a performing status due to a variety of factors, including payment history, the value of collateral supporting the credits, and personal guarantees. While in a performing status as of December 31, 2013, these loans exhibit certain risk factors, which have the potential to cause them to become nonperforming. Accordingly, management's attention is focused on these potential problem loans which are reviewed on at least a quarterly basis.

#### **Allowance for Loan Losses**

The allowance for loan losses is maintained at a level that management considers adequate to provide for the inherent risk of loss in the current loan portfolio. Management's evaluation is based on a continuing review of the loan portfolio that includes many factors, such as identification of adverse situations that affect a borrower's ability to repay, a review of overall portfolio quality, and an assessment of current economic conditions.

At December 31, 2013, the allowance for loan losses amounted to \$3.8 million and represented .99% of loans receivable, net. At December 31, 2012, the allowance for loan losses was \$3.7 million and represented .99% of loans receivable, net.

The following table presents the activity in the allowance for loan losses for the years ended December 31:

	<u>2013</u>	<u>2012</u>	<u>2011</u>	<u>2010</u>	<u>2009</u>
		(dollar	s in thousan	ids)	
Balance at beginning of year	\$3,740	\$3,299	\$2,909	\$3,139	\$3,035
Loan charge-offs					
Real Estate loans	(196)	(4)	(251)	(1)	(48)
Commercial loans	-	-	(35)	(633)	(213)
Consumer loans	(88)	(88)	(110)	(233)	(358)
Total loans charged-off	(284)	(92)	(396)	(867)	(619)
Loan recoveries					
Real Estate loans	1	1	2	18	-
Commercial loans	11	15	23	16	1
Consumer loans	51	54	93	88	130
Total loans recovered	63	70	118	122	131
Net charge-offs	(221)	(22)	(278)	(745)	(488)
Provision charged to expense	315	463	668	515	592
Balance at end of year	\$3,834	\$3,740	\$3,299	\$2,909	\$3,139
Allowance to total loans at end of period	0.99%	0.99%	0.95%	0.94%	1.02%
Net charge-offs to					<u> </u>
average loans outstanding	0.06%	0.01%	0.09%	0.25%	0.15%

The Bank's ratio of allowance to total loans remained the same at .99% for 2013. This reflects relative consistency in loans classified substandard and in loans more than 30 days delinquent, with the allocation of the reserve shifting from commercial and commercial real estate loans towards residential real estate loans, consistent with the change in loan portfolio composition.

The following table is an allocation of the loan loss allowance by loan type:

#### Allocation of the reserve by loan type:

	December 31,				
(in thousands)	2013	2012	2011	2010	2009
Residential real estate loans	\$ 1,489	\$1,142	\$ 950	\$ 729	\$ 559
Commercial real estate loans	1,281	1,331	1,217	1,040	1,223
Commercial loans	696	804	707	650	804
Consumer loans	368	463	425	490	553
Balance at end of year	\$ 3,834	\$ 3,740	\$3,299	\$ 2,909	\$3,139

The above allocation is not indicative of the specific amounts on the loan categories in which future charge-offs may occur, nor is it an indication of future loss trends. The allocation of the allowance to each category does not restrict the use of the allowance to absorb losses in any category.

#### **Securities**

The Bank's investment strategy is to maintain a securities portfolio that: provides a source of liquidity through cashflow and maturities, provides collateralization for borrowings and selling opportunities; contributes to the Bank's overall profitability; and provides a balance to interest rate and credit risk in other categories of the balance sheet. The Bank does not maintain a trading account and does not engage in derivative activities in carrying out its investment strategy.

Our portfolio does not contain any "private label" mortgage-backed securities. The mortgage-backed securities in our portfolio are all direct pass-through securities guaranteed by Fannie Mae, Freddie Mac, or Government National Mortgage Association. We do not invest in securities backed by subprime credits, nor do we invest in any equity investments in Freddie Mac and Fannie Mae. Therefore, we have not been impacted by the issues troubling those institutions that invested in these securities.

At December 31, 2013 and 2012, the Bank's securities portfolio consisted primarily of U.S. Government sponsored entities and mortgage-backed securities that provide high quality and low credit risk to the overall balance sheet mix. At December 31, 2013, all but \$7.8 million of the Bank's total portfolio of \$71.3 million is classified as available for sale in order to: (i) provide management with the flexibility to make adjustments to the portfolio given changes in the economic and/or interest rate environment; (ii) to fulfill unanticipated liquidity needs; or (iii) to take advantage of alternative opportunities.

The following table sets forth certain information concerning the Bank's securities portfolio for the years ended:

	2013	2012	2011
(in thousands)			
Securities available for sale:			
Fair Value:			
U.S. Government sponsored entities	\$ 5,841	\$ 2,193	\$ 2,343
Mortgage-backed securities - U.S. Government sponsored entities	44,527	51,069	68,861
Municipal securities	13,096	13,613	15,332
Total of securities available for sale	\$ 63,464	\$ 66,875	\$ 86,536
Securities held to maturity:			
Amortized cost:	Φ 007	Ф 000	Ф 500
Mortgage-backed securities - U.S. Government sponsored entities	\$ 237	\$ 333	\$ 528
Municipal securities	7,084	4,714	3,495
Other debt securities	484_	474_	598_
Total of securities held to maturity	\$ 7,805	\$ 5,521	\$ 4,621

The average yield on the U.S. Government sponsored entities obligations available for sale at December 31, 2013 was 3.60%. The average yield on mortgage-backed securities available for sale at December 31, 2013 was 2.82%. The average yield on municipal securities available for sale on December 31, 2013 was 4.23%.

The following table presents a maturity distribution at amortized cost for securities available for sale and the weighted average yield for each type and range of maturity as of December 31, 2013:

(in thousands)		U.S. Gover		Mort	gage-backe U.S. Gove sponsored		 Munici Securi	•		Total	
	A	mount	Yield		Amount	Yield	 		A	mount	Yield
Within one year	\$	1,000	1.30%	\$	-	0.00%	\$ -	0.00%	\$	1,000	1.30%
After one to five years		-	0.00%		413	4.53%	-	0.00%		413	4.53%
After five to ten years		2,000	3.44%		11,166	2.45%	1,533	3.92%		14,699	2.74%
After ten years Total	\$	2,857 5,857	4.52% 3.60%	\$	32,230 43,809	2.92% 2.82%	\$ 11,215 12,748	4.27% 4.23%	\$	46,302 62,414	3.35% 3.18%

The following table presents a maturity distribution at amortized cost for securities held to maturity and the weighted average yield for each type and range of maturity as of December 31, 2013:

(in thousands)	_	age-backed U.S. Goverr sponsored			Municip Securiti		Other D			Total	
	Ar	nount	Yield	A	mount	Yield			Ar	nount	Yield
Within one year	\$	-	0.00%	\$	-	0.00%	\$ 110	3.25%	\$	110	3.25%
After one to five years		216	4.26%		-	0.00%	-	0.00%		216	4.26%
After five to ten years		21	6.42%		114	3.50%	-	0.00%		135	3.95%
After ten years Total	\$	237	0.00% 4.45%	\$	6,970 7,084	4.39% 4.38%	\$ 374 484	5.15% 4.72%	\$	7,344 7,805	4.43% 4.40%

Any unrealized losses on individual securities are attributed to changes in the interest rates and not credit quality. The Bank does not have the intent to sell any securities with unrealized losses and it is more likely than not that it will not have to sell these securities before recovery of their cost basis. Therefore, the Bank does not consider any of its securities to be other than temporarily impaired at December 31, 2013.

### **Deposits**

Customer deposits, consisting of savings and money market accounts, time deposits, and retail and commercial checking accounts, represent the primary source of asset funding for the Bank. The Bank's customer deposits decreased by \$11.8 million or 2.9% to \$397.7 million at December 31, 2013, from the December 31, 2012 level of \$409.6 million. Certificates of deposit ("CD"), a higher cost source of funds, comprised 44.8% of total deposits December 31, 2013 compared to 47.0% at December 31, 2012.

	Decei	December 31,		
(in thousands)	2013	2012		
Noninterest-bearing demand	\$ 59,885	\$	61,444	
Interest-bearing:				
NOW accounts	77,736		76,133	
Regular savings	48,790		46,312	
IRA savings	8,408		9,615	
Mortgage escrow savings	3,452		2,862	
Money market savings	21,130		20,131	
Club accounts	275		245	
Certificates of deposit	178,057		192,823	
Total interest-bearing	337,848		348,121	
	\$ 397,733	\$	409,565	

The decrease in total deposits resulted from a decrease in time deposits of \$14.8 million and a decrease in transaction accounts of \$1.6 million. These decreases were partially offset by increases of \$1.9 million in savings accounts, \$1.6 million in NOW accounts, and an increase in money market accounts of \$999,000. Substantially all of the Bank's deposits are considered by management to be core deposits, and as a matter of policy, the Bank does not utilize brokers to solicit deposits.

#### **Borrowings**

Total borrowings, comprised primarily of term advances and securities sold under repurchase agreements from the FHLB of New York, increased by \$2.5 million to \$56.5 million at December 31, 2013. FHLB advances increased by \$2.5 million to \$30.5 million at December 31, 2013. Securities sold under agreements to repurchase with the FHLB were \$26.0 million at December 31, 2013 and December 31, 2012.

## **Capital Resources**

The Bank exceeds all minimum regulatory capital requirements. Total shareholders' equity at December 31, 2013 was \$54.0 million, a decrease of \$12.9 million from December 31, 2012. The decrease in total shareholders' equity resulted from the redemption of \$14.1 million of preferred stock in 2013, cash dividends on common and preferred stock of \$3.4 million, and a decrease in accumulated other comprehensive income of \$1.2 million. These decreases were

partially offset by net income of \$5.1 million and increases in total shareholders' equity of \$269,000, \$217,000, and \$301,000 related to the exercise of stock options, the issuance of treasury shares, and stock-based compensation expense, respectively.

At December 31, 2013, there were 2,659,972 shares of common stock outstanding. Book value per share was \$16.64 at December 31, 2013. The Bank's cash dividends paid per common share during 2013 was \$.84. The Bank has paid regular cash dividends on its common stock since the first quarter of 1988 and intends to continue the practice of regular cash dividend payments on its common stock as long as it remains profitable and is in compliance with regulatory capital requirements. The Bank also paid a 10% stock dividend on December 27, 2013.

The Bank had 10,000 shares of preferred stock outstanding at December 31, 2013. Preferred shares outstanding are nonvoting, noncumulative perpetual preferred stock. Ten thousand shares relate to a sale of preferred stock in 2007. There were 14,063 shares related to the Bank's participation in 2011 in the Treasury Department's SBLF Program that were retired in 2013. See Note 18 to the Consolidated Financial Statements for further description of the Bank's outstanding preferred stock.

Capital adequacy in the banking industry is evaluated primarily by the use of ratios that measure capital and capital components against total assets, as well as against assets that are weighted based on risk characteristics. At December 31, 2013 and 2012, the Bank exceeded its minimum regulatory capital requirements. At December 31, 2013 and 2012, the Bank's consolidated core (Tier 1) capital ratios were 8.39% and 10.38%, respectively. At December 31, 2013 and 2012, the Bank's consolidated risk-based capital ratios were 14.50% and 18.20%, respectively.

#### **RESULTS OF OPERATIONS**

### **Earnings Summary**

The Bank's net income for 2013 was \$5.1 million compared with net income for 2012 of \$5.2 million, a decrease of \$159,000 or 3.1%. Net income for 2011 was \$5.0 million. Diluted earnings per share were \$1.40, \$1.37, and \$1.28 for the years 2013, 2012, and 2011, respectively. The increase in earnings per diluted share from 2012 to 2013, despite lower net income, is a result of the full redemption in 2013 of our preferred stock issued to the U.S. Department of Treasury under the Small Business Lending Fund program.

#### **Net Interest Income**

Net interest income is the principal component of net income for the Bank and represents the difference between the interest earned on assets, primarily loans and securities, and the interest paid on deposits and borrowed funds. There are two ratios the Bank uses to evaluate net interest income. They are interest rate spread and net interest margin. Interest rate spread is the difference between the average yield earned on interest-earning assets and the average rate paid on interest-bearing liabilities. Net interest margin is the measure of net interest income as a percentage of average interest-earning assets. Unlike net interest spread, the net interest margin takes into account the level of average earning assets that are funded by interest-free sources, such as noninterest-bearing demand deposits.

Net interest income decreased by \$36,000 or .2% to \$15.1 million in 2013. The Bank's interest rate spread for 2013 was 3.06%, a decrease of 11 basis points from 2012. The Bank's net interest margin decreased by 9 basis points to 3.25% in 2013 from 3.34% in 2012.

Total average interest-earning assets increased by \$11.2 million to \$463.1 million in 2013, an increase of 2.5%. The average yield on total interest-earning assets decreased to 4.37% in 2013 from 4.64% in 2012.

Total average loans increased by \$19.4 million to \$382.4 million. The average yield on loans decreased by 36 basis points from 4.99% in 2012 to 4.63% in 2013. Total average residential real estate loans, which represents the greatest proportion of total loans, increased by \$22.2 million to \$241.1 million. Average commercial loans, including commercial real estate, decreased by \$4.3 million to \$103.2 million. Average consumer loans increased \$1.4 million.

Total average securities, including short-term investments, decreased by \$8.2 million to \$80.7 million. The average yield on securities, including short-term investments, decreased from 3.28% in 2012 to 3.21% in 2013.

Compared to 2011 results, net interest income decreased by \$461,000 or 3.0% to \$15.1 million in 2012. The Bank's net interest rate spread was 3.17% in 2012, a decrease of 14 basis points from 2011. The Bank's net interest margin decreased by 17 basis point from 3.51% in 2011 to 3.34% in 2012.

The following table sets forth, for the periods indicated, summary information regarding: (i) the dollar amount of interest income from interest-earning assets and the resultant average yields; (ii) the dollar amount of interest expense on interest-bearing liabilities and the resultant average costs; (iii) net interest income; (iv) interest rate spread; and (v) net interest margin. Average balances are daily averages. No tax equivalent adjustments were made. Nonaccrual loans are included in average loans.

		2013			2012			2011	
	Average			Average			Average		
(dollars in thousands)	Balance	Interest	Yield/Rate	Balance	Interest	Yield/Rate	Balance	Interest	Yield/Rate
Assets:									
Loans	\$382,403	\$ 17,733	4.63 %	\$ 362,986	\$ 18,114	4.99 %	6 \$325,172	\$ 18,140	5.58 %
Short-term investments	2,158	1	0.03	1,371	-	0.04	1,084	-	0.02
Securities	78,532	2,519	3.21	87,539	2,871	3.28	117,305	3,960	3.38
Total interest-									
earning assets	463,093	20,253	4.37	451,896	20,985	4.64	443,561	22,100	4.98
Noninterest-									
earning assets	57,315			74,451			59,638		
Total assets	\$520,408			\$ 526,347			\$503,199		
Liabilities and shareholde Interest-bearing	. ,								
deposits	\$338.347	3.224	0.95	\$ 340.236	3.712	1.09	\$320.227	3.850	1.20
Borrowings	56,626	1,976	3.49	59,623	2,184	3.66	72,563	2,700	3.72
Total interest-	•	,		,	,		•	,	
bearing liabilities	394,973	5,200	1.31	399,859	5,896	1.47	392,790	6,550	1.67
Noninterest-									
bearing liabilities	66,014			60,633			50,535		
Shareholders' equity	59,421			65,855			59,874		
Total liabilities and									
shareholders' equity	\$520,408			\$ 526,347			\$503,199		
Net interest income		\$ 15,053			\$ 15,089			\$ 15,550	
Interest rate spread			3.06 %			3.17 %	6		3.31 %
Net interest margin			3.25 %			3.34 %	<i>L</i>		3.51 %

The following table presents certain information regarding changes in interest income and interest expense of the Bank for the periods indicated. For each category of interest-earning assets and interest-bearing liabilities, information is provided with respect to changes attributable to: (i) changes in volume (i.e., changes in volume multiplied by prior year rate); (ii) changes in rate (i.e., changes in rate multiplied by prior year volume); and (iii) changes in rate/volume (i.e., change in rate multiplied by change in volume), which cannot be segregated and have been allocated proportionately to the changes due to volume and to the changes due to rate:

		13 Compare	d to 2012 ase) Due to			)12 Compare ease (Decrea		
			, 240 10	Total Increase		(====		Total Increase
(in thousands)	Vo	olume	Rate	(Decrease)	\ 	/olume	Rate	(Decrease)
Interest income:								
Loans	\$	940	(1,320)	(380)	\$	1,993	(2,019)	(26)
Securities		(259)	(93)	(352)		956	(133)	(1,089)
Total interest income	\$	681	(1,413)	(732)	\$	1,037	(2,152)	(1,115)
Interest expense:								
Deposits	\$	(26)	(462)	(488)	\$	229	(367)	(138)
Borrowings		(107)	(101)	(208)		(475)	(41)	(516)
Total interest expense	•	(133)	(563)	(696)	•	(246)	(408)	(654)
Net interest income	\$	814	(850)	(36)	\$	1,283	(1,744)	(461)

The weighted average cost of total interest-bearing liabilities, which is comprised of deposits and borrowings, decreased to 1.31% in 2013 as compared with the 2012 average cost of 1.47%. The cost of certificates of deposit decreased by 18 basis points from 1.79% in 2012 to 1.61% in 2013. The Bank experienced a decrease in average borrowed funds of \$3.0 million from 2012. The cost of these funds decreased from 3.66% in 2012 to 3.49% in 2013.

The daily average balance, average cost, and interest expense for the Bank's deposit categories is summarized below:

		2013			2012	
	Average	Average	Interest	Average	Average	Interest
	Balance	Cost	Expense	Balance	Cost	Expense
(dollars in thousands)						
Noninterest-bearing	\$59,870	-%	\$ -	\$53,797	-%	\$ -
NOW accounts	73,862	0.14%	106	72,069	0.22%	157
Savings accounts	81,745	0.21%	171	76,334	0.16%	125
Time deposits	182,740	1.61%	2,947	191,833	1.79%	3,430
Total deposits	\$398,217	0.81%	\$ 3,224	\$394,033	0.94%	\$ 3,712
		2011				
	Average	Average	Interest			
	Balance	Cost	Expense			
Noninterest-bearing	\$44,892	-%	\$ -			
NOW accounts	67,225	0.27%	191			
Savings accounts	74,882	0.32%	241			
Time deposits	178,119	1.92%	3,418			
Total deposits	\$365,118	1.05%	\$ 3,850			
				•		

Maturities of time certificates of deposit of \$100,000 or more outstanding at December 31, 2013 are summarized as follows:

(in thousands)	
3 months or less	\$ 6,704
over 3 through 6 months	7,048
over 6 through 12 months	11,653
over 12 months	 51,376
	\$ 76,781

The following table presents the interest expense on the Bank's borrowings for the years ended December 31:

	2013	3 2012	2011
	(dollars in the	ousands)	
Repurchase agreements	\$ 1,025	\$ 1,059	\$ 1,220
FHLB term advances	951	1,125	1,475
Notes payable	-	-	5
Total borrowings	\$1,976	\$2,184	\$2,700

Managing and maintaining net interest income and net interest margin is a primary focus for the Bank and is a key determinant in the maintenance and improvement of overall earnings. Management will focus on generating growth in core retail and commercial deposits through its existing market and branch network. To the extent possible, within acceptable levels of risk, the Bank intends to manage its asset and liability mix to optimize the level of its net interest margin.

#### **Provision for Loan Losses**

Management maintains an allowance for loan losses at a level considered adequate to provide for the estimated inherent risk of loss in the current loan portfolio based upon its quarterly analysis. Management uses the results of the analysis in determining the amount of the quarterly provision for loan losses that it considers necessary to maintain the allowance for loan losses at an adequate level. Based on this analysis, the provision for loan losses amounted to \$315,000 and \$463,000 in 2013 and 2012, respectively.

The Bank's ratio of allowance to total loans remained .99% in 2013, as it was also .99% in 2012. Loans more than 30 days delinquent were .26% of total loans at December 31, 2013 and .21% of total loans at December 31, 2012.

#### Noninterest Income

Total noninterest income for 2013 was \$5.6 million, a decrease of \$493,000 or 8.2% from noninterest income for 2012. This decrease is due primarily to a decrease in the gain on sale of loans of \$554,000. The decrease in the gains from the sale of loans reflects a decrease in the level of residential real estate loans sold in 2013, as well as a decrease in the average premiums received for loans sold in 2013 compared to 2012.

### **Noninterest Expense**

Total noninterest expense was \$13.9 million and \$12.9 million for 2013 and 2012, respectively. The \$13.9 million of noninterest expense for 2013 represents an increase of \$918,000 or 7.1% from the 2012 levels. Salaries and benefits increased by \$612,000 or 9.0% from the 2012 expense of \$6.8 million. The increase in salaries and benefits reflects an increase in staffing, in addition to normal annual salary increases. Net occupancy expense and other expense increased \$129,000 and \$116,000, reflecting a full year of expenses for two new branch locations opened in 2012 and for two new locations added in 2013.

#### **Income Taxes**

The Bank's income tax expense amounted to \$1.4 million, \$2.5 million, and \$2.4 million in 2013, 2012, and 2011, respectively. Effective tax rates for these periods were 21.4%, 32.5%, and 32.0%, respectively. The decrease in the effective rate for 2013 is attributable to tax benefits available to the Bank related to stock option exercises by senior officers considered to be disqualifying dispositions for tax purposes. For 2013 and 2012, tax exempt investment income and earnings on bank-owned life insurance were 18.3% and 14.8% of income before taxes.

### Comparison of 2012 and 2011 Operating Results

The Bank's net income for 2012 was \$5.2 million compared with net income for 2011 of \$5.0 million, an increase of \$184,000 or 3.7%. Diluted earnings per share were \$1.37 for 2012 and \$1.28 for 2011.

#### **Net Interest Income**

Net interest income decreased by \$461,000 or 3.0% to \$15.1 million in 2012. The Bank's interest rate spread for 2012 was 3.17%, a decrease of 14 basis points from 2011. The Bank's net interest margin decreased by 17 basis points to 3.34% in 2012 from 3.51% in 2011.

#### **Provision for Loan Losses**

The provision for loan losses amounted to \$463,000 in 2012 versus \$668,000 in 2011. The Bank's ratio of allowance to total loans increased from .95% in 2011 to .99% in 2012. This reflects an increase in loans classified substandard of \$1.5 million, an increase in commercial real estate loans, and the concurrent increase of the ratio of commercial real estate loans to total loans. In addition, loans more than 30 days delinquent increased from .18% of total loans at December 31, 2011 to .21% of total loans at December 31, 2012.

