CHEMUNG FINANCIAL CORP
Form 10-Q
August 01, 2018

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

FORM 10-Q

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

For Quarterly period ended June 30, 2018
Or

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

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

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

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

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

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

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

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

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

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

The number of shares of the registrant's common stock, $.01 par value, outstanding on July 31, 2018 was 4,803,888.

CHEMUNG FINANCIAL CORPORATION AND SUBSIDIARIES

INDEX

## GLOSSARY OF ABBREVIATIONS AND TERMS

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

| Abbreviations | |
|---|---|
| ALCO | Asset-Liability Committee |
| ASU | Accounting Standards Update |
| Bank | Chemung Canal Trust Company |
| Basel III | The Third Basel Accord of the Basel Committee on Banking Supervision |
| Board of Directors | Board of Directors of Chemung Financial Corporation |
| CDARS | Certificate of Deposit Account Registry Service |
| CDO | Collateralized Debt Obligation |
| CECL | Current expected credit loss |
| CFS | CFS Group, Inc. |
| Corporation | Chemung Financial Corporation |
| CRM | Chemung Risk Management, Inc. |
| Dodd-Frank Act | The Dodd-Frank Wall Street Reform and Consumer Protection Act |
| EPS | Earnings per share |
| Exchange Act | Securities Exchange Act of 1934 |
| FASB | Financial Accounting Standards Board |
| FDIC | Federal Deposit Insurance Corporation |
| FHLBNY | Federal Home Loan Bank of New York |
| FRB | Board of Governors of the Federal Reserve System |
| FRBNY | Federal Reserve Bank of New York |
| Freddie Mac | Federal Home Loan Mortgage Corporation |
| GAAP | U.S. Generally Accepted Accounting Principles |
| ICS | Insured Cash Sweep Service |
| IFRS | International Financial Reporting Standards |
| MD&A | Management's Discussion and Analysis of Financial Condition and Results of Operations |
| NAICS | North American Industry Classification System |
| N/M | Not meaningful |
| OPEB | Other postemployment benefits |
| OREO | Other real estate owned |
| OTTI | Other-than-temporary impairment |
| PCI | Purchased credit impaired |
| ROA | Return on average assets |
| Regulatory Relief Act | Economic Growth, Regulatory Relief, and Consumer Protection Act |
| ROE | Return on average equity |
| RWA | Risk-weighted assets |
| SBA | Small Business Administration |
| SEC | Securities and Exchange Commission |
| Securities Act | Securities Act of 1933 |
| Tax Act | Tax Cuts and Jobs Act of 2017 |
| TDRs | Troubled debt restructurings |
| WMG | Wealth Management Group |

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| Terms | |
| Allowance for loan losses to total loans | Represents period-end allowance for loan losses divided by retained loans. |
| Assets under administration | Represents assets that are beneficially owned by clients and all investment decisions pertaining to these assets are also made by clients. |
| Assets under management | Represents assets that are managed on behalf of clients. |
| Basel III | A comprehensive set of reform measures designed to improve the regulation, supervision, and risk management within the banking sector. The reforms require banks to maintain proper leverage ratios and meet certain capital requirements. |
| Benefit obligation | Refers to the projected benefit obligation for pension plans and the accumulated postretirement benefit obligation for OPEB plans. |
| Capital Bank | Division of Chemung Canal Trust Company located in the "Capital Region" of New York State and includes the counties of Albany and Saratoga. |
| CDARS | Product involving a network of financial institutions that exchange certificates of deposits among members in order to ensure FDIC insurance coverage on customer deposits above the single institution limit. Using a sophisticated matching system, funds are exchanged on a dollar-for-dollar basis, so that the equivalent of an original deposit comes back to the originating institution. |
| Captive insurance company | A company that provides risk-mitigation services for its parent company. |
| Collateralized debt obligation | A structured financial product that pools together cash flow-generating assets, such as mortgages, bonds, and loans. |
| Collateralized mortgage obligations | A type of mortgage-backed security with principal repayments organized according to their maturities and into different classes based on risk. The mortgages serve as collateral and are organized into classes based on their risk profile. |
| Dodd-Frank Act | The Dodd-Frank Act was enacted on July 21, 2010 and significantly changed the bank regulatory landscape and has impacted and will continue to impact the lending, deposit, investment, trading and operating activities of financial institutions and their holding companies. The Dodd-Frank Act requires various federal agencies to adopt a broad range of new rules and regulations, and to prepare various studies and reports for Congress. |
| Fully taxable equivalent basis | Income from tax-exempt loans and investment securities that have been increased by an amount equivalent to the taxes that would have been paid if this income were taxable at statutory rates; the corresponding income tax impact related to tax-exempt items is recorded within income tax expense. |
| GAAP | Accounting principles generally accepted in the United States of America. |
| Holding company | Consists of the operations for Chemung Financial Corporation (parent only). |
| ICS | Product involving a network of financial institutions that exchange interest-bearing money market deposits among members in order to ensure FDIC insurance coverage on customer deposits above the single institution limit. Using a sophisticated matching system, funds are exchanged on a dollar-for-dollar basis, so that the equivalent of an original deposit comes back to the originating institution. |
| Loans held for sale | Residential real estate loans originated for sale on the secondary market with maturities from 15-30 years. |
| Long term lease obligation | An obligation extending beyond the current year, which is related to a long term capital lease that is considered to have the economic characteristics of asset ownership. |
| | A type of asset-backed security that is secured by a collection of mortgages. |

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|---|---|
| Mortgage-backed securities | |
| Municipal clients | A political unit, such as a city, town, or village, incorporated for local self-government. |
| N/A | Data is not applicable or available for the period presented. |
| N/M | Not meaningful. |
| Non-GAAP | A calculation not made according to GAAP. |
| Obligations of state and political subdivisions | An obligation that is guaranteed by the full faith and credit of a state or political subdivision that has the power to tax. |

