CORTLAND BANCORP INC
Form 10-Q
August 12, 2014

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

x QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended June 30, 2014

or

¨ TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition from to

Commission file number: 0-13814

Cortland Bancorp

(Exact name of registrant as specified in its charter)

Ohio	34-1451118
(State or other jurisdiction of	(I.R.S. Employer
Incorporation or organization)	Identification No.)
194 West Main Street, Cortland, Ohio	44410
(Address of principal executive offices)	(Zip code)

330- 637-8040

(Registrant's telephone number, including area code)

N/A

(Former name, former address and former fiscal year, if changed since last report)

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

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

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

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

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes ¨ No x

APPLICABLE ONLY TO CORPORATE ISSUERS:

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

TITLE OF CLASS	SHARES OUTSTANDING
Common Stock, No Par Value	4,527,848 Shares August 5, 2014

CORTLAND BANCORP AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS (UNAUDITED)

(Amounts in thousands, except share data)

	June 30, 2014	December 31, 2013
ASSETS		
Cash and due from banks	$8,944	$8,271
Interest-earning deposits	2,774	4,125
Total cash and cash equivalents	11,718	12,396
Investment securities available-for-sale (Note 3)	170,913	160,886
Trading securities (Note 3)	7,679	7,247
Loans held for sale	56	656
Total loans (Note 4)	316,567	346,833
Less allowance for loan losses (Note 4)	(4,134)	(3,764)
Net loans	312,433	343,069
Premises and equipment	6,608	6,676
Bank-owned life insurance	16,815	15,049
Other assets	8,195	10,939
Total assets	$534,417	$556,918
LIABILITIES		
Noninterest-bearing deposits	$92,178	$89,905
Interest-bearing deposits	332,887	358,764
Total deposits	425,065	448,669
Short-term borrowings	3,780	3,804
Federal Home Loan Bank advances - short term	5,000	8,100
Federal Home Loan Bank advances - long term	34,500	34,500
Subordinated debt (Note 7)	5,155	5,155
Other liabilities	6,514	7,155
Total liabilities	480,014	507,383
SHAREHOLDERS' EQUITY		
Common stock - $5.00 stated value - authorized 20,000,000 shares; issued 4,728,267 shares in 2014 and 2013; outstanding shares, 4,527,848 in 2014 and 2013	23,641	23,641
Additional paid-in capital	20,833	20,833
Retained earnings	13,510	11,502
Accumulated other comprehensive loss	(28)	(2,888)
Treasury stock, at cost, 200,419 shares in 2014 and 2013	(3,553)	(3,553)
Total shareholders' equity	54,403	49,535
Total liabilities and shareholders' equity	$534,417	$556,918

See accompanying notes to the unaudited consolidated financial statements of Cortland Bancorp and Subsidiaries

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CORTLAND BANCORP AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF INCOME (UNAUDITED)

(Amounts in thousands, except share data)

	THREE MONTHS ENDED		SIX MONTHS ENDED	
	JUNE 30,		JUNE 30,	
	2014	2013	2014	2013
INTEREST INCOME				
Interest and fees on loans	$3,961	$3,925	$8,049	$7,984
Interest and dividends on investment securities:				
Taxable interest	681	617	1,364	1,265
Nontaxable interest	441	350	854	652
Dividends	35	36	63	66
Other interest income	5	10	10	16
Total interest income	5,123	4,938	10,340	9,983
INTEREST EXPENSE				
Deposits	414	527	845	1,110
Other short-term borrowings	—	1	1	2
Federal Home Loan Bank advances - short term	36	20	139	35
Federal Home Loan Bank advances - long term	254	288	441	577
Subordinated debt	22	22	44	45
Total interest expense	726	858	1,470	1,769
Net interest income	4,397	4,080	8,870	8,214
PROVISION FOR LOAN LOSSES	150	150	300	350
NET INTEREST INCOME AFTER PROVISION FOR LOAN LOSSES	4,247	3,930	8,570	7,864
NON-INTEREST INCOME				
Fees for customer services	484	455	943	898
Investment securities available-for-sale gains - net	—	152	193	152
Trading security gains (losses), net	141	(51)	267	(51)
Mortgage banking gains	117	638	198	1,326
Other real estate gains - net	19	13	19	13
Earnings on bank-owned life insurance	88	99	161	183
Wealth management income	84	40	165	65
Other non-interest income	14	34	52	64
Total non-interest income	947	1,380	1,998	2,650
NON-INTEREST EXPENSES				
Salaries and employee benefits	2,306	2,545	4,500	5,023
Net occupancy and equipment expense	466	478	947	928
State and local taxes	85	140	170	279
FDIC insurance expense	83	110	158	198
Professional fees	233	199	405	414
Other operating expenses	736	835	1,352	1,604
Total non-interest expenses	3,909	4,307	7,532	8,446
INCOME BEFORE FEDERAL INCOME TAX EXPENSE	1,285	1,003	3,036	2,068

Federal income tax expense	246	204	665	439
NET INCOME	$1,039	$799	$2,371	$1,629
EARNINGS PER SHARE	$0.23	$0.18	$0.52	$0.36
CASH DIVIDENDS DECLARED PER SHARE	$0.05	$0.03	$0.08	$0.06

See accompanying notes to the unaudited consolidated financial statements of Cortland Bancorp and Subsidiaries

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CORTLAND BANCORP AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (UNAUDITED)

(Amounts in thousands)

	THREE MONTHS ENDED JUNE 30,		SIX MONTHS ENDED JUNE 30,	
	2014	2013	2014	2013
Net income	$1,039	$799	$2,371	$1,629
Other comprehensive income (loss):				
Securities available for sale:				
Unrealized holding gains (losses) on available-for-sale securities	1,923	(3,368)	4,487	(2,763)
Tax effect	(654)	1,144	(1,526)	939
Reclassification adjustment for net gains realized in net income	—	(152)	(193)	(152)
Tax effect	—	52	66	52
Total securities available for sale	1,269	(2,324)	2,834	(1,924)
Change in post-retirement obligations	13	(23)	26	(23)
Total other comprehensive income (loss)	1,282	(2,347)	2,860	(1,947)
Total comprehensive income (loss)	$2,321	$(1,548)	$5,231	$(318)

See accompanying notes to the unaudited consolidated financial statements of Cortland Bancorp and Subsidiaries

CORTLAND BANCORP AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY (UNAUDITED)

(Amounts in thousands)

	Common Stock	Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Loss	Treasury Stock	Total Shareholders' Equity
SIX MONTHS ENDED June 30, 2013						
Balance at December 31, 2012	$ 23,641	$ 20,850	$ 10,262	$ (1,707)	$ (3,594)	$ 49,452
Net income	—	—	1,629	—	—	1,629
Other comprehensive loss, net of tax	—	—	—	(1,947)	—	(1,947)
Cash dividend declared ($0.06 per share)	—	—	(272)	—	—	(272)
Treasury shares reissued (2,333 shares)	—	(17)	—	—	41	24
Balance at June 30, 2013	$ 23,641	$ 20,833	$ 11,619	$ (3,654)	$ (3,553)	$ 48,886
SIX MONTHS ENDED June 30, 2014						
Balance at December 31, 2013	$ 23,641	$ 20,833	$ 11,502	$ (2,888)	$ (3,553)	$ 49,535
Net income	—	—	2,371	—	—	2,371
Other comprehensive income, net of tax	—	—	—	2,860	—	2,860
Cash dividend declared ($0.08 per share)	—	—	(363)	—	—	(363)
Balance at June 30, 2014	$ 23,641	$ 20,833	$ 13,510	$ (28)	$ (3,553)	$ 54,403

See accompanying notes to the unaudited consolidated financial statements of Cortland Bancorp and Subsidiaries

CORTLAND BANCORP AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)

(Amounts in thousands)

	FOR THE SIX MONTHS ENDED JUNE 30,	
	2014	2013
Net cash flow from operating activities	$4,370	$8,473
Cash flow from investing activities		
Purchases of available-for-sale securities	(26,810)	(23,113)
Proceeds from sale of securities	10,237	12,452
Proceeds from call, maturity and principal payments on securities	10,173	25,249
Net decrease in loans made to customers	30,279	15,106
Proceeds from disposition of other real estate	52	305
Purchases of bank-owned life insurance	(1,605)	(714)
Purchases of premises and equipment	(283)	(621)
Net cash flow from investing activities	22,043	28,664
Cash deficit from financing activities		
Net decrease in deposit accounts	(23,604)	(45,931)
Net change in short-term borrowings	(124)	(368)
Net change in Federal Home Loan Bank advances - short term	(3,000)	—
Dividends paid	(363)	(272)
Treasury shares reissued	—	24
Net cash deficit from financing activities	(27,091)	(46,547)
Net change in cash and cash equivalents	(678)	(9,410)
Cash and cash equivalents		
Beginning of period	12,396	27,577
End of period	$11,718	$18,167
Supplemental disclosures:		
Cash paid during the period for:		
Interest	$1,490	$1,807
Transfer of loans to other real estate owned	$57	$234

See accompanying notes to the unaudited consolidated financial statements of Cortland Bancorp and Subsidiaries

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

1.) Basis of Presentation:

The accompanying unaudited consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States (U.S. GAAP) for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by U.S. GAAP for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring items) considered necessary for a fair presentation have been included. Operating results for the three and six months ended June 30, 2014 are not necessarily indicative of the results that may be expected for the year ending December 31, 2014. These interim unaudited consolidated financial statements should be read in conjunction with our annual audited financial statements as of December 31, 2013, included in our Form 10-K for the year ended December 31, 2013, filed with the United States Securities and Exchange Commission. The accompanying consolidated balance sheet at December 31, 2013, has been derived from the audited consolidated balance sheet but does not include all of the information and footnotes required by U.S. GAAP for complete financial statements.

2.) Reclassifications:

Certain items contained in the 2013 financial statements have been reclassified to conform to the presentation for 2014. Such reclassifications had no effect on the net results of operations or equity.

3.) Investment Securities:

Investments in debt and equity securities are classified as held-to-maturity, available-for-sale or trading. Securities classified as held-to-maturity are those that management has the positive intent and ability to hold to maturity. Securities classified as available-for-sale are those that could be sold for liquidity, investment management, or similar reasons, even though management has no present intentions to do so. Securities classified as trading are those that management has bought principally for the purpose of selling in the near term. The Company currently has no securities classified as held-to-maturity.

Available-for-sale securities are carried at fair value with unrealized gains and losses recorded as a separate component of shareholders' equity, net of tax. Realized gains or losses on dispositions are based on net proceeds and the adjusted carrying amount of securities sold, using the specific identification method. Interest income includes amortization of purchase premium or discount and is amortized on the level-yield method without anticipating payments, except for U.S. Government mortgage-backed and related securities where twelve months of historical prepayments are taken into consideration. Trading securities are carried at fair value with valuation adjustments included in other non-interest income.

Securities are evaluated periodically to determine whether a decline in value is other-than-temporary. Management utilizes criteria such as the magnitude and duration of the decline, along with the reasons underlying the decline, to determine whether the loss in value is other-than-temporary. The term "other-than-temporary" is not intended to indicate that the decline in value is permanent, but indicates that the prospect for a near-term recovery of value is not necessarily favorable and that there is a lack of evidence to support a realizable value equal to or greater than the carrying value of the investment. Unrealized losses on available-for-sale investments have not been recognized into income. However, once a decline in value is determined to be other-than-temporary, the credit related other-than-temporary impairment (OTTI) is recognized in earnings while the non-credit related OTTI on securities not expected to be sold is recognized in other comprehensive income (loss).

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

The following table is a summary of investment securities available-for-sale:

	(Amounts in thousands)			
June 30, 2014	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
U.S. Treasury securities	$104	$ 3	$ —	$107
U.S. Government agencies and corporations	8,603	108	103	8,608
Obligations of states and political subdivisions	49,925	1,319	461	50,783
U.S. Government-sponsored mortgage-backed securities	89,343	831	855	89,319
U.S. Government-sponsored collateralized mortgage obligations	18,259	137	29	18,367
Trust preferred securities	1,668	—	988	680
Total debt securities	167,902	2,398	2,436	167,864
Federal Home Loan Bank (FHLB) stock	2,823	—	—	2,823
Federal Reserve Bank (FRB) stock	226	—	—	226
Total regulatory stock	3,049	—	—	3,049
Total investment securities available-for-sale	$170,951	$ 2,398	$ 2,436	$170,913

	(Amounts in thousands)			
December 31, 2013	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
U.S. Treasury securities	$107	$ 5	$ —	$112
U.S. Government agencies and corporations	9,259	—	312	8,947
Obligations of states and political subdivisions	44,575	467	1,507	43,535
U.S. Government-sponsored mortgage-backed securities	79,255	644	1,877	78,022
U.S. Government-sponsored collateralized mortgage obligations	17,120	105	140	17,085
Trust preferred securities	11,854	—	1,718	10,136
Total debt securities	162,170	1,221	5,554	157,837
Federal Home Loan Bank (FHLB) stock	2,823	—	—	2,823
Federal Reserve Bank (FRB) stock	226	—	—	226
Total regulatory stock	3,049	—	—	3,049
Total investment securities available-for-sale	$165,219	$ 1,221	$ 5,554	$160,886

The regulatory stock is carried at cost and the Company is required to hold such investments as a condition of membership in order to transact business with the FHLB of Cincinnati and the FRB.

The Bank is required to maintain a minimum investment in stock of the FHLB and FRB. The stock is bought from and sold based upon its par value. The stock does not have a readily determinable fair value and as such is classified as restricted stock, carried at cost and evaluated by management. The stock's value is determined by the ultimate recoverability of the par value rather than by recognizing temporary declines. The determination of whether the par value will ultimately be recovered is influenced by criteria such as the following: (a) the significance of the decline in net assets of the FHLB and FRB as compared to the capital stock amount and the length of time this situation has persisted, (b) commitments by the FHLB and FRB to make payments required by law or regulation and the level of such payments in relation to the operating performance, (c) the impact of legislative and regulatory changes on the customer base of the FHLB and FRB and (d) the liquidity position of the FHLB and FRB.

At June 30, 2014, trading securities of $7.7 million are an investment in obligations of states and political subdivisions and include cash equivalent investments for trading liquidity. There were $7.2 million held at December 31, 2013. Unrealized gains and losses on trading securities at June 30, 2014 were $49,600 and $5,500, respectively, compared to $51,800 and $3,100, respectively, at December 31, 2013. Total net unrealized gains of $44,100 for the six months ended June 30, 2014 and realized gains of $222,900 are included in the Consolidated Statement of Income.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

The amortized cost and fair value of debt securities at June 30, 2014, by contractual maturity, are shown below. Actual maturities will differ from contractual maturities because issuers may have the right to call or prepay obligations with or without call or prepayment penalties.

	(Amounts in thousands)	
	Amortized Cost	Fair Value
Due in one year or less	$234	$239
Due after one year through five years	1,866	1,895
Due after five years through ten years	15,776	15,987
Due after ten years	42,424	42,057
Total	60,300	60,178
U.S. Government-sponsored mortgage-backed and related securities	107,602	107,686
Total debt securities	$167,902	$167,864

The table below sets forth the proceeds and gains or losses realized on available for sale securities sold or called for the periods presented:

	(Amounts in thousands)			
	THREE MONTHS ENDED June 30,		SIX MONTHS ENDED June 30,	
	2014	2013	2014	2013
Proceeds on securities sold	$—	$2,000	10,237	7,000
Gross realized gains	—	177	637	177
Gross realized losses	—	(25)	444	(25)

Investment securities with a carrying value of approximately $118.5 million at June 30, 2014 and $108.5 million at December 31, 2013 were pledged to secure deposits and for other purposes. The remaining securities provide an adequate level of liquidity.

The following is a summary of the fair value of available for sale securities with unrealized losses and an aging of those unrealized losses at June 30, 2014:

(Amounts in thousands)

	Less than 12 Months		12 Months or More		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
U.S. Government agencies and corporations	$336	$ 1	$1,884	$ 102	$2,220	$ 103
Obligations of states and political subdivisions	608	1	10,449	460	11,057	461
U.S. Government-sponsored mortgage-backed securities	9,479	51	38,155	804	47,634	855
U.S. Government-sponsored collateralized mortgage obligations	4,539	15	3,000	14	7,539	29
Trust preferred securities	—	—	680	988	680	988
Total	$14,962	$ 68	$54,168	$ 2,368	$69,130	$ 2,436

The above table comprises 49 investment securities where the fair value is less than the related amortized cost.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

The following is a summary of the fair value of securities with unrealized losses and an aging of those unrealized losses at December 31, 2013:

	(Amounts in thousands)					
	Less than 12 Months		12 Months or More		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
U.S. Government agencies and corporations	$7,144	$ 129	$1,803	$ 183	$8,947	$ 312
Obligations of states and political subdivisions	19,785	1,142	1,883	365	21,668	1,507
U.S. Government-sponsored mortgage-backed securities	34,424	1,044	29,922	833	64,346	1,877
U.S. Government-sponsored collateralized mortgage obligations	6,575	126	2,095	14	8,670	140
Trust preferred securities	—	—	1,633	1,718	1,633	1,718
Total	$67,928	$ 2,441	$37,336	$ 3,113	$105,264	$ 5,554

The above table comprises 83 investment securities where the fair value is less than the related amortized cost.