#### **Noninterest Income**

Total noninterest income for 2012 was \$6.1 million, an increase of \$1.3 million or 28.0% from noninterest income for 2011. This increase is due primarily to an increase in the gain on sale of loans of \$1.7 million, partially offset by a decrease in the net gain on sale of securities of \$373,000. The decrease in the net gain on sale of securities results from lower levels of securities sales. The increase in the gains from the sale of loans reflects an increase in the level of residential real estate loans sold in 2012, as well as an increase in the average premiums received for loans sold in 2012 compared to 2011.

### **Noninterest Expense**

Total noninterest expense was \$12.9 million and \$12.2 million for 2012 and 2011, respectively. The \$12.9 million of noninterest expense for 2012 represents an increase of \$742,000 or 6.1% from the 2011 levels. Salaries and benefits increased by \$279,000 or 4.3% from the 2011 expense of \$6.5 million.

The increase in salaries and benefits reflects some additional staffing, in addition to normal annual salary increases. Professional fees expense increased by \$130,000 primarily as a result of one-time expenses in early 2012 related to the Bank's charter conversion, as well as the purchase and opening of a new branch in the first quarter of 2012. Marketing expense increased by \$86,000 and relates to the Bank's focus on deposit growth. Equipment expense increased by \$92,000, primarily the result of higher equipment depreciation expense. Other expense increased by \$281,000, reflecting increases in costs such as postage, printing, supplies, and data processing related to the Bank's addition of branches and growth in deposits and lending. These increases were partially offset by a decrease in regulatory expenses of \$102,000 due primarily to a decrease in FDIC premiums paid by the Bank, resulting from the FDIC's change in its assessment formula.

#### **Income Taxes**

The Bank's income tax expense increased from 2011 to 2012 due to higher levels of earnings. The Bank's income tax expense amounted to \$2.5 million and \$2.4 million in 2012 and 2011. Effective tax rates were 32.5% for 2012 and 32.0% for 2011. The increase in the effective tax rate for 2012 is attributable to a lower level of earnings on bank-owned life insurance and tax exempt income, as a percentage of the Bank's earnings before taxes. For 2012 and 2011, tax exempt investment income and earnings on bank-owned life insurance were 14.8% and 16.1% of income before taxes.

#### **Recently Issued Accounting Standards**

For discussion of recent accounting pronouncements, see Note 1 of the Consolidated Financial Statements set forth in Item 8.

#### Item 7A – Quantitative and Qualitative Disclosures about Market Risk

#### **Asset/Liability Management**

The Bank, like other financial institutions, is subject to interest rate risk to the extent that its interest-bearing liabilities reprice on a different basis or at different time periods from its interest-earning assets. The scheduled maturities of the Bank's fixed rate interest-earning assets are generally longer than the maturities of the Bank's fixed rate interest-bearing liabilities. Therefore, interest rate risk is the most significant market risk affecting the Bank. Other types of market risk, such as foreign currency exchange rate risk and commodity price risk, do not arise in the normal course of the Bank's business activities.

One of the standard methods banks use to measure interest rate sensitivity is to model the economic value of equity (EVE) in various interest rate scenarios. This method estimates the economic value of the Bank's assets and liabilities, given different increases and decreases in interest rates. Due to the historically low interest environment we are currently experiencing,

the Bank has focused on the change in the economic value of equity for a 200 basis points increase in rates and a 100 basis point decrease in rates as its guideline for determining the Bank's interest rate risk sensitivity. The Bank's EVE given shocks of -100, +200, and 0 basis points as of December 31, 2013, is shown in the table below.

## Interest Rate Sensitivity of Economic Value of Equity (EVE)

-	<b>-100 bp</b> (doll	0 bp ars in thousands)	+200 bp
Assets	\$525,129	\$516,450	\$486,289
Liabilities	465,891	460,446	445,451
Off-balance sheet positions	515	190	(711)
Economic Value of Equity	\$59,753	\$56,194	\$40,127
EVE as a percentage of the present value of assets	11.38%	10.88%	8.25%
Change in the EVE ratio	+50 bp	-	-263 bp

Generally, a bank with an increased EVE under decreased interest rates would have higher net interest income in times of decreasing market interest rates and lower net interest income in times of increasing market interest rates. Therefore, a primary objective of the Bank's policies is to manage interest rate risk over time in order to optimize net interest income in changing interest rate environments without incurring imprudent interest rate sensitivity risks. The Bank's strategies are intended to be responsive to changes in interest rates and to prudently accommodate customer demands for particular types of deposit and loan products. As of December 31, 2013, management has classified the Bank's interest rate sensitivity risk as moderate.

The following table sets forth scheduled contractual maturities of the Bank's commercial real estate and commercial loans as of December 31, 2013. Based on experience with such loans, partial or full repayment of a portion of the Bank's commercial real estate loans and commercial loans prior to contractual maturity can be expected.

	Within	One to	Over	
(in thousands)	one year	four years	four years	Total
Commercial real estate	\$ 5,545	\$ 38,245	\$ 35,345	\$ 79,135
Real estate construction	5,467	-	-	5,467
Commercial loans	7,767_	11,186_	5,073	24,026
Total	\$ 18,779	\$ 49,431	\$ 40,418	\$108,628

Of the loan amounts shown above maturing over one year, \$66.3 million have adjustable rates and \$23.6 million have fixed rates.

## Liquidity

Liquidity refers to the availability of funds to meet deposit withdrawals, fund loan commitments, and pay expenses. Proper liquidity management provides the necessary access to funds to satisfy these requirements. Failure to manage liquidity properly can result in the necessity to fund these obligations on less than desirable terms. The Bank monitors the level of short-term assets and liabilities, maintaining an appropriate balance between liquidity, risk, and return.

The Bank's primary sources of cash and cash equivalents are interest and other revenue, loan payments, and securities portfolio maturities, or sales. Cash and cash equivalents are also provided by new deposits and borrowings. If the Bank requires funds beyond its ability to generate them internally, borrowing arrangements with the Federal Home Loan Bank provide an additional source of funds.

The Bank's Consolidated Statements of Cash Flows presented in the Consolidated Financial Statements included with this Annual Report identify cash flows from operating, investing, and financial activities. During 2013, \$8.3 million was provided by operating activities, \$14.6 million was used by investing activities, and \$26.3 million was used by financing activities. Accordingly, cash and cash equivalents decreased by \$32.7 million to \$7.6 million at December 31, 2013.

Management monitors the Bank's liquidity position on a regular basis as part of the asset/liability and funds management process and anticipates that sufficient funds were available to meet current loan commitments and any unanticipated outflow of deposits. At December 31, 2013, outstanding loan commitments amounted to \$19.8 million. Time certificates of deposit scheduled to mature in one year or less at December 31, 2013 totaled \$74.0 million. Based on historic retention rates, management believes that a significant portion of these deposits will remain with the Bank.

We are contractually obligated to make payments as follows (dollars in thousands):

		Less than			More than
	Total	1 Year	1-3 Years	3-5 Years	5 Years
(dollars in thousands)				· <u> </u>	
Total Borrowings	\$ 56,500	\$ 14,500	32,000	\$ 4,000	\$ 6,000
Operating Leases	1,168	275	476	241	176
Total Obligations	\$ 57,668	\$ 14,775	\$ 32,476	\$ 4,241	\$ 6,176

#### Impact of Inflation

The Consolidated Financial Statements have been prepared in accordance with generally accepted accounting principles with regard to measurement of financial position and operating results in terms of historic dollars without consideration of the change in purchasing power of money over time due to inflation. Essentially, all of the Bank's assets and liabilities are monetary in nature. Consequently, interest rates have a more significant impact on a financial institution's performance than does inflation. The primary impact of inflation on operations of the Bank is increased operating expenses.

Item 8 - Financial Statements and Supplementary Data

#### Elmira Savings Bank and Subsidiaries

#### **Consolidated Balance Sheets**

		Decem	ber 31	,
(in thousands, except for share and per share data)		2013		2012
Assets				
Cash and due from banks	\$	7,077	\$	39,64°
Federal funds sold and other short-term investments	·	564		68
Total cash and equivalents		7,641		40,32
Securities available for sale, at fair value		63,464		66,87
Securities held to maturity - fair value \$8,302				
at December 31, 2013, and \$5,853 at December 31, 2012		7,805		5,52
Federal Reserve and Federal Home Loan Bank (FHLB) stock, at cost		10,417		9,17
Loans held for sale		1,847		3,16
Loans receivable		389,129		378,10
Less: Allowance for loan losses		3,834		3,74
Net loans		385,295		374,36
Premises and equipment, net		8,620		7,94
Bank-owned life insurance		12,387		11,98
Accrued interest receivable		1,454		1,52
ntangible assets, net		210		31
Goodwill		12,320		12,32
Other assets		2,865		3,40
Total assets	\$	514,325	\$	536,93
Liabilities and Shareholders' Equity				
Deposits	\$	397,733	\$	409,56
Borrowings	·	56,500	·	54,00
Other liabilities		6,067		6,46
Total liabilities		460,300		470,02
Shareholders' equity:				
Preferred stock, \$1,000 liquidation value per issued share; 5,000,000 shares				
authorized; 10,000 shares issued at December 31, 2013 and 24,063 shares		0.700		22.70
issued at December 31, 2012 Common stock, \$1 par value; authorized 5,000,000 shares;		9,700		23,76
2,776,240 shares issued at December 31, 2013				
and 2,454,840 at December 31, 2012		2,776		2,45
Additional paid-in capital		41,693		41,44
Retained earnings		2,485		86
Treasury stock, at cost; 116,268 shares at December 31, 2013 and				
125,865 shares at December 31, 2012		(3,327)		(3,54
Accumulated other comprehensive income		644		1,87
Total Elmira Savings Bank shareholders' equity		53,971		66,85
Noncontrolling interest		54		5
Total shareholders' equity		54,025		66,90
	<u> </u>	51/1 225	¢	536.03
Total liabilities and shareholders' equity	\$	514,325	\$	536,93

See accompanying notes to consolidated financial statements.