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| Obligations of U.S. Government | A federally guaranteed obligation backed by the full power of the U.S. government, including Treasury bills, Treasury notes and Treasury bonds. |
| Obligations of U.S. Government sponsored enterprise obligations | Obligations of agencies originally established or chartered by the U.S. government to serve public purposes as specified by the U.S. Congress; these obligations are not explicitly guaranteed as to the timely payment of principal and interest by the full faith and credit of the U.S. government. |
| OREO | Represents real property owned by the Corporation, which is not directly related to its business and is most frequently the result of a foreclosure on real property. |
| OTTI | Impairment charge taken on a security whose fair value has fallen below the carrying value on the balance sheet and whose value is not expected to recover through the holding period of the security. |
| PCI loans | Represents loans that were acquired in the Fort Orange Financial Corp. transaction and deemed to be credit-impaired on the acquisition date in accordance with the guidance of FASB. |
| Political subdivision | A county, city, town, or other municipal corporation, a public authority, or a publicly-owned entity that is an instrumentality of a state or a municipal corporation. |
| Pre-provision profit/(loss) | Represents total net revenue less noninterest expense, before income tax expense (benefit). The Corporation believes that this financial measure is useful in assessing the ability of a bank to generate income in excess of its provision for credit losses. |
| Regulatory Relief Act | The Regulatory Relief Act was enacted on May 22, 2018 provides certain limited amendments to the Dodd-Frank Act, as well as certain targeted modifications to other post-financial crisis regulatory requirements. In addition, the legislation establishes new consumer protections and amends various securities- and investment company-related requirements. |
| RWA | Risk-weighted assets consist of on- and off-balance sheet assets that are assigned to one of several broad risk categories and weighted by factors representing their risk and potential for default. On-balance sheet assets are risk-weighted based on the perceived credit risk associated with the obligor or counterparty, the nature of any collateral, and the guarantor, if any. Off-balance sheet assets such as lending-related commitments, guarantees, derivatives and other applicable off-balance sheet positions are risk-weighted by multiplying the contractual amount by the appropriate credit conversion factor to determine the on-balance sheet credit equivalent amount, which is then risk-weighted based on the same factors used for on-balance sheet assets. Risk-weighted assets also incorporate a measure for market risk related to applicable trading assets-debt and equity instruments. The resulting risk-weighted values for each of the risk categories are then aggregated to determine total risk-weighted assets. |
| SBA loan pools | Business loans partially guaranteed by the SBA. |
| Securities sold under agreements to repurchase | Sale of securities together with an agreement for the seller to buy back the securities at a later date. |
| Tax Act | The Tax Act was enacted on December 22, 2017 and amended the Internal Revenue Code of 1986. The legislation reduced the U.S. federal corporate income tax rate from 35 percent to 21 percent, with some related business deductions and credits being either reduced or eliminated. |
| TDR | A TDR is deemed to occur when the Corporation modifies the original terms of a loan agreement by granting a concession to a borrower that is experiencing financial difficulty. |
| Trust preferred securities | A hybrid security with characteristics of both subordinated debt and preferred stock which allows for early redemption by the issuer, makes fixed or variable payments, and matures at face value. |
| Unaudited | Financial statements and information that have not been subjected to auditing procedures sufficient to permit an independent certified public accountant to express an opinion. |
| WMG | Provides services as executor and trustee under wills and agreements, and guardian, custodian, trustee and agent for pension, profit-sharing and other employee benefit trusts, as well as various investment, financial planning, pension, estate planning and employee benefit administration |

services.

CHEMUNG FINANCIAL CORPORATION AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
(UNAUDITED)

| (in thousands, except share and per share data) | June 30, 2018 | December 31, 2017 |
|---|---|---|
| ASSETS | | |
| Cash and due from financial institutions | $30,837 | $27,966 |
| Interest-earning deposits in other financial institutions | 3,978 | 2,763 |
| Total cash and cash equivalents | 34,815 | 30,729 |
| | | |
| Equity investments, at estimated fair value | 2,112 | 2,337 |
| Securities available for sale, at estimated fair value | 265,157 | 293,091 |
| Securities held to maturity, estimated fair value of $3,790 at June 30, 2018 and $3,776 at December 31, 2017 | 3,806 | 3,781 |
| FHLBNY and FRBNY Stock, at cost | 5,816 | 5,784 |
| | | |
| Loans, net of deferred loan fees | 1,334,444 | 1,311,824 |
| Allowance for loan losses | (19,645) | (21,161) |
| Loans, net | 1,314,799 | 1,290,663 |
| | | |
| Loans held for sale | 684 | 542 |
| Premises and equipment, net | 26,049 | 26,657 |
| Goodwill | 21,824 | 21,824 |
| Other intangible assets, net | 1,709 | 2,085 |
| Bank-owned life insurance | 3,014 | 2,982 |
| Accrued interest receivable and other assets | 30,381 | 27,145 |
| | | |
| Total assets | $1,710,166 | $1,707,620 |
| | | |
| LIABILITIES AND SHAREHOLDERS' EQUITY | | |
| Deposits: | | |
| Non-interest-bearing | $462,233 | $467,610 |
| Interest-bearing | 1,016,676 | 999,836 |
| Total deposits | 1,478,909 | 1,467,446 |
| | | |
| FHLBNY overnight advances | 58,950 | 57,700 |
| Securities sold under agreements to repurchase | — | 10,000 |
| FHLBNY term advances | — | 2,000 |
| Long term capital lease obligation | 4,411 | 4,517 |
| Dividends payable | 1,249 | 1,232 |
| Accrued interest payable and other liabilities | 14,867 | 14,912 |
| Total liabilities | 1,558,386 | 1,557,807 |
| | | |
| Shareholders' equity: | | |
| Common stock, $0.01 par value per share, 10,000,000 shares authorized; 5,310,076 issued at June 30, 2018 and December 31, 2017 | 53 | 53 |
| Additional paid-in capital | 45,873 | 45,967 |
| Retained earnings | 132,973 | 128,453 |

| | | |
|---|---|---|
| Treasury stock, at cost; 507,471 shares at June 30, 2018 and 559,094 shares at December 31, 2017 | (12,998 ) | (14,320 ) |
| Accumulated other comprehensive loss | (14,121 ) | (10,340 ) |
| Total shareholders' equity | 151,780 | 149,813 |
| Total liabilities and shareholders' equity | $ 1,710,166 | $ 1,707,620 |

See accompanying notes to unaudited consolidated financial statements.