The trust preferred securities with an unrealized loss represent pools of trust preferred debt issued by bank holding companies. The unrealized losses on the Company’s investment in U.S. Government-sponsored-mortgage-backed securities, U.S. Government-sponsored collateralized mortgage obligations, obligations of states and political subdivisions and U.S. Government agencies and corporations were caused by changes in market rates and related spreads. It is expected that the securities would not be settled at less than the amortized cost of the Company’s investment because the decline in fair value is attributable to changes in interest rates and relative spreads and not credit quality. Also, except for the securities described below, the Company does not intend to sell those investments and it is not more-likely-than-not that the Company will be required to sell the investments before recovery of its amortized cost basis less any current period credit loss. The Company does not consider these investments to be other-than-temporarily impaired at June 30, 2014.

Securities Deemed to be Other-Than-Temporarily Impaired

The Company reviews investment debt securities on an ongoing basis for the presence of other-than-temporary impairment (OTTI) with formal reviews performed quarterly.

For debt securities in an unrealized loss position, management assesses whether (a) it has the intent to sell the debt security or (b) it is more-likely-than-not that it will be required to sell the debt security before its anticipated recovery. If either of these conditions is met, an OTTI on the security must be recognized.

In instances in which a determination is made that a credit loss (defined as the difference between the present value of the cash flows expected to be collected and the amortized cost basis) exists but the entity does not intend to sell the debt security and it is not more-likely-than-not that the entity will be required to sell the debt security before the anticipated recovery of its remaining amortized cost basis (i.e., the amortized cost basis less any current-period credit loss), the Company presents the amount of the OTTI recognized in the Consolidated Statement of Income.

In these instances, the impairment is separated into (a) the amount of the total impairment related to the credit loss, and (b) the amount of the total impairment related to all other factors. The amount of the total OTTI related to the credit loss is recognized in earnings. The amount of the total impairment related to all other factors is recognized in other comprehensive income. The total other-than-temporary impairment is presented in the Consolidated Statement of Income with an offset for the amount of the total other-than-temporary impairment that is recognized in other comprehensive income (loss).

As more fully disclosed in Note 9, the Company assessed the impairment of certain securities currently in an illiquid market. The Company records impairment credit losses in earnings (before tax) and non-credit impairment losses in other comprehensive income (loss) (before tax). Through the impairment assessment process, there was no impairment loss recognized in the three or six months ended June 30, 2014 or June 30, 2013.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

The following provides a cumulative rollforward of credit losses recognized in earnings for trust preferred securities held.

	(Amounts in thousands)			
	THREE MONTHS ENDED June 30,		SIX MONTHS ENDED June 30,	
	2014	2013	2014	2013
Beginning balance	$140	$351	$2,305	$351
Reduction for debt securities for which other-than-temporary impairment has been previously recognized and there is no related other comprehensive income	—	—	—	—
Credit losses on debt securities for which other-than-temporary impairment has not been previously recognized	—	—	—	—
Additional credit losses on debt securities for which other-than-temporary impairment was previously recognized	—	—	—	—
Sale of debt securities	—	—	(2,165)	—
Credit losses on debt securities for which other-than-temporary				
Sale of debt securities	—	—	—	—
Ending balance	$140	$351	$140	$351

In January 2014, the Company determined that its portfolio of insurance trust preferred collateralized debt obligations, commonly known as iTruPS securities, are considered disallowed investments under the final rule implementing Section 619 of the Dodd-Frank Wall Street Reform and Consumer Protection Act, commonly referred to as the Volcker Rule, which was originally released jointly by five regulatory agencies on December 10, 2013, and further clarified with the release of the Interim Final Rule on January 14, 2014. The final rule requires banking entities to divest disallowed securities by July 21, 2015, unless, upon application, the Federal Reserve grants extensions to July 21, 2017.

With the release of the Interim Final Rule on January 14, 2014, the joint agencies granted relief by permitting financial institutions to retain their interests in certain collateralized debt obligations, but limited that provision to those collateralized by issuances prior to May 2010 from bank or thrift holding companies with less than $15 billion in consolidated assets. The Interim Final Rule did not contain a provision for issuances by insurance companies, which comprise the various iTruPS securities owned by the Company.

The disallowed iTruPS consisted of nine positions with an amortized cost of $10.5 million at December 31, 2013. Because the Company could no longer hold the securities until their anticipated recovery, an OTTI had to be recognized for the entire amount of unrealized loss as of December 31, 2013. The fair value of the iTruPS as determined by the discounted cash flow model used by the Company aggregated to $8.5 million. The resulting OTTI charge of approximately $2.0 million was included in the Consolidated Statements of Income in 2013. In February 2014, the Company completed the sale of all nine of the disallowed investments.

At June 30, 2014 and December 31, 2013, there were $251,000 and $1.2 million, respectively, of investment securities considered to be in non-accrual status. This balance is comprised of one of its two investments in trust preferred securities at June 30, 2014. As a result of the delay in the collection of interest payments, management placed this security in non-accrual status. Current estimates indicate that the interest payment delays may exceed ten years. The remaining trust preferred security is in accrual status.

4.) Loans and Allowance for Loan Losses:

The Company, through the Bank, grants residential, consumer and commercial loans to customers located primarily in Northeastern Ohio and Western Pennsylvania.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

The following represents the composition of the loan portfolio for the period ending:

	(Amounts in thousands)			
	June 30, 2014		December 31, 2013	
	Balance	%	Balance	%
Commercial	$46,253	14.6	$73,643	21.2
Commercial real estate	205,594	64.9	206,744	59.6
Residential real estate	40,569	12.8	42,288	12.2
Consumer - home equity	19,560	6.2	19,510	5.6
Consumer - other	4,591	1.5	4,648	1.4
Total loans	$316,567		$346,833	

Management has an established methodology to determine the adequacy of the allowance for loan losses that assesses the risks and losses inherent in the loan portfolio. For purposes of determining the allowance for loan losses, the Company has segmented loans in the portfolio by product type. Loans are segmented into the following pools: commercial loans, commercial real estate loans, residential real estate loans and consumer loans. The Company also sub-segments the consumer loan portfolio into the following two classes: home equity loans and other consumer loans. Historical loss percentages for each risk category are calculated and used as the basis for calculating allowance allocations. These historical loss percentages are calculated over multiple periods for all portfolio segments. Management evaluates these results and utilizes the most reflective period in the calculation. Certain qualitative factors are then added to the historical allocation percentage to get the adjusted factor.

These factors include, but are not limited to, the following:

Factor Considered:	Risk Trend:
Levels of and trends in charge-offs, classifications and non-accruals	Stable
Trends in volume and terms	Increasing
Changes in lending policies and procedures	Stable
Experience, depth and ability of management	Stable
Economic trends	Decreasing
Concentrations of credit	Increasing

The following factors are analyzed and applied to loans internally graded with higher credit risk in addition to the above factors for non-classified loans:

Factor Considered:	Risk Trend:
Levels and trends in classification	Stable
Declining trends in financial performance – Commercial real estate and Commercial	Stable

Structure and lack of performance measures – Commercial real estate and Commercial	Stable
Migration between risk categories	Increasing

The provision charged to operations can be allocated to a loan segment either as a positive or negative value as a result of any material changes to: net charge-offs or recovery, risk factors or loan balances. The increase in provision to the commercial real estate loan category was due mainly to an increase in the historical loss factor.

The following is an analysis of changes in the allowance for loan losses for the periods ended:

THREE MONTHS ENDED	(Amounts in thousands)					
June 30, 2014	Commercial	Commercial real estate	Residential real estate	Consumer - home equity	Consumer - other	Total
Balance at beginning of period	$684	$ 2,897	$ 293	$ 90	$ 87	$4,051
Loan charge-offs	—	—	(19)	(39)	(34)	(92)
Recoveries	—	—	1	3	21	25
Net loan recoveries (charge-offs)	—	—	(18)	(36)	(13)	(67)
Provision charged to operations	65	(6)	20	46	25	150
Balance at end of period	$749	$ 2,891	$ 295	$ 100	$ 99	$4,134

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

June 30, 2013	Commercial	Commercial real estate	Residential real estate	Consumer - home equity	Consumer - other	Total
	(Amounts in thousands)					
Balance at beginning of period	$619	$ 2,738	$ 334	$ 107	$ 93	$3,891
Loan charge-offs	—	—	(5)	—	(26)	(31)
Recoveries	112	3	4	4	12	135
Net loan recoveries (charge-offs)	112	3	(1)	4	(14)	104
Provision charged to operations	(180)	294	7	16	13	150
Balance at end of period	$551	$ 3,035	$ 340	$ 127	$ 92	$4,145

SIX MONTHS ENDED June 30, 2014	Commercial	Commercial real estate	Residential real estate	Consumer - home equity	Consumer - other	Total
	(Amounts in thousands)					
Balance at beginning of period	$593	$ 2,638	$ 356	$ 88	$ 89	$3,764
Loan charge-offs	(112)	—	(19)	(39)	(69)	(239)
Recoveries	262	—	2	8	37	309
Net loan recoveries (charge-offs)	150	—	(17)	(31)	(32)	70
Provision charged to operations	6	253	(44)	43	42	300
Balance at end of period	$749	$ 2,891	$ 295	$ 100	$ 99	$4,134

June 30, 2013	Commercial	Commercial real estate	Residential real estate	Consumer - home equity	Consumer - other	Total
	(Amounts in thousands)					
Balance at beginning of period	$639	$ 2,616	$ 343	$ 123	$ 104	$3,825
Loan charge-offs	(1)	(72)	(79)	—	(55)	(207)
Recoveries	116	3	5	9	44	177
Net loan recoveries (charge-offs)	115	(69)	(74)	9	(11)	(30)
Provision charged to operations	(203)	488	71	(5)	(1)	350
Balance at end of period	$551	$ 3,035	$ 340	$ 127	$ 92	$4,145

The total allowance reflects management’s estimate of loan losses inherent in the loan portfolio at the consolidated balance sheet date.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

The following tables present a full breakdown by portfolio segment, the changes in the allowance for loan losses and the recorded investment in loans for the periods ended June 30, 2014 and December 31, 2013:

	(Amounts in thousands)					
June 30, 2014	Commercial	Commercial real estate	Residential real estate	Consumer - home equity	Consumer - other	Total
Allowance for loan losses:						
Ending allowance balance attributable to loans:						
Individually evaluated for impairment	$35	$ 250	$ —	$ —	$ —	$285
Collectively evaluated for impairment	714	2,641	295	100	99	3,849
Total ending allowance balance	$749	$ 2,891	$ 295	$ 100	$ 99	$4,134
Loan Portfolio:						
Individually evaluated for impairment	$248	$ 5,766	$ —	$ —	$ —	$6,014
Collectively evaluated for impairment	46,005	199,828	40,569	19,560	4,591	310,553
Total ending loans balance	$46,253	$ 205,594	$ 40,569	$ 19,560	$ 4,591	$316,567

	(Amounts in thousands)					
December 31, 2013	Commercial	Commercial real estate	Residential real estate	Consumer - home equity	Consumer - other	Total
Allowance for loan losses:						
Ending allowance balance attributable to loans:						
Individually evaluated for impairment	$50	$ 251	$ —	$ —	$ —	$301
Collectively evaluated for impairment	543	2,387	356	88	89	3,463
Total ending allowance balance	$593	$ 2,638	$ 356	$ 88	$ 89	$3,764
Loan Portfolio:						
Individually evaluated for impairment	$418	$ 5,134	$ —	$ —	$ —	$5,552
Collectively evaluated for impairment	73,225	201,610	42,288	19,510	4,648	341,281
Total ending loans balance	$73,643	$ 206,744	$ 42,288	$ 19,510	$ 4,648	$346,833

The decrease in commercial loan balances from year-end was due in part to 60-day term commercial loans for a total of $27.6 million that closed in December 2013 and were fully secured by segregated deposit accounts with the Bank. The loans matured in the first quarter of 2014. The increase in the allowance for the commercial and commercial real estate categories is due to increases in substandard and special mention loans as shown in the following tables.

The following tables represent credit exposures by internally assigned grades for June 30, 2014 and December 31, 2013. The grading analysis estimates the capability of the borrower to repay the contractual obligations of the loan agreements as scheduled or at all. The Company's internal credit risk grading system is based on experiences with similarly graded loans.

The Company’s internally assigned grades are as follows:

Pass – loans which are protected by the current net worth and paying capacity of the obligor or by the value of the underlying collateral. Within this category, there are grades of exceptional, quality, acceptable and pass monitor.
Special Mention – loans where a potential weakness or risk exists, which could cause a more serious problem if not corrected.
Substandard – loans that have a well-defined weakness based on objective evidence and are characterized by the distinct possibility that the Bank will sustain some loss if the deficiencies are not corrected.
Doubtful – loans classified as doubtful have all the weaknesses inherent in a substandard asset but with the severity which makes collection in full highly questionable and improbable, based on existing circumstances.
Loss – loans classified as a loss are considered uncollectible, or of such value that continuance as an asset is not warranted. This rating does not mean that the assets have no recovery or salvage value but rather that the assets should be charged off now, even though partial or full recovery may be possible in the future.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

The following table is a summary of credit quality indicators by internally assigned grade as of June 30, 2014 and December 31, 2013:

	(Amounts in thousands)	
	Commercial	Commercial real estate
June 30, 2014		
Pass	$42,271	$ 188,273
Special Mention	3,707	10,489
Substandard	275	6,832
Doubtful	—	—
Ending Balance	$46,253	$ 205,594

	(Amounts in thousands)	
	Commercial	Commercial real estate
December 31, 2013		
Pass	$72,562	$ 192,604
Special Mention	626	9,158
Substandard	455	4,982
Doubtful	—	—
Ending Balance	$73,643	$ 206,744

The Company evaluates the classification of consumer, home equity and residential loans primarily on a pooled basis. If the Company becomes aware that adverse or distressed conditions exist that may affect a particular loan, the loan is downgraded following the above definitions of special mention and substandard.

The following table is a summary of consumer credit exposure as of June 30, 2014 and December 31, 2013:

	(Amounts in thousands)		
	Residential real estate	Consumer - home equity	Consumer-other
June 30, 2014			
Performing	$39,085	$ 19,297	$ 4,580
Nonperforming	1,484	263	11
Total	$40,569	$ 19,560	$ 4,591

(Amounts in thousands)

	Residential real estate	Consumer - home equity	Consumer- other
December 31, 2013			
Performing	$41,807	$ 19,438	$ 4,632
Nonperforming	481	72	16
Total	$42,288	$ 19,510	$ 4,648

Loans are considered to be nonperforming when they become 90 days past due or on nonaccrual status, though the Company may be receiving partial payments of interest and partial repayments of principal on such loans. When a loan is placed in non-accrual status, previously accrued but unpaid interest is deducted from interest income. Loans in foreclosure are considered nonperforming.

Troubled Debt Restructuring

Nonperforming loans also include certain loans that have been modified in trouble debt restructurings (TDRs) where economic concessions have been granted to borrowers who have experienced or are expected to experience financial difficulties. These concessions typically result from the Company's loss mitigation activities and could include reductions in the interest rate, payment extensions, forgiveness of principal, forbearance or other actions. Certain TDRs are classified as nonperforming at the time of restructure and may only be returned to performing status after considering the borrower's sustained repayment performance for a reasonable period, generally six months.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

There were no loans modified as TDRs for the three and six months ended June 30, 2014. There were no TDRs approved in the twelve months period preceding June 30, 2014 that subsequently defaulted in the periods presented.

(Dollar amounts in thousands)

	Three Months Ended June 30, 2013				Six Months Ended June 30, 2013			
	Number of contracts	Pre-modification recorded investment	Post-modification recorded investment	Increase in the allowance	Number of contracts	Pre-modification recorded investment	Post-modification recorded investment	Increase in the allowance
Commercial	1	$ 44	$ 44	$ —	1	$ 44	$ 44	$ —
Commercial real estate	2	650	650	—	2	650	650	—
Total restructured loans	3	$ 694	$ 694	$ —	3	$ 694	$ 694	$ —
Subsequently defaulted	—	$ —			—	$ —		

The following table is an aging analysis of the recorded investment of past due loans as of June 30, 2014 and December 31, 2013:

(Amounts in thousands)

	30-59 Days Past Due	60-89 Days Past Due	90 Days Or Greater	Total Past Due	Current	Total Loans	Recorded Investment > 90 Days and Accruing
June 30, 2014							
Commercial	$10	$14	$ 24	$48	$46,205	$46,253	$ —
Commercial real estate	—	298	1,284	1,582	204,012	205,594	—
Residential real estate	55	1,357	320	1,732	38,837	40,569	—
Consumer:							
Consumer - home equity	159	—	119	278	19,282	19,560	—
Consumer - other	15	—	11	26	4,565	4,591	—
Total	$239	$1,669	$ 1,758	$3,666	$312,901	$316,567	$ —

(Amounts in thousands)

30-59 Days Past	60-89 Days Past	90 Days Or Greater	Total Past Due	Current	Total Loans	Recorded Investment > 90 Days

	Due	Due					and Accruing
December 31, 2013							
Commercial	$—	$—	$ 30	$30	$73,613	$73,643	$ —
Commercial real estate	—	—	1,136	1,136	205,608	206,744	—
Residential real estate	—	201	380	581	41,707	42,288	—
Consumer:							
Consumer - home equity	—	7	65	72	19,438	19,510	—
Consumer - other	29	—	16	45	4,603	4,648	—
Total	$29	$208	$ 1,627	$1,864	$344,969	$346,833	$ —

An impaired loan is a loan on which, based on current information and events, it is probable that a creditor will be unable to collect all amounts due (including both interest and principal) according to the contractual terms of the loan agreement. However, an insignificant delay or insignificant shortfall in amount of payments on a loan does not indicate that the loan is impaired.

When a loan is determined to be impaired, impairment should be measured based on the present value of expected future cash flows discounted at the loan's effective interest rate. However, as a practical expedient, the Company will measure impairment based on a loan's observable market price, or the fair value of the collateral if the loan is collateral dependent.