#### Elmira Savings Bank and Subsidiaries

#### **Consolidated Statements of Income**

Interest and dividend income:         Total interest and fees on loans         \$ 17,733         \$ 18,114         \$ 18,146           Interest and fees on loans         1,744         2,111         3,140           Interest and dividends on securities         1,744         2,111         3,140           Taxable         7,766         760         20.20           Non-taxable         20,253         20,985         22,000           Interest on dividends on securities         3,224         3,712         3,800           Interest on borrowings         3,224         3,712         3,800           Interest on borrowings         1,976         2,184         2,700           Net interest income deposits interest income after provision for loan losses         3,50         6,550           Net interest income         1,505         4,62         1,850           Net interest income         1,550         3,58         1,550           Net interest income after provision for loan losses         1,550         3,58         1,550           Net interest income         1,550         3,58         1,550           Net interest income after provision for loan losses         1,357         1,24         1,23           Net interest income after provision for loan losses         1,357	•				
Interest and dividend income:		Voors anded December 21			
Interest and dividend income:   Interest and fees on loans   \$17,733   \$18,114   \$18,140   Interest and dividends on securities   Taxable   1,744   2,111   3,140   Non-taxable   776   760   820,	(in thousands, except for per share amounts)				
Interest and flees on loans   \$17,733   \$18,114   \$18,140     Interest and dividends on securities   1,744   2,111   3,140     Non-tavable   776   760   820     Total interest and dividend income   20,253   20,985   22,100     Interest expense:		2010	2012	2011	
Taxable   1,744   2,111   3,140   Non-laxable   776   760   820		\$ 17,733	\$ 18.114	\$ 18.140	
Taxable   1,744   2,111   3,140   Non-laxable   776   760   820   Region		ψ,σσ	Ψ,	Ψ .σ,σ	
Non-taxable		1.744	2.111	3.140	
Interest expense:   Interest and dividend income		,		,	
Interest expense:					
Interest on deposits   1,976   2,184   2,700   1,976   2,184   2,700   1,976   2,184   2,700   1,976   2,184   2,700   1,976   2,184   2,700   1,976   2,184   2,700   1,976   2,184   2,700   1,976   2,184   2,700   1,976   2,184   2,700   1,976   2,184   2,700   1,976   2,184   2,700   1,976   2,184   2,184   2,185   1,855	Total interest and dividend income	20,253	20,985	22,100	
Interest on deposits   1,976   2,184   2,700   1,976   2,184   2,700   1,976   2,184   2,700   1,976   2,184   2,700   1,976   2,184   2,700   1,976   2,184   2,700   1,976   2,184   2,700   1,976   2,184   2,700   1,976   2,184   2,700   1,976   2,184   2,700   1,976   2,184   2,700   1,976   2,184   2,184   2,185   1,855					
Interest on borrowings	Interest expense:				
Total Interest expense         5,200         5,896         6,550           Net interest income         15,053         15,089         15,550           Provision for loan losses         315         463         668           Net interest income after provision for loan losses         14,738         14,626         14,882           Noninterest income:         Service fees         1,357         1,242         1,236           Gain on sale of loans held for sale         3,007         3,561         1,836           Net gain on sale of loans held for sale         3,007         3,561         1,836           Net gain on sale of securities         61         75         448           Other service fees         660         677         634           Earnings on bank-owned life insurance         399         388         369           Other         73         107         204           Total noninterest income         5,557         6,050         4,727           Noninterest expense:         Salaries and benefits         7,382         6,770         6,491           Net cocupancy         1,259         1,130         1,154           Equipment         1,022         946         854           Marketing and pub	·	•	3,712		
Net interest income         15,053         15,053         15,050         15,550           Provision for loan losses         315         463         668           Net interest income after provision for loan losses         14,738         14,626         14,882           Noninterest income:         Service fees           Service fees         1,357         1,242         1,236           Gain on sale of loans held for sale         3,007         3,561         1,336           Net gain on sale of securities         661         75         448           Other service fees         660         677         634           Earnings on bank-owned life insurance         399         388         369           Other         73         0,050         4,727           Noninterest expense:         318         6,707         6,491           Noninterest expense:         31,252         6,700         6,491           Noninterest expense:         31,252         6,700         6,491           Net coupancy         1,259         1,130         1,154           Equipment         1,022         946         854           Marketing and public relations         676         722         636	Interest on borrowings	1,976	2,184	2,700	
Net interest income         15,053         15,053         15,050         15,550           Provision for loan losses         315         463         668           Net interest income after provision for loan losses         14,738         14,626         14,882           Noninterest income:         Service fees           Service fees         1,357         1,242         1,236           Gain on sale of loans held for sale         3,007         3,561         1,336           Net gain on sale of securities         661         75         448           Other service fees         660         677         634           Earnings on bank-owned life insurance         399         388         369           Other         73         0,050         4,727           Noninterest expense:         318         6,707         6,491           Noninterest expense:         31,252         6,700         6,491           Noninterest expense:         31,252         6,700         6,491           Net coupancy         1,259         1,130         1,154           Equipment         1,022         946         854           Marketing and public relations         676         722         636					
Provision for loan losses         315         463         668           Net interest income after provision for loan losses         14,738         14,626         14,882           Noninterest income:         3,007         3,561         1,357         1,242         1,236           Gain on sale of loans held for sale         3,007         3,561         1,836           Net gain on sale of securities         61         75         448           Other service fees         660         677         634           Earnings on bank-owned life insurance         399         388         369           Other         73         107         204           Total noninterest income         5,557         6,050         4,727           Noninterest expense:           Salaries and benefits         7,382         6,770         6,491           Net occupancy         1,259         1,130         1,154           Equipment         1,022         946         854           Marketing and public relations         676         722         636           Marketing and public relations         674         643         513           Other         2,849         2,733         2,554 <td< td=""><td>Total interest expense</td><td>5,200</td><td>5,896</td><td>6,550</td></td<>	Total interest expense	5,200	5,896	6,550	
Provision for loan losses         315         463         668           Net interest income after provision for loan losses         14,738         14,626         14,882           Noninterest income:         3,007         3,561         1,357         1,242         1,236           Gain on sale of loans held for sale         3,007         3,561         1,836           Net gain on sale of securities         61         75         448           Other service fees         660         677         634           Earnings on bank-owned life insurance         399         388         369           Other         73         107         204           Total noninterest income         5,557         6,050         4,727           Noninterest expense:           Salaries and benefits         7,382         6,770         6,491           Net occupancy         1,259         1,130         1,154           Equipment         1,022         946         854           Marketing and public relations         676         722         636           Marketing and public relations         674         643         513           Other         2,849         2,733         2,554 <td< td=""><td>No.</td><td></td><td>4= 000</td><td></td></td<>	No.		4= 000		
Net interest income after provision for loan losses         14,738         14,626         14,882           Noninterest income:         Service fees         1,357         1,242         1,236           Gain on sale of loans held for sale         3,007         3,561         1,836           Net gain on sale of loans held for sale         60         677         634           Cher service fees         660         677         634           Earnings on bank-owned life insurance         399         388         369           Other         73         107         204           Total noninterest income         5,557         6,050         4,727           Noninterest expense:         Salaries and benefits         7,382         6,770         6,491           Net occupancy         1,259         1,130         1,154           Equipment         1,229         1,130         1,154           Marketing and public relations         676         722         636           Professional fees         674         643         513           Other         2,849         2,733         2,554           Income before income taxes         6,433         7,732         7,407           Income before income taxes </td <td></td> <td>•</td> <td></td> <td></td>		•			
Noninterest income:   Service fees					
Service fees         1,357         1,242         1,236           Gain on sale of loans held for sale         3,007         3,561         1,836           Net gain on sale of securities         60         677         634           Other service fees         660         677         634           Earnings on bank-owned life insurance         399         388         369           Other         73         107         204           Noninterest expense:         Salaries and benefits         7,382         6,770         6,491           Net occupancy         1,259         1,130         1,154           Equipment         1,022         946         854           Marketing and public relations         676         7674         643         513           Other         2,849         2,733         2,554           Income before income taxes         6,433         7,732         7,407           Income before income taxes         1,374         2,514         2,373           Less: Net income attributable to noncontrolling interest         5         5         5           Net income attributable to Elmira Savings Bank         5,054         5,213         5,029           Dividend on pref	Net interest income aπer provision for loan losses	14,738	14,626	14,882	
Service fees         1,357         1,242         1,236           Gain on sale of loans held for sale         3,007         3,561         1,836           Net gain on sale of securities         60         677         634           Other service fees         660         677         634           Earnings on bank-owned life insurance         399         388         369           Other         73         107         204           Noninterest expense:         Salaries and benefits         7,382         6,770         6,491           Net occupancy         1,259         1,130         1,154           Equipment         1,022         946         854           Marketing and public relations         676         7674         643         513           Other         2,849         2,733         2,554           Income before income taxes         6,433         7,732         7,407           Income before income taxes         1,374         2,514         2,373           Less: Net income attributable to noncontrolling interest         5         5         5           Net income attributable to Elmira Savings Bank         5,054         5,213         5,029           Dividend on pref	Nanintaract income:				
Gain on sale of loans held for sale         3,007         3,561         1,836           Net gain on sale of securities         61         75         448           Other service fees         660         677         634           Earnings on bank-owned life insurance         399         388         369           Other         73         107         204           Total noninterest income         5,557         6,050         4,727           Noninterest expense:         Salaries and benefits         7,382         6,770         6,491           Net occupancy         1,259         1,103         1,154           Equipment         1,022         946         854           Marketing and public relations         676         722         636           Professional fees         674         643         513           Other         2,849         2,733         2,554           Income before income taxes Income		1 257	1 2/12	1 226	
Net gain on sale of securities         61         75         448           Other service fees         660         677         634           Earnings on bank-owned life insurance         399         388         369           Other         73         107         204           Noninterest expense:           Salaries and benefits         7,382         6,770         6,491           Net occupancy         1,259         1,130         1,154           Equipment         1,022         946         854           Marketing and public relations         676         722         636           Professional fees         674         643         513           Other         2,849         2,733         2,554           Total noninterest expense         13,862         12,944         12,202           Income before income taxes income		•			
Other service fees         660 Branings on bank-owned life insurance         677 Base Basic earnings on bank-owned life insurance         660 Base Basic earnings on bank-owned life insurance         677 Base Basic earnings per common sharee         660 Base Basic earnings per common sharee         677 Base Basic earnings per common sharee         660 Base Basic earnings per common sharee         677 Base Basic earnings per common sharee         660 Base Basic earnings per common sharee         677 Base Basic earnings per common sharee         660 Base Basic earnings per common sharee         677 Base Basic earnings per common sharee         678 Basic earnings per common sharee         677 Base Basic earnings		,			
Earnings on bank-owned life insurance         399         388         369           Other         73         107         204           Total noninterest income         5,557         6,050         4,727           Noninterest expense:         388         6,770         6,491           Net occupancy:         1,259         1,130         1,154           Equipment         1,022         946         854           Marketing and public relations         676         722         636           Professional fees         674         643         513           Other         2,849         2,733         2,554           Total noninterest expense         13,862         12,944         12,202           Income taxes         6,433         7,732         7,407           Income taxes         1,374         2,514         2,373           Net income         5,059         5,218         5,034           Less: Net income attributable to Income Incom	ŭ				
Other         73         107         204           Total noninterest income         5,557         6,050         4,727           Noninterest expense:         Salaries and benefits         7,382         6,770         6,491           Net occupancy         1,259         1,130         1,154         Equipment         1,022         946         854           Marketing and public relations         676         722         636         6722         636         6722         636         674         643         513         513         Other         2,849         2,733         2,554           Total noninterest expense         13,862         12,944         12,202           Income taxes         6,433         7,732         7,407           Income taxes         1,374         2,514         2,373           Net income         5,059         5,218         5,034           Less: Net income attributable to elmira Savings Bank         5,054         5,213         5,029           Dividend on preferred stock         1,215         1,609         1,512           Accretion of preferred stock discount         -         -         -         252           Income available to common shareholders         3,839         3,604					
Total noninterest income         5,557         6,050         4,727           Noninterest expense:         Salaries and benefits         7,382         6,770         6,491           Net occupancy         1,259         1,130         1,154           Equipment         1,022         946         854           Marketing and public relations         676         722         636           Professional fees         674         643         513           Other         2,849         2,733         2,554           Income before income taxes         6,433         7,732         7,407           Income taxes         1,374         2,514         2,373           Less: Net income attributable to noncontrolling interest         5,059         5,218         5,034           Less: Net income attributable to Elmira Savings Bank         5,054         5,213         5,029           Dividend on preferred stock         1,215         1,609         1,512           Accretion of preferred stock discount         -         -         -         252           Income available to common shareholders         \$ 3,839         \$ 3,604         \$ 3,265	· ·				
Noninterest expense:   Salaries and benefits   7,382   6,770   6,491     Net occupancy   1,259   1,130   1,154     Equipment   1,022   946   854     Marketing and public relations   676   722   636     Professional fees   674   643   513     Other   2,849   2,733   2,554      Total noninterest expense   13,862   12,944   12,202     Income before income taxes   6,433   7,732   7,407     Income taxes   1,374   2,514   2,373     Net income attributable to noncontrolling interest   5   5   5      Net income attributable to Elmira Savings Bank   5,054   5,213   5,029     Dividend on preferred stock   1,215   1,609   1,512     Accretion of preferred stock discount   -   252     Income available to common shareholders   \$3,839   \$3,604   \$3,265     Basic earnings per common share   \$1.47   \$1.44   \$1.32     Basic earnings per common share   \$1.47   \$1.44   \$1.32     Total noninterest expense   \$1.47   \$1			-	-	
Salaries and benefits         7,382         6,770         6,491           Net occupancy         1,259         1,130         1,154           Equipment         1,022         946         854           Marketing and public relations         676         722         636           Professional fees         674         643         513           Other         2,849         2,733         2,554           Income before income taxes         6,433         7,732         7,407           Income taxes         1,374         2,514         2,373           Net income         5,059         5,218         5,034           Less: Net income attributable to noncontrolling interest         5         5         5           Net income attributable to Elmira Savings Bank         5,054         5,213         5,029           Dividend on preferred stock         1,215         1,609         1,512           Accretion of preferred stock discount         -         -         -         252           Income available to common shareholders         \$ 3,839         \$ 3,604         \$ 3,265	Total noninterest income	5,557	6,050	4,727	
Salaries and benefits         7,382         6,770         6,491           Net occupancy         1,259         1,130         1,154           Equipment         1,022         946         854           Marketing and public relations         676         722         636           Professional fees         674         643         513           Other         2,849         2,733         2,554           Income before income taxes         6,433         7,732         7,407           Income taxes         1,374         2,514         2,373           Net income         5,059         5,218         5,034           Less: Net income attributable to noncontrolling interest         5         5         5           Net income attributable to Elmira Savings Bank         5,054         5,213         5,029           Dividend on preferred stock         1,215         1,609         1,512           Accretion of preferred stock discount         -         -         -         252           Income available to common shareholders         \$ 3,839         \$ 3,604         \$ 3,265					
Net occupancy         1,259         1,130         1,154           Equipment         1,022         946         854           Marketing and public relations         676         722         636           Professional fees         674         643         513           Other         2,849         2,733         2,554           Income before income taxes         6,433         7,732         7,407           Income taxes         1,374         2,514         2,373           Net income         5,059         5,218         5,034           Less: Net income attributable to noncontrolling interest         5         5         5           Net income attributable to Elmira Savings Bank         5,054         5,213         5,029           Dividend on preferred stock         1,215         1,609         1,512           Accretion of preferred stock discount         -         -         -         252           Income available to common shareholders         \$ 3,839         \$ 3,604         \$ 3,265	Noninterest expense:				
Equipment Marketing and public relations         1,022         946         854           Marketing and public relations         676         722         636           Professional fees         674         643         513           Other         2,849         2,733         2,554           Income before income taxes         6,433         7,732         7,407           Income taxes         1,374         2,514         2,373           Net income         5,059         5,218         5,034           Less: Net income attributable to noncontrolling interest         5         5         5           Net income attributable to Elmira Savings Bank         5,054         5,213         5,029           Dividend on preferred stock         1,215         1,609         1,512           Accretion of preferred stock discount         -         -         -         252           Income available to common shareholders         \$ 3,839         \$ 3,604         \$ 3,265           Basic earnings per common share         \$ 1.47         \$ 1.44         \$ 1.32	Salaries and benefits	7,382	6,770	6,491	
Marketing and public relations         676         722         636           Professional fees         674         643         513           Other         2,849         2,733         2,554           Total noninterest expense         13,862         12,944         12,202           Income before income taxes Income tax	· · ·	•			
Professional fees Other         674 2,849         643 513 5,54           Other         2,849         2,733         2,554           Total noninterest expense         13,862         12,944         12,202           Income before income taxes Income taxe	• •	,			
Other         2,849         2,733         2,554           Total noninterest expense         13,862         12,944         12,202           Income before income taxes Income ta	•				
Total noninterest expense         13,862         12,944         12,202           Income before income taxes Income taxes Income taxes Income taxes         6,433         7,732         7,407           Net income taxes Income taxes Income taxes Income attributable to noncontrolling interest         5,059         5,218         5,034           Less: Net income attributable to noncontrolling interest         5         5         5         5           Net income attributable to Elmira Savings Bank         5,054         5,213         5,029           Dividend on preferred stock Accretion of preferred stock discount         1,215         1,609         1,512           Accretion of preferred stock discount         -         -         252           Income available to common shareholders         \$ 3,839         \$ 3,604         \$ 3,265           Basic earnings per common share         \$ 1.47         \$ 1.44         \$ 1.32					
Income before income taxes   6,433   7,732   7,407     Income taxes   1,374   2,514   2,373     Net income   5,059   5,218   5,034     Less: Net income attributable to noncontrolling interest   5   5   5     Net income attributable to Elmira Savings Bank   5,054   5,213   5,029     Dividend on preferred stock   1,215   1,609   1,512     Accretion of preferred stock discount   -   252     Income available to common shareholders   \$ 3,839   \$ 3,604   \$ 3,265     Basic earnings per common share   \$ 1.47   \$ 1.44   \$ 1.32     Income available to common share   \$ 1.47   \$ 1.44   \$ 1.32     Income available to common share   \$ 1.47   \$ 1.44   \$ 1.32     Income available to common share   \$ 1.47   \$ 1.44   \$ 1.32     Income available to common share   \$ 1.47   \$ 1.44   \$ 1.32     Income available to common share   \$ 1.47   \$ 1.44   \$ 1.32     Income available to common share   \$ 1.47   \$ 1.44   \$ 1.32     Income available to common share   \$ 1.47   \$ 1.44   \$ 1.32     Income available to common share   \$ 1.47   \$ 1.44   \$ 1.32     Income available to common share   \$ 1.47   \$ 1.44   \$ 1.32     Income available to common share   \$ 1.47   \$ 1.44   \$ 1.32     Income available to common share   \$ 1.47   \$ 1.44   \$ 1.32     Income available to common share   \$ 1.47   \$ 1.44   \$ 1.32     Income available to common share   \$ 1.47   \$ 1.44   \$ 1.32     Income available to common share   \$ 1.47   \$ 1.44   \$ 1.32     Income available to common share   \$ 1.47   \$ 1.44   \$ 1.32     Income available to common share   \$ 1.47   \$ 1.44   \$ 1.32     Income available to common share   \$ 1.47   \$ 1.44   \$ 1.32     Income available to common share   \$ 1.47   \$ 1.44   \$ 1.32     Income available to common share   \$ 1.47   \$ 1.44   \$ 1.32     Income available to common share   \$ 1.47   \$ 1.44   \$ 1.32     Income available to common share   \$ 1.47   \$ 1.44   \$ 1.32     Income available to common share   \$ 1.47   \$ 1.44   \$ 1.32     Income available to common share   \$ 1.47   \$ 1.44   \$ 1.32     Income available to common share   \$ 1.47	Other	2,849	2,733	2,554	
Income before income taxes   6,433   7,732   7,407     Income taxes   1,374   2,514   2,373     Net income   5,059   5,218   5,034     Less: Net income attributable to noncontrolling interest   5   5   5     Net income attributable to Elmira Savings Bank   5,054   5,213   5,029     Dividend on preferred stock   1,215   1,609   1,512     Accretion of preferred stock discount   -   252     Income available to common shareholders   \$ 3,839   \$ 3,604   \$ 3,265     Basic earnings per common share   \$ 1.47   \$ 1.44   \$ 1.32     Income available to common share   \$ 1.47   \$ 1.44   \$ 1.32     Income available to common share   \$ 1.47   \$ 1.44   \$ 1.32     Income available to common share   \$ 1.47   \$ 1.44   \$ 1.32     Income available to common share   \$ 1.47   \$ 1.44   \$ 1.32     Income available to common share   \$ 1.47   \$ 1.44   \$ 1.32     Income available to common share   \$ 1.47   \$ 1.44   \$ 1.32     Income available to common share   \$ 1.47   \$ 1.44   \$ 1.32     Income available to common share   \$ 1.47   \$ 1.44   \$ 1.32     Income available to common share   \$ 1.47   \$ 1.44   \$ 1.32     Income available to common share   \$ 1.47   \$ 1.44   \$ 1.32     Income available to common share   \$ 1.47   \$ 1.44   \$ 1.32     Income available to common share   \$ 1.47   \$ 1.44   \$ 1.32     Income available to common share   \$ 1.47   \$ 1.44   \$ 1.32     Income available to common share   \$ 1.47   \$ 1.44   \$ 1.32     Income available to common share   \$ 1.47   \$ 1.44   \$ 1.32     Income available to common share   \$ 1.47   \$ 1.44   \$ 1.32     Income available to common share   \$ 1.47   \$ 1.44   \$ 1.32     Income available to common share   \$ 1.47   \$ 1.44   \$ 1.32     Income available to common share   \$ 1.47   \$ 1.44   \$ 1.32     Income available to common share   \$ 1.47   \$ 1.44   \$ 1.32     Income available to common share   \$ 1.47   \$ 1.44   \$ 1.32     Income available to common share   \$ 1.47   \$ 1.44   \$ 1.32     Income available to common share   \$ 1.47   \$ 1.44   \$ 1.32     Income available to common share   \$ 1.47	Total manintagest symmes	42.000	12.044	40.000	
Income taxes         1,374         2,514         2,373           Net income         5,059         5,218         5,034           Less: Net income attributable to noncontrolling interest         5         5         5           Net income attributable to Elmira Savings Bank         5,054         5,213         5,029           Dividend on preferred stock         1,215         1,609         1,512           Accretion of preferred stock discount         -         -         252           Income available to common shareholders         \$ 3,839         \$ 3,604         \$ 3,265           Basic earnings per common share         \$ 1.47         \$ 1.44         \$ 1.32	Total noninterest expense	13,862	12,944	12,202	
Income taxes         1,374         2,514         2,373           Net income         5,059         5,218         5,034           Less: Net income attributable to noncontrolling interest         5         5         5           Net income attributable to Elmira Savings Bank         5,054         5,213         5,029           Dividend on preferred stock         1,215         1,609         1,512           Accretion of preferred stock discount         -         -         252           Income available to common shareholders         \$ 3,839         \$ 3,604         \$ 3,265           Basic earnings per common share         \$ 1.47         \$ 1.44         \$ 1.32	Income hefore income taxes	6 433	7 732	7.407	
Net income         5,059         5,218         5,034           Less: Net income attributable to noncontrolling interest         5         5         5           Net income attributable to Elmira Savings Bank         5,054         5,213         5,029           Dividend on preferred stock Accretion of preferred stock discount         1,215         1,609         1,512           Accretion of preferred stock discount         -         -         -         252           Income available to common shareholders         \$ 3,839         \$ 3,604         \$ 3,265           Basic earnings per common share         \$ 1.47         \$ 1.44         \$ 1.32		•	,		
Less: Net income attributable to noncontrolling interest         5         5         5           Net income attributable to Elmira Savings Bank         5,054         5,213         5,029           Dividend on preferred stock Accretion of preferred stock discount         1,215         1,609         1,512           Accretion of preferred stock discount         -         -         -         252           Income available to common shareholders         \$ 3,839         \$ 3,604         \$ 3,265           Basic earnings per common share         \$ 1.47         \$ 1.44         \$ 1.32	moone taxes	1,014	2,014	2,070	
Less: Net income attributable to noncontrolling interest         5         5         5           Net income attributable to Elmira Savings Bank         5,054         5,213         5,029           Dividend on preferred stock Accretion of preferred stock discount         1,215         1,609         1,512           Accretion of preferred stock discount         -         -         -         252           Income available to common shareholders         \$ 3,839         \$ 3,604         \$ 3,265           Basic earnings per common share         \$ 1.47         \$ 1.44         \$ 1.32	Net income	5.059	5.218	5.034	
Dividend on preferred stock         1,215         1,609         1,512           Accretion of preferred stock discount         -         -         -         252           Income available to common shareholders         \$ 3,839         \$ 3,604         \$ 3,265           Basic earnings per common share         \$ 1.47         \$ 1.44         \$ 1.32		•	-, -	,	
Dividend on preferred stock         1,215         1,609         1,512           Accretion of preferred stock discount         -         -         -         252           Income available to common shareholders         \$ 3,839         \$ 3,604         \$ 3,265           Basic earnings per common share         \$ 1.47         \$ 1.44         \$ 1.32					
Accretion of preferred stock discount  252  Income available to common shareholders  \$ 3,839 \$ 3,604 \$ 3,265  Basic earnings per common share  \$ 1.47 \$ 1.44 \$ 1.32	Net income attributable to Elmira Savings Bank	5,054	5,213	5,029	
Accretion of preferred stock discount  252  Income available to common shareholders  \$ 3,839 \$ 3,604 \$ 3,265  Basic earnings per common share  \$ 1.47 \$ 1.44 \$ 1.32					
Income available to common shareholders\$ 3,839\$ 3,604\$ 3,265Basic earnings per common share\$ 1.47\$ 1.44\$ 1.32	•	1,215	1,609	1,512	
Basic earnings per common share \$ 1.47 \$ 1.44 \$ 1.32	Accretion of preferred stock discount	-	-	252	
Basic earnings per common share \$ 1.47 \$ 1.44 \$ 1.32					
	Income available to common shareholders	\$ 3,839	\$ 3,604	\$ 3,265	
Diluted earnings per common share \$ 1.40 \$ 1.37 \$ 1.28	Basic earnings per common share	\$ 1.47	\$ 1.44	\$ 1.32	
Diluted earnings per common share \$ 1.40 \$ 1.37 \$ 1.28	<b>5</b> 0	<u>.</u>			
	Diluted earnings per common share	\$ 1.40	\$ 1.37	\$ 1.28	

Per share data has been restated to reflect a 10% stock dividend paid on December 27, 2013 and a 5% stock dividend paid on December 28, 2012.

See accompanying notes to consolidated financial statements.

### Elmira Savings Bank and Subsidiaries

#### **Consolidated Statements of Comprehensive Income**

		Years ended December 31,					
(in thousands)	2013		2012		2011		
Net income	\$	5,054	\$	5,213	\$	5,029	
Other comprehesive income (loss):							
Net unrealized holding gains (losses) on securities available for sale		(1,943)		-		2,014	
Tax benefit (expense)		753		-		(779)	
		(1,190)		_		1,235	
Realized securities gains included in net income		(61)		(75)		(448)	
Tax expense		23		29		173	
		(38)		(46)		(275)	
Other comprehensive income (loss), net of tax		(1,228)		(46)		960	
Comprehensive income	\$	3,826	\$	5,167	\$	5,989	

See accompanying notes to consolidated financial statements.

## Elmira Savings Bank and Subsidiaries

## Consolidated Statements of Shareholders' Equity

(in thousands, except for share and	Preferred	Common	Additional paid-in	Retained	Treasury	Accumulated other comprehensive	Noncontrolling	
per share amounts)  Balance at December 31, 2010	stock \$ 18,481	stock \$ 2,090	capital \$ 35,065	earnings \$ 3,353	stock \$ (3,548)	income \$ 958	Interest 52	Total \$ 56,451
Net income	-	-	-	5,029	-		5	5,034
Other comprehensive income		_		-,		960		960
10% Stock dividend (196,819 shares)	-	197	2,960	(3,157)	_	-	_	-
Cash in lieu of fractional			_,,,,,	(=, -=-)				
shares resulting from a 10% stock dividend	-	-	-	(3)	-	-	-	(3)
Stock based compensation expense	-	-	360	-	-	-	-	360
Issuance of common shares (3,128 shares)	-	3	(3)	-	-	-	-	-
Exercise of stock options, net (2,714 shares)	-	3	20	-	-	-	-	23
Preferred stock redemption (9,090 shares)	(9,033)	-	-	(57)	-	-	-	(9,090)
Preferred stock issued, net of issuance costs (14,063 shares)	14,063	-	-	(50)	-	-	-	14,013
Accretion of discount on preferred stock	252	-	-	(252)	-	-	-	-
Cash dividend on preferred stock	-	-	-	(1,512)	-	-	(5)	(1,517)
Cash dividend on common stock (\$.65 per share)  Balance at December 31, 2011	23,763	2,293	38,402	(1,616) <b>1,735</b>	(3,548)	1,918	52	(1,616) <b>64,615</b>
	20,700	2,230			(0,040)	1,510		
Net income	-	-	-	5,213	-		5	5,218
Other comprehensive loss	-	-		-	-	(46)	-	(46)
5% Stock dividend (110,417 shares)	-	110	2,387	(2,497)	-	-	-	-
Cash in lieu of fractional shares resulting from a 5%								
stock dividend	-	-	-	(7)	-	-	-	(7)
Stock based compensation expense	-	-	340	-	-	-	-	340
Issuance of common shares (12,321 shares)	-	12	(12)	-	-	-	-	-
Exercise of stock options, net (39,446 shares)	-	40	331	-	-	-	-	371
Preferred stock repurchased - noncontrolling interest	-	-	-	-	-	-	(1)	(1)
Cash dividend on preferred stock	-	-	-	(1,609)	-	-	(5)	(1,614)
Cash dividend on common stock (\$.77 per share)  Balance at December 31, 2012	23,763	2,455	41,448	(1,967) <b>868</b>	(3,548)	1,872	<u>-</u> 51	(1,967) <b>66,909</b>
Net income	-	-	, -	5,054	-	-	5	5,059
			_	2,22		(4.228)	_	
Other comprehensive loss	-	-		-	-	(1,228)	-	(1,228)
10% Stock dividend (241,493 shares)	-	242	(242)	-	-	-	-	-
Cash in lieu of fractional shares resulting from a 10% stock dividend	_	_	_	(9)	_	_	_	(9)
Stock based compensation expense	-	-	301	-	-	-	-	301
Issuance of common shares (6,382 shares)	-	6	(6)		-	-	-	-
Exercise of stock options, net (73,525 shares)	-	73	196	_	_	_	_	269
	(14,063)							
Preferred stock redemption (14,063 shares)	(14,003)	-		-	-	-	•	(14,063)
Issuance of treasury stock (9,597 shares)	-	-	(4)	-	221	•	•	217
Preferred stock repurchased - noncontrolling interest	-	-	-	-	-	-	(2)	(2)
Preferred stock issued - noncontrolling interest	-	-	-	-	-	-	5	5
Cash dividend on preferred stock	-	-	-	(1,215)	-	-	(5)	(1,220)
Cash dividend on common stock (\$.84 per share)	<u> </u>			(2,213)	<u> </u>		-	(2,213)
Balance at December 31, 2013	\$ 9,700	\$ 2,776	\$ 41,693	\$ 2,485	\$ (3,327)	\$ 644	\$ 54	\$ 54,025

Per share data has been restated to reflect the 10% stock dividend paid on December 27, 2013 and the 5% stock dividend paid on December 28, 2012. See accompanying notes to consolidated financial statements.

