EMCLAIRE FINANCIAL CORP
Form 10-K
March 21, 2014

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-K

(Mark One):

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

For the fiscal year ended: December 31, 2013

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

For the transition period from: ___________ to ___________

Commission File Number: 000-18464

EMCLAIRE FINANCIAL CORP
(Exact name of registrant as specified in its charter)

Pennsylvania (State or other jurisdiction of incorporation or organization)	25-1606091 (I.R.S. Employer Identification No.)
612 Main Street, Emlenton, PA (Address of principal executive office)	16373 (Zip Code)

Registrant's telephone number: (724) 867-2311

Securities registered pursuant to Section 12(b) of the Act:

Common Stock, par value $1.25 per share (Title of Class)	**NASDAQ Capital Markets (NASDAQ)** (Name of exchange on which registered)

Securities registered pursuant to Section 12(g) of the Act: None.

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. YES ¨ NO x.

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act.
YES ¨ NO x.

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate website, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 month (or for such shorter period that the registrant was required to submit and post such files). YES x NO ¨.

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. ¨

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company.
Large accelerated filer ¨ Accelerated filer ¨ Non-accelerated filer ¨ Smaller reporting company x

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

As of June 30, 2013, the aggregate value of the 1,485,964 shares of Common Stock of the Registrant issued and outstanding on such date, which excludes 276,194 shares held by the directors and officers of the Registrant as a group, was approximately $36.7 million. This figure is based on the last sales price of $24.70 per share of the Registrant's Common Stock on June 30, 2013. The number of outstanding shares of common stock as of March 21, 2014, was 1,770,158.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the Proxy Statement for the 2014 Annual Meeting of Stockholders are incorporated by reference in Part III of this Form 10-K.

EMCLAIRE FINANCIAL CORP

TABLE OF CONTENTS

PART I

Item 1.	Business	K-3
Item 1A.	Risk Factors	K-20
Item 1B.	Unresolved Staff Comments	K-20
Item 2.	Properties	K-20
Item 3.	Legal Proceedings	K-20
Item 4.	Mine Safety Disclosures	K-20

PART II

Item 5.	Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities	K-20
Item 6.	Selected Financial Data	K-21
Item 7.	Management's Discussion and Analysis of Financial Condition and Results of Operations	K-21
Item 7A.	Quantitative and Qualitative Disclosures About Market Risk	K-34
Item 8.	Financial Statements and Supplementary Data	K-34
Item 9.	Changes in and Disagreements with Accountants on Accounting and Financial Disclosure	K-34
Item 9A.	Controls and Procedures	K-34
Item 9B.	Other Information	K-35

PART III

Item 10.	Directors, Executive Officers and Corporate Governance	K-35
Item 11.	Executive Compensation	K-35
Item 12.	Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters	K-35
Item 13.	Certain Relationships and Related Transactions, and Director Independence	K-36

Item 14.	Principal Accountant Fees and Services	K-36
	PART IV	
Item 15.	Exhibits and Financial Statement Schedules	K-37
SIGNATURES AND CERTIFICATIONS		K-39

Discussions of certain matters in this Form 10-K and other related year end documents may constitute forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended (the Exchange Act), and as such, may involve risks and uncertainties. Forward-looking statements, which are based on certain assumptions and describe future plans, strategies, and expectations, are generally identifiable by the use of words or phrases such as "believe", "plan", "expect", "intend", "anticipate", "estimate", "project", "forecast", "may increase", "may fluctuate", "may improve" and similar e future or conditional verbs such as "will", "should", "would", and "could". These forward-looking statements relate to, amo other things, expectations of the business environment in which the Corporation operates, projections of future performance, potential future credit experience, perceived opportunities in the market and statements regarding the Corporation's mission and vision. The Corporation's actual results, performance and achievements may differ materially from the results, performance, and achievements expressed or implied in such forward-looking statements due to a wide range of factors. These factors include, but are not limited to, changes in interest rates, general economic conditions, the local economy, the demand for the Corporation's products and services, accounting principles or guidelines, legislative and regulatory changes, monetary and fiscal policies of the U.S. Government, U.S. Treasury, and Federal Reserve, real estate markets, competition in the financial services industry, attracting and retaining key personnel, performance of new employees, regulatory actions, changes in and utilization of new technologies and other risks detailed in the Corporation's reports filed with the Securities and Exchange Commission (SEC) from time to time. These factors should be considered in evaluating the forward-looking statements, and undue reliance should not be placed on such statements. The Corporation does not undertake, and specifically disclaims any obligation, to update any forward-looking statements to reflect occurrences or unanticipated events or circumstances after the date of such statements.

PART I

Item 1. Business

General

Emclaire Financial Corp (the Corporation) is a Pennsylvania corporation and financial holding company that provides a full range of retail and commercial financial products and services to customers in western Pennsylvania through its wholly owned subsidiary bank, The Farmers National Bank of Emlenton (the Bank). The Corporation also provides real estate settlement services through its subsidiary, Emclaire Settlement Services, LLC (the Title Company).

The Bank was organized in 1900 as a national banking association and is a financial intermediary whose principal business consists of attracting deposits from the general public and investing such funds in real estate loans secured by liens on residential and commercial property, consumer loans, commercial business loans, marketable securities and interest-earning deposits. The Bank operates through a network of fourteen retail branch offices in Venango, Butler, Clarion, Clearfield, Crawford, Elk, Jefferson and Mercer counties, Pennsylvania. The Corporation and the Bank are headquartered in Emlenton, Pennsylvania.

The Bank is subject to examination and comprehensive regulation by the Office of the Comptroller of the Currency (OCC), which is the Bank's chartering authority, and the Federal Deposit Insurance Corporation (FDIC), which insures customer deposits held by the Bank to the full extent provided by law. The Bank is a member of the Federal Reserve Bank of Cleveland (FRB) and the Federal Home Loan Bank of Pittsburgh (FHLB). The Corporation is a registered bank holding company pursuant to the Bank Holding Company Act of 1956, as amended (BHCA), and a financial holding company under the Gramm-Leach Bliley Act of 1999 (GLBA).

At December 31, 2013, the Corporation had $525.8 million in total assets, $45.1 million in stockholders' equity, $352.4 million in net loans and $432.0 million in total deposits.

K-3

Lending Activities

General. The principal lending activities of the Corporation are the origination of residential mortgage, commercial mortgage, commercial business and consumer loans. Nearly all of the Corporation's loans are originated in and secured by property within the Corporation's primary market area.

One-to-Four Family Mortgage Loans. The Corporation offers first mortgage loans secured by one-to-four family residences located mainly in the Corporation's primary lending area. One-to-four family mortgage loans amounted to 29.5% of the total loan portfolio at December 31, 2013. Typically such residences are single-family owner occupied units. The Corporation is an approved, qualified lender for the Federal Home Loan Mortgage Corporation (FHLMC) and the FHLB. As a result, the Corporation may sell loans to and service loans for the FHLMC and FHLB in market conditions and circumstances where this is advantageous in managing interest rate risk.

Home Equity Loans. The Corporation originates home equity loans secured by single-family residences. Home equity loans amounted to 24.6% of the total loan portfolio at December 31, 2013. These loans may be either a single advance fixed-rate loan with a term of up to 20 years or a variable rate revolving line of credit. These loans are made only on owner-occupied single-family residences.

Commercial Business and Commercial Real Estate Loans. Commercial lending constitutes a significant portion of the Corporation's lending activities. Commercial business and commercial real estate loans amounted to 43.3% of the total loan portfolio at December 31, 2013. Commercial real estate loans generally consist of loans granted for commercial purposes secured by commercial or other nonresidential real estate. Commercial loans consist of secured and unsecured loans for such items as capital assets, inventory, operations and other commercial purposes.

Consumer Loans. Consumer loans generally consist of fixed-rate term loans for automobile purchases, home improvements not secured by real estate, capital and other personal expenditures. The Corporation also offers unsecured revolving personal lines of credit and overdraft protection. Consumer loans amounted to 2.6% of the total loan portfolio at December 31, 2013.

Loans to One Borrower. National banks are subject to limits on the amount of credit that they can extend to one borrower. Under current law, loans to one borrower are limited to an amount equal to 15% of unimpaired capital and surplus on an unsecured basis, and an additional amount equal to 10% of unimpaired capital and surplus if the loan is secured by readily marketable collateral. At December 31, 2013, the Bank's loans to one borrower limit based upon 15% of unimpaired capital was $7.4 million. The Bank may grant credit to borrowers in excess of the legal lending limit as part of the Legal Lending Limit Pilot Program approved by the OCC which allows the Bank to exceed its legal lending limit within certain parameters. At December 31, 2013, the Bank's largest single lending relationship had an outstanding balance of $7.4 million.

Loan Portfolio. The following table sets forth the composition and percentage of the Corporation's loans receivable in dollar amounts and in percentages of the portfolio as of December 31:

(Dollar amounts in thousands)	2013 Dollar Amount	%	2012 Dollar Amount	%	2011 Dollar Amount	%	2010 Dollar Amount	%	2009 Dollar Amou
Mortgage loans on real estate:									
Residential first mortgages	$ 105,541	29.5 %	$ 97,246	28.7 %	$ 93,610	29.6 %	$ 84,575	27.3 %	$ 74,0
Home equity loans and lines of credit	87,928	24.6 %	85,615	25.2 %	71,238	22.5 %	75,458	24.3 %	77,2
Commercial	101,499	28.4 %	98,823	29.2 %	94,765	30.0 %	93,028	30.0 %	89,9
Total real estate loans	294,968	82.5 %	281,684	83.1 %	259,613	82.1 %	253,061	81.6 %	241,
Other loans:									
Commercial business	53,214	14.9 %	45,581	13.4 %	43,826	13.9 %	43,780	14.1 %	41,5
Consumer	9,117	2.6 %	11,886	3.5 %	12,642	4.0 %	13,443	4.3 %	12,8
Total other loans	62,331	17.5 %	57,467	16.9 %	56,468	17.9 %	57,223	18.4 %	54,4
Total loans receivable	357,299	100.0 %	339,151	100.0 %	316,081	100.0 %	310,284	100.0 %	295,
Less:									
Allowance for loan losses	4,869		5,350		3,536		4,132		3,20
Net loans receivable	$ 352,430		$ 333,801		$ 312,545		$ 306,152		$ 292,

The following table sets forth the final maturity of loans in the Corporation's portfolio as of December 31, 2013. Demand loans having no stated schedule of repayment and no stated maturity are reported as due within one year.