The following are the criteria for selecting individual loans / relationships for impairment analysis. Non-homogenous loans which meet the criteria below are evaluated quarterly.

All borrowers whose loans are classified doubtful by examiners and internal loan review

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

All loans on non-accrual status
Any loan in foreclosure
Any loan with a specific reserve
Any loan determined to be collateral dependent for repayment
Loans classified as troubled debt restructuring

Any loan evaluated for impairment is excluded from the general pool of loans in the ALLL calculation regardless if a specific reserve was determined. If management determines that the value of the impaired loan is less than the recorded investment in the loan (net of previous charge-offs, deferred loan fees or costs and unamortized premium or discount), impairment is recognized through an allowance estimate or a charge-off to the allowance.

The following table presents the recorded investment and unpaid principal balances for impaired loans, excluding homogenous loans for which impaired analyses are not necessarily performed, with the associated allowance amount, if applicable, at June 30, 2014 and December 31, 2013. Also presented are the average recorded investments in the impaired balances and interest income recognized after impairment for the three and six months ended June 30, 2014 and 2013.

	(Amounts in thousands)		
	Recorded Investment	Unpaid Principal Balance	Related Allowance
June 30, 2014			
With no related allowance recorded:			
Commercial	$213	$ 213	$ —
Commercial real estate	4,210	4,920	—
With an allowance recorded:			
Commercial	35	35	35
Commercial real estate	1,556	1,556	250
Total:			
Commercial	$248	$ 248	$ 35
Commercial real estate	$5,766	$ 6,476	$ 250

	(Amounts in thousands)		
	Recorded Investment	Unpaid Principal Balance	Related Allowance
December 31, 2013			
With no related allowance recorded:			
Commercial	$320	$ 320	$ —
Commercial real estate	3,554	3,554	—
With an allowance recorded:			

Commercial	98	98	50
Commercial real estate	1,580	1,580	251
Total:			
Commercial	$418	$ 418	$ 50
Commercial real estate	$5,134	$ 5,134	$ 251

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

	(Amounts in thousands)			
	THREE MONTHS ENDED		SIX MONTHS ENDED	
	Average Recorded Investment	Interest Income Recognized	Average Recorded Investment	Interest Income Recognized
June 30, 2014				
With no related allowance recorded:				
Commercial	$215	$ 4	$219	$ 10
Commercial real estate	4,030	43	3,849	88
With an allowance recorded:				
Commercial	73	—	84	-
Commercial real estate	1,561	28	1,569	36
Total:				
Commercial	$288	$ 4	$303	$ 10
Commercial real estate	$5,591	$ 71	$5,418	$ 124

	(Amounts in thousands)			
	THREE MONTHS ENDED		SIX MONTHS ENDED	
	Average Recorded Investment	Interest Income Recognized	Average Recorded Investment	Interest Income Recognized
June 30, 2013				
With no related allowance recorded:				
Commercial	$106	$ —	$55	$ —
Commercial real estate	1,118	8	987	11
With an allowance recorded:				
Commercial	42	—	44	—
Commercial real estate	3,228	30	3,604	41
Total:				
Commercial	$148	$ —	$99	$ —
Commercial real estate	$4,346	$ 38	$4,591	$ 52

The following table is a summary of classes of loans on non-accrual status as of June 30, 2014 and December 31, 2013:

	(Amounts in thousands)	
	June 30, 2014	December 31, 2013

Commercial	$35	$ 98
Commercial real estate	1,786	1,279
Residential real estate	1,484	481
Consumer:		
Consumer - home equity	263	72
Consumer - other	11	16
Total	$3,579	$ 1,946

5.) Legal Proceedings:

The Company is involved in legal actions arising in the ordinary course of business. In the opinion of management, the outcomes from these matters, either individually or in the aggregate, are not expected to have any material effect on the Company.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

6.) Earnings Per Share and Capital Transactions:

The Company currently maintains a simple capital structure; therefore, there are no dilutive effects to earnings per share. The following table sets forth the computation of earnings per common share. Earnings per share is computed by dividing net income by the weighted average number of shares outstanding during the applicable period.

	THREE MONTHS ENDED June 30,		SIX MONTHS ENDED June 30,	
	2014	2013	2014	2013
Net income (amounts in thousands)	$1,039	$799	$2,371	$1,629
Weighted average common shares outstanding	4,527,848	4,527,847	4,527,848	4,526,844
Earnings per share	$0.23	$0.18	$0.52	$0.36

7.) Subordinated Debt:

In July 2007, a trust formed by the Company issued $5.0 million of floating rate trust preferred securities as part of a pooled offering of such securities due December 2037. The Company owns all $155,000 of the common securities issued by the trust. The securities bear interest at the 3-month LIBOR rate plus 1.45%. The rates at June 30, 2014 and December 31, 2013 were 1.68% and 1.69%, respectively. The Company issued subordinated debentures to the trust in exchange for the proceeds of the trust preferred offering. The debentures represent the sole assets of this trust. The Company may redeem the subordinated debentures, in whole or in part, at par.

The trust is not consolidated with the Company's financial statements. Accordingly, the Company does not report the securities issued by the trust as liabilities, but instead reports as liabilities the subordinated debentures issued by the Company and held by the trust. The subordinated debentures qualify as Tier 1 capital for regulatory purposes in determining and evaluating the Company's capital adequacy.

8.) Commitments:

Commitments to fund certain mortgage loans (interest rate locks) to be sold into the secondary market, forward contracts for the future sale of mortgage-backed securities and forward contracts for the future delivery of these mortgage loans are considered derivatives. The Company currently chooses to enter into individual best effort loan sale contracts for the future delivery of residential mortgage loans. These contracts are entered into at the same time that the interest rate lock is entered into with the customer, thereby eliminating the necessity of forward contracts for the future sale of mortgage-backed securities. These contracts are also considered to be derivative instruments and limit the Company's exposure to potential movements in market interest rates. Should levels of loan originations increase to previous levels, the Company may return to entering into forward contracts for the future delivery of mortgage loans.

The Company reports the fair value of the derivative assets and liabilities in other assets and other liabilities; associated income and expense is reported in mortgage banking gains.

Although residential mortgage loans originated and sold are without recourse as to performance, third parties to which the loans are sold can require repurchase of loans in the event noncompliance with the representations and warranties included in the sales agreements exists. These repurchases are typically those for which the borrower is in a nonperforming status, diminishing the prospects for future collection on the loan. The Company historically has not been required to repurchase any loans; however, provision is made for the contingent probability of this occurrence.

The Bank is a party to financial instruments with off-balance sheet risk in the normal course of business to meet the financing needs of its customers. These financial instruments include commitments to extend credit, standby letters of credit and financial guarantees. Such instruments involve, to varying degrees, elements of credit risk in excess of the amount recognized on the consolidated balance sheets. The contract or notional amounts or those instruments reflect the extent of involvement the Company has in particular classes of financial instruments.

In the event of nonperformance by the other party, the Company’s exposure to credit loss on these financial instruments is represented by the contract or notional amount of the instrument. The Company uses the same credit policies in making commitments and conditional obligations as it does for instruments recorded on the balance sheet. The amount and nature of collateral obtained, if any, is based on management’s credit evaluation.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

The following table is a summary of such contractual commitments:

	(Amounts in thousands)	
	June 30, 2014	December 31, 2013
Commitments to extend credit:		
Fixed rate	$20,430	$ 14,439
Variable rate	62,079	53,275
Standby letters of credit	679	670

Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Generally these financial arrangements have fixed expiration dates or other termination clauses and may require payment of a fee. Standby letters of credit are conditional commitments issued by the Company to guarantee the performance of a customer to a third party. Since many of the commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. The Company evaluates each customer’s creditworthiness 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 of the counterparty. Collateral held varies but may include accounts receivable, inventory, property, plant and equipment and income-producing commercial properties. The increase in commitments is in line with the Company’s increased focus on commercial and industrial lending, and specifically lines of credit.

The Company also offers limited overdraft protection as a non-contractual courtesy which is available to businesses as well as individually/jointly owned accounts in good standing for personal or household use. The Company reserves the right to discontinue this service without prior notice.

The following table is a summary of overdraft protection for the periods indicated:

	(Amounts in thousands)	
	June 30, 2014	December 31, 2013
Overdraft protection available on depositors' accounts	$9,680	$ 9,678
Balance of overdrafts included in loans	532	190
Average daily balance of overdrafts	117	115
Average daily balance of overdrafts as a percentage of available	1.21 %	1.19 %

9.) Fair Value of Assets and Liabilities:

Measurements

The Company groups assets and liabilities recorded at fair value into 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. A financial instrument's level within the fair value hierarchy is based on the lowest level of input that is significant to the fair value measurement (with level 1 considered highest and level 3 considered lowest). A brief description of each level follows:

Level 1: Quoted prices are available in active markets for identical assets or liabilities as of the reported date.

Level 2: Pricing inputs are other than quoted prices in active markets, which are either directly or indirectly observable as of the reported date. The nature of these assets and liabilities include items for which quoted prices are available but which trade less frequently, and items that are fair valued using other financial instruments, the parameters of which can be directly observed.

Level 3: Assets and liabilities that have little to no pricing observability as of the reported date. These items do not have two-way markets and are measured using management's best estimate of fair value, where inputs into the determination of fair value require significant management judgment or estimation.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

The following table presents the assets reported on the consolidated balance sheets at their fair value as of June 30, 2014 and December 31, 2013 by level within the fair value hierarchy. Financial assets and liabilities are classified in their entirety based on the lowest level of input that is significant to the fair value measurement.

	(Amounts in thousands)			
		Fair Value Measurements at June 30, 2014 Using		
Description	June 30, 2014	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
ASSETS				
U.S. Treasury securities	$ 107	$—	$ 107	$ —
U.S. Government agencies and corporations	8,608	—	8,608	—
Obligations of states and political subdivisions	50,783	—	50,783	—
U.S. Government-sponsored mortgage-backed securities	89,319	—	89,319	—
U.S. Government-sponsored collateralized mortgage obligations	18,367	—	18,367	—
Trust preferred securities	680	—	—	680
Regulatory stock	3,049	3,049	—	—
Trading securities	7,679	—	7,679	—
Loans held for sale	56	56	—	—

	(Amounts in thousands)			
		Fair Value Measurements at December 31, 2013 Using		
Description	December 31, 2013	Quoted Prices in Active Markets for Identical Assets	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)

		(Level 1)		
ASSETS				
U.S. Treasury securities	$112	$—	$ 112	$ —
U.S. Government agencies and corporations	8,947	—	8,947	—
Obligations of states and political subdivisions	43,535	—	43,535	—
U.S. Government-sponsored mortgage-backed securities	78,022	—	78,022	—
U.S. Government-sponsored collateralized mortgage obligations	17,085	—	17,085	—
Trust preferred securities	10,136	—	—	10,136
Regulatory stock	3,049	3,049	—	—
Trading securities	7,247	—	7,247	—
Loans held for sale	656	656	—	—

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

The following tables present the changes in the Level 3 fair value category for the three and six months ended June 30, 2014 and 2013. The Company classifies financial instruments in Level 3 of the fair-value hierarchy when there is reliance on at least one significant unobservable input to the valuation model. In addition to these unobservable inputs, the valuation models for Level 3 financial instruments typically also rely on a number of inputs that are readily observable either directly or indirectly.

	(Amounts in thousands)			
	Three Months Ended		Six Months Ended	
	June 30, 2014	June 30, 2013	June 30, 2014	June 30, 2013
	Trust preferred securities	Trust preferred securities	Trust preferred securities	Trust preferred securities
Beginning balance	$743	$ 8,686	$10,136	$ 7,612
Net realized/unrealized gains/(losses) included in:				
Noninterest income	—	—	—	—
Other comprehensive income	(6)	998	730	2,070
Discount accretion (premium amortization)	—	2	7	4
Sales	—	—	(10,044)	—
Purchases, issuance, and settlements	(57)	—	(149)	—
Ending balance	$680	$ 9,686	$680	$ 9,686
Losses included in net income for the period relating to assets held at period end	$—	$ —	$—	$ —

The Company conducts OTTI analyses on a quarterly basis. The initial indication of other-than-temporary impairment for both debt and equity securities is a decline in the fair value below the amount recorded for an investment. A decline in value that is considered to be other-than-temporary is recorded as a loss within non-interest income in the consolidated statements of income. In determining whether an impairment is other than temporary, the Company considers a number of factors, including, but not limited to, the length of time and extent to which the market value has been less than cost, recent events specific to the issuer, including investment downgrades by rating agencies and economic conditions of its industry, and a determination that the Company does not intend to sell those investments and it is not more-likely-than-not that the Company will be required to sell the investments before recovery of its amortized cost basis less any current period credit loss. Among the factors that are considered in determining the Company’s intent and ability is a review of its capital adequacy, interest rate risk position and liquidity.

The Company also considers the issuer’s financial condition, capital strength and near-term prospects. In addition, for debt securities the Company considers the cause of the price decline (general level of interest rates and industry- and issuer-specific factors), current ability to make future payments in a timely manner and the issuer’s ability to service debt, the assessment of a security’s ability to recover any decline in market value, the ability of the issuer to meet contractual obligations and the Company’s intent and ability to retain the security. All of the foregoing require considerable judgment.

Trust Preferred Securities

Trust preferred securities are accounted for under FASB ASC Topic 325 Investments Other. The Company evaluates current available information in estimating the future cash flows of securities and determines whether there have been favorable or adverse changes in estimated cash flows from the cash flows previously projected. The Company considers the structure and term of the pool and the financial condition of the underlying issuers. Specifically, the evaluation incorporates factors such as interest rates and appropriate risk premiums, the timing and amount of interest and principal payments and the allocation of payments to the various note classes. Current estimates of cash flows are based on the most recent trustee reports, announcements of deferrals or defaults, expected future default rates and other relevant market information.

The Company holds trust preferred securities that are backed by pooled trust preferred debt issued by banks, thrifts and insurance companies. These securities were all rated investment grade at inception. Beginning the second half of 2008 and into 2014, factors outside the Company’s control impacted the fair value of these securities and will likely continue to do so for the foreseeable future. These factors include, but are not limited to, the following: guidance on fair value accounting, issuer credit deterioration, issuer deferral and default rates, potential failure or government seizure of underlying financial institutions or insurance companies, ratings agency actions, or regulatory actions. As a result of changes in these and various other factors during 2009 and into 2014, Moody’s Investors Service, Fitch Ratings and Standards and Poor’s downgraded multiple trust preferred securities, including securities held by the Company. All of the trust preferred securities held by the Company are now considered to be below investment grade. The deteriorating economic, credit and financial conditions experienced in 2008 and through 2014 have resulted in illiquid and inactive financial markets and severely depressed prices for these securities. As referenced in Note 2, Investment Securities, with the release of the Volcker Rule in December 2013, the Company could no longer support the ability to hold certain trust preferred securities comprised of obligations issued by insurance companies. The inability to hold the investments triggered a $2.0 million OTTI recognition reflecting the estimated fair value of the securities at December 31, 2013. For the remaining bank-issued trust preferred securities, the Company does not intend to sell the securities and it is more-likely-than-not that the Company will not be required to sell the securities before recovery of its amortized cost basis. There is a risk that subsequent evaluations could result in recognition of OTTI charges in the future. The securities had life-to-date impairment losses as presented below.

The following table details the breakdown of trust preferred securities for the periods indicated:

	(Dollar amounts in thousands)	
	June 30, 2014	December 31, 2013
Total number of trust preferred securities	2	12
Par value	$ 1,808	$ 14,366
Number not considered OTTI	1	1
Par value	$ 808	$ 956
Number considered OTTI	1	11
Par value	$ 1,000	$ 13,410
Life-to-date impairment recognized in earnings	$ 140	$ 2,305
Life-to-date impairment recognized in other comprehensive income	988	1,718
Total life-to-date impairment	$ 1,128	$ 4,023

The following table details the one debt security with other-than-temporary impairment, its credit rating at June 30, 2014 and the related losses recognized in earnings:

(Amounts in thousands)				
Moody's/Fitch Rating	Amount of OTTI related to	Additions in QTD March 31, 2014	Additions in QTD June 30, 2014	Amount of OTTI related to

		credit loss at January 1, 2014			credit loss at June 30, 2014
Trapeza IX B-1	Ca/CC	$ 140	$ —	$ —	$ 140
Total		$ 140	$ —	$ —	$ 140

The following table details the two debt securities with other-than-temporary impairment, their credit ratings at June 30, 2013 and the related losses recognized in earnings:

(Amounts in thousands)

	Moody's/Fitch Rating	Amount of OTTI related to credit loss at January 1, 2013	Additions in QTD March 31, 2013	Additions in QTD June 30, 2013	Amount of OTTI related to credit loss at June 30, 2013
PreTSL XXIII Class C-FP	Ca/C	$ 211	$ —	$ —	$ 211
Trapeza IX B-1	Ca/CC	140	—	—	140
Total		$ 351	$ —	$ —	$ 351

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

The following table provides additional information related to the Company's trust preferred securities as of June 30, 2014 used to evaluate other-than-temporary impairments:

(Amounts in thousands)

Deal	Class	Amortized Cost	Fair Value	Unrealized Gain/(Loss)	Moody's/ Fitch Rating	Number of Issuers Currently Performing	Deferrals and Defaults as a % of Current Collateral	Excess Subordination as a % of Current Performing Collateral
PreTSL XXIII	C-2	$ 808	$ 250	$ (558)	Ca/C	94	23.3 %	— %
Trapeza IX	B-1	860	430	(430)	Ca/CC	33	18.1	—
Total		$ 1,668	$ 680	$ (988)				

The following table provides additional information related to the Company's trust preferred securities as of December 31, 2013 used to evaluate other-than-temporary impairments:

(Amounts in thousands)

Deal	Class	Amortized Cost	Fair Value	Unrealized Gain/(Loss)	Moody's/ Fitch Rating	Number of Issuers Currently Performing	Deferrals and Defaults as a % of Current Collateral	Excess Subordination as a % of Current Performing Collateral
PreTSL XXIII	C-2	$ 956	$ 392	$ (564)	Ca/C	93	24.2 %	— %
PreTSL XXIII	C-FP	1,535	811	(724)	Ca/C	93	24.2	—
I-PreTSL I	B-1	770	770	—	NR/CCC	14	17.3	7.78
I-PreTSL I	B-2	770	770	—	NR/CCC	14	17.3	7.78
I-PreTSL I	B-3	770	770	—	NR/CCC	14	17.3	7.78
I-PreTSL II	B-3	2,700	2,700	—	NR/B	21	8.0	18.03
I-PreTSL III	B-2	870	870	—	Ba3/CCC	20	14.1	14.74
I-PreTSL III	C	620	620	—	NR/CCC	20	14.1	4.7
I-PreTSL IV	B-1	860	860	—	Ba2/B	30	—	17.67
I-PreTSL IV	B-2	860	860	—	Ba2/B	30	—	17.67
I-PreTSL IV	C	283	283	—	Caa1/CCC	30	—	11.16
Trapeza IX	B-1	860	430	(430)	Ca/CC	32	20.9	—

Total	$ 11,854	$10,136	$ (1,718)

The market for these securities at June 30, 2014 and December 31, 2013 is not active and markets for similar securities are also not active. The inactivity was evidenced first by a significant widening of the bid-ask spread in the brokered markets in which trust preferred securities trade and then by a significant decrease in the volume of trades relative to historical levels. The new issue market is also inactive as no new trust preferred securities have been issued since 2007. There are currently very few market participants who are willing and/or able to transact for these securities. The pooled market value for these securities remains very depressed relative to historical levels. Although there has been marked improvement in the credit spread premium in the corporate bond space, no such improvement has been noted in the market for trust preferred securities.