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

| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|---|---|---|---|---|
| (in thousands, except per share data) | 2018 | 2017 | 2018 | 2017 |
| Interest and dividend income: | | | | |
| Loans, including fees | $14,300 | $12,817 | $28,350 | $25,316 |
| Taxable securities | 1,264 | 1,398 | 2,553 | 2,820 |
| Tax exempt securities | 295 | 276 | 603 | 514 |
| Interest-earning deposits | 10 | 193 | 32 | 348 |
| Total interest and dividend income | 15,869 | 14,684 | 31,538 | 28,998 |
| Interest expense: | | | | |
| Deposits | 608 | 549 | 1,109 | 1,087 |
| Securities sold under agreements to repurchase | 44 | 95 | 137 | 288 |
| Borrowed funds | 200 | 90 | 375 | 179 |
| Total interest expense | 852 | 734 | 1,621 | 1,554 |
| Net interest income | 15,017 | 13,950 | 29,917 | 27,444 |
| Provision for loan losses | 2,362 | 421 | 3,071 | 1,461 |
| Net interest income after provision for loan losses | 12,655 | 13,529 | 26,846 | 25,983 |
| | | | | |
| Non-interest income: | | | | |
| WMG fee income | 2,373 | 2,269 | 4,689 | 4,378 |
| Service charges on deposit accounts | 1,144 | 1,225 | 2,308 | 2,409 |
| Interchange revenue from debit card transactions | 996 | 964 | 2,031 | 1,884 |
| Net gains (losses) on security transactions | — | 12 | — | 12 |
| Net gains on sales of loans held for sale | 59 | 53 | 105 | 122 |
| Net gains (losses) on sales of other real estate owned | (48) | (9) | (4) | 8 |
| Income from bank-owned life insurance | 17 | 18 | 33 | 35 |
| Other | 784 | 490 | 1,638 | 1,021 |
| Total non-interest income | 5,325 | 5,022 | 10,800 | 9,869 |
| | | | | |
| Non-interest expenses: | | | | |
| Salaries and wages | 5,564 | 5,422 | 11,278 | 10,697 |
| Pension and other employee benefits | 1,518 | 1,540 | 3,176 | 3,091 |
| Other components of net periodic pension and postretirement benefits | (408) | (333) | (816) | (666) |
| Net occupancy expenses | 1,643 | 1,702 | 3,251 | 3,308 |
| Furniture and equipment expenses | 702 | 781 | 1,360 | 1,462 |
| Data processing expense | 1,764 | 1,587 | 3,506 | 3,191 |
| Professional services | 508 | 417 | 1,048 | 717 |
| Legal accruals and settlements | 989 | 850 | 989 | 850 |
| Amortization of intangible assets | 182 | 213 | 376 | 439 |
| Marketing and advertising expenses | 255 | 118 | 604 | 367 |
| Other real estate owned expenses | 100 | 11 | 238 | 31 |
| FDIC insurance | 301 | 309 | 618 | 634 |
| Loan expense | 184 | 166 | 353 | 282 |
| Other | 1,665 | 1,549 | 3,152 | 2,974 |
| Total non-interest expenses | 14,967 | 14,332 | 29,133 | 27,377 |

| | | | | |
|---|---|---|---|---|
| Income before income tax expense | 3,013 | 4,219 | 8,513 | 8,475 |
| Income tax expense | 486 | 1,263 | 1,547 | 2,540 |
| Net income | $2,527 | $2,956 | 6,966 | $5,935 |
| | | | | |
| Weighted average shares outstanding | 4,828 | 4,797 | 4,825 | 4,793 |
| Basic and diluted earnings per share | $0.52 | $0.62 | $1.44 | $1.24 |

See accompanying notes to unaudited consolidated financial statements.

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

| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|---|---|---|---|---|
| (in thousands) | 2018 | 2017 | 2018 | 2017 |
| Net income | $2,527 | $2,956 | $6,966 | $5,935 |
| Other comprehensive income (loss): | | | | |
| Unrealized holding gains (losses) on securities available for sale | (400) | 2,854 | (4,839) | 6,020 |
| Reclassification adjustment for gains realized in net income | — | (12) | — | (12) |
| Net unrealized gains (losses) | (400) | 2,842 | (4,839) | 6,008 |
| Tax effect | (101) | 1,078 | (1,233) | 2,267 |
| Net of tax amount | (299) | 1,764 | (3,606) | 3,741 |
| | | | | |
| Change in funded status of defined benefit pension plan and other benefit plans: | | | | |
| Net gain (loss) arising during the period | — | — | — | — |
| Reclassification adjustment for amortization of prior service costs | (55) | (55) | (110) | (110) |
| Reclassification adjustment for amortization of net actuarial loss | 73 | 88 | 146 | 176 |
| Total before tax effect | 18 | 33 | 36 | 66 |
| Tax effect | 4 | 13 | 9 | 25 |
| Net of tax amount | 14 | 20 | 27 | 41 |
| | | | | |
| Total other comprehensive income (loss) | (285) | 1,784 | (3,579) | 3,782 |
| | | | | |
| Comprehensive income | $2,242 | $4,740 | $3,387 | $9,717 |

See accompanying notes to unaudited consolidated financial statements.

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

| (in thousands, except share and per share data) | Common Stock | Additional Paid-in Capital | Retained Earnings | Treasury Stock | Accumulated Other Comprehensive Loss | Total |
|---|---|---|---|---|---|---|
| Balances at January 1, 2017 | $ 53 | $ 45,603 | $ 124,111 | $ (15,265) | $ (10,754) | $ 143,748 |
| Net income | — | — | 5,935 | — | — | 5,935 |
| Other comprehensive income | — | — | — | — | 3,782 | 3,782 |
| Restricted stock awards | — | 107 | — | — | — | 107 |
| Restricted stock units for directors' deferred compensation plan | — | 49 | — | — | — | 49 |
| Cash dividends declared ($0.52 per share) | — | — | (2,461) | — | — | (2,461) |
| Distribution of 7,880 shares of treasury stock for directors' compensation | — | 68 | — | 201 | — | 269 |
| Distribution of 5,861 shares of treasury stock for employee compensation | — | 50 | — | 150 | — | 200 |
| Distribution of 2,438 shares of treasury stock for deferred directors’ compensation | — | (51) | — | 62 | — | 11 |
| Sale of 8,788 shares of treasury stock (a) | — | 97 | — | 225 | — | 322 |
| Forfeiture of 1,139 shares of restricted stock awards | — | 43 | — | (43) | — | — |
| Balances at June 30, 2017 | $ 53 | $ 45,966 | $ 127,585 | $ (14,670) | $ (6,972) | $ 151,962 |
| | | | | | | |
| Balances at December 31, 2017, as reported | $ 53 | $ 45,967 | $ 128,453 | $ (14,320) | $ (10,340) | $ 149,813 |
| Cumulative effect of accounting change (b) | — | — | 40 | — | (202) | (162) |
| Balances at January 1, 2018, as adjusted | 53 | 45,967 | 128,493 | (14,320) | (10,542) | 149,651 |
| Net income | — | — | 6,966 | — | — | 6,966 |
| Other comprehensive loss | — | — | — | — | (3,579) | (3,579) |
| Restricted stock awards | — | 232 | — | — | — | 232 |
| Restricted stock units for directors' deferred compensation plan | — | 47 | — | — | — | 47 |
| Cash dividends declared ($0.52 per share) | — | — | (2,486) | — | — | (2,486) |
| Distribution of 6,015 shares of treasury stock for directors' compensation | — | 147 | — | 154 | — | 301 |
| Distribution of 1,784 shares of treasury stock for employee compensation | — | 44 | — | 45 | — | 89 |
| Distribution of 36,681 shares of treasury stock for deferred directors’ compensation | — | (722) | — | 940 | — | 218 |
| Sale of 7,143 shares of treasury stock (a) | — | 158 | — | 183 | — | 341 |
| Balances at June 30, 2018 | $ 53 | $ 45,873 | $ 132,973 | $ (12,998) | $ (14,121) | $ 151,780 |

(a) All treasury stock sales were completed at the prevailing market price with the Chemung Canal Trust Company Profit Sharing, Savings, and Investment Plan which is a defined contribution plan sponsored by the Bank.
(b) Due to implementation of ASC 2016-01. See "Adoption of New Accounting Standards" discussion in Note 1.