(Dollar amounts in thousands)	Due in one year or less	Due from one to five years	Due from five to ten years	Due after ten years	Total
Residential mortgages	$ 1,805	$ 2,895	$ 5,703	$ 95,138	$ 105,541
Home equity loans and lines of credit	145	9,995	26,597	51,191	87,928
Commercial mortgages	1,409	8,662	31,419	60,009	101,499
Commercial business	2,893	9,295	7,771	33,255	53,214
Consumer	356	4,404	668	3,689	9,117
	$ 6,608	$ 35,251	$ 72,158	$ 243,282	$ 357,299

The following table sets forth the dollar amount of the Corporation's fixed and adjustable rate loans with maturities greater than one year as of December 31, 2013:

(Dollar amounts in thousands)	Fixed rates	Adjustable rates
Residential mortgage	$ 90,397	$ 13,339
Home equity loans and lines of credit	73,453	14,330
Commercial mortgage	18,472	81,618

Commercial business		19,728		30,593
Consumer		4,958		3,803
	$	207,008	$	143,683

Contractual maturities of loans do not reflect the actual term of the Corporation's loan portfolio. The average life of mortgage loans is substantially less than their contractual terms because of loan prepayments and enforcement of due-on-sale clauses, which give the Corporation the right to declare a loan immediately payable in the event, among other things, that the borrower sells the real property subject to the mortgage. Scheduled principal amortization also reduces the average life of the loan portfolio. The average life of mortgage loans tends to increase when current market mortgage rates substantially exceed rates on existing mortgages and conversely, decrease when rates on existing mortgages substantially exceed current market interest rates.

K-5

Delinquencies and Classified Assets

Delinquent Loans and Other Real Estate Acquired Through Foreclosure (OREO). Typically, a loan is considered past due and a late charge is assessed when the borrower has not made a payment within fifteen days from the payment due date. When a borrower fails to make a required payment on a loan, the Corporation attempts to cure the deficiency by contacting the borrower. The initial contact with the borrower is made shortly after the seventeenth day following the due date for which a payment was not received. In most cases, delinquencies are cured promptly.

If the delinquency exceeds 60 days, the Corporation works with the borrower to set up a satisfactory repayment schedule. Typically, loans are considered nonaccruing upon reaching 90 days delinquent, although the Corporation may be receiving partial payments of interest and partial repayments of principal on such loans. When a loan is placed in nonaccrual status, previously accrued but unpaid interest is deducted from interest income. The Corporation institutes foreclosure action on secured loans only if all other remedies have been exhausted. If an action to foreclose is instituted and the loan is not reinstated or paid in full, the property is sold at a judicial or trustee's sale at which the Corporation may be the buyer.

Real estate properties acquired through, or in lieu of, foreclosure are to be sold and are initially recorded at fair value at the date of foreclosure less costs to sell, thereby establishing a new cost basis. After foreclosure, management periodically performs valuations and the real estate is carried at the lower of carrying amount or fair value less the cost to sell the property. Revenue and expenses from operations and changes in the valuation allowance are included in the loss on foreclosed real estate. The Corporation generally attempts to sell its OREO properties as soon as practical upon receipt of clear title.

As of December 31, 2013, the Corporation's nonperforming assets were $5.3 million, or 1.01% of the Corporation's total assets, compared to $7.2 million or 1.41% of the Corporation's total assets, at December 31, 2012. Nonperforming assets at December 31, 2013 included nonaccrual loans, loans past due 90 days and still on accrual status and OREO of $5.2 million, $62,000 and $107,000, respectively. Included in nonaccrual loans at December 31, 2013 were 12 loans totaling $2.5 million considered to be troubled debt restructurings (TDRs). Interest income of $439,000 would have been recorded in 2013 if the nonaccrual loans had been current and performing during the entire period. Interest of $32,000 on these loans was included in income during 2013.

Classified Assets. Regulations applicable to insured institutions require the classification of problem assets as "substandard," "doubtful," or "loss" depending upon the existence of certain characteristics as discussed below. A category designated "special mention" must also be maintained for assets currently not requiring the above classifications but having potential weakness or risk characteristics that could result in future problems. An asset is classified as substandard if not adequately protected by the current net worth and paying capacity of the obligor or of the collateral pledged, if any. A substandard asset is characterized by the distinct possibility that the Corporation will sustain some loss if the deficiencies are not corrected. Assets classified as doubtful have all the weaknesses inherent in those classified as substandard. In addition, these weaknesses make collection or liquidation in full, on the basis of currently existing facts, conditions and values, highly questionable or improbable. Assets classified as loss are considered uncollectible and of such little value that their continuance as assets is not warranted.

The Corporation's classification of assets policy requires the establishment of valuation allowances for loan losses in an amount deemed prudent by management. Valuation allowances represent loss allowances that have been established to recognize the inherent risk associated with lending activities. When the Corporation classifies a problem asset as a loss, the portion of the asset deemed uncollectible is charged off immediately.

The Corporation regularly reviews the problem loans and other assets in its portfolio to determine whether any require classification in accordance with the Corporation's policy and applicable regulations. As of December 31, 2013, the Corporation's classified and criticized assets amounted to $12.7 million or 2.4% of total assets, with $930,000

identified as special mention and $11.8 million classified as substandard.

K-6

Included in classified and criticized assets at December 31, 2013 are four large loan relationships exhibiting credit deterioration impacting the ability of the borrowers to comply with their present loan repayment terms on a timely basis.

The first, with an outstanding balance of $2.8 million at December 31, 2013, was originated for the construction of a hotel, restaurant and retail plaza secured by such property and the borrower's personal residence. The hotel, restaurant and retail plaza are complete and operational. However, cash flows from operations have not been consistent and are impacted by the seasonal nature of the hotel. In addition, the borrower has limited liquid sources of repayment. As a result, the borrower has listed substantial real estate holdings for sale. At December 31, 2013, the loan was performing and classified as substandard. Ultimately, due to the estimated value of the borrower's significant real estate holdings, the Corporation does not currently expect to incur a loss on this loan.

The second relationship, with an outstanding balance of $2.1 million at December 31, 2013, consists of two commercial real estate mortgage loans originated for the purchase and renovation of a commercial office building. The loans are secured by senior lien positions on the office building and the assignment of lease income. Due to the inability to fully rent the building, cash flows are insufficient to meet the debt service requirements, operating expenses and real estate taxes. Given this deficiency, the loans have been determined to be impaired. At December 31, 2012, the loans had an outstanding balance of $3.4 million, were 30-59 days delinquent, nonperforming and indentified as substandard with the amount of the collateral deficiency rated as doubtful. At December 31, 2012, the specific reserve allocated to these loans was $1.4 million. During 2013, the Corporation charged-off the $941,000 portion of the loans that was previously rated as doubtful. In addition, the borrower has continued to make regular payments which decreased the outstanding balance by $296,000 during 2013. At December 31, 2013, the loans were 30-59 days delinquent, nonperforming, indentified as substandard and had a specific reserve of $145,000 allocated to them.

The third relationship, with an outstanding balance of $2.1 million at December 31, 2013, consists of one commercial real estate mortgage loan and six commercial business loans. The loans are secured by lien positions on the manufacturing facilities and other business assets. While this relationship has historically had positive cash flows and all loans have remained current, the borrower has gone through a transition period due to revenue concentration in one customer and is currently reporting losses and displaying cash flow deficits. At December 31, 2013, the loans were performing but identified as substandard. As a result of the recent appraised value of the collateral, the Corporation does not currently expect to incur a loss on this relationship.

The fourth, with an outstanding balance of $1.3 million at December 31, 2013, is a consumer installment loan for the purpose of consolidating various personal debts. This loan is secured by a lien on the primary residence of the borrower discussed in the first loan above. The original debtor has been discharged in bankruptcy and the debt is currently being repaid by the collateral owner securing the loan. At December 31, 2013, the loan was nonperforming, classified as substandard and considered a TDR. As a result of the estimated value of the collateral, the Corporation does not currently expect to incur a loss on this loan.

The following table sets forth information regarding the Corporation's nonperforming assets as of December 31:

(Dollar amounts in thousands)	2013	2012	2011	2010	2009
Nonperforming loans	$ 5,207	$ 6,988	$ 5,565	$ 6,611	$ 2,418
Total as a percentage of gross loans	1.46 %	2.06 %	1.76 %	2.13 %	0.82 %
Repossessions	-	-	-	-	40

Real estate acquired through foreclosure	107	180	307	373	173
Total as a percentage of total assets	0.02 %	0.04 %	0.06 %	0.08 %	0.05 %
Total nonperforming assets	$ 5,314	$ 7,168	$ 5,872	$ 6,984	$ 2,631
Total nonperforming assets as a percentage of total assets	1.01 %	1.41 %	1.19 %	1.45 %	0.56 %
Allowance for loan losses as a percentage of nonperforming loans	93.51 %	76.56 %	63.54 %	62.50 %	132.42 %

K-7

Allowance for Loan Losses. Management establishes allowances for estimated losses on loans based upon its evaluation of the pertinent factors underlying the types and quality of loans; historical loss experience based on volume and types of loans; trend in portfolio volume and composition; level and trend on nonperforming assets; detailed analysis of individual loans for which full collectability may not be assured; determination of the existence and realizable value of the collateral and guarantees securing such loans and the current economic conditions affecting the collectability of loans in the portfolio. The Corporation analyzes its loan portfolio at least quarterly for valuation purposes and to determine the adequacy of its allowance for losses. Based upon the factors discussed above, management believes that the Corporation's allowance for losses as of December 31, 2013 of $4.9 million was adequate to cover probable incurred losses in the portfolio at such time.