Given conditions in the debt markets today and the absence of observable transactions in the secondary and the new issue markets, the Company determined the following:

The few observable transactions and market quotations that are available are not reliable for purposes of determining fair value at June 30, 2014;

An income valuation approach technique (present value technique) that maximizes the use of relevant observable inputs and minimizes the use of unobservable inputs will be equally or more representative of fair value than the market approach valuation technique used at measurement dates prior to 2008; and

The trust preferred securities will be classified within Level 3 of the fair value hierarchy because the Company determined that significant judgments are required to determine fair value at the measurement date.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

The Company enlisted the aid of an independent third party to perform the trust preferred security valuations. The approach to determining fair value involved the following process:

1. Estimate the credit quality of the collateral using average probability of default values for each issuer (adjusted for rating levels).
2. Consider the potential for correlation among issuers within the same industry for default probabilities (e.g. banks with other banks).
3. Forecast the cash flows for the underlying collateral and apply to each trust preferred security tranche to determine the resulting distribution among the securities, including prepayment and cures.
4. Discount the expected cash flows to calculate the present value of the security.

The effective discount rates on an overall basis generally range from 11.19% to 16.40% and are highly dependent upon the credit quality of the collateral, the relative position of the tranche in the capital structure of the trust preferred security and the prepayment assumptions.

With the passage of the Dodd-Frank Act, trust preferred securities issued by institutions with assets greater than $15.0 billion will no longer be included in Tier 1 capital after 2013. As a result, prepayment assumptions were adjusted to include early redemptions by all institutions meeting this criteria. As the vast majority of institutions in the trust preferred securities collateral base fall below this threshold, the revised assumption did not materially impact the valuation results.

The following table presents the assets measured on a nonrecurring basis on the consolidated balance sheets at their fair value as of June 30, 2014 and December 31, 2013, by level within the fair value hierarchy. Impaired loans that are collateral dependent are written down to fair value through the establishment of specific reserves. Techniques used to value the collateral that secure the impaired loans include: quoted market prices for identical assets classified as Level 1 inputs; observable inputs, employed by certified appraisers, for similar assets classified as Level 2 inputs. In cases where valuation techniques include inputs that are unobservable and are based on estimates and assumptions developed by management based on the best information available under each circumstance, the asset valuation is classified as Level 3 inputs.

	(Amounts in thousands) June 30, 2014			
	Level 1	Level 2	Level 3	Total
Assets measured on a nonrecurring basis:				
Impaired loans	$—	$ —	$5,729	$5,729

	(Amounts in thousands) December 31, 2013			
	Level 1	Level 2	Level 3	Total
Assets measured on a nonrecurring basis:				
Impaired loans	$—	$ —	$5,251	$5,251
Other real estate owned	$—	$ —	$33	$33

Financial Instruments

The Company disclosures fair value information about financial instruments, whether or not recognized in the consolidated balance sheets, for which it is practicable to estimate the value. In cases where quoted market prices are not available, fair values are based on estimates using present value or other estimation techniques. Those techniques are significantly affected by the assumptions used, including the discount rate and estimates of future cash flows.

Such techniques and assumptions, as they apply to individual categories of the financial instruments, are as follows:

Cash and cash equivalents – The carrying amounts for cash and cash equivalents are a reasonable estimate of those assets' fair value.

Investment securities – Fair values of securities are based on quoted market prices, where available. If quoted market prices are not available, fair values are based on quoted market prices of comparable securities. Prices on trust preferred securities were calculated using a discounted cash-flow technique. Cash flows were estimated based on credit and prepayment assumptions. The present value of the projected cash flows was calculated using a discount rate equal to the current yield used to accrete the beneficial interest.

Loans held for sale – Loans held for sale consist of residential mortgage loans originated for sale. Loans held for sale are recorded at fair value based on what the secondary markets are currently offering for loans with similar characteristics.

Loans, net of allowance for loan losses – Market quotations are generally not available for loan portfolios. The fair value is estimated by discounting future cash flows using current market inputs at which loans with similar terms and qualities would be made to borrowers of similar credit quality.

Bank-owned life insurance – The fair value is based upon the cash surrender value of the underlying policies and matches the book value.

Accrued interest receivable – The carrying amount is a reasonable estimate of these assets' fair value.

Demand, savings and money market deposits – Demand, savings, and money market deposit accounts are valued at the amount payable on demand.

Time deposits – The fair value of certificates of deposit is based on the discounted value of contractual cash flows. The discount rates are estimated using market rates currently offered for similar instruments with similar remaining maturities.

FHLB advances – The fair value for fixed rate advances is estimated by discounting the future cash flows using rates at which advances would be made to borrowers with similar credit ratings and for the same remaining maturities. The fair value for the fixed rate advances that are convertible to quarterly LIBOR floating rate advances on or after certain specified dates at the option of the FHLB and the FHLB fixed rate advances that are putable on or after certain specified dates at the option of the FHLB are priced using the FHLB of Cincinnati's model.

Short-term borrowings – Short-term borrowings generally have an original term to maturity of one year or less. Consequently, their carrying value is a reasonable estimate of fair value.

Subordinated debt – The floating issuances curves to maturity are averaged to obtain an index. The spread between BBB-rated bank debt and 25-year swap rates is determined to calculate the spread on outstanding trust preferred securities. The discount margin is then added to the index to arrive at a discount rate, which determines the present value of projected cash flows.

Accrued interest payable – The carrying amount is a reasonable estimate of these liabilities' fair value. The fair value of unrecorded commitments at June 30, 2014 and December 31, 2013 is not material.

In addition, other assets and liabilities of the Company that are not defined as financial instruments are not included in the disclosures, such as property and equipment. Also, non-financial instruments typically not recognized in financial statements nevertheless may have value but are not included in the above disclosures. These include, among other items, the estimated earning power of core deposit accounts, the trained work force, customer goodwill and similar items. Accordingly, the aggregate fair value amounts presented do not represent the underlying value of the Company.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

The carrying amounts and estimated fair values of the Company's financial instruments are as follows:

	(Amounts in thousands) June 30, 2014 Carrying Amount	Level 1	Level 2	Level 3	Estimated Fair Value
ASSETS:					
Cash and cash equivalents	$11,718	$11,718	$—	$—	$11,718
Investment securities available-for-sale	170,913	3,049	167,184	680	170,913
Trading securities	7,679	—	7,679	—	7,679
Loans held for sale	56	56	—	—	56
Loans, net of allowance for loan losses	312,433	—	—	316,852	316,852
Bank-owned life insurance	16,815	16,815	—	—	16,815
Accrued interest receivable	1,683	1,683	—	—	1,683
LIABILITIES:					
Demand, savings and money market deposits	$293,818	$293,818	$—	$—	$293,818
Time deposits	131,247	—	—	134,462	134,462
Short-term borrowings	3,780	3,780	—	—	3,780
Federal Home Loan Bank advances - short term	5,000	5,000	—	—	5,000
Federal Home Loan Bank advances - long term	34,500	—	—	36,241	36,241
Subordinated debt	5,155	—	—	5,096	5,096
Accrued interest payable	269	269	—	—	269

	(Amounts in thousands) December 31, 2013 Carrying Amount	Level 1	Level 2	Level 3	Estimated Fair Value
ASSETS:					
Cash and cash equivalents	$12,396	$12,396	$—	$—	$12,396
Investment securities available-for-sale	160,886	3,049	147,701	10,136	160,886
Trading securities	7,247	—	7,247	—	7,247
Loans held for sale	656	656	—	—	656
Loans, net of allowance for loan losses	343,069	—	—	349,190	349,190
Bank-owned life insurance	15,049	15,049	—	—	15,049
Accrued interest receivable	1,675	1,675	—	—	1,675
LIABILITIES:					
Demand, savings and money market deposits	$316,708	$316,708	$—	$—	$316,708
Time deposits	131,961	—	—	135,712	135,712

Short-term borrowings	3,804	3,804	—	—	3,804
Federal Home Loan Bank advances - short term	8,100	8,100	—	—	8,100
Federal Home Loan Bank advances - long term	34,500	—	—	36,646	36,646
Subordinated debt	5,155	—	—	4,694	4,694
Accrued interest payable	290	290	—	—	290

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

The following table presents quantitative information about the Level 3 significant unobservable inputs for assets and liabilities measured at fair value on a recurring and nonrecurring basis at June 30, 2014:

	(Amounts in thousands) Fair value at June 30, 2014	Valuation Technique	Significant Unobservable Input	Description of Inputs
Trust preferred securities	$ 680	Discounted Cash Flow	Projected Prepayments	1) Trust preferred securities issued by banks subject to Dodd-Frank's phase-out of trust preferred securities from Tier 1 Capital. All fixed rate within one year; variable rate at increasing intervals depending on spread. 2) Trust preferred securities issued by healthy, well capitalized banks that have fixed rate coupons greater than 8%.3) 1% annually for

	all other fixed rate issues and all variable rate issues.4)
	Zero for collateral issued by REITs and 2% for insurance companies.
Projected Defaults	1) All deferring issuers that do not meet the criteria for curing, as described below, are projected to default immediately. 2) Banks with high, near team default risk are identified using a CAMELS model, and projected to default immediately. Healthy banks are projected to default at a rate of 2% annually for 2 years, and 0.36% annually thereafter. 3) Insurance and REIT defaults are

	projected according to the historical default rates exhibited by companies with the same credit ratings. Historical default rates are doubled in each of the first two years of the projection to account for current economic conditions. Unrated issuers are assumed to have CCC- ratings.
Projected Cures	1) Deferring issuers that have definitive agreements to either be acquired or recapitalized.
Projected Recoveries	1) Zero for insurance companies, REITs and insolvent banks, and 10% for projected bank deferrals lagged 2 years.
Discount Rates	1) Ranging from ~11.38% to ~16.42%, depending on each bond's

				seniority and remaining subordination after projected losses. Range (10)% to (30)%
Impaired loans	$ 5,729	Appraisal of Collateral (1)	Appraisal Adjustments (2)	Weighted average (12)% Range (1)% to (24)%
			Liquidation Expenses (2)	Weighted average (6)%

(1) Fair value is generally determined through independent appraisals of the underlying collateral, which generally include various Level 3 inputs which are not identifiable.
(2) Appraisals may be adjusted by management for qualitative factors such as economic conditions and estimated liquidation expenses. The range and weighted average of liquidation expenses are presented as a percent of the appraisal. The adjustment of appraised value is measured as the effect on fair value as a percentage of unpaid principal.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

The following table presents quantitative information about the Level 3 significant unobservable inputs for assets and liabilities measured at fair value on a recurring and nonrecurring basis at December 31, 2013:

	(Amounts in thousands) Fair value at December 31, 2013	Valuation Technique	Significant Unobservable Input	Description of Inputs
Trust preferred securities	$ 10,136	Discounted Cash Flow	Projected Prepayments	1) Trust preferred securities issued by banks subject to Dodd-Frank's phase-out of trust preferred securities from Tier 1 Capital. All fixed rate within one year; variable rate at increasing intervals depending on spread. 2) Trust preferred securities issued by healthy, well capitalized banks that have fixed rate coupons greater than 8%. 3) 1% annually for all other fixed rate issues and all variable rate issues. 4) Zero for collateral issued by REITs and 2% for insurance companies.
			Projected	

Defaults	1) All deferring issuers that do not meet the criteria for curing, as described below, are projected to default immediately. 2) Banks with high, near team default risk are identified using a CAMELS model, and projected to default immediately. Healthy banks are projected to default at a rate of 2% annually for 2 years, and 0.36% annually thereafter. 3) Insurance and REIT defaults are projected according to the historical default rates exhibited by companies with the same credit ratings. Historical default rates are doubled in each of the first two years of the projection to account for current economic conditions. Unrated issuers are assumed to have CCC- ratings.
Projected Cures	1) Deferring issuers that have definitive agreements to either be acquired or recapitalized.
Projected Recoveries	1) Zero for insurance companies, REITs and insolvent banks, and 10% for projected bank deferrals lagged 2 years.
Discount Rates	1) Ranging from ~5.65% to ~17.85%,

				depending on each bond's seniority and remaining subordination after projected losses.
Impaired loans	5,251	Appraisal of Collateral (1)	Appraisal Adjustments (2)	Weighted average (21)%
			Liquidation Expenses (2)	Weighted average (6)%
Other real estate owned	33	Appraisal of Collateral (1), (3)	Appraisal Adjustments (2)	0%

(1) Fair value is generally determined through independent appraisals of the underlying collateral, which generally include various Level 3 inputs which are not identifiable.

(2) Appraisals may be adjusted by management for qualitative factors such as economic conditions and estimated liquidation expenses. The range and weighted average of liquidation expenses are presented as a percent of the appraisal. The adjustment of appraised value is measured as the effect on fair value as a percentage of unpaid principal.

(3) Includes qualitative adjustments by management and estimated liquidation expenses.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

10.) Accumulated Other Comprehensive Income:

The following table presents the changes in accumulated other comprehensive loss by component net of tax for the three and six months ended June 30, 2014 and 2013:

	(Amounts in thousands) Unrealized gains on available-for-sale securities (a)	Change in pension and postretirement obligations
Balance as of December 31, 2013	$ (2,860)	$ (28)
Other comprehensive income before reclassification	1,692	13
Amount reclassified from accumulated other comprehensive loss	(127)	—
Total other comprehensive income	1,565	13
Balance as of March 31, 2014	(1,295)	(15)
Other comprehensive income before reclassification	1,269	13
Amount reclassified from accumulated other comprehensive loss	—	—
Total other comprehensive income	1,269	13
Balance as of June 30, 2014	$ (26)	$ (2)

	(Amounts in thousands) Unrealized gains on available-for-sale securities (a)	Change in pension and postretirement obligations
Balance as of December 31, 2012	$ (1,707)	$ —
Other comprehensive income before reclassification	400	—
Amount reclassified from accumulated other comprehensive loss	—	
Total other comprehensive income	400	—
Balance as of March 31, 2013	(1,307)	
Other comprehensive loss before reclassification	(2,224)	(23)
Amount reclassified from accumulated other comprehensive income	(100)	—
Total other comprehensive income	(2,324)	(23)
Balance as of June 30, 2013	$ (3,631)	$ (23)

(a) All amounts are net of tax. Amounts in parentheses indicate debits.

The following table presents significant amounts reclassified out of each component of accumulated other comprehensive income for the three and six months ended June 30, 2014 and 2013:

	(Amounts in thousands) THREE MONTHS ENDED		
	June 30, 2014	June 30, 2013	
	Amount reclassified from accumulated other comprehensive income	Amount reclassified from accumulated other comprehensive income	Affected line item in the statement where net income is presented
Details about other comprehensive income:			
Unrealized gains on available-for-sale securities	$—	$ (152)	Investment securities gains, net
	—	52	Federal income tax expense
	$—	$ (100)	Net of tax

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

	(Amounts in thousands) SIX MONTHS ENDED		
	June 30, 2014	June 30, 2013	
	Amount reclassified from accumulated other comprehensive income	Amount reclassified from accumulated other comprehensive income	Affected line item in the statement where net income is presented
Details about other comprehensive income:			
Unrealized gains on available-for-sale securities	$(193)	$ (152)	Investment securities gains, net
	66	52	Federal income tax expense
	$(127)	$ (100)	Net of tax

11.) Post-Retirement Obligations:

The Company accrues for the monthly benefit expense of post-retirement cost of insurance for split dollar life insurance coverage. There was a $2,000 credit to expense recorded for the quarter ended June 30, 2014, with a $26,000 credit to other comprehensive income and $10,000 expensed in the quarter ended June 30, 2013. The total accumulated liability at June 30, 2014 was $586,000 and $614,000 at December 31, 2013.