See accompanying notes to unaudited consolidated financial statements.

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

| (in thousands) | Six Months Ended June 30, | |
|---|---|---|
| CASH FLOWS FROM OPERATING ACTIVITIES: | 2018 | 2017 |
| Net income | $6,966 | $5,935 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| Amortization of intangible assets | 376 | 439 |
| Provision for loan losses | 3,071 | 1,461 |
| Net losses on disposal of fixed assets | 10 | 31 |
| Depreciation and amortization of fixed assets | 1,816 | 1,946 |
| Amortization of premiums on securities, net | 608 | 736 |
| Gains on sales of loans held for sale, net | (105) | (122) |
| Proceeds from sales of loans held for sale | 5,308 | 6,204 |
| Loans originated and held for sale | (5,345) | (6,056) |
| Net gains on equity investments | (36) | (64) |
| Net gains on securities transactions | — | (12) |
| Net (gains) losses on sales of other real estate owned | 4 | (8) |
| Purchase of equity investments | (50) | (39) |
| Expense related to restricted stock units for directors' deferred compensation plan | 47 | 49 |
| Expense related to employee stock compensation | 89 | 200 |
| Expense related to employee restricted stock awards | 232 | 107 |
| Income from bank-owned life insurance | (33) | (35) |
| Increase in other assets and accrued interest receivable | (4,197) | (132) |
| Decrease in accrued interest payable | (33) | (47) |
| Increase (decrease) in other liabilities | 1,825 | (1,594) |
| Net cash provided by operating activities | 10,553 | 8,999 |
| | | |
| CASH FLOWS FROM INVESTING ACTIVITIES: | | |
| Proceeds from sales and calls of securities available for sale | 820 | 1,075 |
| Proceeds from maturities and principal collected on securities available for sale | 21,666 | 24,624 |
| Proceeds from maturities and principal collected on securities held to maturity | 585 | 1,544 |
| Purchases of securities available for sale | — | (41,306) |
| Purchases of securities held to maturity | (610) | (1,767) |
| Purchase of FHLBNY and FRBNY stock | (17,123) | (173) |
| Redemption of FHLBNY and FRBNY stock | 17,091 | 450 |
| Purchases of premises and equipment | (1,218) | (890) |
| Proceeds from sales of other real estate owned | 1,295 | 176 |
| Net increase in loans | (27,451) | (53,083) |
| Net cash used in investing activities | (4,945) | (69,350) |
| | | |
| CASH FLOWS FROM FINANCING ACTIVITIES: | | |
| Net increase (decrease) in demand deposits, interest-bearing demand accounts, savings accounts, and insured money market accounts | (16,269) | 79,997 |
| Net increase (decrease) in time deposits | 27,732 | (11,303) |
| Net decrease in securities sold under agreements to repurchase | (10,000) | (15,669) |
| Net increase in FHLBNY overnight advances | 1,250 | — |
| Repayments of FHLBNY long term advances | (2,000) | (55) |

| | | |
|---|---|---|
| Payments made on capital leases | (106 ) | (102 ) |
| Sale of treasury stock | 341 | 322 |
| Cash dividends paid | (2,470 ) | (2,455 ) |
| Net cash (used in) provided by financing activities | (1,522 ) | 50,735 |
| Net increase (decrease) in cash and cash equivalents | 4,086 | (9,616 ) |
| Cash and cash equivalents, beginning of period | 30,729 | 74,162 |
| Cash and cash equivalents, end of period | $34,815 | $64,546 |

(continued)

See accompanying notes to unaudited consolidated financial statements.

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

| (in thousands) | Six Months Ended June 30, | |
|---|---|---|
| Supplemental disclosure of cash flow information: | 2018 | 2017 |
| Cash paid (received) for: | | |
| Interest | $1,654 | $1,601 |
| Income taxes | $1,355 | $4,050 |
| Supplemental disclosure of non-cash activity: | | |
| Transfer of loans to other real estate owned | $244 | $116 |
| Dividends declared, not yet paid | $1,249 | $1,231 |
| Distribution of treasury stock for directors' compensation | $301 | $269 |
| Distribution of treasury stock for deferred directors' compensation | $218 | $11 |

See accompanying notes to unaudited consolidated financial statements.
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CHEMUNG FINANCIAL CORPORATION AND SUBSIDIARIES
NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Organization

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

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

Basis of Presentation

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

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions based on available information. These estimates and assumptions affect the amounts reported in the financial statements and disclosures provided, and actual results could differ. In the opinion of management, all adjustments (consisting of normal recurring adjustments) and disclosures necessary for the fair presentation of the accompanying consolidated financial statements have been included. The unconsolidated financial statements should be read in conjunction with the Corporation's 2017 Annual Report on Form 10-K for the year ended December 31, 2017. The results of operations for any interim periods are not necessarily indicative of the results which may be expected for the entire year or any other period.

Reclassifications

Some items in the prior year financial statements were reclassified to conform to the current presentation. Reclassifications had no effect on prior year net income or shareholders' equity.

Recent Accounting Pronouncements

In February 2016, the FASB issued ASU 2016-02, Leases (Topic 842). ASU 2016-02 requires companies that lease valuable assets to recognize on their balance sheets the assets and liabilities generated by contracts longer than a year. The amendments in this update are effective for annual periods, and interim periods within those annual periods, beginning after December 15, 2018, though early adoption is permitted. The Corporation intends to adopt the new lease guidance as of January 1, 2019 and is currently evaluating the impact that adoption of these updates will have on its consolidated financial statements. Currently, the Corporation believes the implementation of this ASU will create a right of use asset of less than $15.0 million for the Corporation's 16 leased facilities and a related capital obligation of the same amount as of January 1, 2019.