The following table sets forth an analysis of the allowance for losses on loans receivable for the years ended December 31:

(Dollar amounts in thousands)	2013	2012	2011	2010	2009
Balance at beginning of period	$ 5,350	$ 3,536	$ 4,132	$ 3,202	$ 2,651
Provision for loan losses	580	2,154	420	1,306	1,367
Charge-offs:					
Residential mortgage loans	(36)	(90)	(224)	(40)	(35)
Home equity loans and lines of credit	(68)	(222)	(188)	(45)	-
Commercial mortgage loans	(941)	(35)	(200)	(61)	(477)
Commercial business loans	-	(50)	(415)	(216)	(264)
Consumer loans	(85)	(101)	(67)	(190)	(83)
	(1,130)	(498)	(1,094)	(552)	(859)
Recoveries:					
Residential mortgage loans	1	84	3	2	-
Home equity loans and lines of credit	-	27	1	2	-
Commercial mortgage loans	8	8	-	147	-
Commercial business loans	18	15	63	5	7
Consumer loans	42	24	11	20	36
	69	158	78	176	43
Net charge-offs	(1,061)	(340)	(1,016)	(376)	(816)
Balance at end of period	$ 4,869	$ 5,350	$ 3,536	$ 4,132	$ 3,202
Ratio of net charge-offs to average loans outstanding	0.30 %	0.10 %	0.32 %	0.12 %	0.29 %
Ratio of allowance to total loans at end of period	1.36 %	1.58 %	1.12 %	1.33 %	1.08 %

The following table provides a breakdown of the allowance for loan losses by major loan category for the years ended December 31:

(Dollar amounts in thousands)	2013		2012		2011		2010
		Percent of		Percent of		Percent of	

Loan Categories:	Dollar Amount	loans in each category to total loans		Dollar Amount	loans in each category to total loans		Dollar Amount	loans in each category to total loans		Dollar Amount
Commercial, financial and agricultural	$ 822	14.9	%	$ 636	13.4	%	$ 590	13.9	%	$ 1,323
Commercial mortgages	2,450	28.4	%	3,090	29.2	%	1,737	30.0	%	1,707
Residential mortgages	923	29.5	%	828	28.7	%	832	29.6	%	398
Home equity loans	625	24.6	%	730	25.2	%	320	22.5	%	572
Consumer loans	49	2.6	%	66	3.5	%	57	4.0	%	132
Unallocated	-	-		-	-		-	-		-
	$ 4,869	100	%	$ 5,350	100	%	$ 3,536	100	%	$ 4,132

K-8

Investment Activities

General. The Corporation maintains an investment portfolio of securities such as U.S. government agencies, mortgage-backed securities, municipal and equity securities.

Investment decisions are made within policy guidelines as established by the Board of Directors. This policy is aimed at maintaining a diversified investment portfolio, which complements the overall asset/liability and liquidity objectives of the Corporation, while limiting the related credit risk to an acceptable level.

The following table sets forth certain information regarding the fair value, weighted average yields and contractual maturities of the Corporation's securities as of December 31, 2013:

(Dollar amounts in thousands)	Due in 1 year or less	Due from 1 to 3 years	Due from 3 to 5 years	Due from 5 to 10 years	Due after 10 years	No scheduled maturity	Total
U.S. Treasury and federal agency	$ -	$ -	$ 973	$ 2,799	$ 396	$ -	$ 4,168
U.S. government sponsored entities and agencies	-	-	12,333	10,559	-	-	22,892
U.S. agency mortgage-backed securities: residential	-	-	-	-	11,361	-	11,361
U.S. agency collateralized mortgage obligations: residential	-	-	-	-	39,722	-	39,722
Corporate securities	-	-	241	-	-	-	241
State and political subdivision	1,008	1,920	3,741	26,463	3,367	-	36,499
Equity securities	-	-	-	-	-	2,421	2,421
Estimated fair value	$ 1,008	$ 1,920	$ 17,288	$ 39,821	$ 54,846	$ 2,421	$ 117,304
Weighted average yield (1)	5.03 %	4.86 %	1.93 %	3.49 %	2.16 %	4.24 %	2.69 %

(1) Taxable equivalent adjustments have been made in calculating yields on state and political subdivision securities.

The following table sets forth the fair value of the Corporation's investment securities as of December 31:

(Dollar amounts in thousands)	2013	2012	2011
U.S. Treasury and federal agency	$ 4,168	$ 3,967	$ 4,460
U.S. government sponsored entities and agencies	22,892	28,162	41,520
U.S. agency mortgage-backed securities: residential	11,361	22,724	37,478
U.S. agency collateralized mortgage obligations: residential	39,722	22,475	-
Corporate securities	241	3,761	-
State and political subdivision	36,499	36,765	37,000
Equity securities	2,421	2,352	2,696
	$ 117,304	$ 120,206	$ 123,154

For additional information regarding the Corporation's investment portfolio see "Note 3 Securities" on page F-15 to the consolidated financial statements.

Sources of Funds

General. Deposits are the primary source of the Corporation's funds for lending and investing activities. Secondary sources of funds are derived from loan repayments, investment maturities and borrowed funds. Loan repayments can be considered a relatively stable funding source, while deposit activity is greatly influenced by interest rates and general market conditions. The Corporation also has access to funds through other various sources. For additional information about the Corporation's sources of funds, see "Management's Discussion and Analysis of Financial Condition and Results of Operations - Liquidity" in item 7.

Deposits. The Corporation offers a wide variety of retail deposit account products to both consumer and commercial deposit customers, including time deposits, noninterest bearing and interest bearing demand deposit accounts, savings deposits and money market accounts.

Deposit products are promoted in periodic newspaper, radio and other forms of advertisements, along with notices provided in customer account statements. The Corporation's marketing strategy is based on its reputation as a community bank that provides quality products and personalized customer service.

The Corporation pays interest rates on its interest bearing deposit products that are competitive with rates offered by other financial institutions in its market area. Management reviews interest rates on deposits bi-weekly and considers a number of factors, including: (1) the Corporation's internal cost of funds; (2) rates offered by competing financial institutions; (3) investing and lending opportunities; and (4) the Corporation's liquidity position.

The following table summarizes the Corporation's deposits as of December 31:

(Dollar amounts in thousands)	2013			2012		
Type of accounts	Weighted average rate	Amount	%	Weighted average rate	Amount	%
Non-interest bearing deposits	-	$ 104,269	24.1 %	-	$ 98,559	22.8 %
Interest bearing demand deposits	0.15 %	221,412	51.3 %	0.15 %	201,919	46.7 %
Time deposits	1.87 %	106,325	24.6 %	2.63 %	131,981	30.5 %
	0.54 %	$ 432,006	100.0 %	0.87 %	$ 432,459	100.0 %

The following table sets forth maturities of the Corporation's certificates of deposit of $100,000 or more at December 31, 2013 by time remaining to maturity:

(Dollar amounts in thousands)	Amount
Less than three months	$ 1,988
Over three months to six months	3,102
Over six months to twelve months	8,637
Over twelve months	29,638
	$ 43,365

Borrowings. Borrowings may be used to compensate for reductions in deposit inflows or net deposit outflows, or to support lending and investment activities. These borrowings include FHLB advances, federal funds, repurchase agreements, advances from the Federal Reserve Discount Window and lines of credit at the Bank and the Corporation with other correspondent banks. The following table summarizes information with respect to borrowings at or for the years ending December 31:

(Dollar amounts in thousands)	2013	2012
Ending balance	$ 44,150	$ 20,000
Average balance	29,381	20,027
Maximum balance	48,400	24,000
Average rate	2.74 %	4.65 %

For additional information regarding the Corporation's deposit base and borrowed funds, see "Management's Discussion and Analysis of Financial Condition and Results of Operations Deposits and Borrowed Funds" in item 7 and "Note 9

Deposits” on page F-26 and “Note 10 Borrowed Funds” on page F-27 to the consolidated financial statements.

K-10

Subsidiary Activity

The Corporation has two wholly owned subsidiaries, the Bank and the Title Company. As of December 31, 2013, the Bank and the Title Company had no subsidiaries.

Personnel

At December 31, 2013, the Corporation had 116 full time equivalent employees. There is no collective bargaining agreement between the Corporation and its employees, and the Corporation believes its relationship with its employees to be satisfactory.

Competition

The Corporation competes for loans, deposits and customers with other commercial banks, savings and loan associations, securities and brokerage companies, mortgage companies, insurance companies, finance companies, money market funds, credit unions and other nonbank financial service providers.

Supervision and Regulation

General. Bank holding companies and banks are extensively regulated under both federal and state law. Set forth below is a summary description of certain provisions of certain laws that relate to the regulation of the Corporation and the Bank. The description does not purport to be complete and is qualified in its entirety by reference to the applicable laws and regulations.

The Corporation. The Corporation is a registered bank holding company, and subject to regulation and examination by the FRB under the BHCA and a financial holding company under the GLBA. The Corporation is required to file with the FRB periodic reports and such additional information as the FRB may require. Recent changes to the Bank Holding Company rating system emphasize risk management and evaluation of the potential impact of non-depository entities on safety and soundness.

