

CHEMUNG FINANCIAL CORP

Form 10-Q

November 14, 2011

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

FORM 10-Q

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

For Quarterly period ended September 30, 2011

Or

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

Commission File No. 0-13888

CHEMUNG FINANCIAL CORPORATION  
(Exact name of registrant as specified in its charter)

New York  
(State or other jurisdiction of incorporation or organization)

16-1237038  
I.R.S. Employer Identification No.

One Chemung Canal Plaza, P.O. Box 1522, Elmira, NY  
(Address of principal executive offices)

14902  
(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:  NO:

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

YES:  NO:

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

Large accelerated filer

Non-accelerated filer

Accelerated filer

Smaller reporting company

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

YES:  NO:

The number of shares of the registrant's common stock, \$.01 par value, outstanding on October 31, 2011 was 4,569,710.



CHEMUNG FINANCIAL CORPORATION AND SUBSIDIARIES

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## PART I. FINANCIAL INFORMATION

## Item 1: Financial Statements

CHEMUNG FINANCIAL CORPORATION AND SUBSIDIARIES  
 CONSOLIDATED BALANCE SHEETS  
 (UNAUDITED)

	SEPTEMBER 30, 2011	DECEMBER, 31, 2010
<b>ASSETS</b>		
Cash and due from financial institutions	\$ 30,748,786	\$ 16,540,095
Interest-bearing deposits in other financial institutions	87,723,958	44,079,682
Total cash and cash equivalents	118,472,744	60,619,777
Securities available for sale, at estimated fair value	279,078,596	223,544,961
Securities held to maturity, estimated fair value of \$8,483,553 at September 30, 2011 and \$8,297,392 at December 31, 2010	7,585,671	7,715,123
Federal Home Loan Bank and Federal Reserve Bank Stock, at cost	5,672,450	3,328,900
Loans, net of deferred origination fees and costs, and unearned income	788,458,576	613,684,369
Allowance for loan losses	(9,676,923)	(9,498,131)
Loans, net	778,781,653	604,186,238
Loans held for sale	74,412	486,997
Premises and equipment, net	24,250,065	24,192,593
Goodwill	22,157,213	9,872,375
Other intangible assets, net	6,478,541	4,655,900
Bank owned life insurance	2,602,647	2,536,715
Other assets	20,768,574	17,187,706
Total assets	\$ 1,265,922,566	\$ 958,327,285
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
<b>Deposits:</b>		
Non-interest-bearing	\$ 261,945,489	\$ 197,322,036
Interest-bearing	780,260,416	589,036,816
Total deposits	1,042,205,905	786,358,852

Securities sold under agreements to repurchase	41,453,658	44,774,615
Federal Home Loan Bank term advances	43,936,174	20,000,000
Accrued interest payable	822,970	784,351
Dividends payable	1,142,015	881,203
Other liabilities	7,674,121	8,119,701
<b>Total liabilities</b>	<b>1,137,234,843</b>	<b>860,918,722</b>

## Shareholders' equity:

Common stock, \$.01 par value per share, 10,000,000 shares authorized;

5,310,076 issued at September 30, 2011 and 4,300,134 issued at

December 31, 2010	53,101	43,001
Additional-paid-in capital	45,709,779	22,022,122
Retained earnings	98,808,285	94,407,620
Treasury stock, at cost (742,518 shares at September 30, 2011; 749,880 shares at December 31, 2010)	(18,948,660)	(19,166,655)
Accumulated other comprehensive income	3,065,218	102,475
<b>Total shareholders' equity</b>	<b>128,687,723</b>	<b>97,408,563</b>

Total liabilities and shareholders' equity                   \$ 1,265,922,566                   \$ 958,327,285

See accompanying notes to unaudited consolidated financial statements.

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

	Nine Months Ended		Three Months Ended	
	September 30,	September 30,	September 30,	September 30,
	2011	2010	2011	2010
<b>INTEREST AND DIVIDEND INCOME</b>				
Loans, including fees	\$31,456,406	\$26,412,468	\$11,673,215	\$ 8,742,046
Taxable securities	4,347,409	4,968,287	1,504,393	1,555,301
Tax exempt securities	1,035,068	888,938	350,557	300,917
Interest-bearing deposits	166,955	123,984	65,139	41,709
<b>Total interest and dividend income</b>	<b>37,005,838</b>	<b>32,393,677</b>	<b>13,593,304</b>	<b>10,639,973</b>
<b>INTEREST EXPENSE</b>				
Deposits	3,325,900	4,452,535	1,138,130	1,335,770
Borrowed funds	783,022	711,231	285,084	239,634
Securities sold under agreements to repurchase	1,056,095	1,257,428	326,542	383,095
<b>Total interest expense</b>	<b>5,165,017</b>	<b>6,421,194</b>	<b>1,749,756</b>	<b>1,958,499</b>
<b>Net interest income</b>	<b>31,840,821</b>	<b>25,972,483</b>	<b>11,843,548</b>	<b>8,681,474</b>
Provision for loan losses	833,333	1,125,000	583,333	375,000
<b>Net interest income after provision for loan losses</b>	<b>31,007,488</b>	<b>24,847,483</b>	<b>11,260,215</b>	<b>8,306,474</b>
<b>Other operating income:</b>				
Wealth management group fee income	5,131,119	6,256,974	1,746,958	2,183,765
Service charges on deposit accounts	3,180,733	3,428,277	1,130,824	1,106,415
Net gain on securities transactions	1,108,091	451,094	428,882	-
Other-than-temporary loss on investment securities:				
Total impairment losses	(67,400)	(393,005)	(67,400)	(56,380)
Loss recognized in other comprehensive income	-	-	-	-
Net impairment loss recognized in earnings	(67,400)	(393,005)	(67,400)	(56,380)
	132,902	166,247	53,571	32,681

Net gain on sales of loans held for sale				
Credit card merchant earnings	162,215	148,107	57,153	48,937
Gains on sales of other real estate owned	89,404	33,550	442	-
Income from bank owned life insurance	65,932	65,213	22,321	22,075
Other	3,617,016	2,750,745	955,712	909,951
Total other operating income	13,420,012	12,907,202	4,328,463	4,247,444
Other operating expenses:				
Salaries and wages	12,534,214	11,362,716	4,272,612	3,768,761
Pension and other employee benefits	3,296,814	2,828,493	1,172,044	809,940
Net occupancy expenses	3,663,005	3,272,432	1,230,490	1,065,930
Furniture and equipment expenses	1,549,048	1,441,030	486,518	465,262
Data processing expense	2,881,150	2,457,347	976,050	822,341
Amortization of intangible assets	753,192	550,531	288,001	180,363
Losses on sales of other real estate owned	1,671	17,983	-	(7,575)
Other real estate owned expenses	86,040	305,147	37,549	112,307
FDIC insurance	737,281	912,652	294,897	287,298
Merger related expenses	2,243,919	-	20,500	-
Other	5,515,652	4,395,221	1,838,726	1,378,395
Total other operating expenses	33,261,986	27,543,552	10,617,387	8,883,022
Income before income tax expense	11,165,514	10,211,133	4,971,291	3,670,896
Income tax expense	3,589,455	3,157,001	1,680,351	1,119,960
Net income	\$ 7,576,059	\$ 7,054,132	\$ 3,290,940	\$ 2,550,936
Weighted average shares outstanding	4,297,777	3,604,502	4,637,392	3,602,277
Basic and diluted earnings per share	\$ 1.76	\$ 1.96	\$ 0.71	\$ 0.71

See accompanying notes to unaudited consolidated financial statements.



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

	Common Stock	Additional Paid-in Capital	Retained Earnings	Treasury Stock	Accumulated Other Comprehensive Income (Loss)	Total
Balances at December 31, 2009	\$ 43,001	\$ 22,806,829	\$ 87,826,331	\$ (20,024,661)	\$ (565,835)	\$ 90,085,665
Comprehensive Income:						
Net income	-	-	7,054,132	-	-	7,054,132
Change in unrealized gains(losses) on securities AFS, net	-	-	-	-	2,633,416	2,633,416
Change in funded status of Employers' Accounting for Defined Benefit Pension and Other Benefit Plans, net	-	-	-	-	231,937	231,937
Total comprehensive income (loss)	-	-	-	-	-	9,919,485
Restricted stock units for directors' deferred compensation plan	-	83,311	-	-	-	83,311
Cash dividends declared (\$.75 per share)	-	-	(2,639,382)	-	-	(2,639,382)
Distribution of 10,082 shares of treasury stock for directors' compensation	-	(44,677)	-	258,906	-	214,229
Distribution of 2,750 shares of treasury stock for employee compensation	-	(15,537)	-	70,537	-	55,000
Purchase of 20,260 shares of treasury stock	-	-	-	(425,566)	-	(425,566)
Balances at September 30, 2010	\$ 43,001	\$ 22,829,926	\$ 92,241,081	\$ (20,120,784)	\$ 2,299,518	\$ 97,292,742
Balances at December 31, 2010	\$ 43,001	\$ 22,022,122	\$ 94,407,620	\$ (19,166,655)	\$ 102,475	\$ 97,408,563

Comprehensive  
Income:

Net income	-	-	7,576,059	-	-	7,576,059
Change in unrealized gains (losses) on securities AFS, net		-	-	-	2,678,187	2,678,187
Change in funded status of Employers' Accounting for Defined Benefit Pension and Other Benefit Plans, net	-	-	-	-	284,556	284,556
Total comprehensive income (loss)	-	-	-	-	-	10,538,802
Restricted stock awards	-	21,226	-	-	-	21,226
Restricted stock units for directors' deferred compensation plan	-	61,129	-	-	-	61,129
Cash dividends declared (\$.75 per share)	-	-	(3,175,394)	-	-	(3,175,394)
Distribution of 10,378 shares of treasury stock for directors' compensation	-	(33,831)	-	265,262	-	231,431
Distribution of 2,392 shares of treasury stock for employee compensation	-	(6,140)	-	61,140	-	55,000
Distribution of 286 shares of treasury stock for director's deferred compensation	-	(7,364)	-	7,310	-	(54)
Distribution of 4,387 shares of treasury stock for employee restricted stock warrants	-	(60,800)	-	112,090	-	51,290
Purchase of 13,981 shares of treasury stock	-	-	-	(327,413)	-	(327,413)
Sale of 3,900 shares of treasury stock	-	(10,101)	-	99,606	-	89,505
Issuance of 1,009,942 shares related to FOFC	10,100	23,723,538	-	-	-	23,733,638

Merger

Balances at

September 30, 2011	\$ 53,101	\$ 45,709,779	\$ 98,808,285	\$ (18,948,660)	\$ 3,065,218	\$ 128,687,723
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See accompanying notes to unaudited consolidated financial statements.

CHEMUNG FINANCIAL CORPORATION AND SUBSIDIARIES  
CONSOLIDATED STATEMENTS OF CASH FLOWS  
(UNAUDITED)  
Nine Months Ended  
September 30,

## CASH FLOWS FROM OPERATING

## ACTIVITIES:

	2011	2010
Net income	\$ 7,576,059	\$ 7,054,132
Adjustments to reconcile net income to net cash provided by operating activities:		
Amortization of intangible assets	753,192	550,531
Provision for loan losses	833,333	1,125,000
Depreciation and amortization of fixed assets	2,129,738	2,057,825
Amortization of premiums on securities, net	960,973	489,661
Gains on sales of loans held for sale, net	(132,902)	(166,247)
Proceeds from sales of loans held for sale	5,523,214	5,686,897
Loans originated and held for sale	(4,977,727)	(5,906,757)
Net gain on sale of other real estate owned	(87,733)	(15,568)
Net gains on securities transactions	(1,108,091)	(451,094)
Net impairment loss recognized on investment securities	67,400	393,005
Decrease in other assets	2,752,047	671,468
(Increase) decrease in prepaid FDIC assessment	(49,464)	819,241
Decrease in accrued interest payable	(265,000)	(235,220)
Expense related to restricted stock units for directors' deferred compensation plan	61,129	83,311
Expense related to employee stock compensation	55,000	55,000
Expense related to employee stock awards	21,226	-
Decrease in other liabilities	(2,243,010)	(2,987,293)
Income from bank owned life insurance	(65,932)	(65,213)
Proceeds from sales of student loans	-	137,509
Net cash provided by operating activities	11,803,452	9,296,188

## CASH FLOWS FROM INVESTING

## ACTIVITIES:

Proceeds from sales and calls of securities available for sale	67,741,210	50,440,459
	23,608,123	49,260,195

Proceeds from maturities and principal collected on securities available for sale		
Proceeds from maturities and principal collected on securities held to maturity	3,448,732	9,561,278
Purchases of securities available for sale	(95,911,022)	(110,793,064)
Purchases of securities held to maturity	(3,319,281)	(5,429,297)
Purchase of Federal Home Loan Bank and Federal Reserve Bank stock	(1,002,500)	(58,200)
Redemption of Federal Home Loan Bank and Federal Reserve Bank stock	237,250	-
Purchases of premises and equipment	(1,307,723)	(1,230,458)
Cash paid Fort Orange Financial Corp. acquisition	(8,137,816)	-
Cash received Fort Orange Financial Corp. acquisition	33,284,995	-
Proceeds from sale of other real estate owned	356,207	236,102
Net (increase) decrease in loans	(10,967,168)	3,210,362
Net cash provided (used) by investing activities	8,031,007	(4,802,623)

#### CASH FLOWS FROM FINANCING ACTIVITIES:

Net increase in demand deposits, NOW accounts, savings accounts, and insured money market accounts	70,452,474	17,197,567
Net decrease in time deposits and individual retirement accounts	(15,073,756)	(14,749,680)
Net decrease in securities sold under agreements to repurchase	(13,889,730)	(10,497,579)
Net decrease in Federal Home Loan Bank long term advances	(317,990)	-
Purchase of treasury stock	(327,413)	(425,566)
Sale of treasury stock	89,505	-
Cash dividends paid	(2,914,582)	(2,641,239)
Net cash provided (used) by financing activities	38,018,508	(11,116,497)
Net increase (decrease) in cash and cash equivalents	57,852,967	(6,622,932)
Cash and cash equivalents, beginning of period	60,619,777	79,738,396
Cash and cash equivalents, end of period	\$ 118,472,744	\$ 73,115,464

See accompanying notes to unaudited consolidated financial statements.

(Cash Flow continued)

Supplemental disclosure of cash  
flow information:

Cash paid during the year for:

Interest	\$	5,126,397	\$	6,656,414
Income Taxes	\$	3,340,847	\$	4,575,675

Supplemental disclosure of  
non-cash activity:

Transfer of loans to other real estate owned	\$	308,976	\$	554,246
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See accompanying notes to unaudited consolidated financial statements.

CHEMUNG FINANCIAL CORPORATION AND SUBSIDIARIES  
NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

1. Basis of Presentation

Chemung Financial Corporation (the "Corporation"), through its wholly owned subsidiaries, Chemung Canal Trust Company (the "Bank") and CFS Group, Inc., a financial services company, provides a wide range of banking, financing, fiduciary and other financial services to its local market area. The consolidated financial statements include the accounts of the Corporation and its wholly owned subsidiaries. All material intercompany accounts and transactions are eliminated in consolidation.