CONSOLIDATED AVERAGE BALANCE SHEETS, YIELDS AND RATES (UNAUDITED)

(Fully taxable equivalent basis in thousands of dollars)
YEAR-TO-DATE AS OF

	JUNE 30, 2014			DECEMBER 31, 2013			JUNE 30, 2013		
	Average Balance	Interest	Average Rate	Average Balance	Interest	Average Rate	Average Balance	Interest	Average Rate
ASSETS									
Interest earning deposits	$6,600	$10	0.32 %	$10,010	$30	0.29 %	$11,814	$16	0.27 %
Investment securities available for sale and trading (1) (2) (3)	175,357	2,707	3.09 %	181,051	4,737	2.61 %	185,575	2,307	2.49 %
Loans (1) (2) (3)	323,733	8,068	5.00 %	318,414	16,032	5.03 %	321,406	8,002	5.00 %
Total interest-earning assets	505,690	$10,785	4.28 %	509,475	$20,799	4.08 %	518,795	$10,325	3.99 %
Cash and due from banks	7,289			7,476			7,486		
Bank premises and equipment	6,615			6,680			6,612		
Other assets	18,940			16,879			17,200		
Total noninterest-earning assets	32,844			31,035			31,298		
Total assets	$538,534			$540,510			$550,093		
LIABILITIES AND SHAREHOLDERS' EQUITY									
Interest-bearing demand deposits	$91,755	$83	0.18 %	$91,386	$177	0.19 %	$93,397	$93	0.20 %
Savings	115,569	33	0.06 %	117,808	83	0.07 %	120,280	44	0.08 %
Time	129,472	729	1.14 %	140,585	1,842	1.31 %	145,733	973	1.35 %
Total interest-bearing deposits	336,796	845	0.51 %	349,779	2,102	0.60 %	359,410	1,110	0.62 %
Other borrowings	47,297	581	2.48 %	44,127	1,212	2.75 %	46,008	614	2.69 %
Subordinated debt	5,155	44	1.69 %	5,155	90	1.75 %	5,155	45	1.77 %
Total interest-bearing liabilities	389,248	$1,470	0.76 %	399,061	$3,404	0.85 %	410,573	$1,769	0.87 %
Demand deposits	88,145			85,771			84,150		
Other liabilities	9,024			6,229			5,387		
Shareholders' equity	52,117			49,449			49,983		
Total liabilities and shareholders' equity	$538,534			$540,510			$550,093		

Net interest income	$9,315	$17,395	$8,556
Net interest rate spread (4)	3.52 %	3.23 %	3.12 %
Net interest margin (5)	3.69 %	3.41 %	3.31 %
Ratio of interest-earning assets to interest-bearing liabilities	1.30	1.28	1.26

(1) Includes both taxable and tax exempt loans and investment securities available-for-sale and trading.

(2) The amounts are presented on a fully taxable equivalent basis using the statutory rate of 34%, and have been adjusted to reflect the effect of disallowed interest expenses related to carrying tax-exempt assets. The tax equivalent income adjustment for loans and investments available for sale and trading was $19,000 and $426,000, respectively, for June 30, 2014; $39,000 and $700,000, respectively, for December 31, 2013; and $18,000 and $324,000, respectively, for June 30, 2013.

(3) Average balance outstanding includes the average amount outstanding of all non-accrual investment securities and loans. Investment securities consist of average total principal adjusted for amortization of premium and accretion of discount and includes both taxable and tax-exempt securities. Loans consist of average total loans, including loans held for sale, less average deferred fees and costs.

(4) Interest rate spread represents the difference between the yield on earning assets and the rate paid on interest-bearing liabilities.

(5) Interest margin is calculated by dividing net interest income by total interest-earning assets.

CONSOLIDATED AVERAGE BALANCE SHEETS, YIELDS AND RATES (UNAUDITED)

(Fully taxable equivalent basis in thousands of dollars)
QUARTER-TO-DATE AS OF

	JUNE 30, 2014			MARCH 31, 2014			JUNE 30, 2013		
	Average Balance	Interest	Average Rate	Average Balance	Interest	Average Rate	Average Balance	Interest	Average Rate
ASSETS									
Interest earning deposits	$7,516	$5	0.33 %	$5,673	$5	0.30 %	$12,612	$10	0.34 %
Investment securities available for sale and trading (1) (2) (3)	179,546	1,377	3.06 %	171,123	1,329	3.11 %	186,017	1,177	2.53 %
Loans (1) (2) (3)	315,426	3,970	5.01 %	332,133	4,098	4.97 %	311,408	3,933	5.06 %
Total interest-earning assets	502,488	$5,352	4.26 %	508,929	$5,432	4.29 %	510,037	$5,120	4.02 %
Cash and due from banks	7,480			7,096			7,382		
Bank premises and equipment	6,585			6,644			6,619		
Other assets	19,723			18,148			18,221		
Total non-interest-earning assets	33,788			31,888			32,222		
Total assets	$536,276			$540,817			$542,259		
LIABILITIES AND SHAREHOLDERS' EQUITY									
Interest-bearing demand deposits	$88,545	$41	0.19 %	$94,991	$42	0.18 %	$89,862	$41	0.18 %
Savings	115,714	17	0.06 %	114,976	16	0.06 %	119,136	22	0.07 %
Time	129,698	356	1.13 %	129,700	373	1.17 %	143,062	464	1.30 %
Total interest-bearing deposits	333,957	414	0.50 %	339,667	431	0.51 %	352,060	527	0.60 %
Other borrowings	45,005	290	2.60 %	49,614	291	2.37 %	44,307	309	2.80 %
Subordinated debt	5,155	22	1.68 %	5,155	22	1.71 %	5,155	22	1.73 %
Total interest-bearing liabilities	384,117	$726	0.76 %	394,436	$744	0.76 %	401,522	$858	0.86 %
Demand deposits	90,162			86,105			83,877		
Other liabilities	8,766			9,286			6,382		
Shareholders' equity	53,231			50,990			50,478		
Total liabilities and	$536,276			$540,817			$542,259		

shareholders' equity			
Net interest income	$4,626	$4,688	$4,262
Net interest rate spread (4)	3.50 %	3.53 %	3.16 %
Net interest margin (5)	3.68 %	3.70 %	3.34 %
Ratio of interest-earning assets to interest-bearing liabilities	1.31	1.29	1.27

(1) Includes both taxable and tax exempt loans and investment securities available-for-sale and trading.

(2) The amounts are presented on a fully taxable equivalent basis using the statutory rate of 34%, and have been adjusted to reflect the effect of disallowed interest expenses related to carrying tax-exempt assets. The tax equivalent income adjustment for loans and investments available for sale and trading was $9,000 and $220,000, respectively, for June 30, 2014; $10,000 and $205,000, respectively, for March 31, 2014; and $8,000 and $174,000, respectively, for June 30, 2013.

(3) Average balance outstanding includes the average amount outstanding of all non-accrual investment securities and loans. Investment securities consist of average total principal adjusted for amortization of premium and accretion of discount and includes both taxable and tax-exempt securities. Loans consist of average total loans, including loans held for sale, less average deferred fees and costs.

(4) Interest rate spread represents the difference between the yield on earning assets and the rate paid on interest-bearing liabilities.

(5) Interest margin is calculated by dividing net interest income by total interest-earning assets.

SELECTED FINANCIAL DATA FOR THE QUARTER ENDED

(In thousands of dollars, except for ratios and per share amounts)

Unaudited	June 30, 2014	March 31, 2014	December 31, 2013	September 30, 2013	June 30, 2013
SUMMARY OF OPERATIONS					
Total interest income	$5,123	$5,217	$5,129	$4,948	$4,938
Total interest expense	(726)	(744)	(792)	(843)	(858)
NET INTEREST INCOME (NII)	4,397	4,473	4,337	4,105	4,080
Provision for loan losses	(150)	(150)	(150)	(150)	(150)
NII after loss provision	4,247	4,323	4,187	3,955	3,930
Investment security gains (losses) including impairment losses	141	319	(1,894)	559	101
Mortgage banking gains	117	81	56	109	638
Other income	689	651	692	573	590
Total non-interest expense	(3,909)	(3,623)	(3,966)	(4,467)	(4,256)
Income (loss) before tax expense (benefit)	1,285	1,751	(925)	729	1,003
Federal income tax expense (benefit)	246	419	(463)	112	204
Net income (loss)	$1,039	$1,332	$(462)	$617	$799
PER COMMON SHARE DATA (1)					
Net earnings (loss)	$0.23	$0.29	$(0.11)	$0.14	$0.18
Book value	12.01	11.55	10.94	10.85	10.80
BALANCE SHEET DATA					
Assets	$534,417	$525,926	$556,918	$536,577	$537,809
Investments	178,592	169,975	168,133	158,102	172,827
Loans	316,567	312,223	346,833	314,927	301,912
Allowance for loan losses	4,134	4,051	3,764	3,943	4,145
Deposits	425,065	417,369	448,669	427,471	430,970
Borrowings	48,435	43,582	51,559	52,677	50,838
Shareholders' equity	54,403	52,309	49,535	49,145	48,886
AVERAGE BALANCES					
Assets	$536,276	$540,817	$529,608	$532,905	$542,259
Investments	179,545	171,123	174,024	179,180	186,017
Loans	314,826	331,489	314,171	304,350	299,504
Deposits	424,119	425,772	426,522	428,817	435,937
Borrowings	50,160	54,769	46,499	48,365	49,462
Shareholders' equity	53,231	50,990	49,527	48,326	50,478
ASSET QUALITY RATIOS					
Net (charge-offs) recoveries	$(67)	$137	$(329)	$(352)	$104

Net (charge-offs) recoveries as a percentage of average total loans	(0.09)%	0.17 %	(0.42)%	(0.46)%	0.14 %
Loans 30 days or more beyond their contractual due date as a percent of total loans	1.16 %	1.06 %	0.54 %	0.99 %	1.04 %
Nonperforming loans	$7,578	$5,903	$6,120	$4,701	$4,929
Nonperforming securities	251	303	1,203	1,030	1,010
Other real estate owned	57	—	33	33	87
Total nonperforming assets	$7,886	$6,206	$7,356	$5,764	$6,026
Nonperforming assets as a percentage of:					
Total assets	1.48 %	1.18 %	1.32 %	1.07 %	1.12 %
Equity plus allowance for loan losses	13.48	11.01	13.80	10.84	11.36
Tier I capital	10.79	10.95	13.39	10.18	10.62
FINANCIAL RATIOS					
Return on average equity	7.81 %	10.45 %	(3.73)%	5.11 %	6.33 %
Return on average assets	0.77	0.99	(0.35)	0.46	0.59
Efficiency ratio	70.14	65.31	74.33	86.78	78.45
Effective tax rate	19.14	23.93	(0.50)	15.36	20.34
Net interest margin	3.68	3.70	3.63	3.42	3.34

(1) Earnings per share are based on weighted average shares outstanding. Book value per common share is based on shares outstanding at each period.

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL

CONDITION AND RESULTS OF OPERATIONS

Financial Review

The following is management's discussion and analysis of the financial condition and results of operations of Cortland Bancorp (the Company). The discussion should be read in conjunction with the Consolidated Financial Statements and related notes and summary financial information included elsewhere in this quarterly report.

Note Regarding Forward-looking Statements

The Private Securities Litigation Reform Act of 1995 provides a "safe harbor" for forward-looking statements. In addition to historical information, certain information included in this discussion and other material filed or to be filed by the Company with the Securities and Exchange Commission (as well as information included in oral statements or other written statements made or to be made by the Company) may contain forward-looking statements that involve risks and uncertainties. The words "believes," "expects," "may," "will," "should," "projects," "contemplates," "anticipates," "f "intends," or similar terminology identify forward-looking statements. These statements reflect management's beliefs and assumptions, and are based on information currently available to management.

Economic circumstances, the Company's operations and actual results could differ significantly from those discussed in any forward-looking statements. Some of the factors that could cause or contribute to such differences are changes in the economy and interest rates either nationally or in the Company's market area, including the impact of the impairment of securities; political actions, including failure of the United States Congress to raise the federal debt ceiling or the imposition of changes in the federal budget; changes in customer preferences and consumer behavior; increased competitive pressures or changes in either the nature or composition of competitors; changes in the legal and regulatory environment; changes in factors influencing liquidity, such as expectations regarding the rate of inflation or deflation, currency exchange rates, and other factors influencing market volatility; changes in assumptions underlying the establishment of reserves for possible loan losses, reserves for repurchase of mortgage loans sold and other estimates; and risks associated with other global economic, political and financial factors.

While actual results may differ significantly from the results discussed in the forward-looking statements, the Company undertakes no obligation to update publicly any forward-looking statement for any reason, even if new information becomes available.

Analysis of Assets and Liabilities for the First Six Months

Earning assets are comprised of deposits at financial institutions, including the Federal Reserve Bank, investment securities and loans. Earning assets were $498.0 million at June 30, 2014, a decrease of 4.2% from the December 31, 2013 balance of $519.7 million. The decrease from December 31, 2013 was mainly due to the following: a decrease in deposits at the Federal Reserve of $1.4 million, an increase in investment securities available for sale of $10.0 million offset by a decrease of $27.6 million of 60-day loans redeemed during the first quarter of 2014. Total assets of $534.4 million at June 30, 2014 reflect a decrease of 4.0% from the December 31, 2013 asset total of $556.9 million.

At June 30, 2014, the investment securities available-for-sale portfolio was $170.9 million compared to $160.9 million at December 31, 2013, an increase of $10.0 million, or 6.2%. Investment securities represented 34.3% of earning assets at June 30, 2014, compared to 31.0% at December 31, 2013. As the Company manages its balance sheet for loan growth, asset mix, liquidity and current interest rates and interest rate forecasts, the investment portfolio is a primary source of liquidity. The investment securities available-for-sale portfolio represented 40.2% of each deposit dollar at June 30, 2014, up from 35.9% of year-end levels.

The investment securities available-for-sale portfolio had net unrealized losses of $26,000 at June 30, 2014, a decrease of $2.8 million compared to net unrealized losses of $2.9 million at December 31, 2013.

The Company had an investment in trading securities of $7.7 million at June 30, 2014, with $7.2 million at December 31, 2013. This modest allocation of the securities portfolio into obligations of state and political subdivisions and cash equivalent instruments is intended to diversify the earnings of the portfolio with non-interest income.

Loans held for sale decreased to $56,000 at June 30, 2014 compared to $656,000 at December 31, 2013. The variance is reflective of the recent decline in mortgage banking volume as more fully disclosed in Noninterest Income.

Total loans at June 30, 2014 were $316.6 million compared to $346.8 million at December 31, 2013, a 8.7% decrease. The decrease in loan balances from year-end was, as stated previously, due in part to 60-day term commercial loans for a total of $27.6 million that closed in December 2013 and were fully secured by segregated deposit accounts with the Bank. The loans matured in the first quarter of 2014. Excluding these loans at December 31, 2013, total loans decreased less than 1%. The Company continues its objective of shifting its asset mix into in-market commercial loans with the intent of improving net interest margin. Total gross loans as a percentage of earning assets stood at 63.6% as of June 30, 2014 and 66.7% as of December 31, 2013. The total loan-to-deposit ratio was 74.5% at June 30, 2014 and 77.3% at December 31, 2013.

At June 30, 2014, the allowance for loan losses of $4.1 million represented approximately 1.31% of outstanding loans. The allowance for loan losses at December 31, 2013 of $3.8 million represented approximately 1.09% of outstanding loans, or 1.18% excluding the 60-day term loans to which none of the allowance is allocated.

During the first six months, loan charge-offs were $239,000 in 2014 compared to $207,000 for the same period in 2013, while the recovery of previously charged-off loans amounted to $309,000 in 2014 and $177,000 in 2013. The net recoveries represent 0.04% of average loans for 2014 and the net charge-offs represent 0.02% for the same period in 2013. Charge-offs of specific problem loans, as well as for smaller balance homogeneous loans, are recorded periodically during the year. The number of loan accounts and the amount of charge-off associated with account balances vary from period to period as loans are deemed uncollectible by management. Nonaccrual loans were $3.6 million at June 30, 2014, or 1.1%, of loans, versus $1.9 million, or 0.56%, of loans at December 31, 2013.

Bank-owned life insurance had a cash surrender value of $16.8 million at June 30, 2014 and $15.0 million at December 31, 2013. This increase is due to the purchase of $1.6 million of bank-owned life insurance in 2014 in connection with split-dollar life insurance being expanded to middle management.

Other assets decreased to $8.2 million at June 30, 2014 from $10.9 million at December 31, 2013. Included in other assets is deferred taxes of $3.4 million and $5.5 million as of June 30, 2014 and December 31, 2013, respectively, and Federal income tax receivable of $1.2 million as of December 31, 2013.

At June 30, 2014, a $1.8 million, and at December 31, 2013, a $1.9 million investment in a partnership fund is included in other assets with an offsetting $1.1 million at June 30, 2014 and $1.8 million at December 31, 2013 in other liabilities, which is the commitment to fund this affordable housing investment.

Noninterest-bearing deposits measured $92.2 million at June 30, 2014 compared to $89.9 million at December 31, 2013. Interest-bearing deposits decreased $25.9 million to $332.9 million at June 30, 2014 from $358.8 million at December 31, 2013. The decrease in interest-bearing deposits from year end is due mainly to segregated money market deposit accounts with the Bank which fully collateralized $27.6 million in 60-day term commercial loans that closed in December 2013. The loans matured and the deposits withdrew in the first quarter of 2014.