The FRB may require the Corporation to terminate an activity or terminate control of or liquidate or divest certain subsidiaries, affiliates or investments when the FRB believes the activity or the control of the subsidiary or affiliate constitutes a significant risk to the financial safety, soundness or stability of any of its banking subsidiaries. The FRB also has the authority to regulate provisions of certain bank holding company debt, including the authority to impose interest ceilings and reserve requirements on such debt. Under certain circumstances, the Corporation must file written notice and obtain FRB approval prior to purchasing or redeeming its equity securities.

Further, the Corporation is required by the FRB to maintain certain levels of capital. See “Capital Standards.”

The Corporation is required to obtain prior FRB approval for the acquisition of more than 5% of the outstanding shares of any class of voting securities or substantially all of the assets of any bank or bank holding company. Prior FRB approval is also required for the merger or consolidation of the Corporation and another bank holding company.

The BHCA generally prohibits a bank holding company from acquiring direct or indirect ownership or control of more than 5% of the outstanding voting shares of any company that is not a bank or bank holding company and from engaging directly or indirectly in activities other than those of banking, managing or controlling banks, or furnishing services to its subsidiaries. However, subject to the prior FRB approval, a bank holding company may engage in any, or acquire shares of companies engaged in, activities that the FRB deems to be so closely related to banking or managing or controlling banks as to be a proper incident thereto.

K-11

The GLBA amended portions of the BHCA to authorize bank holding companies to engage in securities, insurance and other activities that are financial in nature or incidental to a financial activity. In order to undertake these activities, a bank holding company must become a financial holding company by submitting to the appropriate FRB a declaration that the company elects to be a financial holding company and a certification that all of the depository institutions controlled by the company are well capitalized and well managed. The Corporation submitted the declaration of election to become a financial holding company with the FRB of Cleveland in February 2007, and the election became effective in March 2007. Recent federal legislation also directed federal regulators to require depository institution holding companies to serve as a source of strength for their depository institution subsidiaries.

Under FRB regulations, the Corporation is required to serve as a source of financial and managerial strength to the Bank and may not conduct operations in an unsafe or unsound manner. In addition, it is the FRB's policy that a bank holding company should stand ready to use available resources to provide adequate capital funds to its subsidiary banks during periods of financial stress or adversity and should maintain the financial flexibility and capital raising capacity to obtain additional resources for assisting its subsidiary banks. A bank holding company's failure to meet its obligations to serve as a source of strength to its subsidiary banks will generally be considered by the FRB to be an unsafe and unsound banking practice or a violation of FRB regulations or both.

The Corporation is also a bank holding company within the meaning of the Pennsylvania Banking Code. As such, the Corporation and its subsidiaries are subject to examination by, and may be required to file reports with, the Pennsylvania Department of Banking and Securities.

The Corporation's securities are registered with the SEC under the Exchange Act. As such, the Corporation is subject to the information, proxy solicitation, insider trading, corporate governance, and other requirements and restrictions of the Exchange Act. The public may obtain all forms and information filed with the SEC through their website http://www.sec.gov.

Regulations were recently adopted by the federal banking agencies to implement the provisions of the Dodd Frank Act commonly referred to as the Volcker Rule. The regulations contain prohibitions and restrictions on the ability of financial institutions, holding companies and their affiliates to engage in proprietary trading and to hold certain interests in, or to have certain relationships with, various types of investment funds, including hedge funds and private equity funds. The regulations will become effective on April 1, 2014 with full compliance being phased in over a period ending on July 21, 2015. The Corporation is currently reviewing its investment portfolio to ensure compliance as the various provisions of the Volcker Rule regulations become effective.

The Bank. As a national banking association, the Bank is subject to primary supervision, examination and regulation by the OCC. The Bank is also subject to regulations of the FDIC as administrator of the Deposit Insurance Fund (DIF) and the FRB. If, as a result of an examination of the Bank, the OCC should determine that the financial condition, capital resources, asset quality, earnings prospects, management, liquidity or other aspects of the Bank's operations are unsatisfactory or that the Bank is violating or has violated any law or regulation, various remedies are available to the OCC. Such remedies include the power to enjoin "unsafe or unsound practices," to require affirmative action to correct any conditions resulting from any violation or practice, to issue an administrative order that can be judicially enforced, to direct an increase in capital, to restrict the Bank's growth, to assess civil monetary penalties, and to remove officers and directors. The FDIC has similar enforcement authority, in addition to its authority to terminate the Bank's deposit insurance in the absence of action by the OCC and upon a finding that the Bank is operating in an unsafe or unsound condition, is engaging in unsafe or unsound activities, or that the Bank's conduct poses a risk to the deposit insurance fund or may prejudice the interest of its depositors.

A national bank may have a financial subsidiary engaged in any activity authorized for national banks directly or certain permissible activities. Generally, a financial subsidiary is permitted to engage in activities that are "financial in nature" or incidental thereto, even though they are not permissible for the national bank itself. The definition of

“financial in nature” includes, among other items, underwriting, dealing in or making a market in securities, including, for example, distributing shares of mutual funds. The subsidiary may not, however, engage as principal in underwriting insurance, issue annuities or engage in real estate development or investment or merchant banking.

The Sarbanes-Oxley Act of 2002. The Sarbanes-Oxley Act of 2002 established a comprehensive framework to modernize and reform the oversight of public company auditing, improve the quality and transparency of financial reporting by those companies and strengthen the independence of auditors. Among other things, the legislation (i) created a public company accounting oversight board that is empowered to set auditing, quality control and ethics standards, to inspect registered public accounting firms, to conduct investigations and to take disciplinary actions, subject to SEC oversight and review; (ii) strengthened auditor independence from corporate management by limiting the scope of consulting services that auditors can offer their public company audit clients; (iii) heightened the responsibility of public company directors and senior managers for the quality of the financial reporting and disclosure made by their companies; (iv) adopted a number of provisions to deter wrongdoing by corporate management; (v) imposed a number of new corporate disclosure requirements; (vi) adopted provisions which generally seek to limit and expose to public view possible conflicts of interest affecting securities analysis; and (vii) imposed a range of new criminal penalties for fraud and other wrongful acts and extended the period during which certain types of lawsuits can be brought against a company or its insiders.

The Dodd-Frank Wall Street Reform and Consumer Protection Act. The Dodd-Frank Act, enacted in 2010, is complex and broad in scope. The Dodd-Frank Act altered the authority and duties of the federal banking and securities regulatory agencies, implemented corporate governance requirements for all public companies related to executive compensation, shareholder proxy access, whistleblower provisions and restricted certain trading activities of banks and their affiliates. In addition, The Dodd-Frank Act established the Consumer Financial Protection Bureau (CFPB), which has extensive regulatory and enforcement powers over consumer financial products and services and the Financial Stability Oversight Council, which has oversight authority for monitoring and regulating systemic risk. The Dodd-Frank Act also required the issuance of numerous implementing regulations, many of which have not yet been issued. The regulations will continue to take effect over several years.

In January 2013, the CFPB issued eight final regulations governing primarily consumer mortgage lending. One of these rules, the ability to repay and qualified mortgage rule, took effect January 10, 2014. The rule imposes additional requirements on lenders including rules designed to require lenders to ensure borrowers' ability to repay their mortgage. Also in January, the CFPB finalized rules on escrow accounts for higher priced mortgage loans, expanded the scope of the high-cost mortgage provision in the Trust in Lending Act and implemented certain mortgage servicing provisions. In November 2013, the CFPB issued a final appraisal rule and an interagency rule on appraisals for higher-priced mortgage loans for which compliance is required by August 1, 2015.

The following aspects of the Dodd-Frank Act are related to the operations of the Bank: (i) a new independent consumer financial protection bureau has been established within the FRB, empowered to exercise broad regulatory, supervisory and enforcement authority with respect to both new and existing consumer financial protection laws. Smaller financial institutions like the Bank are subject to the supervision and enforcement of their primary federal banking regulator with respect to the federal consumer financial protection laws; (ii) the Federal Deposit Insurance Act was amended to direct federal regulators to require depository institution holding companies to serve as a source of strength for their depository institution subsidiaries; (iii) Tier 1 capital treatment for "hybrid" capital items like trust preferred securities has been eliminated subject to various grandfathering and transition rules; (iv) the prohibition on payment of interest on demand deposits was repealed, effective July 21, 2011, thereby permitting depository institutions to pay interest on business transaction and other accounts; (v) state law is preempted only if it would have a discriminatory effect on a federal savings association or is preempted by any other federal law. The OCC must make a preemption determination on a case-by-case basis with respect to a particular state law or other state law with substantively equivalent terms; (vi) deposit insurance was permanently increased to $250,000; (vii) deposit insurance assessment base calculation now equals the depository institution's total assets minus the sum of its average tangible equity during the assessment period; and (viii) the minimum reserve ratio of the DIF increased to 1.35% of estimated annual insured deposits or assessment base; however, the FDIC is directed to "offset the effect" of the increased reserve ratio for insured depository institutions with total consolidated assets of less than $10 billion.

