CANANDAIGUA NATIONAL CORP
Form 10-Q
November 08, 2013

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

[Ö] Quarterly report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
For the quarterly period ended September 30, 2013
OR
[ ] 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: 2-94863

CANANDAIGUA NATIONAL CORPORATION
(Exact name of registrant as specified in its charter)

New York	**16-1234823**
(State or other jurisdiction of incorporation or organization)	*(IRS Employer Identification Number)*
72 South Main Street Canandaigua, New York	**14424**
(Address of principal executive offices)	*(Zip code)*

(585) 394-4260
(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months, and (2) has been subject to such filing requirements for the past 90 days.

Yes [Ö] No [ ]

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months.

Yes [Ö] No [ ]

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer, or a smaller reporting company.

Large accelerated filer [ ] Accelerated filer [Ö] Non-accelerated filer [ ] Smaller reporting company [ ]

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

Yes [ ] No [Ö]

The registrant had 1,879,060 shares of common stock, par value $5.00, outstanding at October 24, 2013.

Forward-Looking Statements

This report, including information incorporated by reference, contains, and future filings by Canandaigua National Corporation on Forms 13-F, 10-K, 10-Q and 8-K and future oral and written statements, press releases, and letters to shareholders by Canandaigua National Corporation and its management may contain, certain "forward-looking statements" intended to qualify for the "safe harbor" provisions of the Private Securities Litigation Reform Act of 1995. When used or incorporated by reference in the Company's disclosures and documents, the words "anticipate," "believe," "contemplate," "estimate," "expect," "foresee," "project," "target," "goal," "budget" and similar expressions are intended to identify forward-looking statements within the meaning of Section 27A of the Securities Act. Such forward-looking statements are subject to certain risks discussed within this document and the Company s most recent Annual Report on Form 10-K, including under the heading Risk Factors in the Company s Annual Report on Form 10-K. These forward-looking statements are based on currently available financial, economic, and competitive data and management's views and assumptions regarding future events. These forward-looking statements are inherently uncertain, so should one or more of these risks or uncertainties materialize, or should underlying assumptions prove incorrect, actual results may vary materially from those anticipated, estimated, expected, projected, targeted, or budgeted. Certain matters which management has identified, which may cause material variations are noted elsewhere herein and in the Company s other publicly filed reports. These forward-looking statements speak only as of the date of the document. We expressly disclaim any obligation or undertaking to publicly release any updates or revisions to any forward-looking statement contained herein. We caution readers not to place undue reliance on any of these forward-looking statements.

Some examples of forward-looking statements include statements related to our expectations on the direction of interest rates, demand for our loans, changes in customer transactions types, and the payment performance of our loan portfolio. Our experience and assumptions we believe are reasonable to form the basis of our stated expectations, but results can also be impacted by other factors.

As described in our public filings, factors which may cause our results to vary materially from our expectations include, among many others, adverse changes in the global economy which may affect interest rates and as well as the stability of our local service areas, which may affect loan demand and credit quality; changes in fees related to servicing electronic transactions which may affect consumer usage, and continued focus of regulatory authorities at the state, federal and international level on bank regulation.

CANANDAIGUA NATIONAL CORPORATION AND SUBSIDIARIES
INDEX TO FORM 10-Q
September 30, 2013

PART I FINANCIAL INFORMATION

Item 1. Financial Statements

CANANDAIGUA NATIONAL CORPORATION AND SUBSIDIARIES
CONDENSED CONSOLIDATED BALANCE SHEETS
At September 30, 2013 (unaudited) and December 31, 2012

(dollars in thousands, except per share data)

		September 30, 2013	December 31, 2012
Assets			
Cash and due from banks	$	53,483	47,748
Interest-bearing deposits with other financial institutions of which $2,470 and $6,311 respectively, is restricted		3,494	8,767
Federal funds sold		43,863	34,644
Securities:			
- Available for sale, at fair value		110,188	102,774
- Held-to-maturity (fair value of $183,721 and $180,015, respectively)		182,038	175,850
Loans - net		1,489,766	1,441,455
Premises and equipment net		14,978	15,119
Accrued interest receivable		7,181	6,596
Federal Home Loan Bank stock and Federal Reserve Bank stock		2,917	2,733
Goodwill		15,570	15,570
Intangible assets net		5,294	6,233
Prepaid FDIC assessment		-	2,824
Other assets		24,733	26,715
Total Assets	$	1,953,505	1,887,028
Liabilities and Stockholders' Equity			
Deposits:			
Demand			
Non-interest bearing	$	318,204	283,547
Interest bearing		193,951	196,478
Savings and money market		865,767	812,485
Time		342,727	370,353
Total deposits		1,720,649	1,662,863
Borrowings		4,165	4,296
Junior subordinated debentures		51,547	51,547