Federal Home Loan Bank advances and short-term borrowings decreased to $43.3 million at June 30, 2014 from $46.4 million at December 31, 2013. Management continues to use short-term borrowings to bridge its current cash flow needs resulting in variations from period to period.

Other liabilities measured $6.5 million at June 30, 2014 and $7.2 million at December 31, 2013. This decrease is due to a reduction of the liability to fund affordable housing explained earlier.

The Company improved its capital levels in the first half of 2014. The Company’s total shareholders’ equity measured $54.4 million at June 30, 2014 and $49.5 million on December 31, 2013. The Company’s capital continues to meet the requirements for the Company to be deemed well-capitalized under all regulatory measures. The Company’s total risk-based capital is $22.9 million in excess of the 10% threshold for the Company to be well-capitalized.

Cash dividends of $.08 per share were paid to shareholders of record to date in 2014. Cash dividends of $0.12 per share were paid to shareholders of record in 2013. At April 30, 2014, the Company announced an increase in the cash dividend to $0.05 per share. On July 28, 2014, the Company announced an additional $0.05 dividend payable on

August 28, 2014 to shareholders of record as of August 11, 2014.

Capital Resources

Regulatory standards for measuring capital adequacy require banks and bank holding companies to maintain capital based on “risk-adjusted” assets so that categories of assets with potentially higher credit risk require more capital backing than assets with lower risk. In addition, banks and bank holding companies are required to maintain capital to support, on a risk-adjusted basis, certain off-balance sheet activities such as standby letters of credit and interest rate swaps.

The risk-based standards classify capital into two tiers. Tier 1 capital consists of common shareholders’ equity, noncumulative and cumulative perpetual preferred stock, qualifying trust preferred securities and minority interests less intangibles, disallowed deferred tax assets and the unrealized market value adjustment of investment securities available-for-sale. Tier 2 capital consists of a limited amount of the allowance for loan and lease losses, perpetual preferred stock (not included in Tier 1), hybrid capital instruments, term subordinated debt, and intermediate-term preferred stock.

The Federal Financial Institutions Examination Council (FFIEC) determines the risk weightings of direct credit substitutions that have been downgraded below investment grade. Included in the definition of a direct credit substitute are mezzanine and subordinated tranches of trust preferred securities and non-agency collateralized mortgage obligations. Following these guidelines results in an increase in total risk-weighted assets with an attendant decrease in the risk-based capital and Tier 1 risk-based capital ratios.

The Company met all capital adequacy requirements to which it was subject as of June 30, 2014 and December 31, 2013, as supported by the data in the following table. As of those dates, the Company met the capital requirements to be deemed "well capitalized" under regulatory prompt corrective action provisions.

	Actual Regulatory Capital Ratios as of:		Regulatory Capital Ratio Requirements:	
	June 30, 2014	December 31, 2013	Well Capitalized	Adequately Capitalized
Tier I capital to risk-weighted assets	14.76 %	13.26 %	6.00 %	4.00 %
Total risk-based capital to risk-weighted assets	15.84 %	14.19 %	10.00 %	8.00 %
Tier I capital to average assets	10.79 %	10.35 %	5.00 %	4.00 %

Risk-based capital standards require a minimum ratio of 8.00% of qualifying total capital to risk-adjusted total assets with at least 4.00% constituting Tier 1 capital. Capital qualifying as Tier 2 capital is limited to 100.00% of Tier 1 capital. All banks and bank holding companies are also required to maintain a minimum leverage capital ratio (Tier 1 capital to total average assets) in the range of 3.00% to 4.00%, subject to regulatory guidelines.

The Federal Deposit Insurance Corporation Improvement Act of 1991 (FDICIA) requires banking regulatory agencies to revise risk-based capital standards to ensure that they adequately account for the following additional risks: interest rate, concentration of credit, and non-traditional activities. Accordingly, regulators will subjectively consider an institution's exposure to declines in the economic value of its capital due to changes in interest rates in evaluating capital adequacy. The following table illustrates the Company's components of risk weighted capital ratios and the excess over amounts considered well-capitalized at June 30, 2014 and December 31, 2013. Management considers these excesses to be adequate with regard to the risks inherent in the balance sheet.

	(Amounts in thousands)	
	June 30, 2014	December 31, 2013
Tier 1 Capital	$57,746	$54,927
Tier 2 Capital	4,217	3,847
QUALIFYING CAPITAL	$61,963	$58,774

Risk-Adjusted Total Assets*	$391,108	$414,230
Tier 1 Risk- Based Capital Excess	$34,280	$30,073
Total Risk- Based Capital Excess	22,852	17,351
Total Leverage Capital Excess	30,980	28,380

* Includes off-balance sheet exposures

Total assets for leverage capital purposes is calculated as average assets less disallowed deferred tax assets and the net unrealized market value adjustment of investment securities available-for-sale, which averaged $535.3 million and $530.9 million for the quarters ended June 30, 2014 and December 31, 2013, respectively.

Regulations require that investments designated as available-for-sale are marked-to-market with corresponding entries to the deferred tax account and shareholders' equity. Regulatory agencies, however, exclude these adjustments in computing risk-based capital, as their inclusion would tend to increase the volatility of this important measure of capital adequacy.

In early September 2013, the regulatory bodies agreed on the provisions of Basel III which substantially revises the capital requirements for all banks, varying with the size of the institution. The new requirements are to be phased in over four years beginning in 2015. The Company is awaiting further clarification and interpretation of the rules before it can assess the future effect on capital.

Certain Non-GAAP Measures

Certain financial information has been determined by methods other than Generally Accepted Accounting Principles (GAAP). Specifically, certain financial measures are based on core earnings rather than net income. Core earnings exclude income, expense, gains and losses that either are not reflective of ongoing operations or that are not expected to reoccur with any regularity or reoccur with a high degree of uncertainty and volatility. Such information may be useful to both investors and management and can aid them in understanding the Company's current performance trends and financial condition. Core earnings are a supplemental tool for analysis and not a substitute for GAAP net income. Reconciliation from GAAP net income to the non-GAAP measure of core earnings is referenced as part of management's discussion and analysis of financial condition and results of operations.

Core earnings, which exclude certain non-recurring items, increased for the six months ended June 30, 2014 as compared to the six months ended June 30, 2013. Core earnings for the first six months of 2014 were $2.2 million, or $0.50 per share, compared to $1.8 million, or $0.39 per share for the first six months of 2013. Core earnings for the second quarter of 2014 were $1.0 million, or $0.23 per share, compared to $883,000, or $0.20 per share for the second quarter of 2013.

The following is the reconciliation between core earnings and earnings under GAAP.

	(Amounts in thousands, except per share amounts)			
	THREE MONTHS ENDED June 30,		SIX MONTHS ENDED June 30,	
	2014	2013	2014	2013
GAAP earnings	$1,039	$799	$2,371	$1,629
Investment gains not in the ordinary course of business (net of tax)*	—	—	(127)	—
Expenses related to reorganization (net of tax)**	—	84	—	131
Core earnings	$1,039	$883	$2,244	$1,760
Core earnings per share	$0.23	$0.20	$0.50	$0.39

* Sale of securities due to Volcker Rule

** Retail branch staff realignment and middle management restructure.

Analysis of Net Interest Income – Six months ended June 30, 2014 and 2013

Net interest income, the principal source of the Company's earnings, is the amount by which interest and fees generated by interest-earning assets, primarily loans and investment securities, exceed the interest cost of deposits and borrowed funds. On a fully taxable equivalent basis, net interest income measured $9.3 million for June 30, 2014 and $8.6 million for June 30, 2013. The resulting net interest margin was 3.69% for June 30, 2014 and 3.31% for June 30, 2013.

The increase in interest income, on a fully taxable equivalent basis, of $460,000 is the product of a 29 basis point increase in interest rates earned offset somewhat by a 2.5% year-over-year decrease in average earning assets. The decrease in interest expense of $299,000 was a product of an 11 basis point decrease in rates paid and a 5.2% decrease in average interest-bearing liabilities. The net result was a 8.9% increase in net interest income on a fully taxable equivalent basis, and a 38 basis point increase in the Company's net interest margin on a slightly smaller asset base with a different mix.

On a fully taxable equivalent basis, income on investment securities available-for-sale and trading increased by $400,000, or 17.3%. The average invested balances in these securities decreased by $10.2 million, or 5.5%, from the levels of a year ago. The decrease in the average balance of investment securities was accompanied by a 60 basis point increase in the tax equivalent yield of the portfolio. The Company will continue attempting to redeploy liquidity into loans which generate greater yields than securities.

On a fully taxable equivalent basis, income on loans increased by $66,000, or 0.8%, for June 30, 2014 compared to the same period in 2013. A $2.3 million increase in the average balance of the loan portfolio, or 0.7%, was accompanied by no change in the portfolio's tax equivalent yield. Likewise, new loan volume is at historic low interest rates, while strong competition for good credits also drives rates downward. The commercial loan portfolio housed the majority of the increase in balances.

Other interest income decreased by $6,000, or 37.5%, from the same period a year ago. The average balance of interest-earning deposits decreased by $5.2 million, or 44.1%. The yield increased by 5 basis points from 2013 to 2014. Management intends to remain fully invested, minimizing on-balance sheet liquidity.

As the Company is located in the heart of the Utica Shale geography, material deposit growth was experienced in the latter part of 2012 as a result of customers receiving signing bonuses for the lease of mineral rights. Nearly $40 million in new deposits has been attributed to these bonuses. In the first half of 2013, nearly half of these funds were withdrawn by customers affecting primarily the time deposit category. Average interest-bearing demand deposits and money market accounts decreased by $1.6 million, or 1.8%, for the six months ended June 30, 2014 compared to the same period of 2013, while average savings balances decreased by $4.7 million, or 3.9%. Total interest paid on interest-bearing demand deposits and money market accounts was $83,000, a $10,000 decrease from last year. The average rate paid on these products decreased by 2 basis points. Total interest paid on savings accounts was $33,000, a $11,000 decrease from 2013. The average rate paid on savings accounts decreased by 2 basis points. The average balance of time deposit products decreased by $16.3 million, or 11.2%, as the average rate paid decreased by 21 basis points, from 1.35% to 1.14%. Interest expense decreased on time deposits by $244,000 from the prior year. Customers are opting for more liquid accounts versus time deposits in this low rate environment. As time deposits mature, the balances are reinvested at the lower current rates. After an extended period of declining average rates paid on deposits, the Company is experiencing a flattening on a linked quarter basis.

Average borrowings and subordinated debt increased by $1.3 million while the average rate paid on borrowings decreased by 20 basis points. Management has paid down long-term borrowings at their respective maturity dates using current liquidity and continues to utilize short-term borrowings to bridge liquidity gaps. Approximately $16 million in upcoming maturing long-term advances are expected to be refinanced at substantially reduced rates.

Impairment Analysis of Investment Securities

The Company owns two trust preferred securities totaling $1.8 million (par value) consisting of collateral issued by banks, thrifts, and insurance companies. The market for these securities at June 30, 2014 is not fully active and markets for similar securities are also not completely active. Given conditions in the debt markets today and the absence of observable transactions in the secondary and new issue markets, the Company determined the few observable transactions and market quotations that are available are not reliable for purposes of determining fair value at June 30, 2014. It was decided that an income valuation approach technique (present value technique) that maximizes the use of relevant observable inputs and minimizes the use of unobservable inputs would be more representative of fair value than the market approach valuation technique used at measurement dates prior to 2008.

The Company enlisted the aid of an independent third party to perform the trust preferred securities valuations. The approach to determining fair value involved the following process:

1. Estimate the credit quality of the collateral using average probability of default values for each issuer (adjusted for rating levels).
2. Consider the potential for correlation among issuers within the same industry for default probabilities (e.g. banks with other banks).
3. Forecast the cash flows for the underlying collateral and apply to each trust preferred security tranche to determine the resulting distribution among the securities.
4. Discount the expected cash flows to calculate the present value of the security.

The effective fair value discount rates on an overall basis generally range from 11.19% to 16.40% and are highly dependent upon the credit quality of the collateral, the relative position of the tranche in the capital structure of the trust preferred securities and the prepayment assumptions.

Based upon the results of the analysis, the Company currently believes that a weighted average price of approximately $0.38 per $1.00 of par value is representative of the fair value of the two trust preferred securities, with individual securities therein ranging from $0.31 to $0.43.

The Company considered all information available as of June 30, 2014 to estimate the impairment and resulting fair value of the trust preferred securities. These securities are supported by a number of banks and insurance companies located throughout the country. While the number of bank failures has declined since the historically high failure rates of 2009, 2010 and 2011, there is still the potential for troubled banks to fail. The Company did not recognize any credit related impairment in the first six months of 2014 or 2013. If the conditions of the underlying banks in the trust preferred securities worsen, there may be additional impairment to recognize in 2014 or later.

Analysis of Provision, Non-Interest Income, Non-Interest Expense and Federal Income Tax - Six Months Ended June 30, 2014 and 2013

During the first six months of both 2013 and 2014, the amount charged to operations as a provision for loan losses was adjusted to account for charge-offs against the allowance, as well as an increase in loan balances recorded in the portfolio, expected losses on specific problem loans and several qualitative factors, including factors specific to the local economy and to industries operating in the local market. The Company has allocated a portion of the allowance for a number of specific problem loans through 2013 and 2014, but has not experienced significant deterioration in any loan type, including the residential real estate portfolios or the commercial loan portfolio, and accordingly has not added any special provision for these loan types. For the six months ended June 30, 2014, the provision for loan losses was $300,000 along with net recoveries of $70,000. For the same period in 2013, the provision was $350,000, which substantially exceeded net charge-offs of $30,000. Provision expense levels are in recognition of loan growth and a changing composition of the loan portfolio as the Company manages its balance sheet with a commercially-oriented focus.

Total non-interest income, excluding investment gains, decreased by $1.0 million, or 39.7%, for June 30, 2014 compared to June 30, 2013. After gains on investment securities and impairment losses, non-interest income decreased by $652,000, or 24.6%, in the first half of 2014 compared to the first half of 2013.

Gains on securities called and net gains on the sale of available-for-sale investment securities increased by $41,000 in the first half of 2014 from year ago levels. The Company sold ten trust preferred securities (including all of the nine iTruPS) accounting for the entire gain in 2014. Trading security gains of $267,000 was recorded in 2014, with a loss of $51,000 in 2013.

The wholesale mortgage unit, CSB Mortgage Company, which was formed in 2011 specifically as a result of strategic initiatives aimed at improving overall profitability, saw mortgage banking gains reach $1.3 million at June 30, 2013. The application volume driving the revenues declined substantially in 2013. The persistent rise in mortgage rates that began in May 2013 caused the Company’s application volume to decline. With the dramatic volume decrease and the prospects for any turnaround considered improbable in the near term, the Company curtailed portions of its mortgage banking activities. Originations from the wholesale channel and all out-of-market retail origination were closed down as of September 13, 2013. In addition to the origination channels, operational staff were also severed in order to right-size the business line with expected volume. The result is a decrease in mortgage banking gains of $1.1 million to $198,000 at June 30, 2014.

Fees for customer services increased by $45,000, or 5.0%, driven by customer activities. Wealth management income of $165,000 was recorded in 2014, compared to $65,000 in 2013. As a revenue diversification initiative, the Company continues to expand wealth management efforts. Advisors sell non-deposit investment products to customers in the Bank’s branch network through a third party marketing and sales support provider. As assets under management grow, fee income paid by the third party provider of non-deposit investment products will continue to enhance non-interest income revenue. Other sources of non-interest income decreased by $28,000 from the same period a year ago. This latter income category is subject to fluctuation due to the non-recurring nature of some of the items.

Total non-interest expenses in the first six months were $7.5 million in 2014 compared to $8.4 million in 2013, a decrease of $914,000, or 10.8%. During the first half of 2014, expenditures for salaries and employee benefits decreased by $523,000, or 10.4%, from the similar period a year ago. Much of this decrease is due to branch restructuring initiatives and the strategic decision management made during the third quarter of 2013 to close the wholesale mortgage operations discussed above. Full time equivalent employment averaged 152 during the first half of 2014 and 166 during the first half of 2013.

All other expense categories decreased by 11.4%, or $391,000 in the aggregate. These expense categories are subject to fluctuation due to non-recurring items. The majority of these decreases relate to the restructuring and curtailment of wholesale mortgage operations in 2013. This also contributed to an improvement in the efficiency ratio from 76.4% for the first half of 2013 to 67.7% for the first half of 2014.

The effective tax rate for the first six months was 21.9% in 2014 and 21.2% in 2013, resulting in income tax expense of $665,000 in 2014 and $439,000 in 2013. These effective rates are normalized tax rates based on the current rate of profitability and tax free components of the revenue stream.

The provision for income taxes differs from the amount of income tax determined applying the applicable U.S. statutory federal income tax rate (34%) to pre-tax income as a result of the following differences:

	(Amounts in thousands) June 30, 2014 Balance	%	2013 Balance	%
Provision at statutory rate	$1,032	34.0	$703	34.0
Add (Deduct):				
Tax effect of earnings on bank-owned life insurance-net	(55)	(1.8)	(63)	(3.0)
Tax effect of non-taxable interest income	(303)	(10.0)	(234)	(11.3)
Tax effect of low income housing credit	(26)	(0.9)	—	—
Tax effect of non-deductible expenses	17	0.6	33	1.5
Federal income tax expense	$665	21.9	$439	21.2

Analysis of Net Interest Income – Second quarter ended June 30, 2014 and 2013

Net interest income, the principal source of the Company’s earnings, is the amount by which interest and fees generated by interest-earning assets, primarily loans and investment securities, exceed the interest cost of deposits and borrowed funds. On a fully taxable equivalent basis, net interest income measured $4.6 million for June 30, 2014 and $4.3 million for June 30, 2013. The resulting net interest margin was 3.68% for June 30, 2014 and 3.34% for June 30, 2013.