The following aspects of the Dodd-Frank Act are related to the operations of the Corporation: (i) the SEC is authorized to adopt rules requiring public companies to make their proxy materials available to shareholders for nomination of their own candidates for election to the board of directors; (ii) public companies are required to provide their shareholders with a non-binding vote: (a) at least once every three years on the compensation paid to executive officers, and (b) at least once every six years on whether they should have a “say on pay” vote every one, two or three years; (iii) a separate, non-binding shareholder vote is required regarding golden parachutes for named executive officers when a shareholder vote takes place on mergers, acquisitions, dispositions or other transactions that would trigger the parachute payments; (iv) securities exchanges are now required to prohibit brokers from using their own discretion to vote shares not beneficially owned by them for certain “significant” matters, which include votes on the election of directors, executive compensation matters, and any other matter determined to be significant; (v) stock exchanges will be prohibited from listing the securities of any issuer that does not have a policy providing for (a) disclosure of its policy on incentive compensation payable on the basis of financial information reportable under the securities laws, and (b) the recovery from current or former executive officers, following an accounting restatement triggered by material noncompliance with securities law reporting requirements, of any incentive compensation paid erroneously during the three-year period preceding the date on which the restatement was required that exceeds the amount that would have been paid on the basis of the restated financial information; (vi) disclosure in annual proxy materials will be required concerning the relationship between the executive compensation paid and the financial performance of the issuer; (vii) Item 402 of Regulation S-K will be amended to require companies to disclose the ratio of the Chief Executive Officer's annual total compensation to the median annual total compensation of all other employees; and (viii) smaller reporting companies are exempt from complying with the internal control over financial reporting auditor attestation requirements of Section 404(b) of the Sarbanes-Oxley Act.

Anti-Money Laundering. All financial institutions, including national banks, are subject to federal laws that are designed to prevent the use of the U.S. financial system to fund terrorist activities. Financial institutions operating in the United States must develop anti-money laundering compliance programs, due diligence policies and controls to ensure the detection and reporting of money laundering. Such compliance programs are intended to supplement compliance requirements, also applicable to financial institutions, under the Bank Secrecy Act and the Office of Foreign Assets Control Regulations. The Bank has established policies and procedures to ensure compliance with these provisions.

Privacy. Federal banking rules limit the ability of banks and other financial institutions to disclose non-public information about consumers to nonaffiliated third parties. Pursuant to these rules, financial institutions must provide (i) initial notices to customers about their privacy policies, describing conditions under which they may disclose nonpublic personal information to nonaffiliated third parties and affiliates; (ii) annual notices of their privacy policies to current customers and (iii) a reasonable method for customers to “opt out” of disclosures to nonaffiliated third parties. These privacy provisions affect how consumer information is transmitted through diversified financial companies and conveyed to outside vendors. The Corporation’s privacy policies have been implemented in accordance with the law.

Dividends and Other Transfers of Funds. Dividends from the Bank constitute the principal source of income to the Corporation. The Corporation is a legal entity separate and distinct from the Bank. The Bank is subject to various statutory and regulatory restrictions on its ability to pay dividends to the Corporation. In addition, the Bank’s regulators have the authority to prohibit the Bank from paying dividends, depending upon the Bank’s financial condition, if such payment is deemed to constitute an unsafe or unsound practice.

Limitations on Transactions with Affiliates. Transactions between national banks and any affiliate are governed by Sections 23A and 23B of the Federal Reserve Act. An affiliate of a national bank includes any company or entity which controls the national bank or that is controlled by a company that controls the national bank. In a holding company context, the holding company of a national bank (such as the Corporation) and any companies which are controlled by such holding company are affiliates of the national bank. Generally, Section 23A limits the extent to

which the national bank of its subsidiaries may engage in “covered transactions” with any one affiliate to an amount equal to 10% of such bank’s capital stock and surplus, and contains an aggregate limit on all such transactions with all affiliates to an amount equal to 20% of such capital stock and surplus. Section 23B applies to “covered transactions” as well as certain other transactions and requires that all transactions be on terms substantially the same, or at least favorable, to the national bank as those provided to a non-affiliate. The term “covered transaction” includes the making of loans to, purchase of assets from and issuance of a guarantee to an affiliate and similar transactions. Section 23B transactions also include the provision of services and the sale of assets by a national bank to an affiliate.

In addition, Sections 22(g) and (h) of the Federal Reserve Act place restrictions on loans to executive officers, directors and principal shareholders of the national bank and its affiliates. Under Section 22(h), loans to a director, an executive officer and to a greater than 10% shareholder of a national bank, and certain affiliated interests of either, may not exceed, together with all other outstanding loans to such person and affiliated interests, the national bank's loans to one borrower limit (generally equal to 15% of the bank's unimpaired capital and surplus). Section 22(h) also requires that loans to directors, executive officers and principal shareholders be made on terms substantially the same as offered in comparable transactions to other persons unless the loans are made pursuant to a benefit or compensation program that (i) is widely available to employees of the bank and (ii) does not give preference to any director, executive officer or principal shareholder, or certain affiliated interests of either, over other employees of the national bank. Section 22(h) also requires prior board approval for certain loans. In addition, the aggregate amount of extensions of credit by a national bank to all insiders cannot exceed the bank's unimpaired capital and surplus. Furthermore, Section 22(g) places additional restrictions on loans to executive officers. The Bank currently is subject to Sections 22(g) and (h) of the Federal Reserve Act and at December 31, 2013, was in compliance with the above restrictions.

Loans to One Borrower Limitations. With certain limited exceptions, the maximum amount that a national bank may lend to any borrower (including certain related entities of the borrower) at one time may not exceed 15% of the unimpaired capital and surplus of the institution, plus an additional 10% of unimpaired capital and surplus for loans fully secured by readily marketable collateral. At December 31, 2013, the Bank's loans-to-one-borrower limit was $7.4 million based upon the 15% of unimpaired capital and surplus measurement. The Bank may grant credit to borrowers in excess of the legal lending limit as part of the Legal Lending Limit Pilot Program approved by the OCC which allows the Bank to exceed its legal lending limit within certain parameters. At December 31, 2013, the Bank's largest single lending relationship had an outstanding balance of $7.4 million.

Capital Standards. The federal banking agencies have adopted minimum risk-based capital guidelines intended to provide a measure of capital that reflects the degree of risk associated with a banking organization's operations for both transactions reported on the balance sheet as assets and transactions which are recorded as off-balance sheet items. Under these guidelines, nominal dollar amounts of assets and credit equivalent amounts of off-balance sheet items are multiplied by one of several risk adjustment percentages, which range from 0% for assets with low credit risk, such as federal banking agencies, to 100% for assets with relatively high credit risk.

The risk-based capital ratio is determined by classifying assets and certain off-balance sheet financial instruments into weighted categories, with higher levels of capital being required for those categories perceived as representing greater risk. Under the capital guidelines, a banking organization's total capital is divided into tiers. "Tier I capital" consists of (1) common equity, (2) qualifying noncumulative perpetual preferred stock, (3) a limited amount of qualifying cumulative perpetual preferred stock and (4) minority interests in the equity accounts of consolidated subsidiaries (including trust-preferred securities), less goodwill and certain other intangible assets. Not more than 25% of qualifying Tier I capital may consist of trust-preferred securities. "Tier II capital" consists of hybrid capital instruments, perpetual debt, mandatory convertible debt securities, a limited amount of subordinated debt, preferred stock that does not qualify as Tier I capital, a limited amount of the allowance for loan and lease losses and a limited amount of unrealized holding gains on equity securities. "Tier III capital" consists of qualifying unsecured subordinated debt. The sum of Tier II and Tier III capital may not exceed the amount of Tier I capital. The guidelines require a minimum ratio of qualifying total capital to risk-adjusted assets of 8% and a minimum ratio of Tier 1 capital to risk-adjusted assets of 4%.

In addition to the risk-based guidelines, federal banking regulators require banking organizations to maintain a minimum amount of Tier 1 capital to adjusted average assets, referred to as the leverage ratio. For a banking organization rated in the highest of the six categories used by regulators to rate banking organizations (CAMELS), the minimum leverage ratio of Tier 1 capital to total assets must be 3%. All other institutions are required to maintain a minimum leverage ratio of 4%.

In addition to these uniform risk-based capital guidelines and leverage ratios that apply across the industry, the regulators have the discretion to set individual minimum capital requirements for specific institutions at rates significantly above the minimum guidelines and ratios. Federal banking regulators may also set capital requirements higher than the minimums described above for financial institutions whose circumstances warrant it. For example, a financial institution experiencing or anticipating significant growth may be expected to maintain capital positions substantially above the minimum supervisory levels without significant reliance on intangible assets.

In July 2013, the Office of the Comptroller of the Currency and the other federal bank regulatory agencies issued a final rule that will revise their leverage and risk-based capital requirements and the method for calculating risk-weighted assets to make them consistent with agreements that were reached by the Basel Committee on Banking Supervision and certain provisions of the Dodd-Frank Act. Among other things, the rule established a new common equity Tier 1 minimum capital requirement (4.5% of risk-weighted assets), increases the minimum Tier 1 capital to risk-based assets requirement (from 4% to 6% of risk-weighted assets), phases out certain kinds of intangibles and instruments treated as capital and assigns a higher risk weight (150%) to exposures that are more than 90 days past due or are on nonaccrual status and to certain commercial real estate facilities that finance acquisition, development or construction of real property. The final rule also requires unrealized gains and losses on certain "available-for-sale" securities holdings to be included for purposes of calculating regulatory capital requirements unless a one-time opt-out is exercised. The rule limits a banking organization's capital distributions and certain discretionary bonus payments if the banking organization does not hold a "capital conservation buffer" consisting of 2.5% of common equity Tier 1 capital to risk-weighted assets in addition to the amount necessary to meet its minimum risk-based capital requirements. The new capital rules maintain the general structure of the prompt corrective action rules, but incorporate the new common equity Tier 1 capital requirement and the increased Tier 1 risk-weighted asset requirement into the prompt corrective action framework.

The final rule becomes effective for the Bank on January 1, 2015. The capital conservation buffer requirement will be phased in beginning January 1, 2016 and ending January 1, 2019, when the full capital conservation buffer requirement will be effective. The final rule also implements consolidated capital requirements for bank holding companies, such as the Corporation, effective January 1, 2015.