The data in the consolidated balance sheet as of December 31, 2010 was derived from the audited consolidated financial statements in the Corporation's 2010 Annual Report on Form 10-K, which was filed with the Securities and Exchange Commission on March 16, 2011. That data, along with the other interim financial information presented in the consolidated balance sheets, statements of income, shareholders' equity and comprehensive income, and cash flows should be read in conjunction with the audited consolidated financial statements, including the notes thereto, contained in the 2010 Annual Report on Form 10-K. Amounts in prior periods' consolidated interim financial statements are reclassified whenever necessary to conform to the current period's presentation.

The consolidated financial statements included herein reflect all adjustments which are, in the opinion of management, of a normal recurring nature and necessary to present fairly the Corporation's financial position as of September 30, 2011 and December 31, 2010, and results of operations for the three and nine-month periods ended September 30, 2011 and 2010, and changes in shareholders' equity and cash flows for the nine-month periods ended September 30, 2011 and 2010. Subsequent events were evaluated for any required recognition or disclosure. The results for the periods presented are not necessarily indicative of results to be expected for the entire fiscal year or any other interim period.

2. Earnings Per Common Share

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 as they are earned. All outstanding unvested share based payment awards that contain rights to nonforfeitable dividends are considered participating securities for this calculation. Restricted stock awards are grants of participating securities. The impact of the participating securities on earnings per share is not material. 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 4,297,777 and 3,604,502 weighted average shares outstanding for the nine-month periods ended September 30, 2011 and 2010, and 4,637,392 and 3,602,277 weighted average shares outstanding for the three-month periods ended September 30, 2011 and 2010, respectively. There were no dilutive common stock equivalents during the three and nine-month periods ended September 30, 2011 or 2010.

3. Fair Value

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

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

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

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

The fair values of securities available for sale are usually determined by obtaining quoted prices on nationally recognized securities exchanges (Level 1 inputs), or matrix pricing, which is a mathematical technique widely used to value debt securities without relying exclusively on quoted prices for the specific securities but rather by relying on the securities' relationship to other benchmark quoted securities (Level 2 inputs).

The Corporation's investment in collateralized debt obligations consisting of pooled trust preferred securities which are issued by financial institutions were historically priced using Level 2 inputs. The lack of observable inputs and market activity in this class of investments has been significant and resulted in unreliable external pricing. Broker pricing and bid/ask spreads, when available, have varied widely. The once active market has become comparatively inactive. As a result, these investments are now priced using Level 3 inputs.

The Corporation has developed an internal model for pricing these securities. This is the same model used in determining other-than-temporary impairment ("OTTI") as further described in Note 8. Information such as historical and current performance of the underlying collateral, deferral/default rates, collateral coverage ratios, break in yield calculations, cash flow projections, liquidity and credit premiums required by a market participant, and financial trend analysis with respect to the individual issuing financial institutions, are utilized in determining individual security valuations. Discount rates were utilized along with the cash flow projections in order to calculate an appropriate fair value. These discount rates were calculated based on industry index rates and adjusted for various credit and liquidity factors. Due to current market conditions as well as the limited trading activity of these securities, the market value of the securities is highly sensitive to assumption changes and market volatility.

The fair value of impaired loans with specific allocations of the allowance for loan losses is generally based on recent real estate appraisals and collateral evaluations. The appraisals may utilize a single valuation approach or a combination of approaches including comparable sales and the income approach. Adjustments are routinely made in the appraisal process by third party appraisers to adjust for differences between the comparable sales and income data available. Such adjustments are typically significant and result in a Level 3 classification of the inputs for determining fair value.





Non-recurring adjustments to certain commercial and residential real estate properties classified as other real estate owned ("OREO") are measured at the lower of carrying amount or fair value, less costs to sell. Fair values are generally based on third party appraisals of the property, resulting in a Level 3 classification. In cases where the carrying amount exceeds the fair value less costs to sell, an impairment loss is recognized.

Assets and liabilities measured at fair value on a recurring basis are summarized below:

		Fair Value Measurement at September 30, 2011		
		Using		
		Quoted Prices in	Significant	Significant
		Active	Other	Unobservable
		Markets for	Observable	Inputs
		Identical	Inputs	Inputs
		Assets	(Level 2)	(Level 3)
Financial Assets:	Fair Value	(Level 1)		
Obligations of U.S. Government and U.S. Government sponsored enterprises	\$ 142,948,508	\$ 36,088,000	\$ 106,860,508	\$ -
Mortgage-backed securities, residential	57,220,655	-	57,220,655	-
Obligations of states and political subdivisions	46,636,291	-	46,636,291	-
Trust Preferred securities	2,280,848	-	1,985,938	294,910
Corporate bonds and notes	13,792,147	-	13,792,147	-
CMO's	8,468,507	-	8,468,507	-
SBA Pool's	2,305,718	-	2,305,718	-
Corporate stocks	5,425,922	4,741,501	684,421	-
Total available for sale securities	\$ 279,078,596	\$ 40,829,501	\$ 237,954,185	\$ 294,910

		Fair Value Measurement at December 31, 2010		
		Using		
		Quoted Prices	Significant	Significant
		in Active	Other	Unobservable
		Markets for	Observable	Inputs
		Identical	Inputs	Inputs
		Assets	(Level 2)	(Level 3)
Financial Assets:	Fair Value	(Level 1)		
Obligations of U.S. Government and U.S. Government sponsored enterprises	\$ 102,131,517	\$ 40,581,250	\$ 61,550,267	\$ -
Mortgage-backed securities, residential	62,761,633	-	62,761,633	-
	38,765,092	-	38,765,092	-

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Obligations of states and political subdivisions				
Trust Preferred securities	2,344,094	-	2,009,509	334,585
Corporate bonds and notes	11,694,190	-	11,694,190	-
Corporate stocks	5,848,435	5,209,069	639,366	-
Total available for sale securities	\$ 223,544,961	\$ 45,790,319	\$ 177,420,057	\$ 334,585

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The table below presents a reconciliation of all assets measured at fair value on a recurring basis using significant unobservable inputs (Level 3) for the nine-month periods ending September 30, 2011 and 2010:

	Fair Value Measurement nine-months ended September 30, 2011 Using Significant Unobservable Inputs (Level 3)	Fair Value Measurement nine-months ended September 30, 2010 Using Significant Unobservable Inputs (Level 3)
Investment Securities Available for Sale		
Beginning balance	\$ 334,585	\$ 511,480
Total gains/losses (realized/unrealized):		
Included in earnings:		
Income on securities	-	-
Impairment charge on investment securities	(67,400)	(393,005)
Included in other comprehensive income	27,725	172,340
Transfers in and/or out of Level 3	-	-
Ending balance September 30	\$ 294,910	\$ 290,815

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

	Fair Value	Fair Value Measurement at September 30, 2011 Using		
		Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Financial Assets:				
Impaired Loans:				
Commercial, financial and agricultural:				
Commercial and industrial	\$ 701,710	\$ -	\$ -	\$ 701,710
Commercial mortgages:	407,551	-	-	407,551
Other	392,257	-	-	392,257
Total Impaired Loans	\$ 1,501,578	\$ -	\$ -	\$ 1,501,578
Other real estate owned, net	\$ 661,475	\$ -	\$ -	\$ 661,475

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Fair Value Measurement at December  
31, 2010  
Using

Quoted  
Prices  
in  
Active  
Markets  
for  
Identical  
Assets  
(Level  
1)

Significant  
Other  
Observable  
Inputs  
(Level  
2)

Significant  
Unobservable  
Inputs  
(Level 3)

Financial Assets:	Fair Value			
<b>Impaired Loans:</b>				
Commercial mortgages:				
Construction	\$ 72,211	\$ -	\$ -	\$ 72,211
Other	580,329	-	-	580,329
Total Impaired Loans	\$ 652,540	\$ -	\$ -	\$ 652,540
Other real estate owned, net	\$ 740,620	\$ -	\$ -	\$ 740,620

Impaired loans, which are measured for impairment using the fair value of the collateral for collateral dependent loans, had a carrying amount of \$3,088,321 with a valuation allowance of \$1,586,743 as of September 30, 2011, resulting in a \$833,333 provision for loan losses for the nine-month period ending September 30, 2011. Impaired loans had a carrying amount of \$892,298, with a valuation allowance of \$239,758 as of December 31, 2010, resulting in no additional provision for loan losses for the year ending December 31, 2010.

OREO, which is measured by the lower of carrying or fair value less costs to sell, had a net carrying amount of \$661,475 at September 30, 2011. The net carrying amount reflects the outstanding balance of \$784,162 net of a valuation allowance of \$122,687 at September 30, 2011 which resulted in write downs of \$12,120 for the nine-month period ending September 30, 2011. OREO had a net carrying amount of \$740,620 at December 31, 2010. The net carrying amount reflected an outstanding balance of \$909,947, net of a valuation allowance of \$169,327 at December 31, 2010 which resulted in write downs of \$169,327 for the year ending December 31, 2010.

The carrying amounts and estimated fair values of other financial instruments, at September 30, 2011 and December 31, 2010, are as follows:

(dollars in thousands)	September 30, 2011		December 31, 2010	
	Carrying Amount	Estimated Fair Value (1)	Carrying Amount	Estimated Fair Value (1)
<b>Financial assets:</b>				
Cash and due from financial institutions	\$ 30,749	\$ 30,749	\$ 16,540	\$ 16,540
Interest-bearing deposits in other financial institutions	87,724	87,724	44,080	44,080
Securities available for sale	279,079	279,079	223,545	223,545
Securities held to maturity	7,586	8,484	7,715	8,297
Federal Home Loan and Federal Reserve Bank stock	5,672	N/A	3,329	N/A
Net loans	778,782	798,889	604,186	618,859
Loans held for sale	74,412	74,412	487	487
Accrued interest receivable	4,001	4,001	2,713	2,713
<b>Financial liabilities:</b>				
<b>Deposits:</b>				
Demand, savings, and insured money market accounts	736,711	736,711	532,555	532,555
Time deposits	305,495	307,978	253,804	256,281
Securities sold under agreements to repurchase	41,454	43,975	44,775	46,667
Federal Home Loan Bank advances	43,936	47,452	20,000	21,609

Accrued interest payable	823	823	784	784
Dividends payable	1,142	1,142	881	881

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

The methods and assumptions used to estimate fair value are described as follows:

Carrying amount is the estimated fair value for cash and due from financial institutions, interest bearing deposits, accrued interest receivable and payable, demand deposits, short-term debt, and variable rate loans or deposits that reprice frequently and fully. The methods for determining the fair values for securities were described previously. For fixed rate loans or deposits and for variable rate loans or deposits with infrequent repricing or repricing limits, fair value is based on discounted cash flows using current market rates applied to the estimated life and credit risk. Fair value of debt is based on current rates for similar financing. It was not practicable to determine the fair value of FHLB stock due to restrictions placed on its transferability. The fair value of off-balance-sheet items is not considered material.

#### 4. Goodwill and Intangible Assets

The changes in goodwill included in the core banking segment during the periods ending September 30, 2011 and 2010 were as follows:

	2011	2010
Beginning of year	\$ 9,872,375	\$ 9,872,375
Acquired goodwill	12,284,838	-
September 30,	\$ 22,157,213	\$ 9,872,375

Acquired intangible assets were as follows at September 30, 2011 and December 31, 2010:

	At September 30, 2011		At December 31, 2010	
	Balance Acquired	Accumulated Amortization	Balance Acquired	Accumulated Amortization
Core deposit intangibles	\$ 3,819,798	\$ 1,050,211	\$ 1,174,272	\$ 674,141
Other customer relationship intangibles	6,063,423	2,354,469	6,133,116	1,977,347
Total	\$ 9,883,221	\$ 3,404,680	\$ 7,307,388	\$ 2,651,488

Aggregate amortization expense was \$753,192 and \$550,531 for the-nine month periods ended September 30, 2011 and 2010, respectively.

The remaining estimated aggregate amortization expense at September 30, 2011 is listed below:

Year	Estimated Expense
2011	\$ 288,001
2012	1,046,720
2013	876,524
2014	777,801
2015	681,176
	2,808,319



2016 and  
thereafter

Total	\$	6,478,541
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## 5. Business Combinations

## Acquisition of Fort Orange Financial Corp.

On April 8, 2011, the Corporation completed its merger with Fort Orange Financial Corp. (“FOFC”), the holding company of Capital Bank & Trust Company (“Capital Bank”) based in Albany, New York, with FOFC being merged with and into the Corporation, and the Corporation being the surviving entity. Immediately following the merger, Capital Bank was merged with and into the Bank.

As of the date of the merger, Capital Bank’s unaudited balance sheet included approximately \$254 million in assets, a loan portfolio approximating \$171 million and deposits of \$199 million. With the completion of the acquisition, the Corporation became a \$1.2 billion financial institution with 28 offices located in eight New York counties, as well as Bradford County in Pennsylvania. The Capital Bank branch locations are in Albany, Clifton Park, Latham and Slingerlands.

Under the terms of an Agreement and Plan of Merger (the “Agreement”) entered into on October 14, 2010, the Corporation purchased all of the outstanding shares of FOFC common stock in a stock and cash transaction valued at \$31.9 million, based upon the Corporation’s closing stock price on April 8, 2011 of \$23.50. For each share of FOFC common stock outstanding immediately prior to the merger, each FOFC shareholder had the right to elect to receive: (i) all cash in the amount of \$7.50 per share (“Cash Consideration”), (ii) all stock at an exchange ratio of 0.3571 of a share of the Corporation’s common stock for each share of FOFC common stock (“Stock Consideration”) or (iii) a mix of Cash Consideration for 25% of their shares and Stock Consideration for 75% of their shares. The total consideration to be paid by the Corporation was subject to the requirement that 25% of the FOFC common stock be acquired for the Cash Consideration and 75% be acquired for the Stock Consideration. As a result of the merger, the Corporation issued approximately 1.01 million additional shares of its common stock.

The table below illustrates the reconciliation of shares outstanding and the calculation of the consideration effectively transferred.

Reconciliation of Shares Outstanding	
FOFC shares outstanding at April 8, 2011	3,771,425
Percentage of stock consideration	75%
FOFC shares exchanged for stock	2,828,569
Exchange Ratio	0.3571
Chemung Financial shares issued to FOFC shareholders (excludes fractional shares)	1,009,942
Chemung Financial shares outstanding April 8, 2011	3,565,610
Total Chemung Financial Shares at April 8, 2011 following the consummation of the transaction	4,575,552
Ownership % held by FOFC shareholders	22%
Ownership % held by legacy Chemung Financial shareholders	78%



Purchase Price Consideration (dollar amounts in thousands, except per share data)	
FOFC shares outstanding at April 8, 2011	3,771,425
Percentage of stock consideration	75%
FOFC shares exchanged for stock	2,828,569
Exchange Ratio	0.3571
Chemung Financial shares issued to FOFC shareholders (excludes fractional shares)	1,009,942
Purchase price per Chemung Financial common share	\$ 23.50
Total stock consideration paid	\$ 23,734
Total cash consideration paid	6,939
Cash paid for fractional shares	3
Cash paid for the settlement of FOFC stock options	545
Cash paid for severance payments	650
Total consideration paid	\$ 31,871

As a result of the FOFC merger, we recognized assets acquired and liabilities assumed at their acquisition date fair value as presented below: (in thousands).