In June 2016, the FASB issued ASU 2016-13, Financial Instruments - Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments. The objective of the ASU is to provide financial statement users with more decision-useful information about the expected credit losses on financial instruments and other commitments to extend credit held by a reporting entity at each reporting date by replacing the incurred loss impairment methodology in current GAAP with a methodology that reflects expected credit losses and requires consideration of a broader range of reasonable and supportable information to form credit loss estimates. The amendments in this ASU are effective for public companies for fiscal years beginning after December 15, 2019, though entities may adopt the amendments earlier for fiscal years beginning after December 15, 2018. The Corporation is currently evaluating the impact of the adoption of this guidance on its consolidated financial statements. The Corporation anticipates that the adoption of the CECL model will result in an increase to the Corporation's allowance for loan losses. The Corporation has established a committee to oversee the implementation of CECL and has selected a vendor to assist in the implementation process. In 2018 the committee plans to begin establishing parameters which will be used in the CECL model with the selected vendor. The Corporation further plans to run its current incurred loss model and a CECL model concurrently for twelve months prior to the adoption of this guidance on January 1, 2020.

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

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

NOTE 2 EARNING PER COMMON SHARE (shares in thousands)

Basic earnings per share is net income divided by the weighted average number of common shares outstanding during the period. Issuable shares, including those related to directors’ restricted stock units and directors’ stock compensation, are considered outstanding and are included in the computation of basic earnings per share. All outstanding unvested share based payment awards that contain rights to non-forfeitable dividends are considered participating securities for this calculation. Restricted stock awards are grants of participating securities and are considered outstanding at grant date. Earnings per share information is adjusted to present comparative results for stock splits and stock dividends that occur. Earnings per share were computed by dividing net income by 4,828 and 4,797 weighted average shares outstanding for the three-month periods ended June 30, 2018 and 2017, respectively. Earnings per share were computed by dividing net income by 4,825 and 4,793 weighted average shares outstanding for the six- month periods ended June 30, 2018 and 2017, respectively. There were no common stock equivalents during the three and six-month periods ended June 30, 2018 or 2017.

NOTE 3 SECURITIES

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

| | June 30, 2018 | | | |
|---|---|---|---|---|
| | Amortized Cost | Unrealized Gains | Unrealized Losses | Estimated Fair Value |
| Obligations of U.S. Government and U.S. Government sponsored enterprises | $15,489 | $ 11 | $ 50 | $15,450 |
| Mortgage-backed securities, residential | 207,708 | 69 | 9,137 | 198,640 |
| Obligations of states and political subdivisions | 47,574 | 37 | 582 | 47,029 |
| Corporate bonds and notes | 249 | 1 | — | 250 |
| SBA loan pools | 3,832 | — | 44 | 3,788 |
| Total | $274,852 | $ 118 | $ 9,813 | $265,157 |

| | December 31, 2017 | | | |
|---|---|---|---|---|
| | Amortized Cost | Unrealized Gains | Unrealized Losses | Estimated Fair Value |
| Obligations of U.S. Government and U.S. Government sponsored enterprises | $15,492 | $ 20 | $ 21 | $15,491 |
| Mortgage-backed securities, residential | 224,939 | 136 | 5,166 | 219,909 |
| Obligations of states and political subdivisions | 52,928 | 355 | 151 | 53,132 |
| Corporate bonds and notes | 249 | 2 | — | 251 |
| SBA loan pools | 4,339 | 1 | 32 | 4,308 |
| Total | $297,947 | $ 514 | $ 5,370 | $293,091 |

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

| | June 30, 2018 | | | |
|---|---|---|---|---|
| | Amortized Cost | Unrealized Gains | Unrealized Losses | Estimated Fair Value |
| Obligations of states and political subdivisions | $1,481 | $ — | $ — | $ 1,481 |
| Time deposits with other financial institutions | 2,325 | — | 16 | 2,309 |
| Total | $3,806 | $ — | $ 16 | $ 3,790 |

| | December 31, 2017 | | | |
|---|---|---|---|---|
| | Amortized Cost | Unrealized Gains | Unrealized Losses | Estimated Fair Value |
| Obligations of states and political subdivisions | $1,946 | $ — | $ — | $ 1,946 |
| Time deposits with other financial institutions | 1,835 | — | 5 | 1,830 |
| Total | $3,781 | $ — | $ 5 | $ 3,776 |

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

| | June 30, 2018 | | | |
|---|---|---|---|---|
| | Available for Sale | | Held to Maturity | |
| | Amortized Cost | Fair Value | Amortized Cost | Fair Value |
| Within one year | $16,875 | $16,873 | $884 | $882 |
| After one, but within five years | 19,459 | 19,347 | 2,689 | 2,675 |
| After five, but within ten years | 26,495 | 26,053 | 233 | 233 |
| After ten years | 483 | 456 | — | — |
| | 63,312 | 62,729 | 3,806 | 3,790 |
| Mortgage-backed securities, residential | 207,708 | 198,640 | — | — |
| SBA loan pools | 3,832 | 3,788 | — | — |
| Total | $274,852 | $265,157 | $3,806 | $3,790 |

The proceeds from sales and calls of securities resulting in gains or losses for the three months ended June 30, 2018 and 2017 are listed below (in thousands):

| | 2018 | 2017 |
|---|---|---|
| Proceeds | $ — | $540 |
| Gross gains | — | 12 |
| Tax expense | — | 4 |

The proceeds from sales and calls of securities resulting in gains or losses for the six months ended June 30, 2018 and 2017 are listed below (in thousands):

| | 2018 | 2017 |
|---|---|---|
| Proceeds | $ — | $540 |
| Gross gains | — | 12 |
| Tax expense | — | 4 |

The following tables summarize the investment securities available for sale with unrealized losses at June 30, 2018 and December 31, 2017 by aggregated major security type and length of time in a continuous unrealized loss position (in thousands):

| June 30, 2018 | Less than 12 months | | 12 months or longer | | Total | |
|---|---|---|---|---|---|---|
| | Fair Value | Unrealized Losses | Fair Value | Unrealized Losses | Fair Value | Unrealized Losses |
| Obligations of U.S. Government and U.S. Government sponsored enterprises | $14,948 | $ 50 | $— | $ — | $14,948 | $ 50 |
| Mortgage-backed securities, residential | 65,746 | 2,193 | 130,586 | 6,944 | 196,332 | 9,137 |
| Obligations of states and political subdivisions | 36,819 | 488 | 1,709 | 94 | 38,528 | 582 |
| SBA loan pools | 243 | 1 | 3,545 | 43 | 3,788 | 44 |
| Total temporarily impaired securities | $117,756 | $ 2,732 | $135,840 | $ 7,081 | $253,596 | $ 9,813 |

| December 31, 2017 | Less than 12 months Fair Value | Unrealized Losses | 12 months or longer Fair Value | Unrealized Losses | Total Fair Value | Unrealized Losses |
|---|---|---|---|---|---|---|
| Obligations of U.S. Government and U.S. Government sponsored enterprises | $14,982 | $ 21 | $— | $ — | $14,982 | $ 21 |
| Mortgage-backed securities, residential | 83,562 | 1,013 | 131,165 | 4,153 | 214,727 | 5,166 |
| Obligations of states and political subdivisions | 20,526 | 133 | 271 | 18 | 20,797 | 151 |
| SBA loan pools | 3,937 | 32 | — | — | 3,937 | 32 |
| Total temporarily impaired securities | $123,007 | $ 1,199 | $131,436 | $ 4,171 | $254,443 | $ 5,370 |

Other-Than-Temporary Impairment

As of June 30, 2018, the majority of the Corporation's unrealized losses in the investment securities portfolio related to mortgage-backed securities. At June 30, 2018, all of the unrealized losses related to mortgage-backed securities were issued by U.S. government sponsored entities, Fannie Mae and Freddie Mac. Because the decline in fair value is attributable to changes in interest rates and not credit quality, and because it is not likely that the Corporation will be required to sell these securities before their anticipated recovery, the Corporation does not consider these securities to be other-than-temporarily impaired at June 30, 2018.