The following table sets forth certain information concerning regulatory capital ratios of the consolidated Corporation and the Bank as of the dates presented:

(Dollar amounts in thousands)	December 31, 2013				December 31, 2012			
	Consolidated		Bank		Consolidated		Bank	
	Amount	Ratio	Amount	Ratio	Amount	Ratio	Amount	Ratio
Total capital to risk-weighted assets:								
Actual	$ 47,711	15.10 %	$ 48,222	15.34 %	$ 50,035	16.62 %	$ 48,585	16.21 %
For capital adequacy purposes	25,269	8.00 %	25,152	8.00 %	24,083	8.00 %	23,971	8.00 %
To be well capitalized	N/A	N/A	31,440	10.00 %	N/A	N/A	29,964	10.00 %
Tier 1 capital to risk-weighted assets:								
Actual	$ 43,722	13.84 %	$ 44,273	14.08 %	$ 46,252	15.36 %	$ 44,820	14.96 %

For capital adequacy purposes	12,634	4.00	%	12,576	4.00	%	12,042	4.00	%	11,985	4.00	%
To be well capitalized	N/A	N/A		18,864	6.00	%	N/A	N/A		17,978	6.00	%
Tier 1 capital to average assets:												
Actual	$ 43,722	8.45	%	$ 44,273	8.58	%	$ 46,252	9.18	%	$ 44,820	8.92	%
For capital adequacy purposes	20,690	4.00	%	20,651	4.00	%	20,148	4.00	%	20,101	4.00	%
To be well capitalized	N/A	N/A		25,814	5.00	%	N/A	N/A		25,126	5.00	%

Prompt Corrective Action and Other Enforcement Mechanisms. Federal banking agencies possess broad powers to take corrective and other supervisory action to resolve the problems of insured depository institutions, including but not limited to those institutions that fall below one or more prescribed minimum capital ratios. Each federal banking agency has promulgated regulations defining the following five categories in which an insured depository institution will be placed, based on its capital ratios: well capitalized, adequately capitalized, undercapitalized, significantly undercapitalized, and critically undercapitalized. At December 31, 2013, the Bank exceeded the required ratios for classification as “well capitalized.”

An institution that, based upon its capital levels, is classified as well capitalized, adequately capitalized, or undercapitalized may be treated as though it were in the next lower capital category if the appropriate federal banking agency, after notice and opportunity for hearing, determines that an unsafe or unsound condition or an unsafe or unsound practice warrants such treatment. At each successive lower capital category, an insured depository institution is subject to more restrictions. The federal banking agencies, however, may not treat a significantly undercapitalized institution as critically undercapitalized.

In addition to measures taken under the prompt corrective action provisions, commercial banking organizations may be subject to potential enforcement actions by the federal regulators for unsafe or unsound practices in conducting their businesses or for violations of any law, rule, regulation, or any condition imposed in writing by the agency or any written agreement with the agency. Finally, pursuant to an interagency agreement, the FDIC can examine any institution that has a substandard regulatory examination score or is considered undercapitalized without the permission of the institution’s primary regulator.

Safety and Soundness Standards. The federal banking agencies have adopted guidelines designed to assist the federal banking agencies in identifying and addressing potential safety and soundness concerns before capital becomes impaired. The guidelines set forth operational and managerial standards relating to: (i) internal controls, information systems and internal audit systems, (ii) loan documentation, (iii) credit underwriting, (iv) asset growth, (v) earnings, and (vi) compensation, fees and benefits. In addition, the federal banking agencies have also adopted safety and soundness guidelines with respect to asset quality and earnings standards. These guidelines provide six standards for establishing and maintaining a system to identify problem assets and prevent those assets from deteriorating. Under these standards, an insured depository institution should: (i) conduct periodic asset quality reviews to identify problem assets, (ii) estimate the inherent losses in problem assets and establish reserves that are sufficient to absorb estimated losses, (iii) compare problem asset totals to capital, (iv) take appropriate corrective action to resolve problem assets, (v) consider the size and potential risks of material asset concentrations, and (vi) provide periodic asset quality reports with adequate information for management and the board of directors to assess the level of asset risk. These guidelines also set forth standards for evaluating and monitoring earnings and for ensuring that earnings are sufficient for the maintenance of adequate capital and reserves.

Insurance of Accounts. Deposit insurance assessment payments, which are determined through a risk-based assessment system, are made to the Deposit Insurance Fund (DIF). Deposit accounts are currently insured by the DIF generally up to a maximum of $250,000 per separately insured depositor.

Under the current assessment system, the FDIC assigns an institution to one of four risk categories designed to measure risk. Total base assessment rates currently range from 0.025% of deposits for an institution in the highest rated category to 0.45% of deposits for an institution in the lowest rated category. In addition, all FDIC insured institutions are required to pay assessments to the FDIC at an annual rate of approximately six tenths of a basis point of insured deposits to fund interest payments on bonds issued by the Financing Corporation, an agency of the federal government established to recapitalize the predecessor to the Savings Association Insurance Fund. These assessments will continue until the Financing Corporation bonds mature in 2017 through 2019.

Under the Federal Deposit Insurance Act, the FDIC may terminate deposit insurance upon a finding that the institution has engaged in unsafe and unsound practices, is in an unsafe or unsound condition to continue operations or has violated any applicable law, regulation, rule order or condition imposed by the FDIC.

Interstate Banking and Branching. Banks have the ability, subject to certain state restrictions, to acquire, by acquisition or merger, branches outside its home state. In addition, recent federal legislation permits a bank headquartered in Pennsylvania to enter another state through de novo branching (as compared to an acquisition) if under the state law in the state which the proposed branch is to be located a state-chartered institution would be permitted to establish the branch. Interstate branches are subject to certain laws of the states in which they are located. Competition may increase further as banks branch across state lines and enter new markets.

Consumer Protection Laws and Regulations. The bank regulatory agencies are focusing greater attention on compliance with consumer protection laws and their implementing regulations. Examination and enforcement have become more intense in nature, and insured institutions have been advised to carefully monitor compliance with such laws and regulations. The Bank is subject to many federal consumer protection statutes and regulations, some of which are discussed below.

The Community Reinvestment Act (CRA) is intended to encourage insured depository institutions, while operating safely and soundly, to help meet the credit needs of their communities. The CRA specifically directs the federal regulatory agencies, in examining insured depository institutions, to assess a bank's record of helping meet the credit needs of its entire community, including low- and moderate-income neighborhoods, in a manner consistent with safe and sound banking practices. On September 1, 2005, the federal banking agencies amended the CRA regulations to (i) establish the definition of "Intermediate Small Bank" as an institution with total assets of $250 million to $1 billion, without regard to any holding company; and (ii) take into account abusive lending practices by a bank or its affiliates in determining a bank's CRA rating. The CRA further requires the agencies to take a financial institution's record of meeting its community credit needs into account when evaluating applications for, among other things, domestic branches, mergers or acquisitions, or holding company formations. The agencies use the CRA assessment factors in order to provide a rating to the financial institution. The ratings range from a high of "outstanding" to a low of "substantial noncompliance." In its last examination for CRA compliance, as of July 16, 2012, the Bank was rated "satisfactory."

The Fair Credit Reporting Act (FCRA), as amended by the Fair and Accurate Credit Transactions Act of 2003 (FACTA), requires financial firms to help deter identity theft, including developing appropriate fraud response programs, and give consumers more control of their credit data. It also reauthorizes a federal ban on state laws that interfere with corporate credit granting and marketing practices. In connection with the FACTA, financial institution regulatory agencies proposed rules that would prohibit an institution from using certain information about a consumer it received from an affiliate to make a solicitation to the consumer, unless the consumer has been notified and given a chance to opt out of such solicitations. A consumer's election to opt out would be applicable for at least five years.

The Federal Trade Commission (FTC), the federal bank regulatory agencies and the National Credit Union Administration (NCUA) have issued regulations (the Red Flag Rules) requiring financial institutions and creditors to develop and implement written identity theft prevention programs as part of the FACTA. The programs were required to be in place by May 1, 2009 and must provide for the identification, detection and response to patterns, practices or specific activities known as red flags that could indicate identity theft. These red flags may include unusual account activity, fraud alerts on a consumer report or attempted use of suspicious account application documents. The program must also describe appropriate responses that would prevent and mitigate the crime and detail a plan to update the program. The program must be managed by the Board of Directors or senior employees of the institution or creditor, include appropriate staff training and provide oversight of any service providers.

The Check Clearing for the 21st Century Act (Check 21) facilitates check truncation and electronic check exchange by authorizing a new negotiable instrument called a "substitute check," which is the legal equivalent of an original check. Check 21, effective October 28, 2004, does not require banks to create substitute checks or accept checks electronically; however, it does require banks to accept a legally equivalent substitute check in place of an original.

K-18

The Equal Credit Opportunity Act (ECOA) generally prohibits discrimination in any credit transaction, whether for consumer or business purposes, on the basis of race, color, religion, national origin, sex, marital status, age (except in limited circumstances), receipt of income from public assistance programs, or good faith exercise of any rights under the Consumer Credit Protection Act.

The Truth in Lending Act (TILA) is designed to ensure that credit terms are disclosed in a meaningful way so that consumers may compare credit terms more readily and knowledgeably. As a result of the TILA, all creditors must use the same credit terminology to express rates and payments, including the annual percentage rate, the finance charge, the amount financed, the total of payments and the payment schedule, among other things.

The Fair Housing Act (FHA) regulates many practices, including making it unlawful for any lender to discriminate in its housing-related lending activities against any person because of race, color, religion, national origin, sex, handicap or familial status. A number of lending practices have been found by the courts to be, or may be considered, illegal under the FHA, including some that are not specifically mentioned in the FHA itself.