The increase in interest income, on a fully taxable equivalent basis, of $232,000 is the product of a 24 basis point increase in interest rates earned offset somewhat by a 1.5% year-over-year decrease in average earning assets. The decrease in interest expense of $132,000 was a product of a 10 basis point decrease in rates paid and a 4.3% decrease in average interest-bearing liabilities. The net result was a 8.5% increase in net interest income on a fully taxable equivalent basis, and a 34 basis point increase in the Company’s net interest margin on a slightly smaller asset base with a different mix.

On a fully taxable equivalent basis, income on investment securities available-for-sale and trading increased by $200,000, or 17.0%. The average invested balances in these securities decreased by $6.5 million, or 3.5%, from the levels of a year ago. The decrease in the average balance of investment securities was accompanied by a 53 basis point increase in the tax equivalent yield of the portfolio. The Company will continue attempting to redeploy liquidity into loans which generate greater yields than securities.

On a fully taxable equivalent basis, income on loans increased by $37,000, or 0.9%, for the second quarter of 2014 compared to the same period in 2013. A $4.0 million increase in the average balance of the loan portfolio, or 1.3%, was accompanied by a 5 basis point decrease in the portfolio’s tax equivalent yield. Likewise, new loan volume is at historic low interest rates, while strong competition for good credits also drives rates downward. The commercial loan portfolio housed the majority of the increase in balances.

Other interest income decreased by $5,000, or 50.0%, from the same period a year ago. The average balance of interest-earning deposits decreased by $5.1 million, or 40.4%. The yield decreased by 1 basis point in the second quarter of 2014 compared to the same period in 2013. Management intends to remain fully invested, minimizing on-balance sheet liquidity.

As the Company is located in the heart of the Utica Shale geography, material deposit growth was experienced in the latter part of 2012 as a result of customers receiving signing bonuses for the lease of mineral rights. Nearly $40 million in new deposits has been attributed to these bonuses. In the first half of 2013, nearly half of these funds were withdrawn by customers affecting primarily the time deposit category. Average interest-bearing demand deposits and money market accounts decreased by $1.3 million, or 1.5%, for the quarter ended June 30, 2014 compared to the same period of 2013, while average savings balances decreased by $3.4 million, or 2.9%. Total interest paid on interest-bearing demand deposits and money market accounts was the same for both years. The average rate paid on these products decreased by 1 basis point. Total interest paid on savings accounts was $17,000, a $5,000 decrease from 2013. The average rate paid on savings accounts decreased by 1 basis point. The average balance of time deposit products decreased by $13.4 million, or 9.3%, as the average rate paid decreased by 17 basis points, from 1.30% to 1.13%. Interest expense decreased on time deposits by $108,000 from the prior year. Customers are opting for more liquid accounts versus time deposits in this low rate environment. As time deposits mature, the balances are reinvested at the lower current rates. After an extended period of declining average rates paid on deposits, the Company is experiencing a flattening on a linked quarter basis.

Average borrowings and subordinated debt increased by $698,000 while the average rate paid on borrowings decreased by 19 basis points. Management has paid down long-term borrowings at their respective maturity dates using current liquidity and continues to utilize short-term borrowings to bridge liquidity gaps. Approximately $16 million in upcoming maturing long-term advances are expected to be refinanced at substantially reduced rates.

Analysis of Provision, Non-Interest Income, Non-Interest Expense and Federal Income Tax - Second Quarter Ended June 30, 2014 and 2013

For the second quarter ended June 30, 2014, the provision for loan losses was $150,000, which substantially exceeded net charge-offs of $67,000. For the same period in 2013, the provision was also $150,000 along with net recoveries of $104,000. Provision expense levels are in recognition of loan growth and a changing composition of the loan portfolio as the Company manages its balance sheet with a commercially-oriented focus.

Total non-interest income, excluding investment gains, decreased by $473,000, or 37.0%, for the quarter ended June 30, 2014 compared to the same quarter in 2013. After gains on investment securities and impairment losses, non-interest income decreased by $433,000, or 31.4%, in the second quarter of 2014 compared to the second quarter of 2013.

Gains on securities called and net gains on the sale of available-for-sale investment securities decreased by $152,000 in the second quarter of 2014 from year ago levels. Trading security gains increased by $192,000 from a loss of $51,000 to a gain of $141,000.

Mortgage banking gains decreased $521,000 from $638,000 for the quarter ended June 30, 2013 to $117,000 for the quarter ended June 30, 2014. The decrease is due to the curtailment of portions of its mortgage banking activities explained earlier.

Wealth management income of $84,000 was recorded in the second quarter of 2014 compared to $40,000 in the same quarter of 2013. As a revenue diversification initiative, the Company continues to expand wealth management efforts. Other sources of non-interest income increased by $4,000 from the same quarter a year ago. This latter income category is subject to fluctuation due to the non-recurring nature of some of the items.

Total non-interest expenses in the second quarter were $3.9 million in 2014 compared to $4.3 million in 2013, a decrease of $398,000, or 9.2%.

During the second quarter of 2014, expenditures for salaries and employee benefits decreased by $239,000, or 9.4%, from the same quarter a year ago. Much of this decrease is due to branch restructuring initiatives and the strategic decision management made during the third quarter of 2013 to close the wholesale mortgage operations discussed above.

All other expense categories decreased by 9.0%, or $159,000 in the aggregate. These expense categories are subject to fluctuation due to non-recurring items. The majority of these decreases relate to the restructuring and curtailment of wholesale mortgage operations. This also contributed to an improvement in the efficiency ratio from 78.5% for the second quarter of 2013 to 70.1% for the second quarter of 2014.

Liquidity

The central role of the Company's liquidity management is to (1) ensure sufficient liquid funds to meet the normal transaction requirements of its customers, (2) take advantage of market opportunities requiring flexibility and speed, and (3) provide a cushion against unforeseen liquidity needs.

Liquidity risk arises from the possibility that the Company may not be able to satisfy current or future financial commitments or may become unduly reliant on alternative funding sources. The objective of liquidity management is to ensure the Company has the ability to fund balance sheet growth and meet deposit and debt obligations in a timely and cost-effective manner. Management monitors liquidity through a regular review of asset and liability maturities, funding sources, and loan and deposit forecasts. The Company maintains strategic and contingency liquidity plans to ensure sufficient available funding to satisfy requirements for balance sheet growth, proper management of capital markets funding sources and addressing unexpected liquidity requirements.

Principal sources of liquidity available to the Company include assets considered relatively liquid, such as interest-bearing deposits in other banks, federal funds sold and, cash and due from banks, as well as cash flows from maturities and repayments of loans, investment securities and mortgage-backed securities.

In order to address the concern of FDIC insurance of larger depositors, the Bank is a member of the Certificate of Deposit Account Registry Service (CDARS®) program and the Insured Cash Sweep (ICS) program. Through CDARS®, the Bank’s customers can increase their FDIC insurance by up to $50.0 million through reciprocal certificate of deposit accounts and likewise through ICS, they can accomplish the same through money market savings accounts. This is accomplished by the Bank entering into reciprocal depository relationships with other member banks. The individual customer’s large deposit is broken into amounts below $250,000 and placed with other banks that are members of the network. The reciprocal member bank issues certificates of deposit or money market savings accounts in amounts that ensure that the entire deposit is eligible for FDIC insurance. At June 30, 2014, the Bank had

$5 million of deposits in the CDARS® program, and had $3.0 million of deposits in the ICS money market program. For regulatory purposes, CDARS® and ICS are considered a brokered deposit.

Along with its liquid assets, the Bank has other sources of liquidity available to it which help to ensure that adequate funds are available as needed. These other sources include, but are not limited to, the ability to obtain deposits through the adjustment of interest rates, the purchasing of federal funds, correspondent bank lines of credit and access to the Federal Reserve Discount Window. The Bank is also a member of the Federal Home Loan Bank of Cincinnati, which provides its largest source of liquidity. At June 30, 2014, the Bank had approximately $18.2 million available of collateral-based borrowing capacity at FHLB of Cincinnati, supplementing the $3.4 million of availability with the Federal Reserve Discount window. Additionally, the FHLB has committed a $25.8 million cash management line, of which nothing has been disbursed, subject to posting additional collateral. The Bank, by policy, has access to approximately 5% of total deposits in brokered certificates of deposit that could be used as an additional source of liquidity. At June 30, 2014, there was a $6.0 million outstanding balance in brokered certificates of deposit. The Company was also granted a total of $8.5 million in unsecured, discretionary Federal Funds lines of credit with no funds drawn upon as of June 30, 2014. Unpledged securities of $48.7 million are also available for borrowing under repurchase agreements or as additional collateral for FHLB lines of credit or to sell to generate liquidity.

The Company has other more limited sources of liquidity. In addition to its existing liquid assets, it can raise funds in the securities market through debt or equity offerings or it can receive dividends from its bank subsidiary. Generally, the Bank may pay dividends without prior approval as long as the dividend is not more than the total of the current calendar year-to-date earnings plus any earnings from the previous two years not already paid out in dividends, as long as the Bank remains well-capitalized after the dividend payment. The amount available for dividend at June 30, 2014 is $6.4 million. Future dividend payments by the Bank to the Company are based upon future earnings. The Holding Company had cash of $26,000 at June 30, 2014 available to meet cash needs. It also held a $6.0 million note receivable, the cash flow from which approximates the debt service on the Junior Subordinated Debentures. Cash is generally used by the Holding Company to pay quarterly interest payments on the debentures, pay dividends to common shareholders and to fund operating expenses.

Cash and cash equivalents decreased from $18.2 million at June 30, 2013 and $12.4 million at December 31, 2013 to $11.7 million at June 30, 2014, as the Company strives to be fully invested, minimizing on balance sheet liquidity. The large decrease from June 30, 2013 is due to a $8.4 million decrease in deposits at the Federal Reserve Bank used to fund earning assets.

The following table details the cash flows from operating activities for the six months ended:

	(Amounts in thousands) June 30,	
	2014	2013
Net income	$2,371	$1,629
Adjustments to reconcile net income to net cash flows from operating activities:		
Depreciation, amortization and accretion	1,210	1,762
Provision for loan loss	300	350
Investment securities gains	(193)	(152)
Other real estate gains	(19)	(13)
Originations of mortgage banking loans held for sale	(6,581)	(181,477)
Proceeds from the sale of mortgage banking loans	7,379	193,101

Net mortgage banking income	(198)	(1,326)
Increase in trading account	(432)	(6,949)
Earnings on bank-owned life insurance	(161)	(183)
Proceeds from IRS refund	1,065	933
Changes in:		
Deferred taxes	562	416
Prepaid FDIC assessment	—	1,187
Other assets and liabilities	(933)	(805)
Net cash flows from operating activities	$4,370	$8,473

Key variations stem from: 1) Provision for loan losses decreased by $50,000 in 2014 from 2013. 2) Gains were recognized on the sale of available-for-sale investments of $193,000 at June 30, 2014 due to the sale of the iTruPS with $152,000 recognized in the same period of 2013. 3) In 2014, a refund of $1.1 million was received from the IRS and in 2013, a refund of $933,000 was received from the IRS. 4) Loans held for sale decreased by $600,000 in 2014 compared to a decrease of $10.3 million in 2013 due to the impact of interest rates on activity of mortgage banking and the exit from wholesale operations in September 2013. 5) A purchase of trading securities was made in April 2013 for $7.0 million. 6) In June 2013, a refund of $1.1 million FDIC assessment was received. Refer to the Consolidated Statements of Cash Flows for a summary of the sources and uses of cash for 2014 and 2013.

Critical Accounting Policies and Estimates

The discussion and analysis of the Company's financial condition and results of operation are based upon the Consolidated Financial Statements, which have been prepared in accordance with U.S. Generally Accepted Accounting Principles (GAAP). The preparation of these consolidated financial statements requires management to make estimates and judgments that affect the reported amounts of assets and liabilities, revenues and expenses, and related disclosures of contingent assets and liabilities at the date of the Company's consolidated financial statements. Actual results may differ from these estimates under different assumptions or conditions.

Certain accounting policies involve significant judgments and assumptions by management which has a material impact on the carrying value of certain assets and liabilities; management considers such accounting policies to be critical accounting policies. The judgments and assumptions used by management are based on historical experience and other factors, which are believed to be reasonable under the circumstances.

Management believes the following are critical accounting policies that require the most significant judgments and estimates used in the preparation of the Company's consolidated financial statements.

Accounting for the Allowance for Loan Losses

The determination of the allowance for loan losses and the resulting amount of the provision for loan losses charged to operations reflects management's current judgment about the credit quality of the loan portfolio and takes into consideration changes in lending policies and procedures, changes in economic and business conditions, changes in the nature and volume of the portfolio and, in the terms of loans, changes in the experience, ability and depth of lending management, changes in the volume and severity of past due, non-accrual and adversely classified or graded loans, changes in the quality of the loan review system, changes in the value of underlying collateral for collateral-dependent loans, the existence and effect of any concentrations of credit and the effect of competition, legal and regulatory requirements and other external factors. The nature of the process by which we determine the appropriate allowance for loan losses requires the exercise of considerable judgment. While management utilizes its best judgment and information available, the ultimate adequacy of the allowance is dependent upon a variety of factors beyond our control, including the performance of the loan portfolio, the economy, changes in interest rates and the view of the regulatory authorities toward loan classifications. The allowance is increased by the provision for loan losses and decreased by charge-offs when management believes the uncollectibility of a loan is confirmed. Subsequent recoveries, if any, are credited to the allowance. A weakening of the economy or other factors that adversely affect asset quality could result in an increase in the number of delinquencies, bankruptcies or defaults and a higher level of non-performing assets, net charge offs, and provision for loan losses in future periods.

The Company's allowance for loan losses methodology consists of three elements: specific valuation allowances based on probable losses on specific loans; valuation allowances based on historical loan loss experience for similar loans with similar characteristics and trends; and general valuation allowances based on general economic conditions and other qualitative risk factors both internal and external to the Company. These elements support the basis for determining allocations between the various loan categories and the overall adequacy of our allowance to provide for probable losses inherent in the loan portfolio.

With these methodologies, a general allowance is established for each loan type based on historical losses for each loan type in the portfolio. Additionally, management allocates a specific allowance for "Impaired Credits," which is based on current information and events; it is probable the Company will not collect all amounts due according to the original contractual terms of the loan agreement. The level of the general allowance is established to provide coverage for management's estimate of the credit risk in the loan portfolio by various loan segments not covered by the specific allowance. Additional information regarding allowance for credit losses can be found in the Notes to the Consolidated

Financial Statements (Note 4) and elsewhere in this Management's Discussion and Analysis.

Investment Securities and Impairment

The classification and accounting for investment securities is discussed in detail in Note 3 of the Consolidated Financial Statements. Investment securities must be classified as held-to-maturity, available-for-sale, or trading. The appropriate classification is based partially on our ability to hold the securities to maturity and largely on management's intentions, if any, with respect to either holding or selling the securities. The classification of investment securities is significant since it directly impacts the accounting for unrealized gains and losses on securities. Unrealized gains and losses on trading securities, if any, flow directly through earnings during the periods in which they arise, whereas available-for-sale securities are recorded as a separate component of shareholders' equity (accumulated other comprehensive income or loss) and do not affect earnings until realized. The fair values of our investment securities are generally determined by reference to quoted market prices and reliable independent sources. At each reporting date, the Company assesses whether there is an "other-than-temporary" impairment to the Company's investment securities. Such impairment must be recognized in current earnings rather than in other comprehensive income (loss).

The Company reviews investment debt securities on an ongoing basis for the presence of other-than-temporary impairment (OTTI) with formal reviews performed quarterly. OTTI losses on individual investment securities are recognized in accordance with FASB ASC topic 320, Investments – Debt and Equity Securities. The purpose of this ASC is to provide greater clarity to investors about the credit and noncredit component of an OTTI event and to communicate more effectively when an OTTI event has occurred. This ASC amends the OTTI guidance in GAAP for debt securities, improves the presentation and disclosure of OTTI on investment securities and changes the calculation of the OTTI recognized in earnings in the financial statements. This ASC does not amend existing recognition and measurement guidance related to OTTI of equity securities.

For debt securities, ASC topic 320 requires an entity to assess whether it has the intent to sell the debt security or it is more-likely-than-not that it will be required to sell the debt security before its anticipated recovery. If either of these conditions is met, an OTTI on the security must be recognized.

In instances in which a determination is made that a credit loss (defined as the difference between the present value of the cash flows expected to be collected and the amortized cost basis) exists but the entity does not intend to sell the debt security and it is not more-likely-than-not that the entity will be required to sell the debt security before the anticipated recovery of its remaining amortized cost basis (i.e., the amortized cost basis less any current-period credit loss), ASC topic 320 changes the presentation and amount of the OTTI recognized in the income statement.

In these instances, the impairment is separated into the amount of the total impairment related to the credit loss and the amount of the total impairment related to all other factors. The amount of the total other-than-temporary impairment related to the credit loss is recognized in earnings. The amount of the total impairment related to all other factors is recognized in other comprehensive income (loss). The total OTTI is presented in the income statement with an offset for the amount of the total OTTI that is recognized in other comprehensive income (loss). In determining the amount of impairment related to credit loss, the Company uses a third party discounted cash flow model, several inputs for which require estimation and judgment. Among these inputs are projected deferral and default rates and estimated recovery rates. Realization of events different than that projected could result in a large variance in the values of the securities.