Total Purchase Price	\$ 31,871
Net assets acquired:	
Cash and due from banks	\$ 33,285
Securities available for sale	46,525
Federal Home Loan Bank Stock	1,578
Loans	164,153
Accrued Interest Receivable	864
Premises and equipment	879
Core deposit intangible	2,646
Deferred tax asset	2,466
Other assets	3,530
Deposits	(200,468)
Borrowings	(34,823)
Accrued Interest Payable	(304)
Other liabilities	(745)
Net assets acquired	\$ 19,586
Goodwill resulting from the FOFC merger	\$ 12,285

The goodwill generated by the FOFC merger consists of, among other things, synergies and increased economies of scale, including the ability to offer more diverse and profitable products, greater diversity in the branch system which may lead to lower cost deposits, and an increased legal lending limit. We expect that no goodwill recognized as a result of the FOFC merger will be deductible for income tax purposes. Purchase accounting adjustments are subject to refinement as management finalizes their fair value measurements, including their analysis of identifiable intangible assets. Since the branches

acquired were merged into the Bank, there is no segment impact of the FOFC merger.

The fair value of the financial assets acquired included loans receivable with an unpaid principal balance of \$170.7 million. U.S. generally accepted accounting principles (“U.S. GAAP”) prohibits carrying over an allowance for loan losses for loans purchased in the merger. The table below illustrates the fair value adjustments made to the unpaid principal balance in order to present a fair value of the loans acquired (in thousands).

Gross loans-unpaid principal balance at April 8, 2011	\$	170,682
Fair value adjustment on pools of homogeneous loans		(1,619)
Credit fair value adjustment on loans with deteriorating credit quality		(4,820)
Fair value of purchased loans at April 8, 2011	\$	164,243

The fair value adjustment on pools of homogeneous loans represents adjustments a prospective acquirer would make to the unpaid principal balance to account for differences between the contractual yield on the portfolio and market interest rates, for credit, and for liquidity. The market rate adjustment represents the movement in market interest rates, irrespective of credit adjustments, compared to the stated rates of the acquired loans. The credit adjustment made on pools of homogeneous loans represents the changes in credit quality of the underlying borrowers from the loan inception to the merger date. The credit adjustment on loans with deteriorating credit quality is derived in accordance with Accounting Standard Codification 310-30, “Loans and Debt Securities Acquired with Deteriorated Credit Quality” and represents the portion of the loan balance that has been deemed uncollectible based on our expectations of future cash flows for each respective loan.

The information below presents the recorded fair value on April 8, 2011 of the Corporation’s purchased impaired loans with the accretable and non-accretable related adjustments from the perspective of total contractual cash flows (in thousands).

Contractually required principal and interest at acquisition	\$	25,718
Contractual cash flows not expected to be collected (nonaccretable discount)		(5,849)
Expected cash flows at acquisition		19,869
Interest component of expected cash flows (accretable yield)		(1,861)
Fair value of loans acquired with deteriorating credit quality	\$	18,008

The results of operations of the merged entity have been reflected in Chemung Financial Corporation’s consolidated statements of income beginning as of the acquisition date. Pro forma condensed consolidated income statements for the three and nine months ended September 30, 2011 and 2010 as if the merger occurred at the beginning of each period presented are as follows (in thousands):

Financial assets:	Nine Months Ended	
	2011	2010
Interest and dividend income	\$40,414	\$42,529

Interest expense	6,025	9,660
Net interest income	34,389	32,869
Provision for loan losses	1,808	2,375
Net interest income after provision for loan losses	32,581	30,494
Non-interest income	\$ 13,472	\$ 13,349
Non-interest expense	32,777	32,117
Income before income taxes	13,276	11,726
Income tax expense	4,406	3,742
Net income	\$ 8,870	\$ 7,984
Weighted average shares outstanding	4,629	4,614
Basic and diluted earnings per share	\$ 1.92	\$ 1.73

The consolidated income statement for the Corporation includes \$5.654 million of net interest income, \$72 thousand of non-interest income and net income of \$2.314 million of the acquiree since the acquisition date.

## 6. Comprehensive Income

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

Comprehensive income for the three and nine-month periods ended September 30, 2011 was \$3,297,441 and \$10,538,802, respectively. Comprehensive income for the three and nine-month periods ended September 30, 2010 was \$3,393,701 and \$9,919,485, respectively. The following summarizes the components of other comprehensive income:

	Nine Months Ended September 30,		Three Months Ended September 30,	
	2011	2010	2011	2010
Other Comprehensive Income				
Unrealized holding gains on securities available for sale	\$ 5,448,351	\$ 4,573,717	\$ 294,210	\$ 1,400,082
Change in unrealized gains (losses) on securities available for sale for which a portion of an other-than-temporary impairment has been recognized in earnings, net of reclassification	27,725	172,340	(9,425 )	(50,760)
Reclassification adjustment net gains realized in net income	(1,108,091 )	(451,094)	(428,882 )	-
Net unrealized gains (losses)	4,367,985	4,294,963	(144,097 )	1,349,322
Tax effect	1,689,798	1,661,547	(55,746 )	521,998
Net of tax amount	\$ 2,678,187	\$ 2,633,416	\$ (88,351 )	\$ 827,324
Change in funded status of defined benefit pension plan and other benefit plans	464,097	378,277	154,699	25,183
Tax effect	179,541	146,340	59,847	9,742
Net of tax amount	284,556	231,937	94,852	15,441
Total other comprehensive income	\$ 2,962,743	\$ 2,865,353	\$ 6,501	\$ 842,765

The following is a summary of the accumulated other comprehensive income balance, net of tax:

	Balance at December 31, 2010	Current Period Change	Balance at September 30, 2011



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Unrealized gains on securities available for sale	\$ 5,661,013	\$ 2,678,187	\$ 8,339,200
Unrealized loss on pension plans and other benefit plans	(5,558,538)	284,556	(5,273,982)
Total	\$ 102,475	\$ 2,962,743	\$ 3,065,218

## 7. Commitments and Contingencies

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

Also in the normal course of business, there are various outstanding claims and legal proceedings involving the Corporation or its subsidiaries. On February 14 and April 14, 2011, the Bank received separate settlement demands from representatives of beneficiaries of certain trusts for which the Bank has acted as trustee. The settlement demands relate to alleged claims of, among other things, breach of the Bank's fiduciary duties as trustee, including the Bank's alleged failure to adequately diversify the relevant trust portfolios. The beneficiaries seek aggregate damages of up to approximately \$27.0 million. On September 16, 2011, the beneficiaries objected in the Surrogate's Court of the State of New York, County of Chemung (the "Surrogate's Court") to accountings with respect to the above-mentioned trusts provided by the Bank, based on allegations similar to those offered in the settlement demands. Although these matters are inherently unpredictable, management will defend against these claims vigorously. Management has concluded that it is reasonably possible, but not probable, that the financial position, results of operations or cash flows of the Corporation could be materially adversely affected in any particular period by the unfavorable resolution of these claims. An amount of loss or range of loss cannot be reasonably estimated at this time.

## 8. Securities

Amortized cost and estimated fair value of securities available for sale are as follows:

	September 30, 2011			
	Amortized Cost	Unrealized Gains	Unrealized Losses	Estimated Fair Value
Obligations of U.S. Government and U.S. Government sponsored enterprises	\$ 139,497,422	\$ 3,476,346	\$ 25,260	\$ 142,948,508
Mortgage-backed securities, residential	54,007,115	3,214,050	510	57,220,655
Collateralized Mortgage obligations	8,285,864	183,403	760	8,468,507
Obligations of states and political subdivisions	44,622,411	2,017,069	3,189	46,636,291
Corporate bonds and notes	13,475,088	476,400	159,341	13,792,147
SBA loan pools	2,265,412	40,306	-	2,305,718
	2,536,347	105,236	360,735	2,280,848

Trust Preferred securities				
Corporate stocks	788,129	4,652,367	14,574	5,425,922
Total	\$ 265,477,788	\$ 14,165,177	\$ 564,369	\$ 279,078,596

	December 31, 2010			
	Amortized Cost	Unrealized Gains	Unrealized Losses	Estimated Fair Value
Obligations of U.S. Government and U.S. Government sponsored enterprises	\$ 101,426,799	\$ 916,547	\$ 211,829	\$ 102,131,517
Mortgage-backed securities, residential	60,379,269	2,385,036	2,672	62,761,633
Obligations of states and political subdivisions	38,143,972	672,067	50,947	38,765,092
Corporate bonds and notes	11,019,343	674,847	-	11,694,190
Trust Preferred securities	2,597,993	134,561	388,460	2,344,094
Corporate stocks	744,763	5,112,755	9,082	5,848,435
Total	\$ 214,312,139	\$ 9,895,813	\$ 662,990	\$ 223,544,961

Amortized cost and estimated fair value of securities held to maturity are as follows:

	September 30, 2011			
	Amortized Cost	Unrealized Gains	Unrealized Losses	Estimated Fair Value
Obligations of states and political subdivisions	\$ 7,585,671	\$ 897,882	\$ -	\$ 8,483,553
Total	\$ 7,585,671	\$ 897,882	\$ -	\$ 8,483,553

	December 31, 2010			
	Amortized Cost	Unrealized Gains	Unrealized Losses	Estimated Fair Value
Obligations of states and political subdivisions	\$ 7,715,123	\$ 582,269	\$ -	\$ 8,297,392
Total	\$ 7,715,123	\$ 582,269	\$ -	\$ 8,297,392

The amortized cost and estimated fair value of debt securities are shown 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:

	September 30, 2011			
	Available for Sale		Held to Maturity	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
Within One Year	\$ 45,528,688	\$ 45,906,777	\$ 2,048,903	\$ 2,083,328
After One, But Within Five Years	193,393,110	200,601,911	3,580,269	4,007,464

After Five, But Within Ten Years	21,308,173	22,862,763	1,956,499	2,392,761
After Ten Years	4,459,688	4,281,223	-	-
Total	\$ 264,689,659	\$ 273,652,674	\$ 7,585,671	\$ 8,483,553

Proceeds from sales and calls of securities available for sale for the three and nine months ended September 30, 2011 were \$11,085,156 and \$67,741,210, respectively. Realized gross gains on these sales and calls were \$428,882 and \$1,108,091 during the three and nine month periods ended September 30, 2011, respectively. There were no sales or calls of securities available for sale that resulted in losses for the three or nine-months ended September 30, 2011.

Proceeds from sales and calls of securities available for sale for the three and nine months ended September 30, 2010, were \$20,000,000 and \$50,440,459, respectively. There were no realized gross gains on these sales and calls were during the three month period ended September 30, 2010 and realized gross gains on these sales and calls were \$451,094 during nine month period ended September 30, 2010. There were no sales or calls of securities available for sale that resulted in losses for the three or nine-months ended September 30, 2010.

The following table summarizes the investment securities available for sale and held to maturity with unrealized losses at September 30, 2011 and December 31, 2010 by aggregated major security type and length of time in a continuous unrealized loss position:

September 30, 2011	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	\$ 14,874,740	25,260	\$ -	\$ -	\$ 14,874,740	\$ 25,260
Mortgage-backed securities, residential	187,675	\$ 510	-	-	187,675	510
Collateralized mortgage obligations	1,167,696	760	-	-	1,167,696	760
Obligations of states and political subdivisions	363,989	3,189	-	-	363,989	3,189
Corporate bonds and notes	5,308,085	159,341	-	-	5,308,085	159,341
Trust preferred securities	-	-	294,910	360,735	294,910	360,735
Corporate stocks	3,353	285	35,703	14,289	39,056	14,574
Total temporarily impaired securities	\$ 21,905,538	\$ 189,345	\$ 330,613	\$ 375,024	\$ 22,236,151	\$ 564,369

December 31, 2010	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	\$ 25,543,154	\$ 211,829	\$ -	\$ -	\$ 25,543,154	\$ 211,829

and U.S. Government sponsored enterprises						
Mortgage-backed securities, residential	844,587	2,672	-	-	844,587	2,672
Obligations of states and political subdivisions	7,746,912	50,947	-	-	7,746,912	50,947
Trust preferred securities	-	-	334,585	388,460	334,585	388,460
Corporate stocks	-	-	40,910	9,082	40,910	9,082
	\$ 34,134,653	\$ 265,448	\$ 375,495	\$ 397,542	\$ 34,510,148	\$ 662,990

### Other-Than-Temporary Impairment

In determining OTTI for debt securities, management considers many factors, including: (1) the length of time and the extent to which the fair value has been less than cost, (2) the financial condition and near-term prospects of the issuer, (3) whether the market decline was affected by macroeconomic conditions, and (4) whether the Corporation has the intent to sell the debt security or more likely than not will be required to sell the debt security before its anticipated recovery. The assessment of whether an other-than-temporary decline exists involves a high degree of subjectivity and judgment and is based on the information available to management at a point in time.

In order to determine OTTI for purchased beneficial interests, the Corporation compares the present value of the remaining cash flows as estimated at the preceding evaluation date to the current expected remaining cash flows. OTTI is deemed to have occurred if there has been an adverse change in the remaining expected future cash flows.

When OTTI occurs, for either debt securities or purchased beneficial interests, the amount of the OTTI recognized in earnings depends on whether an entity intends to sell the security or more likely than not will be required to sell the security before recovery of its amortized cost basis, less any current-period credit loss. If an entity intends to sell or more likely than not will be required to sell the security before recovery of its amortized cost basis, less any current-period credit loss, the OTTI shall be recognized in earnings equal to the entire difference between the investment's amortized cost basis and its fair value at the balance sheet date. If an entity does not intend to sell the security and it is not more likely than not that the entity will be required to sell the security before recovery of its amortized cost basis less any current-period loss, the OTTI shall be separated into the amount representing the credit loss and the amount related to all other factors. The amount of the total OTTI related to the credit loss is determined based on the present value of cash flows expected to be collected and is recognized in earnings. The amount of the total OTTI related to other factors is recognized in other comprehensive income, net of applicable taxes. The previous amortized cost basis less the OTTI recognized in earnings becomes the new amortized cost basis of the investment.

As of September 30, 2011, the majority of the Corporation's unrealized losses in the investment securities portfolio related to two pooled trust preferred securities. The decline in fair value on these securities is primarily attributable to the financial crisis and resulting credit deterioration and financial condition of the underlying issuers, all of which are financial institutions. This deterioration may affect the future receipt of both principal and interest payments on these securities. This fact combined with the current illiquidity in the market makes it unlikely that the Corporation would be able to recover its investment in these securities if the securities were sold at this time. One of these securities has been previously written down through the income statement to an amount considered to be immaterial to the financial statements. Therefore management is no longer analyzing this security for further impairment.