The Home Mortgage Disclosure Act (HMDA) grew out of public concern over credit shortages in certain urban neighborhoods and provides public information that will help show whether financial institutions are serving the housing credit needs of the neighborhoods and communities in which they are located. The HMDA also includes a “fair lending” aspect that requires the collection and disclosure of data about applicant and borrower characteristics as a way of identifying possible discriminatory lending patterns and enforcing anti-discrimination statutes.

The term “predatory lending,” much like the terms “safety and soundness” and “unfair and deceptive practices,” is far-reaching and covers a potentially broad range of behavior. As such, it does not lend itself to a concise or a comprehensive definition. Generally speaking, predatory lending involves at least one, and perhaps all three, of the following elements (i) making unaffordable loans based on the assets of the borrower rather than on the borrower’s ability to repay an obligation (“asset-based lending”); (ii) inducing a borrower to refinance a loan repeatedly in order to charge high points and fees each time the loan is refinanced (“loan flipping”); and (iii) engaging in fraud or deception to conceal the true nature of the loan obligation from an unsuspecting or unsophisticated borrower.

FRB regulations aimed at curbing such lending significantly widened the pool of high-cost home-secured loans covered by the Home Ownership and Equity Protection Act of 1994, a federal law that requires extra disclosures and consumer protections to borrowers. Lenders that violate the rules face cancellation of loans and penalties equal to the finance charges paid.

Effective April 8, 2005, OCC guidelines require national banks and their operating subsidiaries to comply with certain standards when making or purchasing loans to avoid predatory or abusive residential mortgage lending practices. Failure to comply with the guidelines could be deemed an unsafe and unsound or unfair or deceptive practice, subjecting the bank to supervisory enforcement actions.

Finally, the Real Estate Settlement Procedures Act (RESPA) requires lenders to provide borrowers with disclosures regarding the nature and cost of real estate settlements. Also, RESPA prohibits certain abusive practices, such as kickbacks, and places limitations on the amount of escrow accounts. Penalties under the above laws may include fines, reimbursements and other penalties. Due to heightened regulatory concern related to compliance with the CRA, FACTA, TILA, FHA, ECOA, HMDA and RESPA generally, the Bank may incur additional compliance costs or be required to expend additional funds for investments in its local community.

Federal Home Loan Bank System. The Bank is a member of the FHLB. Among other benefits, each FHLB serves as a reserve or central bank for its members within its assigned region. Each FHLB is financed primarily from the sale of consolidated obligations of the FHLB system. Each FHLB makes available loans or advances to its members in compliance with the policies and procedures established by the Board of Directors of the individual FHLB. As an

FHLB member, the Bank is required to own a certain amount of capital stock in the FHLB. At December 31, 2013, the Bank was in compliance with the stock requirements.

Federal Reserve System. The FRB requires all depository institutions to maintain noninterest bearing reserves at specified levels against their transaction accounts (primarily checking) and non-personal time deposits. At December 31, 2013, the Bank was in compliance with these requirements.

Item 1A. Risk Factors

Not required as the Corporation is a smaller reporting company.

Item 1B. Unresolved Staff Comments

None.

Item 2. Properties

The Corporation owns no real property but utilizes the main office of the Bank, which is owned by the Bank. The Corporation's and the Bank's executive offices are located at 612 Main Street, Emlenton, Pennsylvania. The Corporation pays no rent or other form of consideration for the use of this facility.

The Bank owns and leases numerous other premises for use in conducting business activities. The Bank considers these facilities owned or occupied under lease to be adequate. For additional information regarding the Bank's properties, see "Note 6 - Premises and Equipment" on page F-24 to the consolidated financial statements.

Item 3. Legal Proceedings

Neither the Bank nor the Corporation is involved in any material legal proceedings. The Bank, from time to time, is party to litigation that arises in the ordinary course of business, such as claims to enforce liens, claims involving the origination and servicing of loans, and other issues related to the business of the Bank. In the opinion of management, the resolution of any such issues would not have a material adverse impact on the financial position, results of operation, or liquidity of the Bank or the Corporation.

Item 4. Mine Safety Disclosures

Not applicable.

PART II

Item 5. Market for the Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities

Market, Holder and Dividend Information

Emclaire Financial Corp common stock is traded on NASDAQ Capital Market (NASDAQ) under the symbol "EMCF". The listed market makers for the Corporation's common stock include:

Boenning and Scattergood, Inc.	**Janney Montgomery Scott LLC**	**Monroe Securities, Inc.**
4 Tower Bridge, Suite 300	1801 Market Street	100 North Riverside Plaza
200 Bar Harbor Drive	Philadelphia, PA 19103-1675	Suite 1620
West Conshohocken, PA 19428	Telephone: (215) 665-6000	Chicago, IL 60606
Telephone: (800) 883-1212		Telephone: (312) 327-2530

The Corporation has traditionally paid regular quarterly cash dividends. Future dividends will be determined by the Board of Directors after giving consideration to the Corporation's financial condition, results of operations, tax status, industry standards, economic conditions, regulatory requirements and other factors.

The following table sets forth the high and low sale and quarter-end closing market prices of our common stock for the last two years as reported by the Nasdaq Capital Market as well as cash dividends paid for the quarterly periods presented.

	Market Price High	Low	Close	Cash Dividend
2013:				
Fourth quarter	$ 28.00	$ 23.77	$ 25.14	$ 0.20
Third quarter	26.97	23.43	25.95	0.20
Second quarter	26.00	22.59	24.70	0.20
First quarter	27.50	20.53	24.00	0.20
2012:				
Fourth quarter	$ 24.46	$ 19.84	$ 20.85	$ 0.28
Third quarter	25.00	18.60	22.45	0.18
Second quarter	20.58	18.01	19.95	0.18
First quarter	18.59	15.23	18.59	0.18

As of March 3, 2014, there were approximately 657 stockholders of record and 1,769,908 shares of common stock entitled to vote, receive dividends and considered outstanding for financial reporting purposes. The number of stockholders of record does not include the number of persons or entities who hold their stock in nominee or "street" name.

Common stockholders may have Corporation dividends reinvested to purchase additional shares. Participants may also make optional cash purchases of common stock through this plan and pay no brokerage commissions or fees. To obtain a plan document and authorization card to participate in the plan, please call 800-757-5755.

Purchases of Equity Securities

The Corporation did not repurchase any of its equity securities in the year ended December 31, 2013.

Item 6. Selected Financial Data

Not required as the Corporation is a smaller reporting company.

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

The following discussion and analysis represents a review of the Corporation's consolidated financial condition and results of operations for the years ended December 31, 2013 and 2012. This review should be read in conjunction with the consolidated financial statements beginning on page F-3.

Overview

The Corporation reported consolidated net income available to common stockholders of $3.4 million or $1.91 per diluted common share for 2013, compared to $3.2 million or $1.80 per diluted common share for 2012. Net income available to common stockholders was impacted by the following:

· Net interest income increased $135,000 or 0.9% in 2013. This increase primarily related to a decrease in interest expense of $1.3 million or 26.1% as the Corporation's cost of funds decreased 29 basis points to 0.79% for 2013

from 1.08% for 2012. The management of funding costs resulted in a 6 basis point increase in the net interest margin to 3.40% for 2013, from 3.34% for 2012, despite decreasing asset yields.

- Provision for loan losses decreased $1.6 million, or 73.1%, to $580,000 for the year ended December 31, 2013 from $2.2 million for 2012. The provision for loan losses for 2012 included a $1.4 million specific reserve related to a $3.4 million commercial real estate credit relationship, which was identified as being impaired during that period.
- Noninterest income decreased $1.0 million, or 21.1%, to $3.9 million for the year ended December 31, 2013 from $4.9 million for 2012. The decrease resulted from a $917,000 decrease in net gains on securities and a $268,000 decrease in commissions on financial services, partially offset by increases in fees and service charges and earnings on bank-owned life insurance of $65,000 and $80,000, respectively.
- Noninterest expense increased $543,000, or 3.9%, to $14.5 million for the year ended December 31, 2013 from $13.9 million for 2012. The increase primarily related to increases in compensation and benefits, premises and equipment expense, professional fees and FDIC insurance expenses of $378,000, $146,000, $43,000 and $54,000, respectively, partially offset by a decrease in intangible asset amortization of $75,000. Noninterest expense for 2013 included $105,000 related to the Bank’s new branch office in Saint Marys, Pennsylvania which opened in October 2013.

Changes in Financial Condition

Total assets increased $16.8 million, or 3.3%, to $525.8 million at December 31, 2013 from $509.0 million at December 31, 2012. This increase primarily related to an increase in net loans receivable, premises and equipment and federal bank stocks of $18.6 million, $3.1 million and $1.1 million, respectively. Partially offsetting these increases were decreases in cash equivalents and investment securities of $3.8 million and $2.9 million, respectively.

The Corporation’s asset growth was primarily funded by an increase in borrowed funds of $24.2 million, partially offset by a decrease in stockholders’ equity of $6.7 million.

Cash and cash equivalents. Cash and cash equivalents decreased $3.8 million, or 18.4%, to $16.7 million at December 31, 2013 from $20.4 million at December 31, 2012. This decrease primarily resulted from the funding of loans. Typically, cash accounts are increased by net operating results, deposits by customers into savings and checking accounts, loan and security repayments and proceeds from borrowed funds. Decreases result from customer deposit withdrawals, new loan originations or other loan fundings, security purchases, repayments of borrowed funds and cash dividends to stockholders.

Securities. Securities decreased $2.9 million, or 2.4%, to $117.3 million at December 31, 2013 from $120.2 million at December 31, 2012. This decrease was partly related to the utilization of cash received from investment security calls and sales to fund loan originations.