## Elmira Savings Bank and Subsidiaries

#### Consolidated Statements of Cash Flows

(in thousands)	_	Years 2013	ended December 2012	oer 31, 2011	
Cash flows from operating activities:		2013	2012		2011
Net income	\$	5,054	\$ 5,213	\$	5,029
Adjustments to reconcile net income to net cash					
provided by operating activities					
Depreciation and amortization of premises and equipment		684	677		611
Accretion of net deferred loan origination costs		(484)	(477)		(357
Amortization of intangible assets		106	128		150
Deferred income taxes		(102)	531		275
Provision for loan losses		315	463		668
Net amortization of premiums and discounts		482	669		739
Net gain on sale of securities		(61)	(75)		(448
Gains on sale of loans held for sale		(3,007)	(3,561)		(1,836
Proceeds from sale of loans held for sale		74,156	82,815		48,804
Originations of loans held for sale		(69,829)	(79,579)		(49,278
Earnings on bank-owned life insurance		(399)	(388)		(369
Stock based compensation		301	340		360
Change in noncontrolling interest		3	(1)		
Changes in certain assets and liabilities affecting operations:					
Accrued interest receivable		75	86		192
Other assets		487	(66)		431
Other liabilities		483	(1,035)		439
Net cash provided by operating activities		8,264	5,740		5,410
Cash flows from investing activities:					
Proceeds from sales of securities available for sale		1,047	1,783		9,419
Proceeds from maturities of and principal collected on securities available for sale		15,692	20,882		38,616
Proceeds from maturities of and principal collected on securities held to maturity		434	510		492
Purchases of securities available for sale		(7,094)	-		(7,080
Purchases of securities held to maturity		(2,719)	(1,412)		(110
Net increase in loans receivable		(19,651)	(35,467)		(36,388
Purchases of Bank-owned life insurance		-	(1,500)		
Purchases of premises and equipment, net		(1,357)	(3,232)		(466
Purchases of Federal Reserve and FHLB stock		(2,945)	(4,847)		(1,659
Redemptions of Federal Reserve and FHLB stock		1,706	964		605
Proceeds from sales of other real estate owned		285	103		791
Net cash (used in) provided by investing activities		(14,602)	(22,216)		4,220
Cash flows from financing activities:					
(Decrease) increase in time deposits		(14,766)	7,366		15,125
Increase in other deposits		2,934	20,470		9,983
Advances from FHLB term advances		15,500			-,
Repayment of FHLB term advances		(13,000)	(14,000)		(5,000
Repayment of securities sold under repurchase agreements		(.0,000,	(2,000)		(6,000
Repayment of notes payable			(19)		(74
riopaymoni or notoc payable			(.0)		14,013
Net proceeds from the issuance of preferred stock			_		(9,090
Net proceeds from the issuance of preferred stock		(14 063)			(0,000
Repayment of preferred stock		(14,063)	-		
Repayment of preferred stock Issuance of treasury stock		217	-		(1.616
Repayment of preferred stock Issuance of treasury stock Cash dividends on common stock		217 (2,213)	(1,967)		
Repayment of preferred stock Issuance of treasury stock Cash dividends on common stock Cash dividends on preferred stock		217	-		
Repayment of preferred stock Issuance of treasury stock Cash dividends on common stock Cash dividends on preferred stock Payment of cash in lieu of fractional shares resulting from		217 (2,213) (1,215)	(1,967) (1,609)		(1,512
Repayment of preferred stock Issuance of treasury stock Cash dividends on common stock Cash dividends on preferred stock Payment of cash in lieu of fractional shares resulting from stock dividend		217 (2,213) (1,215)	(1,967) (1,609)		(1,512
Repayment of preferred stock Issuance of treasury stock Cash dividends on common stock Cash dividends on preferred stock Payment of cash in lieu of fractional shares resulting from stock dividend Net proceeds from the exercise of stock options		217 (2,213) (1,215) (9) 269	(1,967) (1,609) (7) 371		(1,616 (1,512 (3 23
Repayment of preferred stock Issuance of treasury stock Cash dividends on common stock Cash dividends on preferred stock Payment of cash in lieu of fractional shares resulting from stock dividend Net proceeds from the exercise of stock options  Net cash (used in) provided by financing activities		217 (2,213) (1,215) (9) 269 (26,346)	(1,967) (1,609) (7) 371 8,605		(1,512 (3 23 15,849
Repayment of preferred stock Issuance of treasury stock Cash dividends on common stock Cash dividends on preferred stock Payment of cash in lieu of fractional shares resulting from stock dividend Net proceeds from the exercise of stock options Net cash (used in) provided by financing activities  Net increase (decrease) in cash and cash equivalents		217 (2,213) (1,215) (9) 269 (26,346) (32,684)	(1,967) (1,609) (7) 371 8,605 (7,871)		(1,512 (3 23 15,849 25,479
Repayment of preferred stock Issuance of treasury stock Cash dividends on common stock Cash dividends on preferred stock Payment of cash in lieu of fractional shares resulting from stock dividend Net proceeds from the exercise of stock options  Net cash (used in) provided by financing activities		217 (2,213) (1,215) (9) 269 (26,346)	(1,967) (1,609) (7) 371 8,605		(1,512 (3 23
Repayment of preferred stock Issuance of treasury stock Cash dividends on common stock Cash dividends on preferred stock Payment of cash in lieu of fractional shares resulting from stock dividend Net proceeds from the exercise of stock options Net cash (used in) provided by financing activities  Net increase (decrease) in cash and cash equivalents		217 (2,213) (1,215) (9) 269 (26,346) (32,684)	(1,967) (1,609) (7) 371 8,605 (7,871)	\$	(1,512 (3 23 15,849 25,479
Repayment of preferred stock Issuance of treasury stock Cash dividends on common stock Cash dividends on preferred stock Payment of cash in lieu of fractional shares resulting from stock dividend Net proceeds from the exercise of stock options Net cash (used in) provided by financing activities  Net increase (decrease) in cash and cash equivalents Cash and cash equivalents, beginning of year  Cash and cash equivalents, end of year		217 (2,213) (1,215) (9) 269 (26,346) (32,684) 40,325	(1,967) (1,609) (7) 371 8,605 (7,871) 48,196	\$	(1,512 (1
Repayment of preferred stock Issuance of treasury stock Cash dividends on common stock Cash dividends on preferred stock Payment of cash in lieu of fractional shares resulting from stock dividend Net proceeds from the exercise of stock options Net cash (used in) provided by financing activities Net increase (decrease) in cash and cash equivalents Cash and cash equivalents, beginning of year Cash and cash equivalents, end of year Supplemental disclosure of cash flow information:		217 (2,213) (1,215) (9) 269 (26,346) (32,684) 40,325	(1,967) (1,609) (7) 371 8,605 (7,871) 48,196	\$	(1,512 (3 23 15,849 25,479 22,717
Repayment of preferred stock Issuance of treasury stock Cash dividends on common stock Cash dividends on preferred stock Payment of cash in lieu of fractional shares resulting from stock dividend Net proceeds from the exercise of stock options Net cash (used in) provided by financing activities  Net increase (decrease) in cash and cash equivalents  Cash and cash equivalents, beginning of year  Cash and cash equivalents, end of year  Supplemental disclosure of cash flow information: Schedule of noncash investing activities:	\$	217 (2,213) (1,215) (9) 269 (26,346) (32,684) 40,325 7,641	(1,967) (1,609) (7) 371 8,605 (7,871) 48,196 \$ 40,325		(1,512 (3,23 15,849 25,479 22,717 48,196
Repayment of preferred stock Issuance of treasury stock Cash dividends on common stock Cash dividends on preferred stock Payment of cash in lieu of fractional shares resulting from stock dividend Net proceeds from the exercise of stock options Net cash (used in) provided by financing activities  Net increase (decrease) in cash and cash equivalents  Cash and cash equivalents, beginning of year  Cash and cash equivalents, end of year  Supplemental disclosure of cash flow information: Schedule of noncash investing activities: Other real estate acquired in settlement of loans		217 (2,213) (1,215) (9) 269 (26,346) (32,684) 40,325 7,641	(1,967) (1,609) (7) 371 8,605 (7,871) 48,196 \$ 40,325	\$	(1,512 (1
Repayment of preferred stock Issuance of treasury stock Cash dividends on common stock Cash dividends on preferred stock Payment of cash in lieu of fractional shares resulting from stock dividend Net proceeds from the exercise of stock options Net cash (used in) provided by financing activities  Net increase (decrease) in cash and cash equivalents  Cash and cash equivalents, beginning of year  Cash and cash equivalents, end of year  Supplemental disclosure of cash flow information: Schedule of noncash investing activities: Other real estate acquired in settlement of loans Loans securitized	\$	217 (2,213) (1,215) (9) 269 (26,346) (32,684) 40,325 7,641	(1,967) (1,609) (7) 371 8,605 (7,871) 48,196 \$ 40,325		(1,512 (1
Repayment of preferred stock Issuance of treasury stock Cash dividends on common stock Cash dividends on preferred stock Payment of cash in lieu of fractional shares resulting from stock dividend Net proceeds from the exercise of stock options  Net cash (used in) provided by financing activities  Net increase (decrease) in cash and cash equivalents  Cash and cash equivalents, beginning of year  Cash and cash equivalents, end of year  Supplemental disclosure of cash flow information: Schedule of noncash investing activities: Other real estate acquired in settlement of loans Loans securitized Cash paid during the year for:	\$	217 (2,213) (1,215) (9) 269 (26,346) (32,684) 40,325 7,641	(1,967) (1,609) (7) 371 8,605 (7,871) 48,196 \$ 40,325 \$ 125 3,671		(1,512 (3 23 15,849 25,479 22,717 48,196
Repayment of preferred stock Issuance of treasury stock Cash dividends on common stock Cash dividends on preferred stock Payment of cash in lieu of fractional shares resulting from stock dividend Net proceeds from the exercise of stock options Net cash (used in) provided by financing activities  Net increase (decrease) in cash and cash equivalents  Cash and cash equivalents, beginning of year  Cash and cash equivalents, end of year  Supplemental disclosure of cash flow information: Schedule of noncash investing activities: Other real estate acquired in settlement of loans Loans securitized	\$	217 (2,213) (1,215) (9) 269 (26,346) (32,684) 40,325 7,641	(1,967) (1,609) (7) 371 8,605 (7,871) 48,196 \$ 40,325		(1,512 (3 23 15,849 25,479 22,717

See accompanying notes to consolidated financial statements.

#### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

#### NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

## **GENERAL**

Elmira Savings Bank and Subsidiaries (the "Bank"), formerly The Elmira Savings Bank, FSB and Subsidiaries, provide financial services to consumers and businesses within the Bank's geographic market area. That area includes Chemung, Steuben, Schuyler and Tompkins Counties and surrounding areas in New York State. The Bank provides traditional banking services to its customers.

The Bank is subject to regulation and periodic examination by certain regulatory agencies. The Bank is chartered under the laws of New York State and is supervised by the New York State Department of Financial Services ("NYSDFS"). The Bank's deposits are insured by the Federal Deposit Insurance Corporation ("FDIC"). The Bank is a member bank of the Federal Reserve System, and therefore, the Federal Reserve Board ("FRB") serves as its primary federal regulator. The Bank is subject to regulation and examination by both the NYSDFS and FRB. The Bank is also a member of the Federal Home Loan Bank system.

#### **BASIS OF PRESENTATION**

The consolidated financial statements include the accounts of Elmira Savings Bank and its subsidiaries, ESB Advisory Services, Inc. and ESB Realty Corp. Intercompany transactions and balances have been eliminated in consolidation.

The consolidated financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America and reporting practices followed by the banking industry. Whenever necessary, prior year amounts are reclassified to conform to current year presentation. In preparing the consolidated financial statements, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities as of the date of the consolidated financial statements and revenues and expenses for the reporting period. Significant items subject to such estimates and assumptions include the allowance for loans losses, valuation of deferred income tax assets, other than temporary impairments of securities, mortgage servicing rights, intangible assets, and the fair value of financial instruments. Actual results could differ from those estimates.

#### FAIR VALUE MEASUREMENTS

The Bank defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants. A fair value measurement assumes that the transaction to sell the asset or transfer the liability occurs in the principal market for the asset or liability or, in the absence of a principal market, the most advantageous market for the asset or liability. The price in the principal (or most advantageous) market used to measure the fair value of the asset or liability shall not be adjusted for transaction costs. An orderly transaction is a transaction that assumes exposure to the

market for a period prior to the measurement date to allow for marketing activities that are usual and customary for transactions involving such assets and liabilities; it is not a forced transaction. Market participants are buyers and sellers in the principal market that are (i) independent, (ii) knowledgeable, (iii) able to transact and (iv) willing to transact.

The Bank applies the use of valuation techniques that are consistent with the market approach, the income approach and/or the cost approach. The market approach uses prices and other relevant information generated by market transactions involving identical or comparable assets and liabilities. The income approach uses valuation techniques to convert future amounts, such as cash flows or earnings, to a single present amount on a discounted basis. The cost approach is based on the amount that currently would be required to replace the service capacity of an asset (replacement cost). Valuation techniques should be consistently applied. Inputs to valuation techniques refer to the assumptions that market participants would use in pricing the asset or liability. Inputs may be observable, meaning those that reflect the assumptions market participants would use in pricing the asset or liability developed based on market data obtained from independent sources, or unobservable, meaning those that reflect the reporting entity's own assumptions about the assumptions market participants would use in pricing the asset or liability developed based on the best information available in the circumstances. In that regard, the Bank establishes a fair value hierarchy for valuation inputs that gives the highest priority to quoted prices in active markets for identical assets or liabilities and the lowest priority to unobservable inputs. The fair value hierarchy is as follows:

- Level 1 Inputs Unadjusted quoted prices in active markets for identical assets or liabilities that the reporting entity has the ability to access at the measurement date.
- Level 2 Inputs Inputs other than quoted prices included in Level 1 that are
  observable for the asset or liability, either directly or indirectly. These might
  include quoted prices for similar assets or liabilities in active markets, quoted
  prices for identical or similar assets or liabilities in markets that are not active,
  inputs other than quoted prices that are observable for the asset or liability
  (such as interest rates, volatilities, prepayment speeds, credit risks, etc.) or
  inputs that are derived principally from or corroborated by market data by
  correlation or other means.
- Level 3 Inputs Unobservable inputs for determining the fair values of assets or liabilities that reflect an entity's own assumptions about the assumptions that market participants would use in pricing the assets or liabilities.

In general, fair value is based upon quoted market prices, where available. If such quoted market prices are not available, fair value is based upon internally developed models that primarily use, as inputs, observable market-based parameters. Valuation adjustments may be made to ensure that financial instruments are recorded at fair value. These adjustments may include amounts to reflect counterparty credit quality, among other things, as well as other unobservable parameters. Any such valuation adjustments are applied

consistently over time. The Bank's valuation methodologies may produce a fair value calculation that may not be indicative of net realizable value or reflective of future fair values. While management believes the Bank's valuation methodologies are appropriate and consistent with other market participants, the use of different methodologies or assumptions to determine the fair value of certain financial instruments could result in a different estimate of fair value at the reporting date.

A description of the valuation methodologies used for instruments measured at fair value is set forth in Note 16.

## **CASH AND CASH EQUIVALENTS**

For purposes of reporting cash flows in the consolidated statements of cash flows, cash and cash equivalents include cash on hand and amount due from banks, as well as federal funds sold and other short-term investments with maturities of three months or less at time of purchase.

## **SECURITIES**

The Bank classifies its debt securities as either available for sale or held to maturity at the time of purchase, as the Bank does not hold any securities considered to be trading. Held to maturity securities are those debt securities that the Bank has the ability and intent to hold until maturity. All other debt securities are classified as available for sale.

Available for sale securities are recorded at fair value. Held to maturity securities are recorded at amortized cost. Unrealized holding gains and losses, net of the related tax effect on available for sale securities, are excluded from earnings and are reported as accumulated other comprehensive income in shareholders' equity until realized.

Premiums and discounts are amortized or accreted over the life of the related debt security as an adjustment of yield using the interest method. Dividend and interest income are recognized when earned. Purchases and sales are recorded on a trade date basis with settlement occurring shortly thereafter. Realized gains and losses on securities sold are determined using the specific identification method

Securities are evaluated on at least a quarterly basis and more frequently when economic or market conditions warrant such an evaluation to determine whether a decline in their value is other than temporary. Management considers the reasons underlying the decline, the magnitude and duration of the decline, and the Bank's intent to sell the security, and whether it is more likely than not that the Bank will not have to sell the security before recovery of its cost basis. If a decline in the fair value of a security, below its cost basis, is determined to be other than temporary, the cost basis of the security is reduced and a corresponding charge to earnings would be recognized.

## FEDERAL RESERVE AND FEDERAL HOME LOAN BANK STOCK

Common stock of the Federal Reserve Bank ("FRB") and Federal Home Loan Bank of New York ("FHLB") represent ownership in institutions that are wholly-

owned by other financial institutions. These securities are accounted for at cost and classified separately on the Consolidated Balance Sheet. The Federal Home Loan Bank of New York has reported profits for 2013 and 2012, remains in compliance with regulatory capital and liquidity requirements, and continues to pay dividends on the stock and make redemptions at the par value. Management concluded that there was no impairment of either the FRB stock or FHLB stock at December 31, 2013 and 2012.

## **LOANS**

Loans receivable are carried at unpaid principal balances, net of deferred fees and costs. Interest on loans receivable is accrued as earned. Loan origination fees and certain direct loan origination costs are deferred and the net fee or cost is recognized as an adjustment to interest income using the interest method over the contractual life of the related loans.

Loans, including impaired loans, are generally classified as nonaccrual if they are past due as to maturity or payment of principal or interest for a period of more than 90 days, unless such loans are well-collateralized and in the process of collection. Loans that are on a current payment status or past due less than 90 days may also be classified as nonaccrual if repayment in full of principal and/or interest is in doubt.

Loans may be returned to accrual status when all principal and interest amounts contractually due (including arrearages) are reasonably assured of repayment within an acceptable period of time, and there is a sustained period of repayment performance (generally a minimum of six months) by the borrower, in accordance with the contractual terms of the loan.

While a loan is classified as nonaccrual and the future collectibility of the recorded loan balance is uncertain, any payments received are generally used to reduce the principal balance. When the future collectibility of the recorded loan balance is expected, interest income may be recognized on a cash basis. In the case where a nonaccrual loan had been partially charged-off, recognition of interest on a cash basis is limited to that which would have been recognized on the recorded loan balance at the contractual interest rate. Interest collections in excess of that amount are recorded as recoveries to the allowance for loan losses until prior charge-offs have been fully recovered.

The Bank sells certain residential real estate loans in the secondary market. The Bank may retain the right to service the loan, or may sell the loan servicing. The Bank determines whether a loan will be held for sale at the time the application is received from the customer. Loans held for sale are carried at the lower of aggregate cost or estimated fair value. Gains and losses on the disposition of loans held for sale are determined on the specific identification method.

The Bank typically retains the servicing rights to mortgage loans sold and recognizes as separate assets, included in other assets, the rights to service loans for others.

## **ALLOWANCE FOR LOAN LOSSES**

The allowance for loan losses is maintained at a level which management believes, to the best of its knowledge, is at a level at each reporting date to cover known and inherent losses in the loan portfolio that are both probable and reasonably estimable. Management's evaluation is based upon a continuing review of the loan portfolio, which includes many factors such as identification of adverse situations affecting the borrower's ability to repay, a review of overall portfolio quality, including the level of nonperforming and delinquent loans, historical loss experience, and an assessment of prevailing economic conditions.

While management uses available information to recognize losses on loans, future additions to the allowance may be necessary based on changes in general economic conditions and the overall financial health of the Bank's market area. In addition, various regulatory agencies, as an integral part of their examination process, periodically review the Bank's allowance for loan losses. Such agencies may require the Bank to recognize additions to the allowance based on their judgment of information available to them at the time of their examination.

Commercial related loans are considered impaired when it is probable that the Bank will be unable to collect all amounts due according to the contractual terms of the loan agreement. Residential mortgage loans, consumer loans, home equity lines of credit and education loans are evaluated collectively since they are homogeneous and generally carry smaller individual balances. In addition, loans restructured in a troubled debt restructuring are also considered impaired loans.

Troubled debt restructurings are individually evaluated and provided for in the allowance for loan and lease losses and are therefore excluded from pooled portfolio allocations. Management continually evaluates loans that are considered troubled debt restructurings under the modified loan terms, including payment history and the borrower's ability to continue to repay the loan based on continued evaluations of their results of operation and cash flow from operations.

The Bank estimates impairment based on the present value of expected future cash flows (discounted at the loan's effective interest rate) or the fair value of the underlying collateral, less estimated costs to sell, if the loan is collateral dependent. An impairment loss exists if the recorded investment in a loan exceeds the value of the loan as measured by the aforementioned methods. Impairment losses are recognized as a component of the allowance for loan losses.

## PREMISES AND EQUIPMENT

Land is carried at cost while buildings, leasehold improvements and furniture, fixtures and equipment are stated at cost less accumulated depreciation and amortization. Depreciation is computed using the straight-line method over the estimated useful lives of the assets, with buildings being thirty-nine years and furniture, fixtures and equipment generally being five years. Leasehold improvements are amortized over the lesser of the estimated useful life or the term of the leases. Maintenance and repairs are charged to expense and improvements are capitalized.

#### **BANK-OWNED LIFE INSURANCE**

Bank-owned life insurance is carried at the cash surrender value of the underlying policies. Income on the investments in the policies, net of insurance costs, is recorded as noninterest income.

## OTHER REAL ESTATE OWNED

Real estate acquired in settlement of loans is recorded at the lower of cost, defined as the loan value at the time of initial foreclosure, or the fair value of the real estate less estimated costs to sell. Write-downs from the recorded investment in the loan to fair value, less estimated costs to sell, at the time of foreclosure are charged to the allowance for loan losses. Subsequent write-downs to fair value, less estimated costs to sell, are charged to other expenses. Operating costs associated with the properties are charged to expense as incurred.

#### **GOODWILL**

Goodwill represents the excess of the purchase price over the fair value of net assets acquired in business combinations. Goodwill is not being amortized, but is required to be tested for impairment annually or more often if certain conditions or events indicate there may be impairment.

The goodwill impairment analysis begins with a qualitative factor test. A qualitative factor test is performed to determine whether it is necessary to perform the two-step qualitative goodwill impairment test. If this qualitative test determines it is unlikely (less than 50% probability) that the carrying value of the Bank's goodwill is less than its fair value, then the Bank does not have to perform a step one impairment test. If the probability is greater than 50%, a step one goodwill impairment test is required.

If required as a result of the qualitative test, the impairment analysis is a two-step test. The first step (Step 1), used to identify potential impairment, involves comparing the Bank's fair value to its carrying value, including goodwill. If the fair value of the Bank exceeds its carrying value, goodwill is considered not to be impaired. If the carrying value exceeds estimated fair value, there is an indication of potential impairment and the second step is performed to measure the amount of impairment.

The second step (Step 2) involves calculating an implied fair value of goodwill for which the first step indicated impairment. The implied fair value of goodwill is determined in a manner similar to the amount of goodwill calculated in a business combination, by measuring the excess of the Bank's fair value, as determined in the first step, over the aggregate fair values of the individual assets, liabilities and identifiable intangibles as if the Bank was being acquired in a business combination. If the implied fair value of goodwill exceeds the carrying value of goodwill, there is no impairment. If the carrying value of goodwill exceeds the implied fair value of the goodwill, an impairment charge is recorded for the excess. An impairment loss cannot exceed the carrying value of goodwill, and the loss establishes a new basis in the goodwill. Subsequent reversal of goodwill impairment losses is not permitted.

#### **INTANGIBLE ASSETS**

Intangible assets, net of accumulated amortization, consist of core deposit intangibles. Core deposit intangibles are being amortized over periods of time that represent the expected lives using a method of amortization that reflects the pattern of economic benefit. Core deposit intangibles are subject to impairment testing whenever events or changes in circumstances indicate their carrying amounts may not be recoverable.

## IMPAIRMENT OF LONG-LIVED ASSETS OTHER THAN GOODWILL

The Bank reviews long-lived assets, including premises and equipment, for impairment whenever events or changes in business circumstances indicate that the remaining useful life may warrant revision or that the carrying amount of the long-lived asset may not be fully recoverable. The Bank performs undiscounted cash flow analyses to determine if impairment exists. If impairment is determined to exist, any related impairment loss is calculated based on fair value. Impairment losses on assets to be disposed of, if any, are based on the estimated proceeds to be received, less costs of disposal.

## MORTGAGE SERVICING RIGHTS

Capitalized mortgage servicing rights are initially recognized based on their fair value, included in other assets, and are amortized as an offset to loan servicing income over the period of estimated net servicing income. Mortgage servicing rights are assessed for impairment based on the fair value of those rights. Prepayment experience on mortgage servicing rights is reviewed periodically and, when actual payments exceed estimated prepayments, the balance of the mortgage servicing assets is reduced by a charge to earnings.

## **INCOME TAXES**

Deferred tax assets and liabilities are recognized for the future tax consequences attributable to "temporary differences" between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. Deferred tax assets and liabilities are measured using currently enacted tax rates applicable to the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period in which the change in rates is enacted. The Bank recognizes interest and penalties accrued on any unrecognized tax benefits as a component of income tax expense.

#### **EARNINGS PER SHARE**

Basic earnings per share excludes dilution and is calculated by dividing net income available to common shareholders (net income less preferred stock dividends and accretion of preferred stock discount) by the weighted average number of common shares outstanding for the period. Diluted earnings per share reflects the potential dilution that could occur if securities or other contracts to issue common stock, such as stock options and unvested restricted shares, were exercised or converted into common stock or resulted in the issuance of common stock that then shared in the earnings of the entity, such as the Bank's common stock warrants. Treasury shares are not deemed outstanding for earnings per share calculations.

All earnings per share data and other per share amounts in the consolidated financial statements have been restated to give retroactive effect to stock dividends.

#### STOCK-BASED COMPENSATION PLANS

Compensation costs recognized include the compensation cost for all sharebased payments that are based on the estimated grant date fair value. Compensation cost is recorded on a straight-line basis over the vesting period of the awards.