Our analysis of these investments includes \$629 thousand book value of a collateralized debt obligation ("CDO") consisting is a pooled trust preferred security. This security was rated high quality at inception, but at September 30, 2011 Moody's rated this security as Caa3, which is defined as substantial risk of default. The Corporation uses the OTTI evaluation model to compare the present value of expected cash flows to the previous estimate to determine if there are adverse changes in cash flows during the quarter. The OTTI model considers the structure and term of the CDO and the financial condition of the underlying issuers. Specifically, the model details interest rates, principal balances of note classes and underlying issuers, the timing and amount of interest and principal payments of the underlying issuers, and the allocation of the payments to the note classes. The current estimate of expected cash flows is



based on the most recent trustee reports and any other relevant market information including announcements of interest payment deferrals or defaults of underlying trust preferred securities.

Assumptions used in the model include expected future default rates and prepayments. We assume no recoveries on defaults and treat all interest payment deferrals as defaults.

In determining the amount of "currently performing" collateral for the purposes of modeling the expected future cash flows, management analyzed the default and deferral history over the past 3 years. This review indicated significant increases in the number and amount of defaults and deferrals by the issuers. Additionally, management has noted the correlation between the rising levels of non-performing loans as a percent of tangible equity plus loan loss reserves by those issuers that have defaulted and/or deferred interest payments. Therefore management has used this ratio as a primary indicator to project the levels of future defaults for modeling purposes. Management recognizes the potential of defaults and deferrals to continue over the next 12 to 24 months. The operating environment remains difficult for community and regional banks in many parts of the country, which could lead to higher default and deferral levels. Seventy-four depository institutions were closed by regulators during the first nine months of 2011.

The following table provides detailed information related to the pooled trust preferred security analyzed at September 30, 2011:

Description	Actual Deferrals as % of Outstanding Collateral	Actual Defaults as % of Original Collateral	Excess Subordination as % of Performing Collateral	Expected Additional Defaults as % of Performing Collateral
TPREF Funding II, Ltd. (Class B)	17.90%	16.06%	-44.27%	16.14%

In the table above, "Excess Subordination as % of Performing Collateral" was calculated by dividing the difference between the total face value of performing collateral less the face value of all outstanding note balances not subordinate to our investment, by the total face value of performing collateral. This ratio measures the extent to which there may be tranches within a pooled trust preferred structure available to absorb credit losses before the Corporation's security would be impacted. As mentioned earlier, the levels of defaults and deferrals in this pool has increased significantly in recent months, which have resulted in a significant reduction in the amount of performing collateral. As a result, the negative Excess Subordination as a % of Performing Collateral percentages shown above indicate there is no support from subordinate tranches available to absorb losses before the Corporation's security would be impacted. A negative ratio is not the only factor to consider when determining if OTTI should be recorded. Other factors affect the timing and amount of cash flows available for payments to investors such as the excess interest paid by the issuers, as issuers typically pay higher rates of interest than are paid out to investors.

Upon completion of the September 30, 2011 analysis, our model indicated an additional other-than-temporary impairment of \$67 thousand on the TPREF Funding II security. This security remained classified as available for sale and represented \$352 thousand of the unrealized losses reported at September 30, 2011. Payments continue to be made as agreed on the TPREF Funding II security.



When the analysis was conducted at September 30, 2011, the present value of expected future cash flows using a discount rate equal to the yield in effect at the time of purchase was compared to the previous quarters' analysis. This analysis indicated a further decline in value attributed to credit related factors stemming from further deterioration in the underlying collateral payment streams. Additionally, to estimate fair value the present value of the expected future cash flows was calculated using a current estimated discount rate that a willing market participant might use to value the security based on current market conditions and interest rates. This comparison indicated a slight decrease in value during the quarter, based on factors other than credit, which resulted in a loss reported in other comprehensive income. Changes in credit quality may or may not correlate to changes in the overall fair value of the impaired securities as the change in credit quality is only one component in assessing the overall fair value of the impaired securities. Therefore, the recognition of additional credit related OTTI could result in a gain reported in other comprehensive income. Total other-than-temporary impairment recognized in accumulated other comprehensive income was \$220,459 and \$265,018 for securities available for sale at September 30, 2011 and September 30, 2010, respectively.

The table below presents a roll forward of the cumulative credit losses recognized in earnings for the three and nine-month periods ending September 30, 2011 and 2010:

	2011	2010
Beginning balance, January 1,	\$ 3,438,673	\$ 3,045,668
Amounts related to credit loss for which an other-than-temporary impairment was not previously recognized	-	-
<b>Additions/Subtractions:</b>		
Amounts realized for securities sold during the period	-	-
Amounts related to securities for which the company intends to sell or that it will be more likely than not that the company will be required to sell prior to recovery of amortized cost basis	-	-
Reductions for increase in cash flows expected to be collected that are recognized over the remaining life of the security	-	-
Increases to the amount related to the credit loss for which other-than-temporary impairment was previously recognized	67,400	393,005
Ending balance, September 30,	\$ 3,506,073	\$ 3,438,673
Beginning balance, July 1,	\$ 3,438,673	\$ 3,382,293
	-	-

Amounts related to credit loss for  
which an other-than-temporary  
impairment was not previously  
recognized

Additions/Subtractions:

Amounts realized for securities sold during the period	-	-
Amounts related to securities for which the company intends to sell or that it will be more likely than not that the company will be required to sell prior to recovery of amortized cost basis	-	-
Reductions for increase in cash flows expected to be collected that are recognized over the remaining life of the security	-	-
Increases to the amount related to the credit loss for which other-than-temporary impairment was previously recognized	67,400	56,380
Ending balance, September 30,	\$ 3,506,073	\$ 3,438,673

## 9. Loans and Allowance for Loan Losses

The composition of the loan portfolio is summarized as follows:

	September 30, 2011	December 31, 2010
Commercial, financial and agricultural	\$ 147,815,433	\$ 114,697,440
Commercial mortgages	250,030,218	133,070,484
Residential mortgages	194,260,610	173,467,806
Indirect consumer loans	96,093,955	98,940,854
Consumer loans	100,258,360	93,507,785
	\$ 788,458,576	\$ 613,684,369

Loans are charged against the allowance for loan losses when management believes that the collectability of all or a portion of the principal is unlikely. The allowance is an amount that management believes will be adequate to absorb probable incurred losses on existing loans. Management's evaluation of the adequacy of the allowance for loan losses is performed on a periodic basis and takes into consideration such factors as the credit risk grade assigned to the loan, historical loan loss experience and review of specific problem loans (including evaluations of the underlying collateral). Historical loss experience is adjusted by management based on their judgment as to the current impact of qualitative factors including changes in the composition and volume of the loan portfolio, overall portfolio quality, and current economic conditions that may affect the borrowers' ability to pay. Management believes that the allowance for loan losses is adequate to absorb probable incurred losses. While management uses available information to recognize losses on loans, future additions to the allowance may be necessary based on changes in economic conditions. In addition, various regulatory agencies, as an integral part of their examination process, periodically review the Corporation's allowance for loan losses. Such agencies may require the Corporation to recognize additions to the allowance based on their judgments about information available to them at the time of their examination.

Management, after considering current information and events regarding a borrower's ability to repay its obligations, classifies a loan as impaired when it is probable that the Corporation will be unable to collect all amounts due according to the contractual terms of the loan agreement. If a loan is impaired, a portion of the allowance is allocated so that the loan is reported, net, at the present value of estimated future cash flows using the loan's existing rate or at the fair value of collateral if repayment is expected solely from the collateral. Large groups of smaller balance homogeneous loans, such as consumer and residential real estate loans, are collectively evaluated for impairment, and accordingly, they are not separately identified for impairment disclosures. Troubled debt restructurings are separately identified for impairment disclosures and are measured at the present value of estimated future cash flows using the loan's effective rate at inception. If a troubled debt restructuring is considered to be a collateral dependent loan, the loan is reported, net, at the fair value of the collateral. For troubled debt restructurings that subsequently default, the Corporation determines the amount of reserve in accordance with the accounting policy for the allowance for loan losses.



The general component of the allowance for loan losses covers non-impaired loans and is based on historical loss experience adjusted for current factors. Loans not impaired but classified as substandard and special mention use a historical loss factor on a rolling five year history of net losses. For all other unclassified loans, the historical loss experience is determined by portfolio class and is based on the actual loss history experienced by the Corporation over the most recent two years. This actual loss experience is supplemented with other economic factors based on the risks present for each portfolio class. These economic factors include consideration of the following: levels of and trends in delinquencies and impaired loans; levels of and trends in charge-offs and recoveries; trends in volume and terms of loans; effects of any changes in risk selection and underwriting standards; other changes in lending policies, procedures, and practices; experience, ability, and depth of lending management and other relevant staff; national and local economic trends and conditions; industry conditions; and effects of changes in credit concentrations. The following portfolio segments have been identified: commercial, financial and agricultural; commercial mortgages; residential mortgages; and consumer loans.

#### Risk Characteristics

Commercial, financial and agricultural loans primarily consist of loans to small to mid-sized businesses in our market area in a diverse range of industries. These loans are of higher risk and typically are made on the basis of the borrower's ability to make repayment from the cash flow of the borrower's business. Further, the collateral securing the loans may depreciate over time, may be difficult to appraise and may fluctuate in value. The credit risk related to commercial loans is largely influenced by general economic conditions and the resulting impact on a borrower's operations or on the value of underlying collateral, if any.

Commercial mortgage loans generally have larger balances and involve a greater degree of risk than residential mortgage loans, inferring higher potential losses on an individual customer basis. Loan repayment is often dependent on the successful operation and management of the properties and/or the businesses occupying the properties, as well as on the collateral securing the loan. Economic events or conditions in the real estate market could have an adverse impact on the cash flows generated by properties securing the Company's commercial real estate loans and on the value of such properties.

Residential mortgage loans are generally made on the basis of the borrower's ability to make repayment from his or her employment and other income, but are secured by real property whose value tends to be more easily ascertainable. Credit risk for these types of loans is generally influenced by general economic conditions, the characteristics of individual borrowers and the nature of the loan collateral.

The consumer loan segment includes home equity lines of credit and home equity loans, which exhibit many of the same risk characteristics as residential mortgages. Indirect and other consumer loans may entail greater credit risk than residential mortgage and home equity loans, particularly in the case of other consumer loans which are unsecured or, in the case of indirect consumer loans, secured by depreciable assets, such as automobiles or boats. In such cases, any repossessed collateral for a defaulted consumer loan may not provide an adequate source of repayment of the outstanding loan balance. In addition, consumer loan collections are dependent on the borrower's continuing financial stability, thus are more likely to be affected by adverse personal circumstances such as job loss, illness or personal bankruptcy. Furthermore, the application of various federal and state laws, including bankruptcy and insolvency laws, may limit the amount which can be recovered on such loans.

No allowance for loan losses was recorded as of September 30, 2011 for loans acquired as part of the FOFC merger. These loans were recorded at fair value at the time of the acquisition.





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Activity in the allowance for loan losses by portfolio segment was as follows:

Nine Months Ended September 30, 2011						
Allowance for loan losses	Commercial, Financial and Agricultural	Commercial Mortgages	Residential Mortgages	Consumer Loans	Unallocated	Total
Beginning balance:	\$ 2,118,299	\$ 2,575,058	\$ 1,301,780	\$ 2,727,022	\$ 775,972	\$ 9,498,131
Charge Offs:	(593,995)	(3,764)	(39,312)	(542,621)	-	(1,179,692)
Recoveries:	314,797	33,304	30,324	146,726	-	525,151
Net charge offs	(279,198)	29,540	(8,988)	(395,895)	-	(654,541)
Provision	1,444,245	(69,375)	(61,068)	(184,348)	(296,121)	833,333
Ending balance	\$ 3,283,346	\$ 2,535,223	\$ 1,231,724	\$ 2,146,779	\$ 479,851	\$ 9,676,923

Three Months Ended September 30, 2011						
Allowance for loan losses	Commercial, Financial and Agricultural	Commercial Mortgages	Residential Mortgages	Consumer Loans	Unallocated	Total
Beginning balance:	\$ 3,081,433	\$ 2,612,655	\$ 1,246,880	\$ 2,297,459	\$ 517,245	\$ 9,755,672
Charge Offs:	(590,992)	-	(39,312)	(201,966)	-	(832,270)
Recoveries:	109,391	7,201	-	53,596	-	170,188
Net charge offs	(481,601)	7,201	(39,312)	(148,370)	-	(662,082)
Provision	683,514	(84,633)	24,156	(2,310)	(37,394)	583,333
Ending balance	\$ 3,283,346	\$ 2,535,223	\$ 1,231,724	\$ 2,146,779	\$ 479,851	\$ 9,676,923

	Three Months Ended September 30, 2010	Nine Months Ended September 30, 2010
Beginning balance:	\$ 10,447,291	\$ 9,967,223
Charge offs:	(1,298,599)	(1,883,840)
Recoveries:	136,369	451,678
Net charge offs	(1,162,230)	(1,432,162)
Provision	375,000	1,125,000
Ending balance	\$ 9,660,061	\$ 9,660,061



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The following tables present the balance in the allowance for loan losses and the recorded investment in loans by portfolio segment based on impairment method as of September 30, 2011 and December 31, 2010. The recorded investment excludes loans acquired in the FOFC merger.