Accrued interest payable and other liabilities		24,061	23,959
Total Liabilities		1,800,422	1,742,665
Canandaigua National Corporation stockholders' equity:			
Preferred stock, $.01 par value; 4,000,000 shares			
authorized, no shares issued or outstanding		-	-
Common stock, $5.00 par value; 16,000,000 shares			
authorized, 1,946,496 shares issued		9,732	9,732
Additional paid-in-capital		10,003	9,974
Retained earnings		141,923	129,502
Treasury stock, at cost (65,736 shares and			
40,993 shares, respectively)		(7,830)	(4,046)
Accumulated other comprehensive income, net		(2,522)	(2,937)
Total Canandaigua National Corporation Stockholders' Equity		151,306	142,225
Non-controlling interests		1,777	2,138
Total Equity		153,083	144,363
Total Liabilities and Equity	$	1,953,505	1,887,028

See accompanying notes to condensed consolidated financial statements.

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CANANDAIGUA NATIONAL CORPORATION AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF INCOME
For the three- and nine-month periods ended September 30, 2013 and 2012 (Unaudited)

(dollars in thousands, except per share data)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2013	**2012**	**2013**	**2012**
Interest income:				
Loans, including fees	$ 16,882	16,793	$ 49,806	49,586
Securities	1,421	1,637	4,513	5,359
Federal funds sold	36	47	111	113
Other	-	4	4	11
Total interest income	18,339	18,481	54,434	55,069
Interest expense:				
Deposits	1,042	1,397	3,312	4,356
Borrowings	17	21	51	73
Junior subordinated debentures	583	706	1,752	2,104
Total interest expense	1,642	2,124	5,115	6,533
Net interest income	16,697	16,357	49,319	48,536
Provision for loan losses	325	1,500	2,025	3,800
Net interest income after provision for loan losses	16,372	14,857	47,294	44,736
Non-interest income:				
Service charges on deposit accounts	3,300	2,950	8,998	8,627
Trust and investment services	4,030	3,218	11,412	9,609
Brokerage and investment subadvisory services	394	790	1,103	2,024
Net gain on sale of mortgage loans	745	1,143	2,830	2,712
Loan servicing, net	233	201	682	631
Loan-related fees	117	95	289	338
Loss on securities transactions, net	5	2	(94)	(89)
Other non-interest income	585	514	1,450	1,998
Total non-interest income	9,409	8,913	26,670	25,850
Operating expenses:				
Salaries and employee benefits	8,714	9,032	27,383	29,204
Occupancy, net	1,877	1,909	5,840	6,013
Technology and data processing	1,373	1,296	3,990	3,848
Professional and other services	1,051	829	3,044	2,710

Marketing and public relations		971	905		2,369	2,259
Office supplies, printing and postage		378	440		1,187	1,286
Intangible amortization		313	490		939	1,194
Other real estate operations		202	213		724	668
FDIC insurance		283	285		878	852
Other operating expenses		1,301	1,296		4,852	3,993
Total operating expenses		16,463	16,695		51,206	52,027
Income before income taxes		9,318	7,075		22,758	18,559
Income taxes		2,959	2,138		7,510	5,603
Net income attributable to noncontrolling interests and Canandaigua National Corporation		6,359	4,937		15,248	12,956
Net income (loss) attributable to noncontrolling interests		2	(51)		(348)	(117)
Net income attributable to Canandaigua National Corporation	$	6,357	4,988	$	15,596	13,073
Basic earnings per share	$	3.37	2.64	$	8.22	6.93
Diluted earnings per share	$	3.31	2.58	$	8.08	6.77

See accompanying notes to condensed consolidated financial statements.