#### COMPREHENSIVE INCOME

Comprehensive income at the Bank represents net income plus or minus other comprehensive income or loss, which consists of the net change in unrealized gains and losses on securities available for sale, net of taxes, and is presented in the Consolidated Statements of Comprehensive Income.

## SECURITIES SOLD UNDER AGREEMENTS TO REPURCHASE

The Bank enters into sales of U.S. Government sponsored enterprises and mortgage-backed securities under agreements to repurchase ("repurchase agreements"). These repurchase agreements are treated as financings, and the obligations to repurchase securities sold are reflected as liabilities in the Consolidated Balance Sheets. The amount of the securities underlying the repurchase agreements remains an asset on the Bank's Consolidated Balance Sheets. The securities underlying the repurchase agreements remain under the Bank's control.

## TRANSFERS OF FINANCIAL ASSETS

Transfers of financial assets, typically residential real estate loans for the Bank, are accounted for as sales when control over the assets has been surrendered. Control over transferred assets is deemed to be surrendered when (1) the assets have been isolated from the Bank, (2) the transferee obtains the right (free of conditions that constrain it from taking advantage of that right) to pledge or exchange the transferred assets, and (3) the Bank does not maintain effective control over the transferred assets through an agreement to repurchase them before their maturity.

## **SEGMENT INFORMATION**

Substantially all of the Bank's operations involve the delivery of loan and deposit products to customers in its primary geographical market. Management makes operating decisions and assesses performance on an entity-wide basis. Therefore, the Bank has only one operating segment for financial reporting.

# FINANCIAL INSTRUMENTS WITH OFF BALANCE SHEET RISK AND CONCENTRATION OF CREDIT RISK

The Bank is a party to certain financial instruments with off-balance sheet risk such as loan commitments, commercial lines of credit, home equity lines of credit, and standby letters of credit. The Bank's policy is to record such instruments when funded. Those instruments involve, to varying degrees, elements of credit and market risk in excess of the amount recognized in the Consolidated Balance Sheet. Credit risk represents the accounting loss that would be recognized at the reporting date if counter-parties failed completely to perform as contracted. Unless noted otherwise, the Bank does not require collateral or other security to support off-balance sheet financial instruments with credit risk. Market risk represents the risk that future changes in market prices may make a financial instrument less valuable.

## RECENTLY ISSUED ACCOUNTING STANDARDS

In February 2013, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") 2013-02 Reporting of Amounts Reclassified out of Accumulated Other Comprehensive Income. The standard requires that companies present either in a single note or parenthetically on the face of the financial statements, the effect of significant amounts reclassified from each component of accumulated other comprehensive income based on its source and the income statement line items affected by the reclassification. The new requirements will take effect for public companies in fiscal years, and interim periods within those years, beginning after December 15, 2012. The Bank adopted this standard on January 1, 2013. The effect of adopting this standard increased our disclosure surrounding reclassification items out of accumulated other comprehensive income.

In February 2013, the FASB issued ASU 2013-04, *Obligations Resulting from Joint and Several Liability Arrangement for which the Total Amount of the Obligation is Fixed at the Reporting Date.* The ASU requires the measurement of obligations resulting from joint and several liability arrangements for which the total amount of the obligation is fixed at the reporting date as the sum of the amount the reporting entity agreed to pay on the basis of its arrangement with its co-obligors, as well as any additional amount that the entity expects to pay on behalf of its co-obligors. The new standard is effective retrospectively for fiscal years and interim periods within those years, beginning after December 15, 2013, and early adoption is permitted. This ASU is not expected to have a significant impact on the Bank's financial statements.

In April 2013, the FASB issued ASU 2013-7, *Presentation of Financial Statements (Topic 205): Liquidation Basis of Accounting.* The amendments in this update are being issued to clarify when an entity should apply the liquidation basis of accounting. In addition, the guidance provides principles for the recognition and measurement of assets and liabilities and requirements for financial statements prepared using the liquidation basis of accounting. The amendments require an entity to prepare its financial statements using the liquidation basis of accounting when liquidation is imminent. Liquidation is imminent when the likelihood is remote that the entity will return from liquidation

and either (a) a plan for liquidation is approved by the person or persons with the authority to make such a plan effective and the likelihood is remote that the execution of the plan will be blocked by other parties or (b) a plan for liquidation is being imposed by other forces (for example, involuntary bankruptcy). If a plan for liquidation was specified in the entity's governing documents from the entity's inception (for example, limited-life entities), the entity should apply the liquidation basis of accounting only if the approved plan for liquidation differs from the plan for liquidation that was specified at the entity's inception. The amendments are effective for entities that determine liquidation is imminent during annual reporting periods beginning after December 15, 2013, and interim reporting periods therein. Entities should apply the requirements prospectively from the date that liquidation becomes imminent. Early adoption is permitted. Entities that use the liquidation basis of accounting as of the effective date in accordance with other Topics (for example, terminating employee benefit plans) are not required to apply the amendments. Instead, those entities should continue to apply the guidance in those other Topics until they have completed liquidation. This ASU is not expected to have a significant impact on the Bank's financial statements.

In June 2013, the FASB issued ASU 2013-08, Financial Services - Investment Companies (Topic 946): Amendments to the Scope, Measurement, and Disclosure Requirements. The amendments in this update affect the scope, measurement, and disclosure requirements for investment companies under U.S. GAAP. The amendments do all of the following: 1. Change the approach to the investment company assessment in Topic 946, clarify the characteristics of an investment company, and provide comprehensive guidance for assessing whether an entity is an investment company. 2. Require an investment company to measure non-controlling ownership interests in other investment companies at fair value rather than using the equity method of accounting. 3. Require the following additional disclosures: (a) the fact that the entity is an investment company and is applying the guidance in Topic 946, (b) information about changes, if any, in an entity's status as an investment company, and (c) information about financial support provided or contractually required to be provided by an investment company to any of its investees. The amendments in this update are effective for an entity's interim and annual reporting periods in fiscal years that begin after December 15, 2013. Earlier application is prohibited. This ASU is not expected to have a significant impact on the Bank's financial statements.

In July 2013, the FASB issued ASU 2013-11, *Income Taxes (Topic 740):* Presentation of an Unrecognized Tax Benefit when a Net Operating Loss Carryforward, a Similar Tax Loss, or a Tax Credit Carryforward Exists. This update applies to all entities that have unrecognized tax benefits when a net operating loss carryforward, a similar tax loss, or a tax credit carryforward exists at the reporting date. An unrecognized tax benefit, or a portion of an unrecognized tax benefit, should be presented in the financial statements as a reduction to a deferred tax asset for a net operating loss carryforward, a similar tax loss, or a tax credit carryforward, except as follows. To the extent a net operating loss carryforward, a similar tax loss, or a tax credit carryforward is not available at the reporting date under the tax law of the applicable jurisdiction to settle any additional income taxes that would result from the disallowance of a tax position or the tax law of the applicable jurisdiction does not require the entity

to use, and the entity does not intend to use, the deferred tax asset for such purpose, the unrecognized tax benefit should be presented in the financial statements as a liability and should not be combined with deferred tax assets. The assessment of whether a deferred tax asset is available is based on the unrecognized tax benefit and deferred tax asset that exist at the reporting date and should be made presuming disallowance of the tax position at the reporting date. The amendments in this update are effective for fiscal years, and interim periods within those years, beginning after December 15, 2013. The amendments should be applied prospectively to all unrecognized tax benefits that exist at the effective date. Retrospective application is permitted. This ASU is not expected to have a significant impact on the Bank's financial statements.

In January 2014, FASB issued ASU 2014-01, Investments - Equity Method and Joint Ventures (Topic 323): Accounting for Investments in Qualified Affordable Housing Projects. The amendments in this update permit reporting entities to make an accounting policy election to account for their investments in qualified affordable housing projects using the proportional amortization method if certain conditions are met. Under the proportional amortization method, an entity amortizes the initial cost of the investment in proportion to the tax credits and other tax benefits received, and recognizes the net investment performance in the income statement as a component of income tax expense (benefit). The amendments in this update should be applied retrospectively to all periods presented. A reporting entity that uses the effective yield method to account for its investments in qualified affordable housing projects before the date of adoption may continue to apply the effective yield method for those preexisting investments. The amendments in this update are effective for public business entities for annual periods and interim reporting periods within those annual periods, beginning after December 15, 2014. Early adoption is permitted. This ASU is not expected to have a significant impact on the Bank's financial statements.

In January 2014, the FASB issued ASU 2014-04, Receivables - Troubled Debt Restructurings by Creditors (Subtopic 310-40): Reclassification of Residential Real Estate Collateralized Consumer Mortgage Loans Upon Foreclosure. The amendments in this update clarify that an in substance repossession or foreclosure occurs, and a creditor is considered to have received physical possession of residential real estate property collateralizing a consumer mortgage loan, upon either (1) the creditor obtaining legal title to the residential real estate property upon completion of a foreclosure or (2) the borrower conveying all interest in the residential real estate property to the creditor to satisfy that loan through completion of a deed in lieu of foreclosure or through a similar legal agreement. Additionally, the amendments require interim and annual disclosure of both (1) the amount of foreclosed residential real estate property held by the creditor and (2) the recorded investment in consumer mortgage loans collateralized by residential real estate property that are in the process of foreclosure according to local requirement of the applicable jurisdiction. The amendments in this update are effective for public business entities for annual periods, and interim periods within those annual periods, beginning after December 15, 2014. An entity can elect to adopt the amendments in this update using either a modified retrospective transition

method or a prospective transition method. This ASU is not expected to have a significant impact on the Bank's financial statements.

## NOTE 2 RESERVE REQUIREMENTS

The Bank is required to maintain certain reserves of cash and/or deposits with the Federal Reserve Bank. The amount of this reserve requirement, which was covered by the Bank's vault cash included in cash and due from banks, was approximately \$429,000 and \$377,000 at December 31, 2013 and 2012, respectively.

## NOTE 3 EARNINGS PER SHARE

The following sets forth certain information regarding the calculation of basic and diluted earnings per share ("EPS") for the years ended December 31:

(in thousands, except share and per share amounts)		2013		2012		2011
Net income	\$	5,054	\$	5,213	\$	5,029
Dividend on Preferred Stock	•	1,215	*	1,609	*	1,512
Accretion of Preferred Stock Discount		-,		-		252
Income available to common shareholders	\$	3,839	\$	3,604	\$	3,265
Weighted average common shares outstanding		2,617,073		2,505,300		2,478,797
Dilutive effect of potential common shares						
related to stock based compensation plans		128,861		122,839		67,823
Weighted average common shares including potential dilution		2,745,934		2,628,139		2,546,620
Basic earnings per share	\$	1.47	\$	1.44	\$	1.32
Diluted earnings per share	\$	1.40	\$	1.37	\$	1.28

There were 25,028, 61,637, and 177,124 antidilutive options and common stock warrants for 2013, 2012, and 2011, respectively. For the year ended December 31, 2013, the exercise price for options that represented antidilutive shares was \$21.02. For the years ended December 31, 2012 and 2011, the exercise price for options and common stock warrants that represented antidilutive shares ranged from \$12.28 to \$19.13.

## NOTE 4 SECURITIES

Securities available for sale are summarized as follows:

(in thousands)	Ar	nortized cost	Gross unrealized gains	Gross unrealized losses	Fair value
December 31, 2013:					
U.S. Government sponsored entities	\$	5,857	85	(101)	5,841
Mortgage-backed securities - U.S. Government sponsored entities		43,809	1,019	(301)	44,527
Municipal securities		12,748	384	(36)	13,096
	\$	62,414	1,488	(438)	63,464
December 31, 2012:					
U.S. Government sponsored entities	\$	2,041	152	-	2,193
Mortgage-backed securities - U.S. Government sponsored entities		49,030	2,040	(1)	51,069
Municipal securities		12,750	863	- '	13,613
	\$	63.821	3.055	(1)	66.875

Securities held to maturity are summarized as follows:

	An	nortized	Gross unrealized	Gross unrealized	Fair
(in thousands)		cost	gains	losses	value
December 31, 2013:					
Mortgage-backed securities - U.S. Government sponsored entities	\$	237	15	-	252
Municipal securities		7,084	491	-	7,575
Other debt securities		484	2	(11)	475
	\$	7,805	508	(11)	8,302
December 31, 2012:					
Mortgage-backed securities - U.S. Government sponsored entities	\$	333	26	-	359
Municipal securities		4,714	287	-	5,001
Other debt securities		474	22	(3)	493
	\$	5,521	335	(3)	5,853

U.S. government-sponsored entity securities represent debt securities issued by Fannie Mae, Freddie Mac, or FHLB. Mortgage-backed securities are all direct pass through securities guaranteed by Fannie Mae, Freddie Mac, or the Government National Mortgage Association.

The contractual maturity distribution of debt securities at December 31, 2013 is shown in the following table. Maturities of mortgage-backed securities are classified in accordance with the final contractual maturities. Expected maturities will differ from contractual maturities because issuers have the right to call or prepay obligations with or without call or prepayment penalties.

		Securities available for sale				Securities he to maturity			
	An	nortized	Fair		Amortized			Fair	
(in thousands)		cost		value		cost		value	
Due in one year or less	\$	1,000	\$	1,002	\$	110	\$	110	
Due after one year through five years		413		439		216		229	
Due after five years through ten years		14,699		14,946		135		142	
Due after ten years		46,302		47,077		7,344		7,821	
	\$	62,414	\$	63,464	\$	7,805	\$	8,302	

At December 31, 2013 and 2012, U. S. Government sponsored entities, mortgage-backed securities, and municipal securities with a fair value of approximately \$2.4 million and \$4.0 million, respectively, have been pledged as collateral for certain deposit relationships and \$27.5 million and \$27.5 million, respectively, have been pledged as collateral for repurchase agreements.

The following table summarizes the Bank's investment securities both available for sale and held to maturity where the current fair value is less than the related amortized cost.

	Less tha	n 12 mo	nths	12 months or longer				Total			
	Fair	Uni	realized		Fair	Unr	ealized		Fair	Uı	realized
(in thousands)	value	L	osses		value	Lo	osses		value		osses
December 31, 2013:											
U.S. Government sponsored entities	\$ 3,899	\$	(101)	\$	-	\$	-	\$	3,899	\$	(101)
Mortgage-backed securities - U.S. Government sponsored entities	14,490		(300)		60		(1)		14,550		(301)
Municipal securities	679		(36)		-		-		679		(36)
Other debt securities	215		(7)		28		(4)		243		(11)
	\$ 19,283	\$	(444)	\$	88	\$	(5)	\$	19,371	\$	(449)
December 31, 2012:											
Mortgage-backed securities - U.S. Government sponsored entities	\$ -	\$	-	\$	69	\$	(1)	\$	69	\$	(1)
Other debt securities	-		-		35		(3)		35		(3)
	\$ -	\$	-	\$	104	\$	(4)	\$	104	\$	(4)

The above table represents 26 investment securities at December 31, 2013, available for sale and held to maturity, where the current fair value is less than the related amortized cost. These unrealized losses do not reflect any

deterioration of the credit worthiness of the issuing entities. No security has a current rating that is below investment grade. The unrealized losses on these temporarily impaired securities are a result of changes in interest rates where the interest rate received is less than the current rate available for new offerings of similar securities, changes in market spreads as a result of shifts in supply and demand, and changes in the level of prepayments for mortgage-related securities. The Bank does not have the intent to sell these securities and it is more likely than not that it will not have to sell the securities before recovery of their cost basis. Therefore, the Bank does not consider these securities to be other than temporarily impaired. However, the Bank will continue to review its investment portfolio to determine whether any particular impairment is other than temporary.

Proceeds from the sales of available-for-sale securities for the years ended December 31, 2013, 2012, and 2011 totaled \$1.0 million, \$1.8 million, and \$9.4 million, respectively.

Gross realized gains and losses from sales of securities available for sale are:

(in thousands)	Gr rea ga	Gross realized losses		
Year ended December 31,				
2013	\$	61	\$	-
2012		75		-
2011		448		-

# NOTE 5 FEDERAL RESERVE BANK AND FEDERAL HOME LOAN BANK STOCK

As a member of the Federal Reserve system, the Bank is required to invest in \$100 par value stock of the FRB. The Bank is required to own a certain amount of FRB stock based on a percentage of the Bank's capital stock and surplus. When such stock is redeemed, the Bank would receive from the FRB an amount equal to the par value of the stock. At December 31, 2013 and 2012, FRB stock owned by the Bank totaled \$1.7 million and \$1.9 million, respectively.

As a member of the FHLB, the Bank is required to invest in \$100 par value stock of the FHLB, based on the level of borrowings and other factors. When such stock is redeemed, the Bank would receive from the FHLB an amount equal to the par value of the stock. At December 31, 2013 and 2012, FHLB stock outstanding was \$8.7 million and \$7.2 million, respectively.

NOTE 6 LOANS
Loans consisted of the following:

(in thousands)	De	cember 31,	Dec	cember 31,
		2013		2012
Real estate loans:				
Residential	\$	239,032	\$	224,167
Commercial		79,135		75,230
Construction		5,467		9,695
		323,634		309,092
Business Loans:				
Commercial loans		24,026		29,102
		24,026		29,102
Consumer Loans:				
Installment loans		33,528		31,534
Home equity loans		5,347		6,252
Other loans		462		479
		39,337		38,265
Loans receivable		386,997		376,459
Net deferred origination fees and costs		2,132		1,649
Loans receivable, net		389,129		378,108
Louis roceivable, net		505, 125		570,100
Allowance for loan losses		3,834		3,740
Net Loans	\$	385,295	\$	374,368

Mortgage loans serviced by the Bank for others, which are not included in the consolidated financial statements, were \$284.7 million and \$234.2 million at December 31, 2013 and 2012, respectively. At December 31, 2013 and 2012, the Bank had \$1.8 million and \$3.2 million of loans held for sale, respectively.

The segments of the Bank's loan portfolio are disaggregated to a level that allows management to monitor risk and performance. The real estate loan segment is further disaggregated into three classes. Residential real estate loans are amortizing term loans, primarily first liens. Commercial real estate loans, which include loans secured by non-owner occupied nonfarm nonresidential properties, generally have a greater risk profile than residential real estate loans. Construction loans are generally made to individuals for the acquisition of and/or construction on a lot or lots on which a residential dwelling is to be built. The commercial loan segment consists of loans made for the purpose of financing the activities of commercial customers. The consumer segment is further disaggregated into three classes. The installment loan segment consists primarily of installment loans (direct and indirect) and overdraft lines of credit connected with customer deposit accounts. Home equity loans consist of amortizing term loans or lines of credit which are generally secured by second liens on residential real estate.

Management evaluates individual loans in the commercial and commercial real estate segments for possible impairment if the loan is in nonaccrual status. Loans are considered to be impaired when, based on current information and events, it is probable that the Bank will be unable to collect the scheduled payments of principal or interest when due according to the contractual terms of the loan agreement. Factors considered by management in evaluating impairment include payment status, collateral value, and the probability of collecting scheduled principal and interest payments when due. Management determines the significance of payment delays and payment shortfalls on a caseby-case basis, taking into consideration all of the circumstances surrounding the loan and the borrower, including the length of the delay, the reasons for the delay, the borrower's prior payment record, and the amount of the shortfall in relation to the principal and interest owed. The Bank does not separately evaluate individual consumer and residential mortgage loans for impairment, unless such loans are part of larger relationship that is impaired, or are classified as a troubled debt restructuring agreement.

Once the determination has been made that a loan is impaired, the determination of whether a specific allocation of the allowance is necessary is measured by comparing the recorded investment in the loan to the fair value of the loan using one of three methods: (a) the present value of expected future cash flows discounted at the loan's effective interest rate; (b) the loan's observable market price; or (c) the fair value of the collateral less selling costs. The method is selected on a loan-by loan basis, with management primarily utilizing the fair value of collateral method. The evaluation of the need and amount of a specific allocation of the allowance and whether a loan can be removed from impairment status is made on a quarterly basis. The Bank's policy for recognizing interest income on impaired loans does not differ from its overall policy for interest recognition.