September 30, 2011

Allowance for loan losses	Commercial, Financial and Agricultural	Commercial Mortgages	Residential Mortgages	Consumer Loans	Unallocated	Total
Ending allowance balance attributable to loans:						
Individually evaluated for impairment	\$ 1,302,878	\$ 283,865	\$ -	\$ -	\$ -	\$ 1,586,743
Collectively evaluated for impairment	1,980,468	2,251,358	1,231,724	2,146,779	479,851	8,090,180
Total ending allowance balance	\$ 3,283,346	\$ 2,535,223	\$ 1,231,724	\$ 2,146,779	\$ 479,851	\$ 9,676,923

December 31, 2010

Allowance for loan losses	Commercial, Financial and Agricultural	Commercial Mortgages	Residential Mortgages	Consumer Loans	Unallocated	Total
Ending allowance balance attributable to loans:						
Individually evaluated for impairment	\$ 23,524	\$ 216,234	\$ -	\$ -	\$ -	\$ 239,758
Collectively evaluated for impairment	2,094,775	2,358,824	1,301,780	2,727,022	775,972	9,258,373
Total ending allowance balance	\$ 2,118,299	\$ 2,575,058	\$ 1,301,780	\$ 2,727,022	\$ 775,972	\$ 9,498,131

September 30, 2011

Loans:	Commercial, Financial and Agricultural	Commercial Mortgages	Residential Mortgages	Consumer Loans	Total
	\$ 4,975,639	\$ 4,399,423	\$ 182,117	\$ -	\$ 9,557,179

Loans individually evaluated for impairment					
Loans collectively evaluated for impairment	114,832,632	153,065,673	173,346,567	190,465,243	\$ 631,710,115
Total ending loans balance	\$ 119,808,271	\$ 157,465,096	\$ 173,528,684	\$ 190,465,243	\$ 641,267,294

## December 31, 2010

Loans:	Commercial, Financial and Agricultural	Commercial Mortgages	Residential Mortgages	Consumer Loans	Total
Loans individually evaluated for impairment	\$ 3,215,761	\$ 4,450,882	\$ 408,392	\$ -	\$ 8,075,035
Loans collectively evaluated for impairment	111,778,238	128,963,664	173,465,831	193,098,341	607,306,074
Total ending loans balance	\$ 114,993,999	\$ 133,414,546	\$ 173,874,223	\$ 193,098,341	\$ 615,381,109

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The following tables present loans individually evaluated for impairment recognized by class of loans as of September 30, 2011 and December 31, 2010, the average recorded investment and interest income recognized by class of loans as of the three and nine month periods ending September 30, 2011:

	September 30, 2011			Nine Months Ended September 30, 2011		Three Months Ended September 30, 2011	
	Unpaid Principal Balance	Allowance for Loan Losses Allocated	Recorded Investment	Average Recorded Investment	Interest Income Recognized	Average Recorded Investment	Interest Income Recognized
With no related allowance recorded:							
Commercial, financial and agricultural:							
Commercial & industrial	\$2,968,386	\$ -	\$2,971,036	\$3,100,655	\$ 25,049	\$ 3,032,483	\$ 6,290
Commercial mortgages:							
Construction	10,739	-	10,739	24,490	-	20,602	-
Other	3,310,502	-	3,307,483	3,447,948	-	3,397,079	-
Residential mortgages	181,705	-	182,117	307,997	-	257,799	-
With an allowance recorded:							
Commercial, financial and agricultural:							
Commercial & industrial	2,004,588	1,302,878	2,004,603	1,953,474	82,548	2,918,444	82,548
Commercial mortgages:							
Construction	11,261	11,261	11,261	27,351	-	15,557	-
Other	1,072,472	272,604	1,069,940	821,994	17,070	823,995	17,070
Total	\$9,559,653	\$1,586,743	\$9,557,179	\$9,683,909	\$124,667	\$10,465,959	\$105,908

December 31, 2010

	Unpaid Principal Balance	Allowance for Loan Losses Allocated	Recorded Investment	Average Recorded Investment	Interest Income Recognized
With no related allowance recorded:					

Commercial,  
financial and  
agricultural:

Commercial & industrial	\$ 4,334,095	\$ -	\$ 3,192,227	\$ 1,876,603	\$ 73,657
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Commercial  
mortgages:

Construction	32,266	-	32,266	8,067	-
Other	4,148,423	-	3,549,686	3,374,678	63,061

Residential mortgages	407,105	-	408,392	309,537	21,324
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With an  
allowance  
recorded:

Commercial,  
financial and  
agricultural:

Commercial & industrial	23,524	23,524	23,534	1,393,995	386
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Agricultural	-	-	-	6,211	453
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Commercial  
mortgages:

Construction	50,939	43,514	50,939	215,901	-
Other	838,277	172,720	817,991	1,378,687	969

Residential mortgages	-	-	-	215,299	6,470
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Total	\$ 9,834,629	\$ 239,758	\$ 8,075,035	\$ 8,778,978	\$ 166,320
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The following table presents the recorded investment in non accrual and loans past due over 90 days still on accrual by class of loans. This table includes loans acquired in the FOFC merger, except those loans with evidence of credit deterioration at the time of the merger.

	September 30, 2011		December 31, 2010	
	Non-Accrual	Loans Past Due Over 90 Days Still Accruing	Non-Accrual	Loans Past Due Over 90 Days Still Accruing
Commercial, financial and agricultural:				
Commercial & industrial	\$ 5,251,391	\$ 3,643	\$ 2,938,174	\$ -
Commercial mortgages	-	-	-	-
Construction	22,000	7,059,479	83,204	-
Other	6,030,548	-	4,230,701	-
Residential mortgages	2,357,889	-	2,558,534	-
Consumer loans				
Credit cards	-	5,512	-	11,174
Home equity lines & loans	526,052	-	545,039	-
Indirect consumer loans	16,196	-	180,632	-
Other direct consumer loans	159,244	-	61,601	-
Total	\$ 14,363,320	\$ 7,068,634	\$ 10,597,886	\$ 11,174



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The following tables present the aging of the recorded investment in loans past due (including non-accrual loans) by class of loans as of September 30, 2011 and December 31, 2010 and by loans originated by the Corporation (referred to as “Legacy” loans) and loans acquired in the FOFC merger (referred to as “Acquired” loans) which are further discussed in Note 5:

September 30, 2011

	30-59 Days Past Due	60-89 Days Past Due	Greater than 90 Days Past Due	Total Past Due	Loans Acquired with deteriorated credit quality	Loans Not Past Due	Total
Legacy Loans: Commercial, financial and agricultural:							
Commercial & industrial	\$ 139,590	\$ 7,743	\$2,918,608	\$ 3,065,941	\$ -	\$116,236,537	\$ 119,302,478
Agricultural	-	-	-	-	-	505,792	505,792
Commercial mortgages:							
Construction	-	-	-	-	-	7,525,126	7,525,126
Other	88,266	-	3,103,796	3,192,062	-	146,747,908	149,939,970
Residential mortgages	1,547,675	455,525	938,554	2,941,754	-	170,586,931	173,528,685
Consumer loans:							
Credit cards	3,558	2,767	5,511	11,836	-	1,857,860	1,869,696
Home equity lines & loans	140,297	-	260,318	400,615	-	77,462,639	77,863,254
Indirect consumer loans	342,674	90,812	141,792	575,278	-	95,813,548	96,388,826
Other direct consumer loans	64,409	7,980	2,835	75,224	-	14,268,243	14,343,467
Total	\$2,326,469	\$564,827	\$7,371,414	\$10,262,710	\$ -	\$631,004,584	\$641,267,294

September 30, 2011

	30-59 Days Past Due	60-89 Days Past Due	Greater than 90 Days Past Due	Total Past Due	Loans Acquired with deteriorated credit quality	Loans Not Past Due	Total
Acquired Loans: Commercial, financial and agricultural:							
Commercial & industrial	\$230,548	\$ 984,202	\$ 198,877	\$ 1,413,627	\$ 1,591,772	\$ 26,996,570	\$ 30,001,969

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Agricultural	-	-	-	-	-	-	-
Commercial mortgages:							
Construction	18,884	423,882	7,059,479	7,502,245	2,305,549	2,907,182	12,714,976
Other	154,383	197,441	1,653,124	2,004,948	11,248,658	65,645,166	78,898,772
Residential mortgages	474,152	65,364	85,181	624,697	222,580	20,547,566	21,394,843
Consumer loans:							
Credit cards	-	-	-	-	-	-	-
Home equity lines & loans	-	-	-	-	-	6,199,175	6,199,175
Indirect consumer loans	-	-	-	-	-	-	-
Other direct consumer loans	-	-	-	-	-	139,238	139,238
Total	\$877,967	\$1,670,889	\$8,996,661	\$11,545,517	\$15,368,559	\$122,434,897	\$149,348,973

	December 31, 2010					
Legacy Loans:	30-59 Days Past Due	60-89 Days Past Due	Greater than 90 Days Past Due	Total Past Due	Loans Not Past Due	Total
Commercial, financial and agricultural						
Commercial & industrial	\$ 33,434	\$ 17,351	\$ 2,914,640	\$ 2,965,425	\$ 111,202,073	\$ 114,167,498
Agricultural	-	-	-	-	826,501	826,501
Commercial mortgages						
Construction	-	-	63,102	63,102	9,029,450	9,092,552
Other	116,432	-	2,913,525	3,029,957	121,292,041	124,321,998
Residential mortgages	1,851,412	277,276	1,404,067	3,532,755	170,341,467	173,874,222
Consumer loans						
Credit cards	4,889	16,635	11,174	32,698	1,989,199	2,021,897
Home equity lines & loans	550,134	79,910	321,116	951,160	76,052,290	77,003,450
Indirect consumer loans	465,818	154,969	146,221	767,008	98,571,142	99,338,150
Other direct consumer loans	51,125	12,502	41,964	105,591	14,629,253	14,734,844
Total	\$ 3,073,244	\$ 558,643	\$ 7,815,809	\$ 11,447,696	\$ 603,933,416	\$ 615,381,112

#### Troubled Debt Restructurings:

The Corporation has not allocated any specific reserves to customers whose loan terms have been modified in troubled debt restructurings as of September 30, 2011 or December 31, 2010. The Corporation has not committed to lend any additional amounts as of September 30, 2011 or December 31, 2010 to customers with outstanding loans that are classified as trouble debt restructurings.

During the three and nine months ended September 30, 2011, no loans were modified as troubled debt restructurings by the Corporation. Additionally, there were no payment defaults on any loans previously modified as troubled debt restructurings within twelve months following the modification. A loan is considered to be in payment default once it is 90 days contractually past due under the modified terms.

#### Credit Quality Indicators:

The Corporation categorizes loans into risk categories based on relevant information about the ability of borrowers to service their debt such as: current financial information, historical payment experience, credit documentation, public information, and current economic trends, among other factors. The Corporation analyzes loans individually by classifying the loans as to credit risk. This analysis includes

new consumer, mortgage and home equity loans and lines with outstanding balances greater than \$50 thousand, \$250 thousand and \$100 thousand, respectively, along with a sample of existing loans and non-homogeneous loans, such as commercial and commercial real estate loans. The loans meeting these criteria are reviewed at least annually. The Corporation uses the following definitions for risk rating:

**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 as 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.

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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.

Loans not meeting the criteria above that are analyzed individually as part of the above described process are considered to be pass rated loans. Based on the analysis's performed as of September 30, 2011 and December 31, 2010, the risk category of the recorded investment of loans by class of loans is as follows:

Legacy Loans:	September 30, 2011				
	Not Rated	Pass	Special Mention	Substandard	Doubtful
Commercial, financial and agricultural:					
Commercial & industrial	\$ -	\$ 98,332,680	\$ 12,549,673	\$ 4,865,665	\$ 3,554,460
Agricultural	-	505,792	-	-	-
Commercial mortgages:					
Construction	-	6,492,114	211,583	481,927	339,502
Other	-	134,922,194	6,805,611	7,660,502	551,663
Residential mortgages	171,275,866	-	-	2,252,819	-
Consumer loans:					
Credit cards	1,869,696	-	-	-	-
Home equity lines & loans	77,337,201	-	-	526,053	-
Indirect consumer loans	96,223,075	-	-	165,751	-
Other direct consumer loans	14,327,271	-	-	16,196	-
Total	\$ 361,033,109	\$ 240,252,780	\$ 19,566,867	\$ 15,968,913	\$ 4,445,625

Acquired

Loans:

Commercial,  
financial and  
agricultural:

Commercial & industrial	\$ -	\$ 27,771,057	\$ 617,784	\$ 21,356	\$ -
Agricultural	-	-	-	-	-
Commercial mortgages:					
Construction	-	5,360,446	3,858,838	1,190,143	-
Other	-	65,659,894	636,087	1,354,133	-

Residential mortgages	21,087,082	-	-	85,181	-
Consumer loans:					
Credit cards	-	-	-	-	-
Home equity lines & loans	6,199,175	-	-	-	-
Indirect consumer loans	-	-	-	-	-
Other direct consumer loans	139,238	-	-	-	-
Total	\$ 27,425,495	\$ 98,791,397	\$ 5,112,709	\$ 2,650,813	\$ -

## December 31, 2010

Legacy Loans:	Not Rated	Pass	Special Mention	Substandard	Doubtful
Commercial, financial and agricultural:					
Commercial & industrial	\$ -	\$ 90,887,538	\$ 16,946,891	\$ 4,770,276	\$ 1,562,794
Agricultural	-	824,882	1,619	-	-
Commercial mortgages:					
Construction	-	7,497,488	672,136	922,928	-
Other	-	108,732,393	7,245,641	8,343,964	-
Residential mortgages	171,024,544	-	-	2,849,678	-
Consumer loans:					
Credit cards	2,021,896	-	-	-	-
Home equity lines & loans	76,458,414	-	-	545,037	-
Indirect consumer loans	99,155,306	-	-	77,883	-
Other direct consumer loans	14,656,690	-	-	182,844	-
Total	\$ 363,317,120	\$ 207,942,301	\$ 24,866,287	\$ 17,692,610	\$ 1,562,794

The Corporation considers the performance of the loan portfolio and its impact on the allowance for loan losses. For residential and consumer loan classes, the Corporation also evaluates credit quality based on the aging status of the loan, which was previously presented, and by payment activity. The following table presents the recorded investment in residential and consumer loans based on payment activity as of September 30, 2011 and December 31, 2010:

September 30, 2011					
Consumer Loans					
	Residential		Home Equity	Indirect	Other Direct
Legacy Loans:	Mortgages	Credit Card	Lines &	Consumer	Consumer
			Loans	Loans	Loans
Performing	\$ 171,255,977	\$ 1,864,184	\$ 77,337,202	\$ 96,229,582	\$ 14,327,271
Non-Performing	2,272,707	5,512	526,052	159,244	16,196
	173,528,684	1,869,696	77,863,254	96,388,826	14,343,467
Acquired Loans:					
Performing	\$ 21,309,662	\$ -	\$ 6,199,175	\$ -	\$ 139,238
Non-Performing	85,181	-	-	-	-
Total	\$ 21,394,843	\$ -	\$ 6,199,175	\$ -	\$ 139,238

December 31, 2010					
Consumer Loans					
	Residential		Home Equity	Indirect	Other Direct
Legacy Loans:	Mortgages	Credit Card	Lines &	Consumer	Consumer
			Loans	Loans	Loans
Performing	\$ 171,070,881	\$ 2,010,723	\$ 76,458,413	\$ 99,157,518	\$ 14,673,243
Non-Performing	2,803,342	11,174	545,037	186,632	61,601
Total	\$ 173,874,223	\$ 2,021,897	\$ 77,003,450	\$ 99,338,150	\$ 14,734,844

## 10. Components of Quarterly and Year-to-Date Net Periodic Benefit Costs

	Nine Months Ended September 30,		Three Months Ended September 30,	
	2011	2010	2011	2010
<b>Qualified Pension</b>				
Service cost, benefits earned during the period	\$ 777,402	\$ 677,654	\$ 259,134	\$ 144,938
Interest cost on projected benefit obligation	1,178,868	1,137,613	392,956	179,589
Expected return on plan assets	(1,757,019)	(1,690,066)	(585,673)	(301,794)
Amortization of unrecognized transition obligation	-	-	-	-
Amortization of unrecognized prior service cost	22,410	34,417	7,470	6,021
Amortization of unrecognized net loss	507,339	410,788	169,113	41,652
Net periodic pension expense	\$ 729,000	\$ 570,406	\$ 243,000	\$ 70,406
<b>Supplemental Pension</b>				
Service cost, benefits earned during the period	\$ 22,968	\$ 23,314	7,656	\$ 6,800
Interest cost on projected benefit obligation	40,330	42,949	13,443	12,525
Expected return on plan assets	-	-	-	-
Amortization of unrecognized prior service cost	-	-	-	-
Amortization of unrecognized net loss	7,098	4,322	2,366	1,260
Net periodic supplemental pension expense	\$ 70,396	\$ 70,585	\$ 23,465	\$ 20,585
<b>Postretirement, Medical and Life</b>				
Service cost, benefits earned during the period	\$ 24,750	\$ 22,500	8,250	\$ 7,500



Interest cost on projected benefit obligation	56,250	56,250	18,750	18,750
Expected return on plan assets	-	-	-	-
Amortization of unrecognized prior service cost	(72,750)	(71,250)	(24,250)	(23,750)
Amortization of unrecognized net gain	-	-	-	-
Net periodic postretirement, medical and life expense	\$ 8,250	\$ 7,500	\$ 2,750	\$ 2,500

On April 21, 2010, the Corporation's Board of Directors approved an amendment to the Corporation's Defined Benefit Pension Plan. Under the amendment, which became effective on July 1, 2010, new employees hired on or after the effective date will not be eligible to participate in the plan, however, existing participants at that time will continue to accrue benefits. The Corporation anticipates that over time the amendment will result in a decrease in the future benefit obligations of the plan and the corresponding net periodic benefit cost associated with the plan.