Income Taxes

The provision for income taxes is based on income reported for financial statement purposes and differs from the amount of taxes currently payable, since certain income and expense items are reported for financial statement purposes in different periods than those for tax reporting purposes. Accrued taxes represent the net estimated amount due or to be received from taxing authorities. In estimating accrued taxes, the Company assesses the relative merits and risks of the appropriate tax treatment of transactions taking into account statutory, judicial and regulatory guidance in the context of the Company’s tax position.

The Company accounts for income taxes using the asset and liability approach, the objective of which is to establish deferred tax assets and liabilities for the temporary differences between the financial reporting basis and tax basis of our assets and liabilities at enacted tax rates expected to be in effect when such amounts are realized or settled. The Company conducts periodic assessments of deferred tax assets, including net operating loss carryforwards, to determine if it is more-likely-than-not that they will be realized. In making these assessments, the Company considers taxable income in prior periods, projected future taxable income, potential tax planning strategies and projected future reversals of deferred tax items. These assessments involve a certain degree of subjectivity which may change significantly depending on the related circumstances.

Authoritative Accounting Guidance

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. For nonpublic entities, the amendments are effective for fiscal years, and interim periods within those years, beginning after December 15, 2014. Early adoption is permitted. The amendments should be applied prospectively to all unrecognized tax benefits that exist at the effective date. Retrospective application is permitted. The Company does not expect this ASU to have a material effect on the Company’s financial position or results of operations.

In January 2014, FASB issued ASU 2014-01, Investments – Equity Method and Join 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 Company'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 requirements 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 Company's financial statements.

In May 2014, the FASB issued ASU 2014-09, Revenue from Contracts with Customers (a new revenue recognition standard). The Update's core principle is that a company will recognize revenue to depict the transfer of goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. In addition, this update specifies the accounting for certain costs to obtain or fulfill a contract with a customer and expands disclosure requirements for revenue recognition. This Update is effective for annual reporting periods beginning after December 15, 2016, including interim periods within that reporting period. The Company is evaluating the effect of adopting this new accounting Update.

In June 2014, the FASB issued ASU 2014-11, Transfers and Servicing (Topic 860): Repurchase-to-Maturity Transactions, Repurchase Financings, and Disclosures. The amendments in this Update change the accounting for repurchase-to-maturity transactions to secured borrowing accounting. For repurchase financing arrangements, the amendments require separate accounting for a transfer of a financial asset executed contemporaneously with a repurchase agreement with the same counterparty, which will result in secured borrowing accounting for the repurchase agreement. The amendments also require enhanced disclosures. The accounting changes in this Update are effective for the first interim or annual period beginning after December 15, 2014. An entity is required to present changes in accounting for transactions outstanding on the effective date as a cumulative-effect adjustment to retained earnings as of the beginning of the period of adoption. Earlier application is prohibited. The disclosure for certain transactions accounted for as a sale is required to be presented for interim and annual periods beginning after December 15, 2014, and the disclosure for repurchase agreements, securities lending transactions, and repurchase-to-maturity transactions accounted for as secured borrowings is required to be presented for annual periods beginning after December 15, 2014, and for interim periods beginning after March 15, 2015. The disclosures are not required to be presented for comparative periods before the effective date. This Update is not expected to have a significant impact on the Company's financial statements.

In June 2014, the FASB issued ASU 2014-12, Compensation-Stock Compensation (Topic 718): Accounting for Share-Based Payments when the Terms of an Award Provide that a Performance Target Could Be Achieved After the Requisite Service Period. The amendments require that a performance target that affects vesting and that could be achieved after the requisite service period be treated as a performance condition. The amendments in this Update are effective for annual periods and interim periods within those annual periods beginning after December 15, 2015. Earlier adoption is permitted. Entities may apply the amendments in this Update either (a) prospectively to all awards granted or modified after the effective date or (b) retrospectively to all awards with performance targets that are outstanding as of the beginning of the earliest annual period presented in the financial statements and to all new or modified awards thereafter. If retrospective transition is adopted, the cumulative effect of applying this Update as of the beginning of the earliest annual period presented in the financial statements should be recognized as an adjustment to the opening retained earnings balance at that date. Additionally, if retrospective transition is adopted, an entity may use hindsight in measuring and recognizing the compensation cost. This Update is not expected to have a significant impact on the Company’s financial statements.

Available Information

The Company files an annual report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and amendments to those reports with the Securities and Exchange Commission (SEC) pursuant to Section 13(a) or 15(d) of the Exchange Act of 1934

Amended (the Exchange Act). The Company's website is www.cortland-banks.com. The Company makes available through its website, free of charge, the reports filed with the SEC, as soon as reasonably practicable after such material is electronically filed, or furnished to, the SEC. The SEC also maintains a website that contains reports, proxy and information statements, and other information regarding issuers that file electronically with the SEC at www.sec.gov. The public may read and copy any materials filed with the Commission at the SEC's Public Reference Room at 100 F Street, NE, Washington, DC 20549, on official business days during the hours of 10:00 am to 3:00 pm. The public may obtain information on the operation of the Public Reference Room by calling the Commission at 1-800-SEC-0330.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

There have been no material changes in the quantitative and qualitative information about market risk from the information provided in the Company’s Form 10-K for the year ended December 31, 2013.

ITEM 4. CONTROLS AND PROCEDURES

Evaluation of Disclosure Controls and Procedures. With the supervision and participation by management, including the Company's principal executive officer and principal financial officer, the effectiveness of disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934 (the "Exchange Act")) has been evaluated as of the end of the period covered by this report. Based upon that evaluation, the Company's principal executive officer and principal financial officer have concluded that these controls and procedures were effective.

Changes in Internal Control Over Financial Reporting. Our Chief Executive Officer and Chief Financial Officer have concluded that there have been no significant changes during the period covered by this report in the Company's internal control over financial reporting (as defined in Rules 13a-13 and 15d-15 of the Exchange Act) that have materially affected, or are reasonably likely to materially affect, internal control over financial reporting.

PART II—OTHER INFORMATION

Item 1. Legal Proceedings

See Note (5) of the financial statements.

Item 1A. Risk Factors

There have been no material changes in the risk factors disclosed by the Company in its Report on Form 10-K for the fiscal year ended December 31, 2013.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds—Not applicable

Company's Common Stock—There were no repurchases of shares of the Company's common stock during the six months ended June 30, 2014.

Item 3. Defaults upon Senior Securities—Not applicable

Item 4. Mine Safety Disclosures—Not applicable

Item 5. Other Information—Not applicable

CORTLAND BANCORP AND SUBSIDIARIES

INDEX TO EXHIBITS

Item 6. Exhibits—The following exhibits are filed or incorporated by reference as part of this report:

Exhibit No.	Exhibit Description	Incorporated by Reference Form**	Exhibit	Filing Date	Filed Herewith
3.1	Restated Amended Articles of Cortland Bancorp reflecting amendment dated June 25, 1999. Note: filed for purposes of SEC reporting compliance only. This restated document has not been filed with the State of Ohio.	10-K(1)	3.1	03/16/06	
3.2	Code of Regulations, as amended:				
	For the Bancorp	10-K(1)	3.2	03/16/06	
	For Cortland Savings and Banking	10-K	3.2	03/15/07	
4.1	The rights of holders of equity securities are defined in portions of the Articles of Incorporation and Code of Regulations as referenced in Exhibits 3.1 and 3.2	10-K(1)	4.1	03/16/06	
4.2	Agreement to furnish instruments and agreements defining rights of holders of long-term debt				ü
*10.1	Group Term Carve Out Plan dated February 23, 2001, by The Cortland Savings and Banking Company with each executive officer other than Rodger W. Platt and with selected other officers, as amended by the August 2002 letter amendment	10-K(1)	10.1	03/16/06	
*10.2	Group Term Carve Out Plan Amended Split Dollar Policy Endorsement entered into by The Cortland Savings and Banking Company on December 15, 2003 with Stephen A. Telego, Sr.	10-K(1)	10.2	03/16/06	
*10.3	Amended Director Retirement Agreement between Cortland Bancorp and Jerry A. Carleton, dated as of December 18, 2007	10-K	10.3	03/17/08	
*10.4	Amended Director Retirement Agreement between Cortland Bancorp and David C. Cole, dated as of December 18, 2007	10-K	10.4	03/17/08	
*10.5	Amended Director Retirement Agreement between Cortland Bancorp and George E. Gessner, dated as of December 18, 2007	10-K	10.5	03/17/08	
*10.6	Amended Director Retirement Agreement between Cortland Bancorp and William A. Hagood, dated as of October 12, 2003	10-K(1)	10.6	03/16/06	

*10.7	Amended Director Retirement Agreement between Cortland Bancorp and James E. Hoffman III, dated as of December 18, 2007	10-K	10.7	03/17/08
*10.8	Amended Director Retirement Agreement between Cortland Bancorp and Neil J. Kaback, dated as of December 18, 2007	10-K	10.8	03/17/08
*10.9	Director Retirement Agreement between Cortland Bancorp and K. Ray Mahan, dated as of March 1, 2001	10-K(1)	10.9	03/16/06
*10.10	Amended Director Retirement Agreement between Cortland Bancorp and Richard B. Thompson, dated as of December 18, 2007	10-K	10.10	03/17/08
*10.11	Amended Director Retirement Agreement between Cortland Bancorp and Timothy K. Woofter, dated as of December 18, 2007	10-K	10.11	03/17/08

Exhibit No.	Exhibit Description	Incorporated by Reference Form**	Exhibit	Filing Date	Filed Herewith
*10.12	Form of Split Dollar Agreement entered into by Cortland Bancorp and each of Directors David C. Cole, George E. Gessner, William A. Hagood, James E. Hoffman III, K. Ray Mahan, and Timothy K. Woofter as of February 23, 2001, as of March 1, 2004, with Director Neil J. Kaback, and as of October 1, 2001, with Director Richard B. Thompson;	10-K(1)	10.12	03/16/06	
	as amended on December 26, 2006, for Directors Cole, Gessner, Hoffman, Mahan, Thompson, and Woofter;	10-K	10.12	03/15/07	
	Amended Split Dollar Agreement and Endorsement entered into by Cortland Bancorp as of December 18, 2007, with Director Jerry A. Carleton	10-K	10.12	03/17/08	
*10.13	Director's Retirement Agreement between Cortland Bancorp and Director Joseph E. Koch, dated as of April 19, 2011	8-K	10.13	04/22/11	
*10.14	Split Dollar Agreement and Endorsement between Cortland Bancorp and Director Joseph E. Koch, dated as of April 19, 2011	8-K	10.14	04/22/11	
*10.15	Form of Indemnification Agreement entered into by Cortland Bancorp with each of its directors	10-K(1)	10.15	03/16/06	
*10.16	Endorsement Split Dollar Agreement between The Cortland Savings and Banking Company and David J. Lucido, dated as of March 27, 2012	10-K	10.16	03/29/12	
*10.17	Sixth Amended Salary Continuation Agreement between The Cortland Savings and Banking Company and Timothy Carney, dated as of March 4, 2014	8-K	10.17	03/10/14	
*10.18	Third Amended Salary Continuation Agreement between The Cortland Savings and Banking Company and Lawrence A. Fantauzzi, dated as of December 3, 2008	8-K	10.18	12/12/08	
*10.19	Sixth Amended Salary Continuation Agreement between The Cortland Savings and Banking Company and James M. Gasior, dated as of March 4, 2014	8-K	10.19	03/10/14	
*10.20	Second Amended Salary Continuation Agreement between The Cortland Savings and Banking Company and Marlene Lenio, dated as of December 3, 2008	8-K	10.20	12/12/08	

*10.20.1	Amendment of the December 3, 2008 Second Amended Salary Continuation Agreement between The Cortland Savings and Banking Company and Marlene J. Lenio	10-Q	10.20.1	05/17/10
*10.21	Amended Salary Continuation Agreement between The Cortland Savings and Banking Company and Craig Phythyon, dated as of December 3, 2008	8-K	10.21	12/12/08
*10.21.1	Amendment of the December 3, 2008 Second Amended Salary Continuation Agreement between The Cortland Savings and Banking Company and Craig M. Phythyon	10-Q	10.21.1	05/17/10

Exhibit No.	Exhibit Description	Incorporated by Reference Form**	Exhibit	Filing Date	Filed Herewith
*10.22	Third Amended Salary Continuation Agreement between The Cortland Savings and Banking Company and Stephen A. Telego, Sr., dated as of December 3, 2008	8-K	10.22	12/12/08	
*10.22.1	Amendment of the December 3, 2008 Third Amended Salary Continuation Agreement between The Cortland Savings and Banking Company and Stephen A. Telego, Sr.	10-Q	10.22.1	05/17/10	
*10.23	Salary Continuation Agreement between The Cortland Savings and Banking Company and David J. Lucido dated as of June 1, 2010	8-K	10.23	06/02/10	
*10.24	Fourth Amended Split Dollar Agreement and Endorsement between The Cortland Savings and Banking Company and Timothy Carney, dated as of April 19, 2011	8-K	10.24	04/22/11	
*10.25	Salary Continuation Agreement between The Cortland Savings and Banking Company and Stanley P. Feret dated as of June 1, 2010	8-K	10.25	06/02/10	
*10.26	Fourth Amended Split Dollar Agreement and Endorsement between The Cortland Savings and Banking Company and James M. Gasior, dated as of April 19, 2011	8-K	10.26	04/22/11	
*10.27	Second Amended Split Dollar Agreement between The Cortland Savings and Banking Company and Marlene Lenio, dated as of December 3, 2008	8-K	10.27	12/12/08	
*10.27.1	Termination of Split Dollar Agreement and Endorsement between The Cortland Savings and Banking Company and Marlene Lenio	10-Q	10.27.1	05/17/10	
*10.28.1	Termination of the Split Dollar Agreement and Endorsement between The Cortland Savings and Banking Company and Craig Phythyon	10-Q	10.28.1	05/17/10	
*10.29	Third Amended Split Dollar Agreement and Endorsement between The Cortland Savings and Banking Company and Stephen A. Telego, Sr., dated as of December 3, 2008	8-K	10.29	12/12/08	
*10.29.1	Termination of the Split Dollar Agreement and Endorsement between The Cortland Savings and Banking Company and Stephen A. Telego, Sr.	10-Q	10.29.1	05/17/10	
*10.30	Endorsement Split Dollar Agreement between The Cortland Savings and Banking Company and Stanley P. Feret, dated as of	10-Q	10.30	08/13/13	

	July 23, 2013				
*10.31.1	Severance Agreement between Cortland Bancorp and Tim Carney, dated as of September 28, 2012	8-K	10.31.1	10/03/12	
*10.31.1.1	Amendment of Severance Agreement of Tim Carney, dated as of June 25, 2014	10-Q	10.31.1.1	08/12/14	ü
*10.31.2	Severance Agreement between Cortland Bancorp and James Gasior, dated as of September 28, 2012	8-K	10.31.2	10/03/12	
*10.31.2.1	Amendment of Severance Agreement of James Gasior, dated as of June 25, 2014	10-Q	10.31.2.1	08/12/14	ü
*10.31.3	Severance Agreement between Cortland Bancorp and David J. Lucido, dated as of September 28, 2012	8-K	10.31.3	10/03/12	

Exhibit No.	Exhibit Description	Incorporated by Reference Form**	Exhibit	Filing Date	Filed Herewith
*10.31.4	Severance Agreement between Cortland Bancorp and David J. Lucido, dated as of June 1, 2010	8-K	10.31.4	10/03/12	
*10.32	Severance Agreement entered into by Cortland Bancorp and The Cortland Savings and Banking Company in December 3, 2008, with each of Marlene J. Lenio, Craig M. Phythyon and Barbara R. Sandrock	8-K	10.32	12/12/08	
*10.32.1	Termination of Severance Agreement entered into by each of Mses. Marlene J. Lenio and Barbara R. Sandrock and Messrs. Craig M. Phythyon and Stephen A. Telego, Sr.	10-Q	10.32.1	05/17/10	
*10.33	Agreement and General Release with Lawrence A. Fantauzzi	8-K	10.1	10/22/09	
*10.34	Severance Agreement between Cortland Bancorp and Stanley P. Feret, dated as of September 28, 2012	8-K	10.34	10/03/12	
11	Statement of re-computation of per share earnings	See Note 6 of Financial Statements			
31.1	Certification of the Chief Executive Officer under Rule 13a-14(a)				ü
31.2	Certification of Chief Financial Officer under Rule 13a-14(a)				ü
32	Section 1350 Certification of Chief Executive Officer and Chief Financial Officer required under section 906 of the Sarbanes-Oxley Act of 2002				ü
101	The following materials from Cortland Bancorp’s Quarterly Report on Form 10-Q for the quarter ended June 30, 2014, formatted in Extensible Business Reporting Language (XBRL): (a) Consolidated Balance Sheets; (b) Consolidated Statements of Income; (c) Consolidated Statements of Comprehensive Income; (d) Consolidated Statements of Changes in Shareholders’ Equity; (e) Consolidated Statements of Cash Flows; and (f) the Notes to Consolidated Financial Statements tagged as blocks of text and in detail (included with this filing)				ü

(1) Film number 06691632
* Management contract or compensatory plan or arrangement
** SEC File No. 000-13814

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CORTLAND BANCORP AND SUBSIDIARIES

SIGNATURES

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

CORTLAND BANCORP

(Registrant)

/s/ James M. Gasior Date: August 12, 2014
James M. Gasior

President and

Chief Executive Officer

(Principal Executive Officer)

/s/ David J. Lucido Date: August 12, 2014
David J. Lucido

Senior Vice President and

Chief Financial Officer

(Principal Financial and Accounting Officer)