The following table summarizes the primary segments of the loan portfolio as of December 31, 2013 and December 31, 2012 (in thousands):

(in thousands)	Residential	Commercial	Construction					
	Real Estate	Real Estate	Real Estate	Commercial	Installment	Home Equity	Other	Total
December 31, 2013								
Total Loans	\$ 239,032	\$ 79,135	\$ 5,467	\$ 24,026	\$ 33,528	\$ 5,347	\$462	\$386,997
Individually evaluated for								
impairment	-	2,453	-	694	-	-	-	3,147
Collectively evaluated for								
impairment	239,032	76,682	5,467	23,332	33,528	5,347	462	383,850
December 31, 2012								
Total Loans	\$ 224,167	\$ 75,230	\$ 9,695	\$ 29,102	\$ 31,534	\$ 6,252	\$479	\$376,459
Individually evaluated for								
impairment	-	2,589	-	674	-	-	-	3,263
Collectively evaluated for								
impairment	224,167	72,641	9,695	28,428	31,534	6,252	479	373,196

The following table summarizes the balance of the allowance for loan losses by portfolio segment, segregated into the amount required for loans individually evaluated for impairment and the amount required for loans collectively evaluated for impairment as of December 31, 2013 and December 31, 2012 (in thousands):

(in thousands)	Ва	lance of	Indi	vidually	Col	lectively
	Allov	wance for	evalu	ated for		uated for
	Loa	n Losses	impa	airment	imp	airment
December 31, 2013						
Real estate						
Residential	\$	1,483	\$	-	\$	1,483
Commercial		1,251		175		1,076
Construction		36		-		36
Business						
Commercial loans		696		196		500
Consumer						
Installment loans		304		-		304
Home equity loans		61		-		61
Other loans		3		-		3
	\$	3,834	\$	371	\$	3,463
December 31, 2012						
Real estate						
Residential	\$	1,131	\$	-	\$	1,131
Commercial		1,279		163		1,116
Construction		63		-		63
Business						
Commercial loans		804		206		598
Consumer						
Installment loans		340		-		340
Home equity loans		117		-		117
Other loans		6		-		6
	\$	3,740	\$	369	\$	3,371

The following table presents impaired loans by class, segregated by those for which a specific allowance was required and those for which a specific allowance was not necessary as of December 31, 2013 and December 31, 2012 (in thousands):

(in thousands)			Loans with	1	Lo No	paired an with Specific owance		Total Imp	aired Loa	ns
	Re	corded	Rel	lated	Re	corded	Re	ecorded		Unpaid rincipal
	Inve	estment	Allo	wance	Inve	estment	Inv	estment	E	Balance
December 31, 2013										
Real estate										
Residential	\$	-	\$	-	\$	-	\$	-	\$	-
Commercial		687		175		1,766		2,453		2,822
Construction		-		-		-		-		-
Business										
Commercial loans		621		196		73		694		763
Consumer										
Installment loans		-		-		-		-		-
Home equity loans		-		-		-		-		-
Other loans		-		-		-		-		-
	\$	1,308	\$	371	\$	1,839	\$	3,147	\$	3,585
December 31, 2012										
Real estate										
Residential	\$	-	\$	-	\$	-	\$	-	\$	-
Commercial		483		163		2,106		2,589		2,883
Construction		-		-		-		-		-
Business										
Commercial loans		654		206		20		674		691
Consumer										
Installment loans		-		-		-		-		-
Home equity loans		-		-		-		-		-
Other loans		-		-		-		-		-
	\$	1,137	\$	369	\$	2,126	\$	3,263	\$	3,574

The following table summarizes interest income recognized on impaired loans:

(in thousands)		Impaired Loans								
		ve Months Ended ber 31, 2013		ve Months Ended per 31, 2012		ve Months Ended ber 31, 2011				
	Ave. Recorded Investment in Impaired Loans	Interest Inc. Recognized on Impaired Loans	Ave. Recorded Investment in Impaired Loans	Investment in Recognized on		Interest Inc. Recognized on Impaired Loans				
With no specific allowance recorded:			,							
Real estate										
Residential	s -	\$ -	\$ -	\$ -	s -	\$ -				
Commercial	1,927	95	2,229	109	1,624	90				
Construction	-	-	-	-	· -	-				
Business										
Commercial loans	85	-	186	-	352	-				
Consumer										
Installment loans	-	-	-	-	-	-				
Home equity loans	-	-	-	-	-	-				
Other loans	-	-	-	-	-	-				
Total impaired loans without a specific allowance	2,012	95	2,415	109	1,976	90				
With a specific allowance recorded:										
Real estate										
Residential	-	-	-	-	-	-				
Commercial	588	36	476	34	1,111	89				
Construction	-	-	-	-	· -	-				
Business										
Commercial loans	626	3	439	10	139	4				
Consumer										
Installment loans	-	-	-	-	-	-				
Home equity loans	-	-	-	-	-	-				
Other loans	-	-	-		-	-				
Total impaired loans with a specific allowance	1,214	39	915	44	1,250	93				
Total impaired loans	\$ 3,226	\$ 134	\$ 3,330	\$ 153	\$ 3,226	\$ 183				

Management uses a seven point internal risk rating system to monitor the credit quality of the overall loan portfolio. The first three categories are considered not criticized, and are aggregated as "Pass" rated. The criticized rating categories utilized by management generally follow bank regulatory definitions. The Special Mention category includes assets that are currently protected but are potentially weak, resulting in an undue and unwarranted credit risk, but not to the point of justifying a Substandard classification. Loans in the Substandard category have well-defined weaknesses that jeopardize the timely liquidation of the debt, and have a distinct possibility that some loss will be sustained if the weaknesses are not corrected. All loans greater than 90 days past due are considered

Substandard. Loans in the Doubtful category have well-defined weaknesses, but with the additional characteristic that the weaknesses make collection or liquidation in full high questionable and improbable. Loans classified in the Loss category are considered uncollectible.

To help ensure that risk ratings are accurate and reflect the present and future capacity of borrowers to repay a loan as agreed, the Bank has a structured loan rating process with several layers of internal and external oversight. The Bank's Commercial Loan Officers are responsible for the timely and accurate risk rating of the loans in their portfolios at origination and on an ongoing basis. The Board Loan Committee performs an annual review of all commercial relationships \$500,000 or greater. Confirmation of the appropriate risk grade is included in the review on an ongoing basis. The Bank has an experienced Asset Classification Committee that reviews and assesses certain commercial relationships in detail on a quarterly basis. The quarterly review by the Asset Classification Committee includes commercial relationships rated at Special Mention or worse, or that meet certain criteria indicating an increased credit risk profile, such as 30 days or more delinquent in the past quarter. The Bank engages an external consultant to conduct loan reviews on at least an annual basis. Generally, the external consultant reviews commercial relationships greater than \$400,000 and/or criticized relationships greater than \$150,000.

Generally, consumer and residential mortgage loans are included in the pass category as long as the loans are performing. The credit risk profile of these loans is generally determined based on payment activity. However, some consumer loans and residential mortgage loans are reviewed in the internal risk rating process when management considers the borrower closely related to a criticized commercial loan. Consumer loans and residential mortgage loans that become delinquent over 90 days or that undergo payment modifications or term extensions raise awareness of increased credit risk. Consumer loans and residential mortgage loans whose risk profile has increased based on the abnormal payment activity noted above are included in the nonperforming category in the table below.

The following table presents the classes of the loan portfolio summarized by credit quality indicators derived from the internal risk rating system or on the basis of performance as of December 31, 2013 and December 31, 2012 (in thousands):

		t Quality Indicators			
	As of	December 31, 201	3		
Commercial Credit Exposure					
Credit Risk Profile by Internally	y Assigned Grade				
			Real Estate -		
		Real Estate -	Commercial		
Grade:	Commercial	Commercial	Construction		
		. 74.040			
Pass	\$ 21,052		\$ 4,409		
Special Mention Substandard	388	,	-		
	2,582		-		
Doubtful	<u>4</u>		<u> </u>		
	\$ 24,026	\$ 79,135	\$ 4,409		
Consumer Credit Exposure Credit Risk Profile by Internall	y Assigned Grade	Poal Fetato -			
	Real Estate -		Consumer - Installment	Consumer - Home Equity	Consumer - Other
Credit Risk Profile by Internall		Residential	Consumer - Installment	Consumer - Home Equity	Consumer - Other
Credit Risk Profile by Internall	Real Estate -	Residential			
Credit Risk Profile by Internall	Real Estate - Residential	Residential Construction	Installment	Home Equity	Other
Credit Risk Profile by Internall Grade: Pass	Real Estate - Residential	Residential Construction	Installment	Home Equity	Other
Credit Risk Profile by Internall Grade: Pass Special Mention	Real Estate - Residential \$ -	Residential Construction	Installment \$ -	Home Equity	Other
Credit Risk Profile by Internall Grade: Pass Special Mention Substandard	Real Estate - Residential \$ -	Residential Construction \$	Installment \$ -	Home Equity	Other
Credit Risk Profile by Internall Grade: Pass Special Mention Substandard	Real Estate - Residential \$ 471	Residential Construction \$	Installment	Home Equity	Other
Credit Risk Profile by Internally  Grade: Pass Special Mention Substandard Doubtful  Credit Risk Profile Based on P	Real Estate - Residential \$ 471	Residential Construction  \$	Installment	Home Equity	Other
Credit Risk Profile by Internally Grade: Pass Special Mention Substandard Doubtful  Credit Risk Profile Based on P	Real Estate - Residential \$ 471 - 471 ayment Activity	Residential Construction  \$	Installment	## Figure   Home Equity    \$	Other
Grade: Pass Special Mention Substandard Doubtful	Real Estate - Residential \$ 471 - 471 rayment Activity	Residential Construction  \$	Installment	## Home Equity  \$	\$

			lity Indicators						
		As of Dece	mber 31, 2012	!					
Commercial Credit Exposure									
Credit Risk Profile by Internall	y Assigned Grade								
•				Real	Estate -				
		F	Real Estate -	Cor	nmercial				
	Comm	ercial	Commercial	Con	struction				
rade:									
Pass	\$ 2	25,430	\$ 66,189	\$	6,772				
Special Mention		253	4,016		-				
Substandard		3,413	5,025		-				
Doubtful		6_	-		-				
	\$ 2	9,102	\$ 75,230	\$	6,772				
Consumer Credit Exposure Credit Risk Profile by Internall	y Assigned Grade								
	y Assigned Grade Real Es Reside	state -	Real Estate - Residential Construction		nsumer - tallment		sumer - e Equity		sumer -
Credit Risk Profile by Internall	Real Es	state -					sumer - e Equity		
Credit Risk Profile by Internall	Real Es	state - ential (	Residential						
Credit Risk Profile by Internall rade: Pass Special Mention	Real Es Reside	state - ential (	Residential Construction	Ins		Hom		0	
Credit Risk Profile by Internall rade: Pass Special Mention Substandard	Real Es Reside	state - ential (	Residential Construction	Ins		Hom		0	
Credit Risk Profile by Internall srade: Pass Special Mention	Real Es Reside	ential (	Residential Construction	Ins	tallment - -	Hom	e Equity - -	0	
Credit Risk Profile by Internall brade: Pass Special Mention Substandard	Real Es Reside	ential (	Residential Construction	Ins	tallment - -	Hom	e Equity - -	0	
Credit Risk Profile by Internall brade: Pass Special Mention Substandard	Real Es Reside	ential (	Residential Construction	Ins	tallment - - 38 -	Hom	e Equity - - 31	0	
rade: Pass Special Mention Substandard Doubtful  Credit Risk Profile Based on F	Real Es_Reside \$	ential (	Residential Construction	Ins	tallment - - 38 -	Hom	e Equity - - 31	0	
cradit Risk Profile by Internall rade: Pass Special Mention Substandard Doubtful  Credit Risk Profile Based on Ferforming	Real Es_Reside \$	state - ential (  759 - 759	Residential Construction  \$	Ins	- - - 38 - 38	Hom	e Equity - - 31 - 31	0	
Grade: Pass Special Mention Substandard Doubtful	Real Es Reside \$  Payment Activity	ratate - ential ( 759 759 759	Residential Construction \$ - - - - - - 2,923	Ins	- - - - - - - - - - - - - - - - - - -	Hom	e Equity 31 - 31 - 6,159	0	- - - - - - -

Management further monitors the performance and credit quality of the loan portfolio by analyzing the age of the portfolio as determined by the length of time a recorded payment is past due. The following table presents the classes of the loan portfolio summarized by the aging categories of performing loans and nonaccrual loans as of December 31, 2013 and December 31, 2012 (in thousands):

(in thousands)		:	30-59	•	60-89								
			Days	- 1	Days	90	Days+	1	otal		Non-	i	Total
	Current	Pa	st Due	Pa	st Due	Pa	ast Due	Pas	st Due	Α	ccrual		Loans
December 31, 2013													
Real estate												i	
Residential	\$ 237,735	\$	659	\$	-	\$	-	\$	659	\$	638	\$	239,032
Commercial	77,101		-		-		-		-		2,034	i	79,135
Construction	5,467		-		-		-		-		-	i	5,467
Business												i	
Commercial loans	23,313		21		-		-		21		692	i	24,026
Consumer												i	
Installment loans	33,218		230		1		-		231		79	i	33,528
Home equity loans	5,224		73		-		-		73		50	i	5,347
Other loans	458		3		-		-		3		1	i	462
	\$ 382,516	\$	986	\$	1	\$	-	\$	987	\$	3,494	\$	386,997
December 31, 2012													
Real estate												i	
Residential	\$ 222,770	\$	511	\$	-	\$	-	\$	511	\$	886	\$	224,167
Commercial	73,064		-		-		-		-		2,166	i	75,230
Construction	9,695		-		-		-		-		-	i	9,695
Business												i	
Commercial loans	28,389		76		-		-		76		637	i	29,102
Consumer												i	
Installment loans	31,244		178		5		-		183		107	ii.	31,534
Home equity loans	6,187		3		-		-		3		62	i	6,252
Other loans	457		9		10		-		19		3		479
	\$ 371,806	\$	777	\$	15	\$		\$	792	\$	3,861	\$	376,459

The aggregate balance of loans not accruing interest amounted to \$3.5 million at December 31, 2013 and \$3.9 million at December 31, 2012. The average recorded investment in nonaccrual loans was \$3.6 million for the year ending December 31, 2013 and \$3.7 million for the year ending December 31, 2012. Interest income that would have been recorded had these loans not been placed on nonaccruing status was \$191,000 in 2013, \$195,000 in 2012, and \$152,000 in 2011.

Loan modifications that are considered troubled debt restructurings completed during the twelve months ended December 31, 2013 and December 31, 2012 (in thousands) were are follows:

	For the twelve months ended December 31,								
		2013		2012					
(in thousands)	Number of Contracts	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment	Number of Contracts	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment			
Business									
Commercial loans		\$ -	\$ -	2	\$ 502	\$ 502			
Total Loan Modifications	_	\$ -	\$ -	2	\$ 502	\$ 502			

Recidivism, or the borrower defaulting on its obligation pursuant to a modified loan considered a troubled debt restructure, generally indicates a higher risk of loss than does a default on a loan that has not undergone a troubled debt restructuring.

There were no loan modifications considered troubled debt restructurings made during the twelve months previous to December 31, 2013 or 2012 that defaulted

during the twelve month periods ending December 31, 2013 or 2012, respectively.

An allowance for loan losses is maintained to absorb losses from the loan portfolio. The allowance for loan losses is based on management's continuing evaluation of the risk characteristics and credit quality of the loan portfolio, assessment of current economic conditions, diversification and size of the portfolio, adequacy of collateral, past and anticipated loss experience, and the amount of non-performing loans.

Loans that are collectively evaluated for impairment are analyzed with general allowances being made as appropriate. For general allowances, historical loss trends are used in the estimation of losses in the current portfolio. These historical loss amounts are modified by other qualitative factors.

The classes described above provide the starting point for the allowance for loan losses analysis. A historical charge-off factor for each loan class is calculated utilizing a defined number of consecutive historical quarters, currently a rolling 12 quarters.

Management has identified a number of additional qualitative factors which it uses to supplement the historical charge-off factor because these factors are likely to cause estimated credit losses associated with the existing loan pools to differ from historical loss experience. The additional factors that are evaluated quarterly and updated using information obtained from internal, regulatory, and governmental sources are: national and local economic trends and conditions; interest rate risk inherent in loan portfolio; levels of and trends in delinquency rates and non-accrual loans; trends in volumes and terms of loans; effects of changes in lending policies; experience, ability, and depth of management and lending staff; level of loan customer leverage; and concentrations of credit from a loan type, industry and/or geographic standpoint.

Management reviews the loan portfolio on a quarterly basis using a defined, consistently applied process in order to make appropriate and timely adjustments to the allowance for loan losses. When information confirms all or part of specific loans to be uncollectible, these amounts are promptly charged off against the allowance for loan losses.

The following table summarizes the activity in the allowance for loan losses:

(in thousands)		dential Estate		nmercial I Estate		truction	Com	mercial	Incto	llment	Hom	e Equity	Other		Tota	
Twelve Months Ended December 31, 2013	Real	Estate	Rea	Estate	Real	Estate	Com	merciai	insta	iment	пош	e Equity	Other		TOTA	
Allowance for Loan Losses:															i	
Balance at beginning of period	s	1.131	\$	1,279	s	63	\$	804	\$	340	\$	117	s	6	\$	3.740
Charge-offs	Ť	(196)	Ψ.	- 1,2.70	•	-	Ψ	-	Ψ.	(69)	•		•	(19)		(284)
Recoveries		1		-		-		11		48		-		3	i	63
Net recoveries (charge-offs)		(195)		-		-		11		(21)		-		(16)		(221)
Provision for Loan Losses		547		(28)		(27)		(119)		(15)		(56)		13	i	315
Balance at end of period	\$	1,483	\$	1,251	\$	36	\$	696	\$	304	\$	61	\$	3	\$	3,834
Twelve Months Ended December 31, 2012																
Allowance for Loan Losses:															i	
Balance at beginning of period	\$	939	\$	1,158	\$	70	\$	707	\$	343	\$	79	\$	3	\$	3,299
Charge-offs		(4)		-		-		-		(86)		-		(2)	i	(92)
Recoveries		1		-		-		15		52		-		2		70
Net recoveries (charge-offs)		(3)						15		(34)						(22)
Provision for Loan Losses		195		121		(7)		82		31		38		3		463
Balance at end of period	\$	1,131	\$	1,279	\$	63	\$	804	\$	340	\$	117	\$	6	\$	3,740
Twelve Months Ended December 31, 2011																
Allowance for Loan Losses:															i	
Balance at beginning of period	\$	724	\$	1,018	\$	27	\$	650	\$	384	\$	101	\$	5	\$	2,909
Charge-offs		(46)		(205)		-		(35)		(96)		-		(14)	i	(396)
Recoveries				2		-		23		91		-		2		118
Net recoveries (charge-offs)		(46)		(203)		-		(12)		(5)		-		(12)		(278)
Provision for Loan Losses		261		343		43		69		(36)		(22)		10		668
Balance at end of period	\$	939	\$	1,158	\$	70	\$	707	\$	343	\$	79	\$	3	\$	3,299

The 2013 credit amounts for the provision for loan losses detailed above for construction, installment, and home equity loans result from improvements in historical loss trends which decrease the historical loss factors utilized in the allowance for loan losses analysis. The 2013 credit provision amount for commercial loans reflects lower loan balances, as well as a lower level of commercial loans classified as substandard. The 2013 credit provision amount for commercial real estate loans reflects improvements in historical loss trends, as well as a lower level of commercial real estate loans classified as special mention. The increase in the provision related to residential real estate in 2013 is a result of an increase in the historical loss factor utilized in the allowance for loan losses analysis due to higher net charge-offs in the first quarter of 2013 and growth in the residential real estate portfolio.

The net credit amount for the provision for loan losses in the construction category for 2012 results from improvements in the related historical loss trend which decreases the historical loss factor utilized in the allowance for loan losses analysis. The net credit amounts for the provision for loan losses in the consumer loan categories for 2011 result from improvements in historical loss trends which decrease the historical loss factors utilized in the allowance for loan losses analysis and also reflect lower loan balance levels from the previous year. The allowance for loan losses is based on estimates, and actual losses will vary from current estimates. Management believes that the granularity of the homogeneous pools and the related historical loss ratios and other qualitative factors, as well as the consistency in the application of assumptions, result in an allowance for loan losses that is representative of the risk found in the components of the portfolio at any given date.

The Bank's market area is generally in Elmira, New York and Ithaca, New York, and includes the surrounding communities in the Southern Tier and Central New York region. Substantially all loans are made in its market area. Accordingly, the ultimate collectibility of a substantial portion of the Bank's loan portfolio is susceptible to changes in the economic conditions in this area. Other than general economic risks, management is not aware of any material concentrations of credit risk to any industry or individual borrower.

Loan transactions with directors and executive officers were made on the same terms as those prevailing at the same time for comparable loans to other customers, and did not, in the opinion of management, involve more than normal credit risk or present other unfavorable features. An analysis of related party loan activity follows:

	Years ended December 31,									
(in thousands)	2013 2012 2011									
Balance at beginning of year	\$	2,711	\$	1,990	\$	2,735				
New Directors/Executive Officers		243		207		-				
New loans and advances		975		1,670		81				
Repayments		(1,443)		(1,156)		(826)				
Balance at end of year	\$	2,486	\$	2,711	\$	1,990				

## NOTE 7 PREMISES AND EQUIPMENT

Premises and equipment, net, are summarized as follows:

	December 31,							
(in thousands)			2012					
Land and land improvements	\$	2,517	\$	1,784				
Building and leasehold improvements		9,320		9,110				
Furniture, fixtures and equipment		7,776		7,292				
Capital projects in progress		45		173				
		19,658		18,359				
Accumulated depreciation and amortization		11,038		10,412				
	\$	8,620	\$	7,947				

Depreciation and amortization expense amounted to \$684,000, \$677,000, and \$611,000 for the years ended December 31, 2013, 2012, and 2011, respectively.

# NOTE 8 ACCRUED INTEREST RECEIVABLE

Accrued interest receivable consisted of the following:

		December 31,			
(in thousands)	20	13		2012	
Accrued interest receivable on securities	\$	437	\$	450	
Accrued interest receivable on loans		1,017		1,079	
	\$	1,454	\$	1,529	

## NOTE 9 GOODWILL AND OTHER INTANGIBLE ASSETS

Information regarding the carrying amount and the amortization expense of the Bank's goodwill and intangible assets is disclosed in the tables below:

	Gros	s Carrying	Accu	mulated	Ne	et Carrying
December 31, 2013 (in thousands)	A	Amount	Amo	rtization		Amount
Amortized intangible assets - Core Deposit Intangible	\$	1,192	\$	982	\$	210
Goodwill		12,320		-		12,320
Total goodwill and amortized intangible assets	\$	13,512	\$	982	\$	12,530

	Gros	s Carrying	Accu	mulated	Ne	t Carrying
December 31, 2012 (in thousands)	P	Amount	Amo	rtization	1	Amount
Amortized intangible assets - Core Deposit Intangible	\$	1,192	\$	876	\$	316
Goodwill		12,320		-		12,320
Total goodwill and amortized intangible assets	\$	13,512	\$	876	\$	12,636

Amortization expense related to core deposit intangibles totaled \$106,000 in 2013, \$128,000 in 2012, and \$150,000 in 2011. The estimated aggregate future amortization expense for intangible assets remaining as of December 31, 2013 is as follows:

Estimated amortization expense: (in thousands)	
For the year ended December 31, 2014	85
For the year ended December 31, 2015	63
For the year ended December 31, 2016	41
For the year ended December 31, 2017	20

The Bank annually tests its goodwill for impairment as of September 30. In performing the qualitative factor step of the goodwill impairment testing and measurement process to assess potential impairment, the probability was less than 50% that the fair value of the Bank's goodwill was less than its carrying value.

As a result, a Step 1 or Step 2 test to quantify the amount of goodwill impaired, was deemed not necessary.

## NOTE 10 DEPOSITS

A summary of deposits follows:

	Decei	ecember 31,		
(in thousands)	2013	2012		
Noninterest-bearing demand	\$ 59,885	\$ 61,444		
Interest-bearing:				
NOW accounts	77,736	76,133		
Regular savings	48,790	46,312		
IRA savings	8,408	9,615		
Mortgage escrow savings	3,452	2,862		
Money market savings	21,130	20,131		
Club accounts	275	245		
Certificates of deposit	178,057	192,823		
Total interest-bearing	337,848	348,121		
	\$ 397,733	\$ 409,565		

Individual time deposit accounts with balances of \$100,000 or more, which are included in the above table, totaled approximately \$76.8 million and \$79.6 million at December 31, 2013 and 2012, respectively.