## 11. Segment Reporting

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

Summarized financial information concerning the Corporation's reportable segments and the reconciliation to the Corporation's consolidated results is shown in the following table. Income taxes are allocated based on the separate taxable income of each entity and indirect overhead expenses are allocated based on reasonable and equitable allocations applicable to the reportable segment. Holding company amounts are the primary differences between segment amounts and consolidated totals, and are reflected in the Holding Company and Other column below, along with amounts to eliminate transactions between segments. (dollars in thousands)

	Three Months Ended September 30, 2011				Nine Months Ended September 30, 2011			
	Core Banking	Trust & Investment Advisory Services	Holding Company And Other	Consolidated Totals	Core Banking	Trust & Investment Advisory Services	Holding Company And Other	Consolidated Totals
Net interest income	\$ 11,842	\$ -	\$ 1	\$ 11,843	\$ 31,834	\$ -	\$ 6	\$ 31,840
Provision for loan losses	583	-	-	583	833	-	-	833
Net interest income after provision for loan losses	11,259	-	1	11,260	31,001	-	6	31,007
Other operating income	2,465	1,747	116	4,328	7,284	5,131	1,005	13,420
Other operating expenses	8,638	1,843	136	10,617	27,259	5,450	553	33,262
Income or (loss) before income tax expense	5,086	(96)	(19)	4,971	11,026	(319)	458	11,165
Income tax expense (benefit)	1,742	(37)	(25)	1,680	3,589	(123)	123	3,589
Segment net income (loss)	\$ 3,344	\$ (59)	\$ 6	\$ 3,291	\$ 7,437	\$ (196)	\$ 335	\$ 7,576
Segment assets					\$ 1,257,067	\$ 5,856	\$ 3,001	\$ 1,265,924

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	Three Months Ended September 30, 2010				Nine Months Ended September 30, 2010			
	Core Banking	Trust & Investment Advisory Services	Holding Company And Other	Consolidated Totals	Core Banking	Trust & Investment Advisory Services	Holding Company And Other	Consolidated Totals
Net interest income	\$ 8,681	\$ -	\$ -	\$ 8,681	\$ 25,969	\$ -	\$ 3	\$ 25,972
Provision for loan losses	375	-	-	375	1,125	-	-	1,125
Net interest income after provision for loan losses	8,306	-	-	8,305	24,844	-	3	24,847
Other operating income	1,911	2,184	152	4,247	6,201	6,257	449	12,907
Other operating expenses	7,047	1,710	125	8,882	21,728	5,309	506	27,543
Income or (loss) before income tax expense	3,170	474	(27)	3,671	9,317	948	(54)	10,211
Income tax expense (benefit)	942	183	(5)	1,120	2,862	367	(72)	3,157
Segment net income (loss)	\$ 2,228	\$ 291	\$ 32	\$ 2,551	\$ 6,455	\$ 581	\$ (18)	\$ 7,054
Segment assets					\$ 962,145	\$ 7,464	\$ 3,091	\$ 972,700

## 12. Stock Based Compensation

## Board of Director's Stock Compensation

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

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

An expense of \$231 thousand related to this compensation was recognized during the year of 2010. During January 2011, 10,378 shares were re-issued from treasury to fund the stock component of directors' compensation.

## Restricted Stock Plan

On June 16, 2010, the Corporation's Board of Directors approved the Corporation's Restricted Stock Plan (the "Plan"), which became effective immediately. Pursuant to the Plan, the Corporation may make discretionary grants of restricted stock to officers other than the Corporation's Chief Executive Officer. Compensation expense is recognized over the vesting period of the awards based on the fair value of the stock at issue date. The maximum number of shares as to which stock awards may be granted under the Plan is 10,000 per year, with these shares vesting over a 5 year period.

A summary of restricted stock activity from December 31, 2010 to September 30, 2011 is presented below:

	Shares	Weighted–Average Grant Date Fair Value
Nonvested at December 31, 2010	5,886	\$21.25
Granted	2,087	22.98
Vested	-	-
Forfeited or Cancelled	-	-
Nonvested at September 30, 2011	7,973	\$21.52

As of September 30, 2011, there was \$150,660 of total unrecognized compensation cost related to nonvested shares granted under the Plan. The cost is expected to be recognized over a weighted-average period of 4.83 years.

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

The review that follows focuses on the significant factors affecting the financial condition and results of operations of the Corporation during the three and nine-month periods ended September 30, 2011, with comparisons to the comparable periods in 2010, as applicable. The following discussion and the unaudited consolidated interim financial statements and related notes included in this report should be read in conjunction with our 2010 Annual Report on Form 10-K, which was filed with the Securities and Exchange Commission on March 16, 2011. The results for the periods presented are not necessarily indicative of results to be expected for the entire fiscal year or any other interim period.

Forward-looking Statements

This discussion contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. The Corporation intends its forward-looking statements to be covered by the safe harbor provisions for forward-looking statements in these sections. All statements regarding the Corporation's expected financial position and operating results, the Corporation's business strategy, the Corporation's financial plans, forecasted demographic and economic trends relating to the Corporation's industry and similar matters are forward-looking statements. These statements can sometimes be identified by the Corporation's use of forward-looking words such as "may," "will," "anticipate," "estimate," "expect," or "intend." The Corporation cannot promise that its expectations in such forward-looking statements will turn out to be correct. The Corporation's actual results could be materially different from expectations because of various factors, including changes in economic conditions or interest rates, credit risk, difficulties in managing our growth, including those in connection with our April 8, 2011 acquisition of Fort Orange Financial Corporation and the integration of its business with ours, competition, changes in law or the regulatory environment, including the Dodd-Frank Wall Street Reform and Consumer Protection Act, and changes in general business and economic trends. Information concerning risks facing the Corporation can be found in our periodic filings with the Securities and Exchange Commission, including in our 2010 Annual Report on Form 10-K. These filings are available publicly on the SEC's website at <http://www.sec.gov>, on the Corporation's website at <http://www.chemungcanal.com> or upon request from the Corporate Secretary at (607) 737-3788. Except as otherwise required by law, the Corporation undertakes no obligation to publicly update or revise its forward-looking statements, whether as a result of new information, future events or otherwise.

Critical Accounting Policies, Estimates and Risks and Uncertainties

Critical accounting policies include the areas where the Corporation has made what it considers to be particularly difficult, subjective or complex judgments concerning estimates, and where these estimates can significantly affect the Corporation's financial results under different assumptions and conditions. The Corporation prepares its financial statements in conformity with accounting principles generally accepted in the United States of America. As a result, the Corporation is required to make certain estimates, judgments and assumptions that it believes are reasonable based upon the information available at that time. These estimates, judgments and assumptions affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the periods presented. Actual results could be different from these estimates.

Management considers the accounting policy relating to the allowance for loan losses to be a critical accounting policy given the uncertainty in evaluating the level of the allowance required to cover probable incurred credit losses inherent in the loan portfolio, and the material effect that such judgments can have on the Corporation's results of operations. While management's current evaluation of the allowance for loan losses indicates that the allowance is adequate, under adversely different conditions or assumptions the allowance would need to be increased. For example, if historical loan loss experience significantly worsened or if current economic conditions significantly deteriorated, additional provisions for loan losses would be required to increase the allowance. In addition, the assumptions and estimates used in the internal reviews of the Corporation's non-performing loans and potential problem loans, and the associated evaluation of the related collateral coverage for these loans, has a significant impact on the overall analysis of the adequacy of the allowance for loan losses. Real estate values in the Corporation's market area did not increase dramatically in the prior several years, and, as a result, any declines in real estate values have been modest. While management has concluded that the current evaluation of collateral values is reasonable under the circumstances, if collateral evaluations were significantly lowered, the Corporation's allowance for loan losses policy would also require additional provisions for loan losses.

Management also considers the accounting policy relating to other-than-temporary impairment ("OTTI") of investment securities to be a critical accounting policy. The determination of whether a decline in market value is other-than-temporary is necessarily a matter of subjective judgment. The timing and amount of any realized losses reported in the Corporation's financial statements could vary if management's conclusions were to change as to whether an other-than-temporary impairment exists. The Corporation assesses whether it intends to sell, or it is more likely than not that it will be required to sell a security in an unrealized loss position before recovery of its amortized cost basis. If either of these criteria is met, the entire difference between amortized cost and fair value is recognized through a charge to earnings. For those securities that do not meet the aforementioned criteria, such as those that management has determined to be other-than-temporarily impaired, the amount of impairment charged to earnings is limited to the amount related to credit losses, while impairment related to other factors is recognized in other comprehensive income. Our analysis of these investments includes \$629 thousand book value of a collateralized debt obligation ("CDO") which is a pooled trust preferred security. This security was rated high quality when purchased, but at September 30, 2011 Moody's rated this security as Caa3 which is defined as substantial risk of default. The Corporation uses an OTTI evaluation model to compare the present value of expected cash flows to the previous estimate to determine if there are adverse changes in cash flows during the quarter. The OTTI model considers the structure and term of the CDO and the financial condition of the underlying issuers. Specifically, the model details interest rates, principal balances of note classes and underlying issuers, the timing and amount of interest and principal payments of the underlying issuers, and the allocation of the payments to the note classes. The current estimate of expected cash flows is based on the most recent trustee reports and any other relevant market information including announcements of interest payment deferrals or defaults of underlying trust preferred securities. Assumptions used in the model include expected future default rates and prepayments. We assume no recoveries on defaults and treat all interest payment deferrals as defaults. Additional default assumptions were made based on credit quality ratios and performance measures of the remaining financial institutions in the pools, as well as overall default rates based on historical bank debt default rate averages. For the three and nine-month periods ended September 30, 2011, the Corporation recognized \$67 thousand in OTTI charges.

Management also considers the accounting policy relating to the valuation of goodwill and other intangible assets to be a critical accounting policy. The initial carrying value of goodwill and other intangible assets is determined using estimated fair values developed from various sources and other generally accepted valuation techniques. Estimates are based upon financial, economic, market and other conditions as they existed as of the date of a particular acquisition. These estimates of fair value are the results of judgments made by the Corporation based upon estimates that are inherently uncertain and changes in the assumptions upon which the estimates were based may have a significant impact on the resulting estimates. In addition to the initial determination of the carrying value, on an ongoing basis management must assess whether there is any impairment of goodwill and other intangible assets that would require an adjustment in carrying value and recognition of a loss in the consolidated statement of income.

#### Financial Condition

Consolidated assets at September 30, 2011 totaled \$1.266 billion, an increase of \$307.6 million or 32.1% since December 31, 2010. As discussed in greater detail below, this increase was due in large part to the Corporation's acquisition of Fort Orange Financial Corp. ("FOFC") and the concurrent merger of its banking subsidiary, Capital Bank & Trust Company ("Capital Bank") into the Bank on April 8, 2011, as well as other organic growth. The increase was reflected principally in a \$174.8 million increase in loans, net of deferred fees and costs and unearned income, a \$55.4 million increase in the securities portfolio, a \$57.9 million increase in cash and cash equivalents and increases in goodwill and other intangible assets totaling \$12.3 million and \$1.8 million, respectively, as well as a \$3.6 million increase in other assets.

As noted above, total loans, net of deferred fees and costs and unearned income increased \$174.8 million or 28.5% from December 31, 2010 to September 30, 2011, principally due to the acquisition of Capital Bank loans totaling \$173.4 million at quarter-end. The most significant growth was in commercial loans (including commercial mortgages), which increased \$150.1 million, with \$145.4 million of this increase associated with the Capital Bank acquisition. Residential mortgages increased \$20.8 million, including Capital Bank mortgages totaling \$21.3 million at September 30, 2011. Total consumer loans were up \$3.9 million, principally due to a \$7.2 million increase in home equity balances, as home equity loans associated with the acquisition totaled \$6.6 million at quarter-end. This increase was offset primarily by a \$2.8 million decrease in indirect consumer installment loans and a \$306 thousand decrease in other consumer installment loans. During the first nine months of this year, approximately \$5.4 million of newly originated residential mortgages were sold in the secondary market to Freddie Mac, with an additional \$475 thousand originated and sold to the State of New York Mortgage Agency.

The composition of the loan portfolio is summarized as follows:

	September 30, 2011	December 31, 2010
Commercial, financial and agricultural	\$ 147,815,433	\$ 114,697,440
Commercial mortgages	250,030,218	133,070,484
	194,260,610	173,467,806

Residential mortgages		
Indirect Consumer loans	96,093,955	98,940,854
Consumer loans	100,258,360	93,507,785
Total loans, net of deferred origination fees and cost, and unearned income	\$ 788,458,576	\$ 613,684,369



The available for sale segment of the securities portfolio totaled \$279.1 million at September 30, 2011, an increase of approximately \$55.5 million or 24.8% from December 31, 2010. At amortized cost, the available for sale portfolio increased \$51.1 million, including approximately \$41.5 million of bonds related to the Capital Bank acquisition. Unrealized appreciation related to the available for sale portfolio increased \$4.4 million since year-end 2010. The increase in the available for sale portfolio at amortized cost is reflected principally in a \$42.5 million increase in federal agency bonds, with \$12.1 million of that total in Capital Bank bonds. Municipal bonds were up \$6.5 million, including \$5.9 million of municipal bonds at Capital Bank. Increases in collateralized mortgage obligations and SBA Guaranteed Loan Pools totaling \$8.3 million and \$2.3 million, respectively, reflect investments acquired in the acquisition. A \$2.4 million increase in corporate bonds includes \$3.0 million of investments acquired from Capital Bank. The above increases were offset in part by a \$6.4 million decrease in mortgage-backed securities and a \$4.5 million decrease in US Treasury bonds. The decrease in mortgage-backed securities reflects paydowns received since year-end 2010, partially offset by mortgage-backed securities acquired from Capital Bank totaling \$9.9 million at September 30, 2011, while the decrease in US Treasuries was due to the sale of three bonds during the year, offset in part by purchases totaling \$30.3 million. The increase in unrealized appreciation related to the available for sale portfolio was due in large part to the impact of lower mid-to long-term rates on the various bond portfolios, offset in part by a decrease in unrealized gains in the Corporation's equity portfolio. The held to maturity portion of the portfolio, consisting of local municipal obligations, decreased approximately \$129 thousand from \$7.7 million at December 31, 2010 to \$7.6 million at September 30, 2011.