## NOTE 4 LOANS AND ALLOWANCE FOR LOAN LOSSES

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

| | June 30, 2018 | December 31, 2017 |
|---|---|---|
| Commercial and agricultural: | | |
| Commercial and industrial | $193,092 | $198,463 |
| Agricultural | 424 | 544 |
| Commercial mortgages: | | |
| Construction | 45,543 | 45,558 |
| Commercial mortgages, other | 621,150 | 598,772 |
| Residential mortgages | 193,423 | 194,440 |
| Consumer loans: | | |
| Credit cards | 1,367 | 1,517 |
| Home equity lines and loans | 99,052 | 100,591 |
| Indirect consumer loans | 162,813 | 153,060 |
| Direct consumer loans | 17,580 | 18,879 |
| Total loans, net of deferred origination fees and costs | $1,334,444 | $1,311,824 |
| Interest receivable on loans | 3,666 | 3,758 |
| Total recorded investment in loans | $1,338,110 | $1,315,582 |

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

The following tables present the activity in the allowance for loan losses by portfolio segment for the three and six-month periods ended June 30, 2018 and 2017 (in thousands):

| | Three Months Ended June 30, 2018 | | | | |
|---|---|---|---|---|---|
| Allowance for loan losses | Commercial and Agricultural | Commercial Mortgages | Residential Mortgages | Consumer Loans | Total |
| Beginning balance | $7,003 | $ 8,640 | $ 1,407 | $ 4,340 | $21,390 |
| Charge-offs | (3,624 ) | (145 ) | (71 ) | (463 ) | (4,303 ) |
| Recoveries | 11 | 1 | — | 184 | 196 |
| Net recoveries (charge-offs) | (3,613 ) | (144 ) | (71 ) | (279 ) | (4,107 ) |
| Provision | 1,579 | 244 | 109 | 430 | 2,362 |
| Ending balance | $4,969 | $ 8,740 | $ 1,445 | $ 4,491 | $19,645 |

| | Three Months Ended June 30, 2017 | | | | |
|---|---|---|---|---|---|
| Allowance for loan losses | Commercial and Agricultural | Commercial Mortgages | Residential Mortgages | Consumer Loans | Total |
| Beginning balance | $1,650 | $ 7,749 | $ 1,512 | $ 4,049 | $14,960 |
| Charge-offs | (2 ) | — | (48 ) | (397 ) | (447 ) |
| Recoveries | 36 | 2 | 13 | 119 | 170 |
| Net recoveries (charge-offs) | 34 | 2 | (35 ) | (278 ) | (277 ) |
| Provision | 199 | 27 | 40 | 155 | 421 |
| Ending balance | $1,883 | $ 7,778 | $ 1,517 | $ 3,926 | $15,104 |

| | Six Months Ended June 30, 2018 | | | | |
|---|---|---|---|---|---|
| Allowance for loan losses | Commercial and Agricultural | Commercial Mortgages | Residential Mortgages | Consumer Loans | Total |
| Beginning balance: | $6,976 | $ 8,514 | $ 1,316 | $ 4,355 | $21,161 |
| Charge-offs: | (3,644 ) | (145 ) | (165 ) | (921 ) | (4,875 ) |
| Recoveries: | 21 | 2 | 5 | 260 | 288 |
| Net recoveries (charge-offs) | (3,623 ) | (143 ) | (160 ) | (661 ) | (4,587 ) |
| Provision | 1,616 | 369 | 289 | 797 | 3,071 |
| Ending balance | $4,969 | $ 8,740 | $ 1,445 | $ 4,491 | $19,645 |

| | Six Months Ended June 30, 2017 | | | | |
|---|---|---|---|---|---|
| Allowance for loan losses | Commercial and Agricultural | Commercial Mortgages | Residential Mortgages | Consumer Loans | Total |
| Beginning balance: | $1,589 | $ 7,270 | $ 1,523 | $ 3,871 | $14,253 |
| Charge-offs: | (7 ) | — | (60 ) | (825 ) | (892 ) |
| Recoveries: | 61 | 3 | 30 | 188 | 282 |
| Net recoveries (charge-offs) | 54 | 3 | (30 ) | (637 ) | (610 ) |
| Provision | 240 | 505 | 24 | 692 | 1,461 |
| Ending balance | $1,883 | $ 7,778 | $ 1,517 | $ 3,926 | $15,104 |

The following tables present the balance in the allowance for loan losses and the recorded investment in loans by portfolio segment and based on impairment method as of June 30, 2018 and December 31, 2017 (in thousands):

| | June 30, 2018 | | | | |
|---|---|---|---|---|---|
| Allowance for loan losses: | Commercial and Agricultural | Commercial Mortgages | Residential Mortgages | Consumer Loans | Total |
| Ending allowance balance attributable to loans: | | | | | |
| Individually evaluated for impairment | $1,285 | $ 453 | $ — | $ — | $1,738 |
| Collectively evaluated for impairment | 3,684 | 8,287 | 1,445 | 4,491 | 17,907 |
| Total ending allowance balance | $4,969 | $ 8,740 | $ 1,445 | $ 4,491 | $19,645 |

| | December 31, 2017 | | | | |
|---|---|---|---|---|---|
| Allowance for loan losses: | Commercial and Agricultural | Commercial Mortgages | Residential Mortgages | Consumer Loans | Total |
| Ending allowance balance attributable to loans: | | | | | |
| Individually evaluated for impairment | $5,135 | $ 802 | $ — | $ — | $5,937 |
| Collectively evaluated for impairment | 1,841 | 7,683 | 1,316 | 4,355 | 15,195 |
| Loans acquired with deteriorated credit quality | — | 29 | — | — | 29 |
| Total ending allowance balance | $6,976 | $ 8,514 | $ 1,316 | $ 4,355 | $21,161 |