Contractual maturities of time certificates of deposit at December 31, 2013 are as follows:

(in thousands)	2013
Maturity distribution	Amount
Due in one year	\$ 73,972
Due in one to two years	68,393
Due in two to three years	25,675
Due in three to four years	6,759
Due in four to five years	3,258
	\$ 178,057

Interest expense on deposit accounts for 2013, 2012, and 2011 is as follows:

(in thousands)	2013	2012	2011
Savings	\$ 139	\$ 77	\$ 158
NOW	106	157	191
Money market	32	48	83
Certificates of deposit	2,947	3,430	3,418
Total interest on deposits	\$ 3,224	\$ 3,712	\$ 3,850

# **NOTE 11 BORROWINGS**

Borrowings consisted of the following:

	December 31,				
(in thousands)	2013		2012		
Securities sold under repurchase agreements	\$ 26,000	\$	26,000		
Federal Home Loan Bank term advances	30,500		28,000		
	\$ 56,500	\$	54,000		

Information related to securities sold under repurchase agreements was as follows:

	Years ended December 31,						
(dollars in thousands)	<u></u>	2013	2012			2011	
Outstanding balance at end of year	\$	26,000	\$	26,000	\$	28,000	
Weighted average interest rate at end of year		3.89%		3.89%		3.93%	
Maximum outstanding at any month end	\$	26,000	\$	28,000	\$	34,000	
Average amount outstanding during year	\$	26,000	\$	26,672	\$	30,247	
Average interest rate during year		3.89%		3.90%		3.98%	

The repurchase agreements, which are callable by the FHLB, had stated final maturities that ranged from 1.7 years to 4.8 years at December 31, 2013, and 2.7 years to 5.8 years at December 31, 2012.

Scheduled contractual repayments for securities sold under repurchase agreements are as follows:

(in thousands)	2013	3
Year		
2015	13	,000
2016	11	,000
2018	2	,000
	\$ 26	,000

At December 31, 2013, \$23.0 million of FHLB term advances were outstanding. At December 31, 2012, \$28.0 million of FHLB term advances were outstanding. At December 31, 2013, rates for outstanding term advances ranged between 1.54% and 3.49%. At December 31, 2012, rates for outstanding term advances ranged between 2.66% and 3.76%. Included in the term advances at December 31, 2013 are \$10.0 million of advances that are currently callable by the FHLB. There were FHLB overnight borrowings of \$7.5 million at December 31, 2013 and none at December 31, 2012. Overnight borrowings outstanding at December 31, 2013 had a rate of .40%. All term advances and overnight borrowings are collateralized by the Bank's investment in FHLB stock and all qualifying mortgage loans pursuant to provisions of a collateral pledge and securities agreement up to a maximum of \$98.9 million.

Scheduled principal reductions for each of the next five years and thereafter for the term advances from the FHLB are as follows (based on contractual maturity dates):

(in thousands)		2013
Year		
2014	\$	7,000
2015		8,000
2018		2,000
Thereafter		6,000
	\$	23,000

# NOTE 12 COMMITMENTS AND CONTINGENCIES Loan Commitments

Loan commitments are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Loan commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. The Bank evaluates each customer's credit worthiness on a case-by-case basis. The amount of collateral obtained, if deemed necessary by the Bank upon extension of credit, is based on management's credit evaluation. Collateral held varies, but may include real estate, accounts receivable, inventory, property, plant and equipment, and income-producing commercial properties.

## **Lease Agreements**

The Bank is committed under nine lease contracts for facilities, which expire between the years 2014 and 2018. The leases contain renewal provisions at the Bank's option and contain no restrictive provisions of consequence.

Expense for leased premises was \$291,000, \$296,000, and \$277,000 for 2013, 2012, and 2011, respectively. Minimum annual lease payments for the non-cancelable operating leases amount to approximately \$274,000 for 2014, \$259,000 for 2015, \$218,000 for 2016, \$172,000 for 2017, \$70,000 for 2018, and none thereafter.

#### **Other Commitments**

In the normal course of business, various commitments and contingent liabilities are outstanding that are not reflected in the consolidated financial statements. Financial instruments with off-balance sheet risk involve elements of credit risk, interest rate risk, liquidity risk, and market risk. The Bank uses the same credit policy to make such commitments as is used for on-balance sheet items. Management does not anticipate any significant losses as a result of these transactions.

Commitments to originate mortgages and other loans were approximately \$19.8 million and \$20.8 million at December 31, 2013 and 2012, respectively. At December 31, 2013 and 2012, approximately \$5.0 million and \$7.7 million of these mortgage commitments were contracted to be sold to either Freddie Mac or the FHLB upon closing. Approximately \$10.8 million and \$13.3 million of the commitments at December 31, 2013 and 2012, respectively, had fixed rates of interest. Commitments under commercial unused lines of credit were approximately \$11.6 million and \$11.9 million at December 31, 2013 and 2012, respectively. Commitments under unused overdraft honors lines of credit were approximately \$4.8 million and \$4.7 million at December 31, 2013 and 2012, respectively. Commitments under standby letters of credit were \$170,000 and \$103,000 at December 31, 2013 and 2012, respectively. The fair value of the Bank's standby letters of credit is not considered material for 2013 and 2012. Commitments for consumer lines of credit were approximately \$8.9 million and \$9.7 million at December 31, 2013 and 2012, respectively. Since some commitments to originate loans expire without being used and some unused lines of credit are never fully drawn upon, the amounts do not necessarily represent expected future cash outlays.

In order to reduce the interest rate risk associated with the portfolio of conventional mortgage loans held for sale, as well as outstanding loan commitments and uncommitted loan applications with rate lock agreements which are intended to be held for sale, the Bank enters into mandatory forward sales commitments to sell loans in the secondary market to unrelated investors. The impact of the estimated fair value of the rate lock agreements, as well as the offsetting estimated fair values of forward sales commitments, are not significant to the consolidated financial statements at December 31, 2013 or 2012.

# **Contingencies**

In the normal course of business, there are various outstanding legal proceedings. In the opinion of management, after consultation with legal counsel, the ultimate disposition of these matters is not expected to have a material adverse effect on the consolidated financial condition of the Bank.

## NOTE 13 INCOME TAXES

Federal and state income tax expense attributable to income before income taxes is as follows:

	Years ended December 31,					
(in thousands)	2013		2012		2011	
Current:						
Federal	\$ 1,180	\$	1,658	\$	1,873	
State	296		325		225	
	1,476		1,983		2,098	
Deferred:						
Federal	551		587		181	
State	(653)		(56)		94	
	(102)		531		275	
	\$ 1,374	\$	2,514	\$	2,373	

The differences between income taxes computed by applying the U.S. Federal statutory tax rate to income before income taxes are as follows:

	Years ended December 31,					
(in thousands)	<b>2013</b> 2012			2011		
Tax computed at statutory rate	\$ 2,186	\$	2,627	\$	2,517	
State tax (credits) provisions, net of Federal (expense) benefit	(236)		177		210	
Tax exempt interest	(399)		(390)		(404)	
Other items, net	(177)		100		50	
	\$ 1,374		2,514		2,373	

The tax effects of temporary differences that give rise to significant portions of the deferred tax assets and deferred tax liabilities at December 31, 2013 and 2012 follow:

(in thousands)	2013	2012
Assets:		
Compensation and benefits	\$ 488	\$ 258
Allowance for loan losses	1,023	986
Mortgage recording tax	859	372
Intangible assets	200	217
Other	321	213
Deferred tax assets	2,891	2,046
Liabilities:		
Mortgage servicing rights	708	595
Deferred loan originations costs	826	639
Net unrealized gain on securities	406	1,182
Goodwill	1,929	1,612
Premises and equipment	172	127
Other	300	219
Deferred tax liabilities	4,341	4,374
Net deferred tax liabilities	\$ (1,450)	\$ (2,328)

Realization of deferred tax assets is dependent upon the generation of future taxable income or the existence of sufficient taxable income within the carryback period. A valuation allowance is recognized when it is considered more likely than not that some portion of the deferred tax assets will not be realized. In assessing the need for a valuation allowance, management considers the scheduled reversal of the deferred tax liabilities, the level of historical taxable income, and projected future taxable income over the periods in which the temporary differences comprising the deferred tax assets will be deductible. Based on its assessment, management determined that no valuation allowance is necessary.

There is currently no liability for uncertain tax positions and no known unrecognized tax benefits. The Bank recognizes, when applicable, interest and penalties related to unrecognized tax benefits in the provision for income taxes in the Statement of Income. The Bank's federal and state income tax returns for taxable years through 2010 have been closed for purposes of examination by the Internal Revenue Service ("IRS") and the New York Department of Revenue.

# NOTE 14 EMPLOYEE STOCK OWNERSHIP AND SAVINGS PLAN

The Bank has an Employee Stock Ownership and Savings Plan ("the Plan"), which covers substantially all employees.

## **401(k) Savings Provisions**

The Plan allows employees to make 401(k) contributions. The Plan requires the Bank to contribute (match) an amount equal to the participants' 401(k) contributions, up to one-half of the first 6% of compensation deferred by each participant. Contributions made may be invested in fixed income securities, diversified mutual funds, or shares of the Bank's common stock. The Bank made 401(k) matching contributions of \$117,000, \$109,000, and \$110,000 for the years ended December 31, 2013, 2012, and 2011, respectively.

## **Employee Stock Ownership Provisions**

Contributions to the Plan are made in cash or common shares of the Bank and are 100% vested for employees with six years or more of service. Contributions for employees with less than six years of service are subject to a vesting schedule. The Bank reports compensation expense equal to cash contributed and the current market price of any shares contributed. Compensation expense related to this plan in 2013, 2012, and 2011 was \$312,000, \$264,000, and \$221,000, respectively.

#### NOTE 15 STOCK-BASED COMPENSATION PLANS

The Bank's Long-Term Incentive Plan authorizes the grant of restricted shares or options to purchase shares of the Bank's common stock up to a combined total equivalent to 317,625 shares. The Board of Directors of Elmira Savings Bank may grant stock options or restricted shares to officers, employees, and certain other qualified individuals. At December 31, 2013 there were 124,980 restricted shares or options available for grant.

The Bank's Non-Employee Directors Equity Compensation Plan authorizes the grant of restricted shares or options to purchase the Bank's common stock up to a combined total equivalent to 190,575 shares. At December 31, 2013 there were 83,321 restricted shares or options available for grant.

Stock options are granted at an exercise price equal to the stock's trading price at the date of grant, may not have a term in excess of ten years, and have vesting periods that range between zero and four years from the grant date. Restricted shares generally vest over a three to five year service period on the anniversary of the grant date. Once vested, these awards are irrevocable. The product of the number of shares granted and the grant date market price of the Bank's common stock determine the fair value of restricted shares under the Bank's restricted share plan. Management recognizes compensation expense for the fair value of restricted shares on a straight line basis over the requisite service period. Prior to the adoption of the Long-Term Incentive Plan, the Bank had similar stock option plans which remain in effect solely with respect to unexercised options issued under those plans.

The Bank's practice is to issue original shares of its common stock upon exercise of stock options rather than from treasury shares. With regard to restricted shares, the Bank's practice is to issue original restricted shares of its common stock at the grant date. The total intrinsic value (which is the amount by which the trading price of the underlying stock exceeds the exercise price of an option) of options exercised was \$1.5 million for 2013, \$440,000 for 2012, and \$22,800 for 2011. There was \$269,000 received in 2013, \$371,000 for 2012, and \$23,000 for 2011 from the exercise of stock options.

The Bank recognized total non-cash stock-based compensation cost of \$301,000, \$340,000, and \$360,000 for 2013, 2012, and 2011, respectively. As of December 31, 2013, the total remaining unrecognized compensation cost related to unvested stock options and restricted shares was \$335,000. unrecognized expense is expected to be recognized over the next three years. Forfeitures are not expected to be significant. The fair value of options vested was \$162,000, \$198,000, and \$186,000 for 2013, 2012, and 2011, respectively. The fair value of each option award is estimated on the date of grant using the Black-Scholes option valuation model that uses the assumptions noted in the following table. Expected volatility is largely based on historical volatility of the Bank's stock over a representative period. Historical option exercise and employee termination activity is used to estimate the expected term of options granted and represents the period of time that options granted are expected to be outstanding. The risk-free rate for periods within the expected life of the option is based on the U.S. Treasury yield curve in effect at the time of grant.

The following table presents the weighted-average assumptions and resulting estimated weighted-average fair value for grants made during 2013, 2012, and 2011.

	2013	2012	2011
Dividend Yield	4.64%	4.57%	4.67%
Volatility	31.88%	32.97%	37.72%
Risk-free interest rate	0.78%	0.83%	1.85%
Expectant life (years)	5	5	5
Fair Value	\$ 3.90	\$ 3.22	\$ 3.73

A summary of the status of the Bank's stock option plans is presented below:

		We	eighted-
		A	verage
	Number of	E	xercise
	Shares		Price
Options:			
Outstanding at December 31, 2011	328,732	\$	12.95
Granted	35,978	\$	15.60
Exercised	(57,465)	\$	10.53
Forfeited	(7,200)	\$	16.10
Outstanding at December 31, 2012	300,046	\$	13.65
Granted	42,077	\$	20.98
Exercised	(165,647)	\$	13.01
Forfeited		\$	-
Outstanding at December 31, 2013	176,476	\$	16.00
Total Exercisable at December 31, 2012	247,162	\$	13.61
Total Exercisable at December 31, 2013	122,318	\$	15.15

A summary of the status of the Bank's non-vested restricted shares is presented below:

		Weighted- Average	
	Number of	Grant Date	
	Share Awards	Fair Value	
Restricted Shares:			
Balance at December 31, 2011	35,968	\$	12.92
Granted	9,847	\$	15.60
Vested	(18,775)	\$	13.01
Forfeited		\$	-
Balance at December 31, 2012	27,040	\$	13.83
Granted	7,007	\$	20.95
Vested	(14,846)	\$	13.19
Forfeited		\$	-
Balance at December 31, 2013	19,201	\$	16.90

The following tables summarize the outstanding and exercisable options at December 31, 2013:

Options Outstanding		Options Exercisable			
		Weighted	Weighted		
		Average		Average	
Exercise	Number	Contractual	Number	r Contractual	
Price	Outstanding	Life	Exercisable	Life	
\$15.49	2,411	0.09	2,411	0.09	
\$13.49	5,736	0.34	5,736	0.34	
\$15.46	7,170	1.38	7,170	1.38	
\$15.98	8,604	2.33	8,604	2.33	
\$19.13	8,598	3.33	8,598	3.33	
\$19.13	5,596	3.33	5,596	3.33	
\$11.71	8,252	4.33	8,252	4.33	
\$11.71	1,709	4.33	1,709	4.33	
\$9.44	7,885	5.38	7,885	5.38	
\$12.28	5,371	6.16	5,371	6.16	
\$13.37	9,462	6.33	9,462	6.33	
\$13.18	9,462	7.34	9,462	7.34	
\$13.20	19,748	7.35	8,638	7.35	
\$15.60	20,211	8.31	5,056	8.31	
\$15.60	14,184	8.31	14,184	8.31	
\$21.02	27,893	9.10	-	-	
\$20.91	14,184	9.33	14,184	9.33	
	176,476	6.49	122,318	5.59	

The aggregate intrinsic value of total options outstanding at December 31, 2013 was \$1.6 million. The aggregate intrinsic value of options exercisable at December 31, 2013 was \$1.2 million.

# NOTE 16 DISCLOSURES ABOUT THE FAIR VALUE OF FINANCIAL INSTRUMENTS

A description of the valuation methodologies used for instruments measured at fair value, as well as the general classification of such instruments pursuant to the valuation hierarchy, is set forth below. These valuation methodologies were applied to all of the Bank's assets and liabilities carried at fair value.

• Securities Available for Sale: Securities classified as available for sale are reported at fair value utilizing Level 2 inputs. For these securities, the Bank obtains fair value measurements from an independent pricing service. The fair value measurements consider observable data that may include dealer quotes, market spreads, callable features, cash flows, the U.S. Treasury yield curve, live trading levels, trade execution data, market consensus prepayment speeds, credit information and the securities' terms and conditions, among other things.

The following table summarizes financial assets and financial liabilities measured at fair value on a recurring basis as of December 31, 2013 and December 31, 2012, segregated by the level of the valuation inputs within the fair value hierarchy utilized to measure fair value:

(In Thousands)	Level 1 Inputs	Level 2 Inputs	Level 3 Inputs	Total Fair Value
At December 31, 2013 Securities available for sale				
U.S. Government-sponsored Entities  Mortgage-backed Securities -	\$	\$5,841	\$	\$5,841
U.S. Government-sponsored Entities	\$	\$44,527	\$	\$44,527
Municipal Securities	\$	\$13,096	\$	\$13,096
At December 31, 2012 Securities available for sale				
U.S. Government-sponsored Entities  Mortgage-backed Securities -	\$	\$2,193	\$	\$2,193
U.S. Government-sponsored Entities	\$	\$51,069	\$	\$51,069
Municipal Securities	\$	\$13,613	\$	\$13,613

The Bank also measures assets and liabilities recorded at fair value on a nonrecurring basis; that is, the instruments are not measured at fair value on an ongoing basis but are subject to fair value adjustments in certain circumstances (for example, when there is evidence of impairment). At December 31, 2013, the Bank had identified loans for nonrecurring fair value measurement with a carrying value of approximately \$3.1 million, \$1.3 million of which had specific reserves included in the allowance for loan losses of \$371,000. At December 31, 2012, the Bank identified loans for nonrecurring fair value measurement with a carrying value of approximately \$3.3 million, \$1.1 million of which had specific reserves included in the allowance for loan losses of \$369,000.

A description of the valuation methodologies used for instruments measured at fair value on a nonrecurring basis, is set forth below:

• Impaired Loans: Impaired loans are carried at the lower of cost or fair value. The Bank determines the fair value based on either the value of collateral, adjusted for estimated selling costs or by determining the present value of the expected future cash flows, discounted at each loan's effective interest rate. The use of independent appraisals, discounted cash flow models, and management's best judgment are significant inputs in arriving at the fair value of impaired loans, and therefore these inputs are classified within level 3 of the fair value hierarchy.

Other Real Estate Owned: Other real estate owned is carried at the lower
of the investment cost of the assets or the fair value of the assets less
estimated selling costs. The use of independent appraisals and
management's best judgment are significant inputs in arriving at the fair value
measure of the underlying collateral, and therefore other real estate owned is
classified within level 3 of the fair value hierarchy.

The following table summarizes financial assets and liabilities measured at fair value on a nonrecurring basis as of December 31, 2013 and December 31, 2012:

(In Thousands)	Level 1 Inputs	Level 2 Inputs	Level 3 Inputs	Total Fair Value
At December 31, 2013				
Impaired Loans	\$	\$	\$2,776	\$2,776
Other Real Estate Owned	\$	\$	\$98	\$98
At December 31, 2012				
Impaired Loans	\$	\$	\$2,894	\$2,894
Other Real Estate Owned	\$	\$	\$125	\$125

The following table provides information describing the valuation processes used to determine nonrecurring fair value measurements categorized within level 3 of the fair value hierarchy (in thousands):

	Fai	ir Value	Valuation Technique	Unobservable Input	Range	Weighted Average
At December 31, 2013 Impaired Loans	\$	216	Property appraisals	Management discount for selling costs, property type, and market volatility	10% - 60% discount	29%
	\$	2,560	Discounted cash flows	Market Rates	5.50% - 10.75%	6.86%
Other Real Estate Owned	\$	98	Property appraisals	Management discount for selling costs, property type, and market volatility	10% - 30% discount	26%
At December 31, 2012 Impaired Loans	\$	145	Property appraisals	Management discount for selling costs, property type, and market volatility	10% - 30% discount	30%
	\$	2,749	Discounted cash flows	Market Rates	5.50% - 10.50%	6.78%
Other Real Estate Owned	\$	125	Property appraisals	Management discount for selling costs, property type, and market volatility	10% - 30% discount	26%

The carrying amounts and fair values of financial instruments, at December 31, 2013 and December 2012, are as follows:

	December 31, 2013							
			Fair \	/alue				
	Carrying				Total			
(in thousands)	value	Level I	Level II	Level III	Fair value			
Financial assets:								
Cash and cash equivalents	\$ 7,641	\$ 7,641	\$ -	\$ -	\$ 7,641			
Securities available for sale	63,464	-	63,464	-	63,464			
Securities held to maturity	7,805	-	252	8,050	8,302			
Federal Reserve and FHLB Stock	10,417	10,417	-	-	10,417			
Net loans, including loans held for sale	387,142	1,847	-	395,891	397,738			
Bank-owned life insurance	12,387	12,387	-	-	12,387			
Mortgage servicing rights	1,920	-	-	2,306	2,306			
Accrued interest receivable	1,454	1,454	-	-	1,454			
Financial liabilities:								
Time deposits	178,057		-	180,146	180,146			
Other deposits	219,676	219,676	-	-	219,676			
Borrowings	56,500	7,500	-	51,144	58,644			
Accrued interest payable	149	149	-	-	149			

December 31, 2012						
			Fair \	/alue		
	Carrying				Total	
(in thousands)	value	Level I	Level II	Level III	Fair value	
Financial assets:						
Cash and cash equivalents	\$ 40,325	\$ 40,325	\$ -	\$ -	\$ 40,325	
Securities available for sale	66,875	-	66,875	-	66,875	
Securities held to maturity	5,521	-	359	5,494	5,853	
Federal Reserve and FHLB Stock	9,178	9,178	-	-	9,178	
Net loans, including loans held for sale	377,535	3,167	-	393,761	396,928	
Bank-owned life insurance	11,988	11,988	-	-	11,988	
Mortgage servicing rights	1,640	1,640	-	-	1,640	
Accrued interest receivable	1,529	1,529	-	-	1,529	
Financial liabilities:						
Time deposits	192,823	-	-	197,916	197,916	
Other deposits	216,742	216,742	-	-	216,742	
Borrowings	54,000	-	-	57,608	57,608	
Accrued interest payable	174	174	-	-	174	

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

#### **Cash and Cash Equivalents**

The carrying amounts for cash and cash equivalents approximate the fair value of such assets.

## **Securities**

The fair values of securities available for sale and all securities held to maturity are based on quoted market prices, if available. If quoted market prices are not available, fair values are based on quoted market prices of comparable instruments. Fair value estimates for certain securities may be determined based upon pricing modeling techniques. Inputs to the pricing models may include recent trades, benchmark interest rates, spreads, and actual and projected cash flows.

#### Federal Reserve and FHLB Stock

The carrying value of Federal Reserve and FHLB Stock, which is redeemable at par, approximates fair value.

# **Net Loans, Including Loans Held for Sale**

The estimated fair value of loans is determined based on discounted cash flow analyses using interest rates currently offered for loans with similar terms to borrowers of similar credit quality. Fair value for impaired loans is estimated using discounted cash flow analyses or underlying collateral values, where applicable.

The estimated fair values of certain mortgage loans may be based on market prices of similar loans sold in conjunction with securitization transactions, adjusted for differences in loan characteristics.

#### **Bank-owned Life Insurance**

The carrying amount for bank-owned life insurance approximates the fair value and represents the cash surrender value of bank-owned policies.