As noted above, total cash and cash equivalents increased \$57.9 million since December 31, 2010. With a significant increase in deposits, as discussed below, exceeding the net increases in loans and securities, as well as the addition of cash acquired in the Capital Bank acquisition, interest bearing deposits at other financial institutions have increased \$43.6 million since year-end. Additionally, cash and due from financial institutions increased \$14.2 million primarily due to an increased level of cash items in process of collection. With total cash and cash equivalents of \$118.5 million at September 30, 2011, the Corporation continues to maintain a strong liquidity position and we continue to evaluate alternative investment of these funds with caution given the low interest rate environment and the inherent interest rate risk associated with longer term securities portfolio investments.

The \$12.3 million increase in goodwill as well as the \$1.8 million increase in other intangible assets was directly related to the FOFC acquisition. The \$1.8 million increase, net of amortization, in other intangible assets includes \$2.4 million in other intangibles associated with this acquisition, which the Corporation is amortizing on an accelerated basis over a 10 year period.

A \$3.6 million increase in other assets was due principally to a \$1.3 million increase in accrued interest receivable due in large part to the FOFC acquisition, a \$464 thousand increase in net deferred tax assets, a \$687 thousand estimated income tax receivable related to the FOFC acquisition and a \$537 thousand increase in accounts receivable.

Since December 31, 2010, total deposits have increased \$255.8 million or 32.5% to \$1.042 billion, with \$177.8 million of this increase attributed to the FOFC acquisition, and \$78.0 million due to organic deposit growth. Non-interest bearing demand deposits increased \$64.6 million, including balances at the Capital Bank offices acquired totaling \$25.5 million, along with increases in public funds and other non-interest bearing demand deposits of \$4.9 million and \$34.2 million, respectively. A \$191.2 million increase in interest bearing balances was due principally to increases in savings and time deposit balances of \$72.8 million and \$51.7 million, respectively, as well as a \$47.8 million increase in NOW accounts and an \$18.9 million increase in insured money market account ("IMMA") balances. The \$72.8 million increase in savings balances includes \$58.9 million related to the FOFC acquisition as well as increases in public fund and other balances totaling \$4.3 million and \$9.6 million, respectively, while the \$51.7 million increase in time deposits includes \$59.1 million of Capital Bank deposits and a \$13.2 million increase in public fund balances, partially offset by decreases in other personal and non-personal balances. The \$47.8 million increase in NOW accounts was principally due to Capital Bank balances totaling \$23.0 million as well as a \$23.3 million increase in public funds, while the \$18.9 million increase in IMMA balances includes \$11.3 million in Capital Bank deposits and a \$9.9 million increase in public fund balances offset by decreases in other personal and non-personal balances.

A \$23.9 million increase in long term borrowings was due to the Corporation assuming the term debt of Capital Bank.

The \$31.3 million increase in total shareholders equity was due in large part to the issuance of 1,009,942 shares to acquire shares of former FOFC shareholders, which resulted in an increase in common stock and additional paid-in-capital totaling \$23.7 million. Other significant increases included a \$4.4 million increase in retained earnings and a \$3.0 million increase in accumulated other comprehensive income.

#### Asset Quality

##### Non-Performing Loans

The recorded investment in non-performing loans at September 30, 2011 totaled \$21.488 million compared to \$11.268 million at year-end 2010, an increase \$10.220 million. Not included in the non-performing loan totals are loans acquired in the FOFC acquisition which the Corporation has identified as purchased credit impaired ("PCI") loans totaling \$15.369 million at September 30, 2011, which are accounted for under separate accounting guidance, Accounting Standards Codification ("ASC") Subtopic 310-30, "Receivables – Loans and Debt Securities Acquired with Deteriorated Credit Quality" as disclosed in Note 9 of the interim financial statements. The increase in non-performing loans was due to increases in non-accrual loans and loans 90 days or more past due totaling \$3.765 million and \$7.058 million, respectively, partially offset by a \$603 thousand decrease in accruing troubled debt restructurings ("TDRs"). The \$3.765 million increase in non-accrual loans was due to a \$4.052 million increase in non-accruing commercial loans that was primarily due to the addition to non-accrual status of two legacy loans totaling \$2.543 million, as well as the addition to non-accrual status of loans acquired in the FOFC acquisition totaling \$1.980 million. These increases were offset in part by principal reductions on other non-accrual commercial loans. The increase in non-accrual commercial loans was partially offset by decreases in non-accrual residential mortgages, home equity and other consumer loans totaling, \$201 thousand, \$19 thousand and \$67 thousand, respectively. Included in the non-accrual loan totals are commercial loans to one borrower totaling \$5.192 million which carry guarantees of the United States Department of Agriculture ("USDA") totaling \$4.847 million, thereby reducing the Corporation's remaining exposure on these loans to \$345 thousand. It is generally the Corporation's policy that a loan 90 days past due be placed in non-accrual status unless factors exist that

would eliminate the need to place a loan in this status. A loan may also be designated as non-accrual at

any time if payment of principal or interest in full is not expected due to deterioration in the financial condition of the borrower. Loans remain in non-accrual status until the loans have been brought current and remain current for a period of six months. In the case of non-accrual loans where a portion of the loan has been charged off, the remaining balance is kept in non-accrual status until the entire principal balance has been recovered.

Accruing loans 90 days or more past due totaled \$7.069 million at September 30, 2011 compared to \$11 thousand at year-end 2010, an increase of \$7.058 million. This increase was due to loans not considered by management to be PCI loans acquired in the FOFC acquisition, including \$7.059 million of construction loans that for a variety of reasons are 90 days or more past their stated maturity dates, however the borrowers continue to make required interest payments. Additionally, these loans carry third party credit enhancements, and based upon the strength of those credit enhancements, the Corporation has not identified these loans as PCI loans and expects to incur no losses on these loans.

As noted above, accruing TDRs decreased \$603 thousand since December 31, 2010 as during the first nine months of this year a commercial loan totaling \$137 thousand and three residential mortgages totaling \$245 thousand at December 31, 2010 were removed from TDR status in accordance with the Corporation's policy that TDRs that have continued to be in compliance with modified terms and conditions for six months and yield a market rate at the time of restructuring not be reported as TDRs in years subsequent to the year in which the loan was first reported as TDR. Additionally, \$221 thousand of principal reductions have been received on a commercial loan TDR. Concessions made on commercial loan TDRs generally involve short term deferrals of principal payments, while residential mortgage restructurings include interest rate and/or payment reductions. Overall, our past experience in working with borrowers in restructuring troubled debt has been favorable. TDRs are evaluated for impairment based upon the present value of expected future cash flows with any changes recorded through the provision for loan losses.

At September 30, 2011, OREO totaled \$661 thousand compared to \$741 thousand at December 31, 2010, a decrease of \$80 thousand. During the first nine months of this year four properties totaling \$309 thousand were placed in OREO and two properties totaling \$268 thousand were sold. Additionally, during the third quarter of this year, the Corporation recognized a \$12 thousand write-down on one property following the receipt of an updated appraisal. The balance of the decrease was due to the receipt of private mortgage insurance reimbursement on one property. At September 30, 2011, OREO properties consisted of five residential properties totaling \$349 thousand, two commercial properties totaling \$94 thousand and undeveloped land totaling \$218 thousand.

#### Impaired Loans

Impaired loans, excluding residential real estate loans determined to be troubled debt restructurings, at September 30, 2011 totaled \$9.375 million compared to \$7.667 million at December 31, 2010. Not included in the impaired loan totals are loans acquired in the FOFC acquisition which the Corporation has identified as PCI loans as these loans are accounted for under ASC Subtopic 310-30 as noted under the above discussion of non-performing loans. The increase of \$1.708 million resulted principally from the above-discussed increase in non-accrual commercial legacy loans, offset in part by decreases in other non-accrual loans and accruing commercial loan TDR's. Included in the impaired loan total are loans totaling \$3.086 million for which impairment allowances of \$1.587 million have been specifically allocated to the allowance for loan losses. As of December 31, 2010, the impaired loan total included \$892 thousand of loans for which specific impairment allowances of \$240 thousand were allocated to the allowance for loan losses. The increases in both the amount of impaired loans for which specific allowances were allocated to the allowance for loan losses and the amount allocated were both primarily due to the above mentioned



addition to non-accrual loans of loans to two borrowers totaling \$2.543 million. The majority of the Corporation's impaired loans are secured and measured for impairment based on collateral evaluations. It is the Corporation's policy to obtain updated appraisals on loans secured by real estate at the time a loan is determined to be impaired. Prior to the receipt of the updated appraisal, an impairment measurement is performed based upon the most recent appraisal on file to determine the amount of any specific allocation or charge-off. Upon receipt and review of the updated appraisal, an additional measurement is performed to determine if any adjustments are necessary to reflect the proper provisioning or charge-off. Impaired loans are reviewed on a quarterly basis to determine if any changes in credit quality or market conditions would require any additional allocation or recognition of additional charge-offs. If market conditions warrant, future appraisals are obtained. Real estate values in the Corporation's market area had not increased dramatically in the prior several years, and, as a result, declines in real estate values have been modest.

The appraisals are performed by independent third parties and reflect the properties market value "as is". In determining the amount of any specific allocation or charge-off, the Corporation will make adjustments to reflect the estimated costs to sell the property. In situations where partial charge-offs have been recognized, any balance remaining continues to be reflected as non-performing until the loan has been paid in full. In the case of impaired loans secured by assets other than real estate (i.e. business assets), a collateral valuation is performed using data from the client's most recently received financial statements, and applying discount rates based upon the type of collateral.

The following table summarizes the Corporation's recorded investment in non-performing assets:

(dollars in thousands)	September 30, 2011	December 31, 2010
Non-accrual loans	\$ 14,363	\$ 10,598
Troubled debt restructurings	56	659
Accruing loans past due 90 days or more	7,069	11
Total non-performing loans	\$ 21,488	\$ 11,268
Other real estate owned	661	741
Total non-performing assets	\$ 22,149	\$ 12,009

In addition to non-performing loans, as of September 30, 2011, the Corporation has identified commercial relationships totaling \$8.2 million as potential problem loans, as compared to \$7.2 million at December 31, 2010. This increase of \$1.0 million resulted from the addition of three commercial relationships totaling \$4.0 million, including \$1.4 million of loans acquired in the FOFC acquisition which were not considered to be PCI loans, partially offset by downgrades of three relationships to non-accrual status totaling \$2.5 million, as well as principal reductions on other potential problem loans. Potential problem loans are loans that are currently performing, but known information about possible credit problems of the related borrowers causes management to have serious doubts as to the ability of such borrowers to comply with the present loan repayment terms, which may result in the disclosure of

such loans as non-performing at some time in the future. Potential problem loans are typically loans that are performing but are classified in the Corporation's loan rating system as "substandard." Management cannot predict the extent to which economic conditions may worsen or other factors which may impact borrowers and the potential problem loans. Accordingly, there can be no assurance that other loans will not become 90 days or more past due, be placed on non-accrual, be restructured, or require increased allowance coverage and provisions for loan losses.

Management's evaluation of the adequacy of the allowance for loan losses is performed on a periodic basis and takes into consideration such factors as historical loan loss experience, review of specific problem loans (including evaluation of the underlying collateral), changes in the composition and volume of the loan portfolio, recent charge-off experience, overall portfolio quality and current economic conditions that may affect the borrowers' ability to pay.

While impaired loans increased \$1.708 million since year-end 2010, this increase, as noted above, was due to the addition of two commercial relationships totaling approximately \$2.543 million which was the main factor behind a \$1.347 million increase in specific allowances allocated against impaired loans. With the exception of these relationships, overall credit quality has remained stable and we continue to see signs of improvement as evidenced by improved credit quality of non-impaired loans and significant reductions in net charge-offs with third quarter and year-to date net charge offs decreasing \$500 thousand and \$778 thousand, respectively, as compared to the corresponding periods in 2010. Based upon an analysis of the factors mentioned above, the Corporation's provision for loan losses for the third quarter of this year totaled \$583 thousand compared to \$375 thousand for the third quarter of 2010, with the year-to-date provision of \$833 thousand down \$292 thousand when compared to last year.

As noted above, net charge-offs for the first nine months of this year as compared to 2010 improved by \$778 thousand from \$1.432 million in net charge-offs during the first nine months of last year to \$654 thousand. This improvement was principally due to decreases in net commercial and consumer loan charge-offs totaling \$613 thousand and \$138 thousand, respectively, as well as a \$27 thousand decrease in net residential mortgage charge-offs. At September 30, 2011, the Corporation's allowance for loan losses totaled \$9.677 million, resulting in a coverage ratio of allowance to non-performing loans of 45.0%. As noted above, included in non-performing loans at September 30, 2011 were loans which carried USDA guarantees totaling \$4.847 million. Also included in the non-performing loan totals are other loans with remaining balances totaling \$259 thousand on which the Corporation has previously recognized partial charge-offs in the amount of \$772 thousand. Excluding the USDA guaranteed amount and other loans for which partial charge-offs have already been recognized from the non-performing total, the coverage ratio of allowance to non-performing loans was 59.1%. This ratio as well as the ratio of allowance to total loans was impacted by the Capital Bank acquisition, as current accounting rules do not allow the acquirer to transfer the acquiree's allowance for loan losses to the acquirer's balance sheet. Rather, the acquiree's overall loan quality is a component in determining the fair value of loans acquired, which are carried on the balance sheet at fair value. Excluding acquired loans reported above as non-performing loans totaling \$9.039 million, as well as the aforementioned USDA guarantee and loans for which partial charge-offs have already been recognized, the allowance to non-performing loan ratio was 131.8%. Excluding loans acquired in the Capital Bank acquisition, the allowance for loan losses to total loans was 1.51% and represents an amount that management believes is adequate to absorb probable incurred loan losses on the Corporation's legacy loan portfolio.

The allocated portions of the allowance reflect management's estimates of specific known risk elements in the respective portfolios. Management's methodology followed in evaluating the allowance for loan losses includes a detailed analysis of historical loss factors for pools of similarly graded loans, as well as specific collateral reviews of relationships graded special mention, substandard or doubtful with outstanding balances of \$1.0 million or greater. Among the factors considered in allocating portions of the allowance by loan type are the current levels of past due, non-accrual and impaired loans, as well as historical loss experience and the evaluation of collateral. In addition, management has formally documented factors considered in determining the appropriate level of general reserves, including current economic conditions, forecasted trends in the credit quality cycle, loan growth, entry into new markets, and industry and peer group trends. These amounts have been included in the allocated portion of the loan categories to which they relate.



At September 30, 2011, in addition to the qualitative factors allocated within the allowance, the Corporation maintained \$480 thousand of the allowance as unallocated. While some preliminary improvements have been seen in the local economy and while some loans have improved, the recovery is still very fragile and management believes it is prudent to see a longer period of sustained improvement before completely reflecting this in the allowance. Additionally, management monitors coverage ratios of nonperforming loans and total loans compared to peers on a regular basis. This analysis also suggests that it would not be prudent to eliminate the unallocated portion of the allowance at this time.