| | June 30, 2018 | | | | |
|---|---|---|---|---|---|
| Loans: | Commercial and Agricultural | Commercial Mortgages | Residential Mortgages | Consumer Loans | Total |
| Loans individually evaluated for impairment | $2,017 | $ 6,847 | $ 417 | $ 61 | $9,342 |
| Loans collectively evaluated for impairment | 192,040 | 661,711 | 193,514 | 281,503 | 1,328,768 |
| Total ending loans balance | $194,057 | $ 668,558 | $ 193,931 | $281,564 | $1,338,110 |

| | December 31, 2017 | | | | |
|---|---|---|---|---|---|
| Loans: | Commercial and Agricultural | Commercial Mortgages | Residential Mortgages | Consumer Loans | Total |
| Loans individually evaluated for impairment | $6,133 | $ 7,302 | $ 427 | $ 64 | $13,926 |
| Loans collectively evaluated for impairment | 193,443 | 638,080 | 194,510 | 274,831 | 1,300,864 |
| Loans acquired with deteriorated credit quality | — | 792 | — | — | 792 |
| Total ending loans balance | $199,576 | $ 646,174 | $ 194,937 | $274,895 | $1,315,582 |

The following table presents loans individually evaluated for impairment recognized by class of loans as of June 30, 2018 and December 31, 2017 (in thousands):

| | June 30, 2018 | | | December 31, 2017 | | |
|---|---|---|---|---|---|---|
| With no related allowance recorded: | Unpaid Principal Balance | Recorded Investment | Allowance for Loan Losses Allocated | Unpaid Principal Balance | Recorded Investment | Allowance for Loan Losses Allocated |
| Commercial and agricultural: | | | | | | |
| Commercial and industrial | $643 | $ 647 | $ — | $861 | $ 867 | $ — |
| Commercial mortgages: | | | | | | |
| Construction | 336 | 338 | — | 364 | 365 | — |
| Commercial mortgages, other | 4,366 | 4,370 | — | 4,135 | 4,138 | — |
| Residential mortgages | 439 | 417 | — | 450 | 427 | — |
| Consumer loans: | | | | | | |
| Home equity lines and loans | 60 | 61 | — | 64 | 64 | — |
| With an allowance recorded: | | | | | | |
| Commercial and agricultural: | | | | | | |
| Commercial and industrial | 1,370 | 1,370 | 1,285 | 5,231 | 5,266 | 5,135 |
| Commercial mortgages: | | | | | | |
| Commercial mortgages, other | 2,173 | 2,139 | 453 | 2,989 | 2,799 | 802 |
| Total | $9,387 | $ 9,342 | $ 1,738 | $14,094 | $ 13,926 | $ 5,937 |

The following table presents the average recorded investment and interest income of loans individually evaluated for impairment recognized by class of loans as of the three and six-month periods ended June 30, 2018 and 2017 (in thousands):

| | Three Months Ended June 30, 2018 | | Three Months Ended June 30, 2017 | | Six Months Ended June 30, 2018 | | Six Months Ended June 30, 2017 | |
|---|---|---|---|---|---|---|---|---|
| With no related allowance recorded: | Average Recorded Investment | Interest Income Recognized (1) | Average Recorded Investment | Interest Income Recognized (1) | Average Recorded Investment | Interest Income Recognized (1) | Average Recorded Investment | Interest Income Recognized (1) |
| Commercial and agricultural: | | | | | | | | |
| Commercial and industrial | $710 | $ 7 | $626 | $ 8 | $762 | $ 15 | $649 | $ 17 |
| Commercial mortgages: | | | | | | | | |
| Construction | 345 | 3 | 1,555 | 3 | 352 | 6 | 1,130 | 6 |
| Commercial mortgages, other | 4,290 | 5 | 5,879 | 32 | 4,240 | 10 | 6,538 | 90 |
| Residential mortgages | 421 | 2 | 417 | 2 | 423 | 4 | 410 | 4 |
| Consumer loans: | | | | | | | | |
| Home equity lines & loans | 61 | 1 | 71 | 1 | 62 | 2 | 79 | 1 |
| With an allowance recorded: | | | | | | | | |
| Commercial and agricultural: | | | | | | | | |
| Commercial and industrial | 3,196 | — | 84 | 1 | 3,886 | — | 56 | 1 |
| Commercial mortgages: | | | | | | | | |
| Commercial mortgages, other | 2,467 | 1 | 4,461 | 4 | 2,578 | 3 | 3,723 | 7 |
| Consumer loans: | | | | | | | | |
| Home equity lines and loans | — | — | 180 | — | — | — | 240 | — |
| Total | $11,490 | $ 19 | $13,273 | $ 51 | $12,303 | $ 40 | $12,825 | $ 126 |

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

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The following table present the recorded investment in non-accrual and loans past due 90 days or more and still accruing by class of loans as of June 30, 2018 and December 31, 2017 (in thousands):

| | Non-accrual | | Loans Past Due 90 Days or More and Still Accruing | |
|---|---|---|---|---|
| | June 30, 2018 | December 31, 2017 | June 30, 2018 | December 31, 2017 |
| Commercial and agricultural: | | | | |
| Commercial and industrial | $1,513 | $ 5,250 | $3 | $ 5 |
| Commercial mortgages: | | | | |
| Construction | 123 | 135 | — | — |
| Commercial mortgages, other | 6,101 | 6,520 | — | — |
| Residential mortgages | 2,981 | 3,160 | — | — |
| Consumer loans: | | | | |
| Credit cards | — | — | 14 | 24 |
| Home equity lines and loans | 1,359 | 1,310 | — | — |
| Indirect consumer loans | 673 | 935 | — | — |
| Direct consumer loans | 40 | 14 | — | — |
| Total | $12,790 | $ 17,324 | $17 | $ 29 |

The following tables present the aging of the recorded investment in loans as of June 30, 2018 and December 31, 2017 (in thousands):

| | June 30, 2018 | | | | | | |
|---|---|---|---|---|---|---|---|
| | 30 - 59 Days Past Due | 60 - 89 Days Past Due | 90 Days or More Past Due | Total Past Due | Loans Acquired with Deteriorated Credit Quality | Loans Not Past Due | Total |
| Commercial and agricultural: | | | | | | | |
| Commercial and industrial | $392 | $— | $17 | $409 | $ — | $193,223 | $193,632 |
| Agricultural | — | — | — | — | — | 425 | 425 |
| Commercial mortgages: | | | | | | | |
| Construction | — | — | — | — | — | 45,671 | 45,671 |
| Commercial mortgages, other | 992 | 93 | 3,339 | 4,424 | — | 618,463 | 622,887 |
| Residential mortgages | 1,117 | 492 | 1,261 | 2,870 | — | 191,061 | 193,931 |
| Consumer loans: | | | | | | | |
| Credit cards | 11 | 11 | 14 | 36 | — | 1,332 | 1,368 |
| Home equity lines and loans | 359 | 196 | 787 | 1,342 | — | 97,995 | 99,337 |
| Indirect consumer loans | 979 | 218 | 231 | 1,428 | — | 161,778 | 163,206 |
| Direct consumer loans | 56 | 24 | 22 | 102 | — | 17,551 | 17,653 |
| Total | $3,906 | $1,034 | $5,671 | $10,611 | $ — | $1,327,499 | $1,338,110 |