# **Mortgage Servicing Rights**

Mortgage servicing rights consist of residential mortgage servicing rights and fair value is estimated by projecting and discounting future cash flows. Various assumptions including future cash flows, market discount rates, expected prepayment rates, servicing costs and other factors are used in the valuation of mortgage servicing rights. The Bank has not made any election to account for mortgage servicing rights under the fair value method. Mortgage servicing rights are accounted for under the amortization method and are adjusted to the lower of aggregate cost or estimated fair value as appropriate.

#### **Accrued Interest Receivable**

The carrying amounts for accrued interest receivable approximate the fair value of such assets.

#### **Deposits**

The fair values estimated for noninterest-bearing demand deposits, NOW accounts, savings accounts, and money market accounts are, by definition, equal to the amount payable on demand at the reporting date (i.e., their carrying amounts). Fair values of fixed rate certificates of deposit are estimated using a discounted cash flow calculation that applies interest rates currently being offered to a schedule of aggregated expected monthly time deposit maturities.

#### **Borrowings**

The fair values of the FHLB advances and securities sold under repurchase agreements are estimated using discounted cash flow analyses based on the Bank's current incremental borrowing rate for similar borrowing arrangements.

#### **Accrued Interest Payable**

The carrying amounts for accrued interest payable approximate the fair value of such liabilities.

#### **Off-Balance-sheet Instruments**

Fair values for the company's off-balance-sheet instruments (lines of credit and commitments to fund loans) are based on fees currently charged to enter into

similar agreements, taking into account the remaining terms of the agreements and the counterparties' credit standing.

#### NOTE 17 ACCUMULATED OTHER COMPREHENSIVE INCOME

A summary of reclassification out of accumulated other comprehensive income by component is as follows:

(in thousands)	2013	2012	2011	Where Net Income is Presented
Realized gain on sale of securities	\$61	\$75	\$448	Noninterest Income - Gain on sale of securities
	61	75	448	Total before income tax
	(23)	(29)	(173)	Income tax expense
Total reclassifications	38	46	275	Net of tax

Our changes in accumulated other comprehensive income are as follows:

		lized gains
	(losses)	on available
(in thousands)	for sale	e securities
Balance at December 31, 2010	\$	958
Other comprehensive income before reclassification		1,235
Amounts reclassified from accumulated other		
comprehensive income		(275)
Net current period other comprehensive income		960
Balance at December 31, 2011	\$	1,918
Other comprehensive income before reclassification		-
Amounts reclassified from accumulated other		
comprehensive income		(46)
Net current period other comprehensive loss		(46)
Balance at December 31, 2012	\$	1,872
Other comprehensive loss before reclassification		(1,190)
Amounts reclassified from accumulated other		
comprehensive income		(38)
Net current period other comprehensive loss		(1,228)
Balance at December 31, 2013	\$	644

## NOTE 18 PREFERRED STOCK AND WARRANT

During 2007, the Bank authorized and issued 10,000 shares of preferred stock. The preferred stock has a liquidation preference of \$1,000 per share. Dividends are paid quarterly in cash at a rate of 8.998% of the liquidation preference through December 2017; thereafter, dividends will be paid at LIBOR plus 4.0%. The preferred stock is redeemable at the Bank's option as of November 16, 2012.

On August 25, 2011, the Bank issued 14,063 shares of preferred stock to the U.S. Department of the Treasury ("Treasury") through the Small Business Lending Fund (SBLF) program. Net proceeds of the offering totaled \$14.0 million after deducting issuance costs.

The Bank utilized \$9.1 million of the proceeds to repay the preferred stock issued to the U.S. Department of the Treasury under the Troubled Assets Relief Program ("TARP") Capital Purchase Program ("CPP") and the related final accrued dividend. The redemption of the preferred stock, which had a carrying value of \$9.0 million, required us to record the remaining discount accretion for the difference between the redemption price and the carrying value of the preferred stock. As a participant in the CPP, the Bank had also issued a warrant to purchase 134,602 shares of common stock. The Bank may have an opportunity in the future to repurchase the warrant at its fair market value. However, the Bank has not reached any agreement with the Treasury to repurchase the warrant, nor can there be any assurance that the Bank will repurchase the warrant in the future.

On March 31, 2013, the Bank redeemed 10,548 shares, or 75% of the preferred stock issued through the SBLF. On December 17, 2013, the Bank fully exited the SBLF program and redeemed the remaining 3,515 shares of preferred stock that had been issued to the Treasury through the SBLF.

# NOTE 19 MINIMUM CAPITAL AND OTHER REGULATORY REQUIREMENTS

FRB capital regulations requires banks to maintain minimum levels of regulatory capital. Under the regulations in effect at December 31, 2013, the Bank is required to maintain a minimum leverage ratio of core (Tier 1) capital to total adjusted tangible assets of 4.0% and a minimum ratio of total capital (core capital and supplementary capital) to risk-weighted assets of 8.0%, of which 4.0% must be core capital.

Under its prompt corrective action regulations, the FRB is required to take certain supervisory actions (and may take additional discretionary actions) with respect to an undercapitalized institution. Such actions could have a direct effect on an institution's financial statements. The regulations establish a framework for the classification of savings institutions into five categories: well-capitalized, adequately capitalized, undercapitalized, significantly undercapitalized, and critically undercapitalized. Generally, an institution is considered well-capitalized if it has a core capital ratio of at least 5.0%; a core (Tier 1) risk-based capital ratio of at least 10.0%.

The following table is a reconciliation of the Bank's generally accepted accounting principles ("GAAP") capital and Regulatory capital at December 31, 2013 and 2012:

			Regulatory Cap	ital Requirements	
	GAAP	Core		Total Risk-Based	
(dollars in thousands)	Capital	Capital	%	Capital	%
December 31, 2013	\$54,025	\$54,025		\$54,025	
Regulatory capital adjustments					
Noncontrolling interest		(54)		(54)	
Allowance for loan losses		-		3,834	
Core deposit intangible		(210)		(210)	
Goodwill (net of deferred tax)		(10,391)		(10,391)	
Net unrealized gain on securities available					
for sale		(644)		(644)	
Total regulatory capital		\$42,726	8.39	\$46,560	14.50
Regulatory capital requirement		20,371	4.00	25,688	8.00
Regulatory capital excess	•	\$22,355	4.39	\$20,872	6.50

			Regulatory Cap	ital Requirements			
			Total				
	GAAP	Core		Risk-Based			
(dollars in thousands)	Capital	Capital	%	Capital	%		
December 31, 2012	\$66,909	\$66,909		\$66,909			
Regulatory capital adjustments							
Noncontrolling interest		(51)		(51)			
Allowance for loan losses		-		3,740			
Core deposit intangible		(316)		(316)			
Goodwill (net of deferred tax)		(10,708)		(10,708)			
Net unrealized gain on securities available							
for sale		(1,872)		(1,872)			
Total regulatory capital		\$53,962	10.38	\$57,702	18.20		
Regulatory capital requirement		20,793	4.00	25,363	8.00		
Regulatory capital excess		\$33,169	6.38	\$32,339	10.20		

As of March 31, 2013, the most recent examination report from our state regulatory agency, the New York State Department of Financial Services, the Bank was categorized as well-capitalized under the regulatory framework for prompt corrective actions. There have been no conditions or events since the notification that management believes have changed the Bank's category. Management believes that as of December 31, 2013, the Bank meets all capital adequacy requirements to which it is subject.

The following is a summary of the Bank's actual capital amounts and ratios as of December 31, 2013 and 2012, compared with the regulatory requirements for minimum capital adequacy for classification of a well-capitalized institution:

	Regulatory Capital Requirements						
December 31, 2013	Ac	tual	Minimum Adequ			sification as apitalized	
(dollars in thousands)	Amount	Ratio	Amount	Ratio	Amount	Ratio	
Core (Tier 1) capital Risk-based capital:	\$42,726	8.39 %	20,371	4.00 %	25,464	5.00 %	
Core (Tier 1) Total risk-based capital	\$42,726 \$46,560	13.31 14.50	12,844 25,688	4.00 8.00	19,266 32,110	6.00 10.00	

		Regulatory Capital Requirements						
December 31, 2012	Actu	ıal	Minimum Adequ			ification as		
(dollars in thousands)	Amount	Ratio	Amount	Ratio	Amount	Ratio		
Core (Tier 1) capital Risk-based capital:	\$53,962	10.38 %	20,793	4.00 %	25,991	5.00 %		
Core (Tier 1) Total risk-based capital	\$53,962 \$57,702	17.02 18.20	12,682 25,363	4.00 8.00	19,022 31,704	6.00 10.00		

The Bank may not declare or pay a cash dividend on, or repurchase any of its capital stock if the effect thereof would cause the capital of the Bank to be reduced below the amount required for the capital requirements imposed by the FRB. (See also Note 18.)

# NOTE 20 SUMMARY OF QUARTERLY FINANCIAL RESULTS (UNAUDITED)

Summarized quarterly unaudited financial results for the years ended December 31, 2013 and 2012 are as follows:

				2	013			
(in thousands, except for per share amounts)	Qu	arter IV	Quarter III		Quarter II		Qı	uarter I
Interest and dividend income	\$	5,067	\$	5,076	\$	5,005	\$	5,105
Interest expense		1,295		1,306		1,293		1,306
Net interest income		3,772		3,770		3,712		3,799
Provision for loan losses		-		50		85		180
Net interest income								
after provision for loan losses		3,772		3,720		3,627		3,619
Noninterest income		1,179		1,474		1,419		1,485
Noninterest expense		3,573		3,428		3,485		3,376
Income before income taxes		1,378		1,766		1,561		1,728
Income taxes		254		397		187		536
Net income		1,124		1,369		1,374		1,192
Less: Net income attributable to noncontrolling interest		5		-		-		-
Net income attributable to Elmira Savings Bank	\$	1,119	\$	1,369	\$	1,374	\$	1,192
Dividend on preferred stock and accretion of discount		277		268		269		401
Income available to common shareholders	\$	842	\$	1,101	\$	1,105	\$	791
Basic earnings per share	\$	0.32	\$	0.42	\$	0.42	\$	0.31
Diluted earnings per share	\$	0.30	\$	0.40	\$	0.40	\$	0.29

	2012							
(in thousands, except for per share amounts)	Quarter IV		Qua	arter III	Quarter II		Quarter I	
Interest and dividend income	\$	5,129	\$	5,237	\$	5,270	\$	5,349
Interest expense		1,390		1,427		1,498		1,581
Net interest income		3,739		3,810		3,772		3,768
Provision for loan losses		42		154		142		125
Net interest income								
after provision for loan losses		3,697		3,656		3,630		3,643
Noninterest income		1,529		1,723		1,548		1,250
Noninterest expense		3,301		3,271		3,157		3,215
Income before income taxes		1,925		2,108		2,021		1,678
Income taxes		621		710		663		520
Net income		1,304		1,398		1,358		1,158
Less: Net income attributable to noncontrolling interest		5		-		-		-
Net income attributable to Elmira Savings Bank	\$	1,299	\$	1,398	\$	1,358	\$	1,158
Dividend on preferred stock		406		405		403		395
Income available to common shareholders	\$	893	\$	993	\$	955	\$	763
Basic earnings per share	\$	0.35	\$	0.40	\$	0.38	\$	0.31
Diluted earnings per share	\$	0.34	\$	0.38	\$	0.36	\$	0.29

Summation of the quarterly net income per share does not necessarily equal the annual amount due the averaging effect of shares throughout the year.



# REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

Board of Directors and Stockholders

Elmira Savings Bank

We have audited the accompanying consolidated statements of financial condition of Elmira Savings Bank and subsidiaries as of December 31, 2013 and 2012, and the related consolidated statements of income, comprehensive income, changes in shareholders' equity, and cash flows for each of the three years in the period ended December 31, 2013. These consolidated financial statements are the responsibility of Elmira Savings Bank's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. Elmira Savings Bank is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. Our audit included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of Elmira Savings Bank's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Elmira Savings Bank and subsidiaries as of December 31, 2013 and 2012, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2013, in conformity with U.S. generally accepted accounting principles.

S.R. Snodgrass P.C.

Wexford, Pennsylvania March 18, 2014

## MANAGEMENT'S STATEMENT OF RESPONSIBILITY

Management is responsible for preparation of the consolidated financial statements and related financial information contained in all sections of this annual report, including the determination of amounts that must necessarily be based on judgments and estimates. It is the belief of management that the consolidated financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America appropriate in the circumstances, and that the financial information appearing throughout this annual report is consistent with the consolidated financial statements.

Management establishes and monitors the Company's system of internal accounting controls to meet its responsibility for reliable financial statements. The system is designed to provide reasonable assurance that assets are safeguarded, and that transactions are executed in accordance with management's authorization and are property recorded.

The Audit Committee of the Board of Directors, composed solely of outside directors, meets periodically and privately with management, internal auditors, and independent auditors, S.R. Snodgrass, P.C., to review matters relating to the quality of financial reporting, internal accounting control, and the nature, extent and results of audit efforts. The independent and internal auditors have unlimited access to the Audit Committee to discuss all such matters. The consolidated financial statements have been audited by the Company's independent auditors for the purpose of expressing an opinion on the consolidated financial statements.

Date: March 18, 2014

/s/ Michael P. Hosey Michael P. Hosey Chief Executive Officer /s/ Jason T. Sanford Jason T. Sanford Senior Vice President Chief Financial Officer

# Item 9 – Changes in and Disagreements with Accountants on Accounting and Financial Disclosure

None

#### Item 9A – Controls and Procedures

#### (a) Evaluation of Disclosure Controls and Procedures

Management carried out an evaluation, under the supervision and with the participation of the Chief Executive Officer and the Chief Financial Officer, of the effectiveness of the design and the operation of the Bank's disclosure controls and procedures (as such term as defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act) as of December 31, 2013, pursuant to Exchange Act Rule 13a-15. Based upon that evaluation, the Chief Executive Officer along with the Chief Financial Officer concluded that the Bank's disclosure controls and procedures as of December 31, 2013, are effective in timely alerting them to material information relating to the Bank required to be in the Bank's periodic filings under the Exchange Act.

## (b) Changes in Internal Controls

There have been no changes in the Bank's internal controls over financial reporting that occurred during the most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, the Bank's internal control over financial reporting.

# (c) Report on Management's Assessment of Internal Control over Financial Reporting

The Bank is responsible for the preparation, integrity, and fair presentation of the financial statements included in this annual report. The financial statements and notes included in this annual report have been prepared in conformity with United States generally accepted accounting principles and necessarily include some amounts that are based on management's best estimates and judgments.

Management of the Bank is responsible for establishing and maintaining effective internal control over financial reporting that is designed to produce reliable financial statements in conformity with United States generally accepted accounting principles. The system of internal control over financial reporting as it relates to the financial statements is evaluated for effectiveness by management and tested for reliability through a program of internal audits. Actions are taken to correct potential deficiencies as they are identified. Any system of internal control, no matter how well designed, has inherent limitations, including the possibility that a control can be circumvented or overridden and misstatements due to error or fraud may occur and not be detected. Also, because of changes in conditions, internal control effectiveness may vary over time. Accordingly, even an effective system of internal control will provide only reasonable assurance with respect to financial statement preparation.

Management assessed the Bank's system of internal control over financial reporting as of December 31, 2013, in relation to criteria for effective internal control over financial reporting as described in "Internal Control – Integrated Framework," issued by the Committee of Sponsoring Organizations of the Treadway Commission. Based on this assessment, management concludes that, as of December 31, 2013, its system of

internal control over financial reporting is effective and meets the criteria of the "Internal Control – Integrated Framework."

This annual report does not include an attestation report of the Bank's registered public accounting firm regarding internal control over financial reporting. Management's report was not subject to attestation by the Bank's registered public accounting firm pursuant to rules of the Securities and Exchange Commission that permit the Bank to provide only management's report in this annual report.

#### Item 9B – Other Information

None

### **PART III**

#### Item 10 – Directors and Executive Officers of the Bank

The information required herein with respect to directors and executive officers is incorporated herein by reference from the Proxy Statement filed with the FRB pursuant to Regulation 14A on March 21, 2014.

# Item 11 – Executive Compensation

Incorporated herein by reference from the Proxy Statement filed with the FRB pursuant to Regulation 14A on March 21, 2014.

# Item 12 – Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters

Incorporated herein by reference from the Proxy Statement filed with the FRB pursuant to Regulation 14A on March 21, 2014.

## Item 13 – Certain Relationships and Related Transactions

Incorporated herein by reference from the Proxy Statement filed with the FRB pursuant to Regulation 14A on March 21, 2014.

#### Item 14 – Principal Accountant Fees and Services

Incorporated herein by reference from the Proxy Statement filed with the FRB pursuant to Regulation 14A on March 21, 2014.

#### **PART IV**

#### Item 15 - Exhibits and Financial Statement Schedules

(a) (1) All financial statement schedules have been omitted as they are not applicable, not required, or the information is included in the Consolidated Financial Statements or notes thereto.

- (a) (2) Exhibits:
  - Exhibit 21 List of Registrant's Subsidiaries
  - Exhibit 22 Proxy Statement dated March 21, 2014.
  - Exhibit 31.1 Certification of the Chief Executive Officer pursuant to section 302 of the Sarbanes-Oxley Act of 2002
  - Exhibit 31.2 Certification of the Chief Financial Officer pursuant to section 302 of the Sarbanes-Oxley Act of 2002
  - Exhibit 32.1 Written statement of Chief Executive Officer pursuant to section 906 of the Sarbanes-Oxley Act of 2002
  - Exhibit 32.2 Written statement of Chief Financial Officer pursuant to section 906 of the Sarbanes-Oxley Act of 2002
- (b) During the three-month period ended December 31, 2013, the Registrant filed two reports on Form 8-K.

On October 23, 2014, Elmira Savings Bank reported third quarter earnings.

On November 27, Elmira Savings Bank reported a \$0.23 per share cash dividend and a 10% stock dividend on existing common shares outstanding.

- (c) See (a) (2) above for all exhibits filed herewith.
- (d) Not applicable.

Pursuant to the requirements of Section 13 or 15 (d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

# **ELMIRA SAVINGS BANK**

(Registrant)

BY: /s/ Michael P. Hosey DATE: March 18, 2014

Michael P. Hosey Chief Executive Officer

BY: /s/ Jason T. Sanford DATE: March 18, 2014

Jason T. Sanford Senior Vice President Chief Financial Officer Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

BY:	/s/ John Brand III John Brand III Chairman of the Board	DA	ATE: March 18, 2014
BY:	/s/ John R. Alexander John R. Alexander, Director	DA	ATE: March 18, 2014
BY:	/s/ Thomas M. Carr Thomas M. Carr, Director	DA	ATE: March 18, 2014
BY:	Anthony J. Cooper, Director	DA	ATE: March 18, 2014
BY:	/s/ Robert K. Lambert Robert K. Lambert, Director	DA	ATE: March 18, 2014
BY:	/s/ Donald G. Quick, Jr. Donald G. Quick, Jr., Director	DA	ATE: March 18, 2014
BY:	/s/ Katherine H. Roehlke Katherine H. Roehlke, Director		ATE: March 18, 2014
BY:	/s/ Kristin A. Swain Kristin A. Swain, Director	DA	ATE: March 18, 2014
BY:	/s/ Arie J. van den Blink Arie J. van den Blink, Director	DA	ATE: March 18, 2014
BY:	A. Scott Welliver, Director	DA	ATE: March 18, 2014
BY:	/s/ Marianne W. Young Marianne W. Young, Director	DA	ATE: March 18, 2014

# **EXHIBIT 21**

# LIST OF REGISTRANT'S SUBSIDIARIES

Subsidiary	State of Incorporation
ESB Advisory Services, Inc.	New York
ESB Realty, Corp.	New York

# **EXHIBIT 31.1 CERTIFICATION**

- I, Michael P. Hosey, Chief Executive Officer, certify that:
  - 1. I have reviewed this annual report on Form 10-K of Elmira Savings Bank;
  - 2. Based on my knowledge, this annual report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this annual report;
  - 3. Based on my knowledge, the financial statements, and other financial information included in this annual report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this annual report;
  - 4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and we have:
    - a. designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this annual report is being prepared;
    - designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
    - evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
    - d. disclosed in this annual report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
  - 5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal controls over financial reporting, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent function):
    - a. all significant deficiencies and material weaknesses in the design or operation of internal controls over financial reporting which are reasonably likely to adversely

affect the registrant's ability to record, process, summarize and report financial information; and

b. any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls, over financial reporting.

Date: March 18, 2014

/s/ Michael P. Hosey

Michael P. Hosey

Chief Executive Officer

# **EXHIBIT 31.2 CERTIFICATION**

I, Jason T. Sanford, Senior Vice President, Chief Financial Officer, certify that:

- 1. I have reviewed this annual report on Form 10-K of Elmira Savings Bank;
- 2. Based on my knowledge, this annual report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this annual report;
- 3. Based on my knowledge, the financial statements, and other financial information included in this annual report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this annual report;
- 4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and we have:
  - a. designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this annual report is being prepared;
  - designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - d. disclosed in this annual report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
- 5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal controls over financial reporting, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent function):
  - a. all significant deficiencies and material weaknesses in the design or operation of internal controls over financial reporting which are reasonably likely to adversely

affect the registrant's ability to record, process, summarize and report financial information; and

b. any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls, over financial reporting.

Date: March 18, 2014 /s/ Jason T. Sanford
Jason T. Sanford

Senior Vice President
Chief Financial Officer

# **EXHIBIT 32.1**

In connection with the filing of the annual report on Form 10-K for the fiscal year ended December 31, 2013 (the "Report") by Elmira Savings Bank (the "Company"), the undersigned, as Chief Executive Officer of the Company, hereby certifies pursuant to 18 U.S.C., section 1350 as adopted pursuant to section 906 of The Sarbanes-Oxley Act of 2002, that, to my knowledge:

The report fully complies with the requirements of section 13(a) or section 15(d), as applicable, of the Securities Exchange Act of 1934; and

The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Date: March 18, 2014

/s/ Michael P. Hosey

Michael P. Hosey

Chief Executive Officer

#### **EXHIBIT 32.2**

In connection with the filing of the annual report on Form 10-K for the fiscal year ended December 31, 2013 (the "Report") by Elmira Savings Bank (the "Company"), the undersigned, as Senior Vice President and Chief Financial Officer of the Company, hereby certifies pursuant to 18 U.S.C., section 1350 as adopted pursuant to section 906 of The Sarbanes-Oxley Act of 2002, that, to my knowledge:

The report fully complies with the requirements of section 13(a) or section 15(d), as applicable, of the Securities Exchange Act of 1934; and

The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Date: March 18, 2014 /s/ Jason T. Sanford

Jason T. Sanford Senior Vice President Chief Financial Officer