Activity in the allowance for loan losses was as follows:

(dollars in thousands)	Nine Months Ended	
	September 30,	
	2011	2010
Balance at beginning of period	\$ 9,498	\$ 9,967
Charge-offs:		
Commercial, financial and agricultural	(594)	(1,178)
Commercial mortgages	(4)	-
Residential mortgages	(39)	(36)
Consumer loans	(543)	(670)
Total	(1,180)	(1,884)
Recoveries:		
Commercial, financial and agricultural	315	315
Commercial mortgages	33	-
Residential mortgages	30	-
Consumer loans	148	137
Total	526	452
Net charge-offs	(654)	(1,432)
Provision charged to operations	833	1,125
Balance at end of period	\$ 9,677	\$ 9,660

#### Results of Operations

##### Third Quarter of 2011 vs. Third Quarter of 2010

Net income for the third quarter of 2011 totaled \$3.291 million, an increase of \$740 thousand or 29.0% as compared to third quarter 2010 net income of \$2.551 million. Earnings per share were unchanged at

\$0.71 per share on 1,035,115 additional average shares outstanding primarily resulting from the FOFC acquisition. The increase in net income can be attributed to the Capital Bank acquisition, particularly due to the increase in net interest income, as, excluding direct transaction costs during the quarter, Capital Bank contributed an estimated \$1.199 million in net income or \$0.26 per share.

Net interest income compared to the third quarter of 2010 increased \$3.162 million or 36.4% to \$11.844 million, with the net interest margin increasing 33 basis points to 4.11%. We attribute this increase principally to the Capital Bank acquisition which had a significant impact on a \$230.8 million or 25.3% increase in average earning assets, as well as a 9 basis point increase in the yield on average earning assets and a 31 basis point decrease in the cost of average interest bearing liabilities. The \$230.8 million increase in average earning assets included a \$197.0 million increase in average loans, with Capital Bank loans accounting for \$168.8 million of this increase, an \$18.6 million increase in the average investment portfolio and a \$15.2 million increase in average interest bearing deposits. The third quarter increase in the average investment portfolio included \$44.9 million of average Capital Bank securities, partially offset by a \$26.3 million decrease in the average balances of other securities. While average

earning assets increased 25.3%, total interest and dividend income increased 27.8% or \$2.953 million with the yield on average earning assets increasing 9 basis points to 4.72%.

Total average funding liabilities, including non-interest bearing demand deposits, as compared to the third quarter of last year, increased \$218.3 million or 24.5% to \$1.109 billion as average deposits and borrowings increased \$196.1 million and \$22.2 million, respectively. In total, average non-interest bearing deposits increased \$57.8 million, with Capital Bank non-interest bearing deposits comprising \$24.8 million of that increase. Average interest bearing deposits increased \$138.3 million due to \$157.5 million in Capital Bank average interest bearing deposits, offset by decreases in other average interest bearing balances. The increase in average interest bearing deposits was reflected principally in a \$73.5 million increase in average savings account balances, as well as increases in average time deposits and NOW accounts totaling \$42.0 million and \$29.3 million, respectively. These increases were partially offset by a \$6.4 million decrease in average IMMA balances. The increase in average borrowings was due principally to an increase in borrowings assumed by the Corporation in the Capital Bank acquisition. While average interest-bearing liabilities increased \$160.5 million, or 23.2%, interest expense decreased \$209 thousand or 10.7%, as the cost of average interest-bearing liabilities decreased 31 basis points to 0.81%.

As discussed under the Asset Quality section of this report, a \$208 thousand increase in the provision for loan losses was principally due to an increase in specific allocations on impaired loans, somewhat offset by improved credit quality in the remainder of the loan portfolio, as well as a decrease in net charge-offs, and reflects management's evaluation of the adequacy of the allowance for loan losses based upon a number of factors, including an analysis of historical loss factors, the evaluation of collateral, recent charge-off experience, overall credit quality, current economic conditions and loan growth.

Non-interest income during the third quarter of 2011 increased \$81 thousand or 1.9% compared to the third quarter of 2010. This increase was principally due to a \$429 thousand increase in net gains on securities transactions, as during the quarter the Corporation sold a US Treasury bond resulting in the above gain. In addition to the above, check card interchange fee income increased \$84 thousand. These increases were offset in part primarily by a \$437 thousand decrease in Wealth Management Group (formerly referred to as Trust and Investment Center) fee income, due to the closing of a large estate during the fourth quarter of 2010.

Third quarter 2011 operating expenses were \$1.734 million or 19.5% higher than the comparable period last year, due in part to the Capital Bank acquisition. The increase in operating expenses was due in large part to increases in salaries and benefits totaling \$504 thousand and \$362 thousand, respectively. Other significant increases included a \$165 thousand increase in net occupancy costs, a \$154 thousand increase in data processing costs, a \$108 thousand increase in amortization of intangible assets, and increases in marketing and advertising and professional services totaling \$84 thousand and \$80 thousand, respectively. The increase in salaries resulted from an increase in staff related to the Capital Bank acquisition as well as merit increases over the past year, while the increase in employee benefits was due principally to health insurance costs and pension expense. Increases in net occupancy costs, amortization of intangible assets and marketing and advertising were due in large part to the Capital Bank acquisition, while increases in data processing reflects higher data communication line charges, Wealth Management Group and check card processing costs. The above increases were offset in part primarily by a \$75 thousand decrease in OREO expenses.

A \$560 thousand increase in income tax expense reflects a \$1.300 million increase in pre-tax income, and an increase in the effective tax rate from 30.5% to 33.8% due to a decrease in the relative percentage of tax exempt income to pre-tax income, as well as a reduction in third quarter 2010 taxes due to a statutory change in the New York State bad debt deduction.

#### Year-to-Date 2011 vs. Year-to-Date 2010

Net income for the nine-month period ended September 30, 2011 totaled \$7.576 million, an increase of \$522 thousand or 7.4% compared to the corresponding period in 2010. Earnings per share decreased 10.2% from \$1.96 to \$1.76 per share on 693,275 additional average shares outstanding. The increase in net income was impacted positively by higher net interest income and non-interest income, as well as a decrease in the provision for loan loss expense, offset by higher operating expenses, including \$2.244 million of direct transaction costs associated with the Capital Bank acquisition. Excluding the direct transaction costs noted above, net income for the nine-month period ended September 30, 2011 would have totaled approximately \$9.031 million or \$2.10 per share, with Capital Bank contributing an estimated \$2.314 million or \$0.54 per share.

Net interest income compared to the first nine months of 2010 increased \$5.868 million or 22.6% with the net interest margin increasing 20 basis points to 4.02%. Once again, management attributes this increase to the Capital Bank acquisition as a \$148.3 million or 16.3% increase in average earning assets and a 36 basis point decrease in the cost of average interest bearing liabilities was partially offset by an 8 basis point decrease in the yield on average earning assets. The \$148.3 million increase in average earning assets included a \$134.5 million increase in average loans, with Capital Bank loans contributing \$107.9 million to this increase, an \$8.6 million increase in average interest bearing deposits and a \$5.2 million increase in the average investment portfolio due to \$29.6 million in Capital bank average investments. While on average, earning assets increased 16.3%, total interest and dividend income increased \$4.612 million or 14.2%, with the yield on average earning assets decreasing 8 basis points to 4.68%.

Total average funding liabilities, including non-interest bearing demand deposits, as compared to the first nine months of last year, increased \$135.7 million or 15.2% to \$1.028 billion as average deposits and borrowings increased \$125.5 million and \$10.2 million, respectively. In total, average non-interest bearing deposits increased \$42.0 million, with Capital Bank non-interest bearing deposits comprising \$16.2 million of that increase. Average interest bearing deposits increased \$83.5 million due to \$104.3 million in Capital Bank average interest bearing deposits, offset by decreases in other average interest bearing balances. The increase in average interest bearing deposits was reflected principally in a \$50.9 million increase in average savings account balances, as well as increases in average NOW and time deposits totaling \$20.2 million and \$18.8 million, respectively. These increases were partially offset by a \$6.4 million decrease in average IMMA balances. The increase in average borrowings was due to borrowings assumed by the Corporation in the Capital Bank acquisition. While average interest-bearing liabilities increased \$93.7 million or 13.4%, interest expense decreased \$1.256 million or 19.6%, as the cost of average interest-bearing liabilities decreased 36 basis points to 0.87%.

As discussed under the Asset Quality section of this report, despite an increase in specific allocations for impaired loans, the year-to-date provision for loan losses decreased \$292 thousand due to overall credit quality improvement in the remainder of the loan portfolio, as well as lower net charge-offs, and reflects management's evaluation of the adequacy of the allowance for loan losses based upon a number of

factors, including an analysis of historical loss factors, the evaluation of collateral, recent charge-off experience, overall credit quality, current economic conditions and loan growth.

Non-interest income for the first nine months of 2011 was \$513 thousand or 4.0% higher than the comparable period last year. This increase was due in part to a \$657 thousand increase in gains on securities transactions and a \$441 thousand increase in revenue from the Corporation's equity investment in Cephass Capital Partners, L.P., a small business investment company limited partnership, due in large part to a gain recognized on the exercise of stock warrants held in one of its investments. Additionally impacting the improvement in non-interest income was a \$326 thousand decrease in OTTI charges on trust preferred securities pools held in the Corporation's investment portfolio, as well as increases in check card interchange fee income and revenue of CFS Group, Inc. totaling \$245 thousand and \$114 thousand, respectively. These increases were partially offset primarily by a \$1.126 million decrease in Wealth Management Group fee income and a \$248 thousand decrease in service charges. The decrease in Wealth Management Group fee income was due to the previously mentioned closing of a large estate during the fourth quarter of last year, while the decrease in service charges was primarily due to lower net overdraft fee income.

Year-to-date operating expenses were \$5.718 million or 20.8% higher than last year, due in large part to the aforementioned direct acquisition transaction costs totaling \$2.244 million. Excluding these costs, all other operating expenses increased \$3.475 million or 12.6%. Similar to third quarter results and for reasons noted above, the major factors affecting this increase include a \$1.171 million increase in salaries, a \$468 thousand increase in employee benefits, a \$424 thousand increase in data processing costs, a \$391 thousand increase in net occupancy costs and increases in professional services and amortization of intangible assets totaling \$303 thousand and \$203 thousand, respectively. Other factors include a \$139 thousand increase in marketing and advertising expenses related to the Capital Bank acquisition, as well as increases in stationery and supplies and furniture and equipment expenses totaling \$127 thousand and \$108 thousand, respectively. The above increases were offset in part by a \$175 thousand decrease in FDIC insurance assessments and a \$219 thousand decrease in OREO expenses.

A \$432 thousand increase in income tax expense was principally due to the \$954 thousand increase in pre-tax income, as well as an increase in the effective tax rate from 30.9% to 32.1% due to a decrease in the relative percentage of tax exempt income to pre-tax income.

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Average Consolidated Balance Sheet and Interest Analysis (dollars in thousands)

	Nine Months Ended September 30, 2011			Nine Months Ended September 30, 2010			Three Months Ended September 30, 2011			Three Septem
	Average Balance	Interest	Yield/ Rate	Average Balance	Interest	Yield/ Rate	Average Balance	Interest	Yield/ Rate	Average Balance
Assets										
Earning assets:										
Loans	\$ 722,583	\$ 31,456	5.82%	\$ 588,109	\$ 26,412	6.00%	\$ 785,193	\$ 11,673	5.90%	\$ 588,179
Taxable securities	208,891	4,348	2.78%	213,323	4,969	3.11%	223,282	1,504	2.67%	215,323
Tax-exempt securities	51,813	1,035	2.67%	42,153	889	2.82%	53,014	351	2.62%	42,357
Federal funds sold	-	-	N/A	-	-	N/A	-	-	N/A	-
Interest-bearing deposits	75,012	167	.30%	66,415	124	0.25%	81,313	65	0.32%	66,121
Total earning assets	1,058,299	37,006	4.68%	910,000	32,394	4.76%	1,142,802	13,593	4.72%	911,980
Non-earning assets:										
Cash and due from banks	22,380			21,834			23,783			20,899
Premises and equipment, net	24,270			24,427			24,327			24,150
Other assets	45,863			37,609			51,867			36,700
Allowance for loan losses	(9,731)			(10,281)			(9,894)			(10,419)
AFS valuation allowance	11,690			9,769			13,727			11,384
Total	\$ 1,152,771			\$ 993,358			\$ 1,246,612			\$ 994,694
Liabilities and Shareholders' Equity										
Interest-bearing liabilities:										
Interest-bearing demand deposits	71,906	63	0.12%	51,718	37	0.10%	80,665	25	0.13%	51,382
Savings and insured money market deposits	345,040	663	0.26%	300,554	769	0.34%	371,306	248	0.26%	304,231
Time deposits	295,080	2,600	1.18%	276,265	3,647	1.76%	314,348	865	1.09%	272,393
Federal Home Loan Bank advances and securities sold under agreements to repurchase	79,984	1,839	3.07%	69,779	1,969	3.77%	86,520	612	2.80%	64,286
Total interest-bearing liabilities	792,010	5,165	0.87%	698,316	6,422	1.23%	852,839	1,750	0.81%	692,292
Non-interest-bearing liabilities:										

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Demand deposits	235,656	193,691	255,957	198,167
Other liabilities	8,096	7,474	9,511	7,931
Total liabilities	1,035,762	899,481	1,118,307	898,390
Shareholders' equity	117,009	93,877	128,305	96,304
Total	\$ 1,152,771	\$ 993,358	\$ 1,246,612	\$ 994,694
Net interest income	\$ 31,841	\$ 25,972	\$ 11,843	
Net interest rate spread	3.81%	3.53%	3.91%	
Net interest margin	4.02%	3.82%	4.11%	



The following table sets forth for the periods indicated, a summary of the changes in interest and dividends earned and interest paid resulting from changes in volume and changes in rates (dollars in thousands):

	Nine Months Ended September 30, 2011 Compared to Nine Months Ended September 30, 2010			Three Months Ended September 30, 2011 Compared to Three Months Ended September 30, 2010		
	Increase (Decrease) Due to Volume	Increase (Decrease) Due to Rate	Increase (Decrease) Due to Net	Increase (Decrease) Due to Volume	Increase (Decrease) Due to Rate	Increase (Decrease) Due to Net
Interest and dividends earned on:						
Loans	\$ 5,876	\$ (832)	\$ 5,044	\$ 2,929	\$ 2	\$ 2,931
Taxable securities	(102)	(519)	(621)	56	(107)	(51)
Tax-exempt securities	195	(49)	146	72	(22)	50
Interest-bearing deposits	17	26	43	11	12	23
Total earning assets	\$ 5,195	\$ (583)	\$ 4,612	\$ 2,741	212	2,953
Interest paid on:						
Demand deposits	\$ 17	\$ 9	\$ 26	\$ 8	\$ 6	\$ 14
Savings and insured money market deposits	103	(209)	(106)	45	(13)	32
Time deposits	234					