| | December 31, 2017 | | | | | | |
|---|---|---|---|---|---|---|---|
| | 30 - 59 Days Past Due | 60 - 89 Days Past Due | 90 Days or More Past Due | Total Past Due | Loans Acquired with Deteriorated Credit Quality | Loans Not Past Due | Total |
| Commercial and agricultural: | | | | | | | |
| Commercial and industrial | $1,689 | $999 | $20 | $2,708 | $ — | $196,322 | $199,030 |
| Agricultural | — | — | — | — | — | 546 | 546 |
| Commercial mortgages: | | | | | | | |
| Construction | — | — | — | — | — | 45,688 | 45,688 |
| Commercial mortgages, other | 2,399 | 115 | 748 | 3,262 | 792 | 596,432 | 600,486 |
| Residential mortgages | 1,399 | 939 | 1,474 | 3,812 | — | 191,125 | 194,937 |
| Consumer loans: | | | | | | | |
| Credit cards | 17 | 9 | 24 | 50 | — | 1,466 | 1,516 |
| Home equity lines and loans | 265 | 31 | 983 | 1,279 | — | 99,599 | 100,878 |
| Indirect consumer loans | 1,822 | 484 | 581 | 2,887 | — | 150,645 | 153,532 |
| Direct consumer loans | 48 | 28 | 2 | 78 | — | 18,891 | 18,969 |
| Total | $7,639 | $2,605 | $3,832 | $14,076 | $ 792 | $1,300,714 | $1,315,582 |

Troubled Debt Restructurings:

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

As of June 30, 2018 and December 31, 2017, the Corporation has a recorded investment in TDRs of $7.1 million and $7.7 million, respectively. There were specific reserves of $0.5 million and $0.7 million allocated for TDRs at June 30, 2018 and December 31, 2017, respectively. As of June 30, 2018, TDRs totaling $1.4 million were accruing interest under the modified terms and $5.7 million were on non-accrual status. As of December 31, 2017, TDRs totaling $1.7 million were accruing interest under the modified terms and $6.0 million were on non-accrual status. The Corporation had committed no additional amounts as of both June 30, 2018 and December 31, 2017, to customers with outstanding loans that are classified as TDRs.

There were no loans modified as TDRs during the three month period ended June 30, 2018 while the terms of certain loans were modified as TDRs during the three month period ended June 30, 2017. The modification of the terms of two commercial & industrial term loans and one commercial line of credit during the three months ended June 30, 2017 included consolidating the loans into one commercial & industrial loan, extending the maturity date by approximately two years and lowering the monthly payment. An additional piece of equipment was taken as collateral but was not considered to be of greater value than the concessions given. The modification of the terms of a residential mortgage loan during the three months ended June 30, 2017 included an extension of the maturity date by approximately five years and a postponement of the scheduled amortized past due payments to the end of the loan.

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During the six months ended June 30, 2018 and 2017, the terms of certain loans were modified as TDRs. The modification of the terms of one commercial & industrial term loan during the six months ended June 30, 2018 included an extension of the maturity date at a stated rate of interest lower than the current market rate for new debt with similar risk. In addition to the modifications noted above, the modification of the terms of one commercial mortgage loan during the six months ended June 30, 2017 included a reduction of the scheduled amortized payments of the loan for greater than a three month period.

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

| June 30, 2017 | Number of Loans | Pre-Modification Outstanding Recorded Investment | Post-Modification Outstanding Recorded Investment |
|---|---|---|---|
| Troubled debt restructurings: | | | |
| Commercial and agricultural: | | | |
| Commercial and industrial | 3 | $ 171 | $ 171 |
| Residential mortgages | 1 | 105 | 105 |
| Total | 4 | $ 276 | $ 276 |

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

The following tables presents loans by class modified as TDRs that occurred during the six months ended June 30, 2018 and 2017 (dollars in thousands):

| June 30, 2018 | Number of Loans | Pre-Modification Outstanding Recorded Investment | Post-Modification Outstanding Recorded Investment |
|---|---|---|---|
| Troubled debt restructurings: | | | |
| Commercial and agricultural: | | | |
| Commercial and industrial | 1 | $ 100 | $ 100 |
| Total | 1 | $ 100 | $ 100 |

| June 30, 2017 | Number of Loans | Pre-Modification Outstanding Recorded Investment | Post-Modification Outstanding Recorded Investment |
|---|---|---|---|
| Troubled debt restructurings: | | | |
| Commercial and agricultural: | | | |
| Commercial and industrial | 3 | $ 171 | $ 171 |
| Commercial mortgages: | | | |
| Commercial mortgages | 1 | $ 166 | $ 166 |
| Residential mortgages | 1 | 105 | 105 |
| Total | 5 | $ 442 | $ 442 |

The TDRs described above did not increase the allowance for loan losses and resulted in no charge-offs during the six months ended June 30, 2018. The TDRs described above increased the allowance for loan losses by $0.1 million and resulted in no charge-offs during the six months ended June 30, 2017.

A loan is considered to be in payment default once it is 90 days contractually past due under the modified terms. There were no payment defaults on any loans previously modified as TDRs within twelve months following the modification during the three and six month periods ended June 30, 2018 and 2017.

Credit Quality Indicators

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

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

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

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

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

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

Commercial loans not meeting the criteria above to be considered criticized or classified are considered to be pass rated loans.  Loans listed as not rated are included in groups of homogeneous loans performing under terms of the loan notes.  Based on the analyses performed as of June 30, 2018 and December 31, 2017, the risk category of the recorded investment of loans by class of loans is as follows (in thousands):

| | June 30, 2018 | | | | | | |
|---|---|---|---|---|---|---|---|
| | Not Rated | Pass | Special Mention | Substandard | Doubtful | Loans acquired with deteriorated credit quality | Total |
| Commercial and agricultural: | | | | | | | |
| Commercial and industrial | $ — | $ 179,814 | $ 9,843 | $ 2,619 | $ 1,356 | $ — | $ 193,632 |
| Agricultural | — | 425 | — | — | — | — | 425 |
| Commercial mortgages: | | | | | | | |
| Construction | — | 45,548 | — | 123 | — | — | 45,671 |
| Commercial mortgages | — | 598,395 | 10,639 | 12,526 | 1,327 | — | |