Loans receivable. Net loans receivable increased $18.6 million, or 5.6%, to $352.4 million at December 31, 2013 from $333.8 million at December 31, 2012. The increase was primarily driven by growth in the Corporation’s residential mortgage, commercial business, commercial real estate and home equity loan portfolios of $8.3 million, $7.6 million, $2.7 million and $2.3 million, respectively, and a $481,000 decrease in the allowance for loan losses. The growth in the Corporation’s residential mortgage portfolio was driven by purchases of fixed-rate loans secured by residential real estate located in an adjacent market which totaled $12.1 million at December 31, 2013. This growth was partially offset by a $2.8 million decrease in the consumer loan portfolio.

Nonperforming assets. Nonperforming assets include nonaccrual loans, loans 90 days past due and still accruing, repossessions and real estate owned. Nonperforming assets were $5.3 million, or 1.01% of total assets, at December 31, 2013 compared to $7.2 million, or 1.41% of total assets, at December 31, 2012. Nonperforming assets consisted of nonperforming loans and real estate owned of $5.2 million and $107,000, respectively, at December 31, 2013 and $7.0 million and $180,000, respectively, at December 31, 2012. This decrease in nonperforming loans was due to a $941,000 partial charge-off of a nonperforming commercial real estate loan for which a specific reserve of $1.4 million was established in 2012 and the continued management and collection efforts related to other nonperforming assets. At December 31, 2013, nonperforming loans consisted primarily of commercial mortgage, consumer and residential mortgage loans.

Federal bank stocks. Federal bank stocks were comprised of FHLB stock and FRB stock of $3.0 million and $984,000, respectively, at December 31, 2013. These stocks are purchased and redeemed at par as directed by the federal banks and levels maintained are based primarily on borrowing and other correspondent relationships between the Corporation and the banks. The Corporation purchased $1.9 million of FHLB capital stock and the FHLB repurchased $802,000 of the Corporation's excess capital stock during 2013.

Bank-owned life insurance (BOLI). The Corporation maintains single premium life insurance policies on certain current and former officers and employees of the Bank. In addition to providing life insurance coverage, whereby the Bank as well as the officers and employees receive life insurance benefits, the appreciation of the cash surrender value of the BOLI will serve to offset and finance existing and future employee benefit costs. Increases in this account are typically associated with an increase in the cash surrender value of the policies, partially offset by certain administrative expenses.

Premises and equipment. Premises and equipment increased $3.1 million, or 34.1%, to $12.3 million at December 31, 2013 from $9.2 million at December 31, 2012. The overall increase in premises and equipment during the year was due to capital expenditures of $3.8 million, partially offset by normal depreciation and amortization of $677,000. Capital expenditures during the year primarily consisted of $2.7 million related to the construction of a new branch banking office in Cranberry Township, Pennsylvania which is expected to open in the second quarter of 2014.

Goodwill. Goodwill was $3.7 million at December 31, 2013 and 2012. Goodwill is evaluated for impairment at least annually and more frequently if events and circumstances indicate that the asset might be impaired. Management evaluated goodwill and concluded that no impairment existed at December 31, 2013.

Core deposit intangible. The core deposit intangible was $965,000 at December 31, 2013. In connection with the assumption of deposits in the 2009 Titusville branch acquisition, the Corporation recorded a core deposit intangible of $2.8 million. This asset represents the long-term value of the core deposits acquired. Fair value was determined using a third-party valuation expert specializing in estimating fair values of core deposit intangibles. The fair value was derived using an industry standard financial instrument present value methodology. All-in costs and runoff balances by year were discounted by comparable term FHLB advance rates, used as an alternative cost of funds measure. This intangible asset amortizes utilizing the double declining balance method of amortization over a weighted average estimated life of nine years. The core deposit intangible asset is not estimated to have a significant residual value. The Corporation recorded $270,000 and $345,000 of intangible amortization in 2013 and 2012, respectively.

Deposits. Total deposits decreased $453,000 to $432.0 million at December 31, 2013 from $432.5 million at December 31, 2012. Noninterest bearing deposits increased $5.8 million, or 5.8%, during the year while interest bearing deposits decreased $6.2 million, or 1.8%.

Borrowed funds. Borrowed funds increased $24.2 million to $44.2 million at December 31, 2013 from $20.0 at December 31, 2012. Borrowed funds at December 31, 2013 consisted of short-term borrowings of $24.2 million and long-term borrowings of $20.0 million. Short-term borrowed funds at December 31, 2013 consisted of $22.0 million in FHLB overnight advances with a rate of 0.25% and $2.2 million outstanding on a line of credit with a correspondent bank at 4.25%. During 2013, short-term borrowings were utilized primarily to fund loan growth and compensate for normal deposit fluctuations.

Stockholders' equity. Stockholders' equity decreased $6.7 million, or 12.9%, to $45.1 million at December 31, 2013 from $51.7 million at December 31, 2012. The decrease primarily related to the redemption of $5.0 million, or 50% of the $10.0 million in outstanding preferred shares and a $3.9 million decrease in accumulated other comprehensive income. These decreases were partially offset by an increase in retained earnings of $2.0 million as a result of net income of $3.8 million in 2013. The decrease in accumulated other comprehensive income resulted from a decrease in the net unrealized gains on securities available for sale following a rise in long term market interest rates and was partially offset by the change in the funded status of the Corporation's defined benefit plan.

Changes in Results of Operations

The Corporation reported net income before preferred stock dividends of $3.8 million and $3.7 million in 2013 and 2012, respectively. The following “Average Balance Sheet and Yield/Rate Analysis” and “Analysis of Changes in Net Interest Income” tables should be utilized in conjunction with the discussion of the interest income and interest expense components of net interest income.

Average Balance Sheet and Yield/Rate Analysis. The following table sets forth, for the periods indicated, information concerning the total dollar amounts of interest income from interest-earning assets and the resulting average yields, the total dollar amounts of interest expense on interest-bearing liabilities and the resulting average costs, net interest income, interest rate spread and the net interest margin earned on average interest-earning assets. For purposes of this table, average loan balances include nonaccrual loans and exclude the allowance for loan losses and interest income includes accretion of net deferred loan fees. Interest and yields on tax-exempt loans and securities (tax-exempt for federal income tax purposes) are shown on a fully tax equivalent basis. The information is based on average daily balances during the periods presented.

(Dollar amounts in thousands)	Year ended December 31,							
	2013				2012			
	Average Balance	Interest	Yield / Rate		Average Balance	Interest	Yield / Rate	
Interest-earning assets:								
Loans, taxable	$ 328,564	$ 16,022	4.88	%	$ 309,559	$ 16,594	5.36	%
Loans, tax-exempt	15,814	819	5.18	%	19,331	879	4.55	%
Total loans receivable	344,378	16,841	4.89	%	328,890	17,473	5.31	%
Securities, taxable	89,052	1,715	1.93	%	102,135	2,246	2.20	%
Securities, tax-exempt	40,197	1,631	4.06	%	36,834	1,635	4.44	%
Total securities	129,249	3,346	2.59	%	138,969	3,881	2.79	%
Interest-earning deposits with banks	12,355	55	0.45	%	23,233	85	0.37	%
Federal bank stocks	3,266	77	2.36	%	3,320	65	1.96	%
Total interest-earning cash equivalents	15,621	132	0.85	%	26,553	150	0.56	%
Total interest-earning assets	489,248	20,319	4.15	%	494,412	21,504	4.35	%
Cash and due from banks	2,043				2,376			
Other noninterest-earning assets	28,280				22,761			
Total Assets	$ 519,571				$ 519,549			
Interest-bearing liabilities:								
Interest-bearing demand deposits	$ 216,341	345	0.16	%	$ 207,689	440	0.21	%
Time deposits	115,989	2,528	2.18	%	139,092	3,605	2.59	%
Total interest-bearing deposits	332,330	2,873	0.86	%	346,781	4,045	1.17	%
Borrowed funds, short-term	9,381	50	0.53	%	27	-	0.00	%
Borrowed funds, long-term (1)	20,000	754	3.77	%	20,000	931	4.66	%
Total borrowed funds	29,381	804	2.74	%	20,027	931	4.65	%
Total interest-bearing liabilities	361,711	3,677	1.02	%	366,808	4,976	1.36	%
Noninterest-bearing demand deposits	103,331	-	-		96,048	-	-	
Funding and cost of funds	465,042	3,677	0.79	%	462,856	4,976	1.08	%

Other noninterest-bearing liabilities	5,236				4,870			
Total Liabilities	470,278				467,726			
Stockholders' Equity	49,293				51,823			
Total Liabilities and Stockholders' Equity	$ 519,571				$ 519,549			
Net interest income		$ 16,642				$ 16,528		
Interest rate spread (difference between weighted average rate on interest-earning assets and interest-bearing liabilities)			3.13	%			2.99	%
Net interest margin (net interest income as a percentage of average interest-earning assets)			3.40	%			3.34	%

(1) Interest on long-term borrowed funds was reduced by $50,000 related to capitalized interest costs on construction in progress.

K-25

Analysis of Changes in Net Interest Income. The following table analyzes the changes in interest income and interest expense in terms of: (1) changes in volume of interest-earning assets and interest-bearing liabilities and (2) changes in yields and rates. The table reflects the extent to which changes in the Corporation's interest income and interest expense are attributable to changes in rate (change in rate multiplied by prior year volume), changes in volume (changes in volume multiplied by prior year rate) and changes attributable to the combined impact of volume/rate (change in rate multiplied by change in volume). The changes attributable to the combined impact of volume/rate are allocated on a consistent basis between the volume and rate variances. Changes in interest income on loans and securities reflect the changes in interest income on a fully tax equivalent basis.

(Dollar amounts in thousands)	2013 versus 2012		
	Increase (decrease) due to		
	Volume	Rate	Total
Interest income:			
Loans	$ 798	$ (1,430)	$ (632)
Securities	(262)	(273)	(535)
Interest-earning deposits with banks	(46)	16	(30)
Federal bank stocks	(1)	13	12