CANANDAIGUA NATIONAL CORPORATION AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

[WITH RESPECTIVE TAX INFORMATION PRESENTED PARENTHETICALLY]
For the three- and nine-month periods ended September 30, 2013 and 2012 (Unaudited)
(dollars in thousands)

		Three Months Ended September 30,	
		2013	2012
Net income attributable to noncontrolling interest and			
Canandaigua National Corporation	$	6,359	4,937
Other comprehensive income:			
Change in fair value of			
interest rate swaps,			
net of tax of $38 and ($260)		56	(294)
Change in unrealized gain on			
on securities available for sale,			
net of taxes of ($174) and ($27)		(362)	(43)
Plus reclassification adjustment			
for realized gains and losses included in			
"Loss on securities transactions, net"			
net of taxes of $16 and ($11)		26	(34)
Other comprehensive income	$	(280)	(371)
Total comprehensive income		6,079	4,566
Comprehensive income attributable			
to the noncontrolling interest	$	2	(51)
Comprehensive income attributable to the Company	$	6,081	4,515

		Nine Months Ended September 30,	
		2013	2012
Net income attributable to noncontrolling interest and			
Canandaigua National Corporation	$	15,248	12,956
Other comprehensive income:			
Change in fair value of			
interest rate swaps,			
net of taxes of $1,562 and ($889) respectively		2,299	(1,190)
Change in unrealized gain on			

on securities available for sale,			
net of taxes of ($1,220) and ($210) respectively		(1,958)	(225)
Plus reclassification adjustment			
for realized gains and losses included in			
"Loss on securities transactions, net"			
net of taxes of $46 and ($10) respectively		74	(32)
Other comprehensive income	$	415	(1,447)
Total comprehensive income		15,663	11,509
Comprehensive income attributable			
to the noncontrolling interest	$	(348)	(117)
Comprehensive income attributable to the Company	$	16,011	11,626

See accompanying notes to condensed consolidated financial statements.

CANANDAIGUA NATIONAL CORPORATION AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF STOCKHOLDERS EQUITY
For the nine-month periods ended September 30, 2013 and 2012 (Unaudited)

(dollars in thousands, except share data)

	Number of Shares Outstanding	Common Stock	Additional Paid-in Capital	Retained Earnings	Treasury Stock	Accumulated Other Comprehensive Income (Loss)	Non-controlling Interest	Total
Balance at December 31, 2012	1,905,503	$ 9,732	9,974	129,502	(4,046)	(2,937)	2,138	144,363
Comprehensive income:								
Change in fair value of interest rate swaps, net of taxes of $1,562		-	-	-	-	2,299	-	2,299
Change in unrealized gain on on securities available for sale, net of taxes of ($1,220)		-	-	-	-	(1,958)	-	(1,958)
Plus reclassification adjustment for realized losses included in net income on called securities, net of taxes of $46		-	-	-	-	74	-	74
Net income (loss) attributable to non-controlling interest and		-	-	15,596	-	-	(348)	15,248

Canandaigua National Corporation								
Total comprehensive income		-	-	15,596	-	415	(348)	15,663
Purchase of treasury stock	(25,197)	-	-	-	(3,820)	-	-	(3,820)
Shares issued as compensation	454	-	29	-	36	-	-	65
Cash dividend - $1.68 per share		-	-	(3,176)	-	-	-	(3,176)
Change in non-controlling interest		-	-	-	-	-	(6)	(6)
Dividend to non-controlling interests		-	-	-	-	-	(6)	(6)
Balance at September 30, 2013	1,880,760	$ 9,732	10,003	141,922	(7,830)	(2,522)	1,778	153,083
Balance at December 31, 2011	1,887,254	$ 9,732	8,834	120,675	(4,912)	(1,455)	2,364	135,238
Comprehensive income:								
Change in fair value of interest rate swaps, net of taxes of ($889)		-	-	-	-	(1,190)	-	(1,190)
Change in unrealized gain on on securities available for sale, net of taxes of ($210)		-	-	-	-	(225)	-	(225)
Plus reclassification adjustment for realized gains and losses included in net income on called securities, net of taxes of ($10)		-	-	-	-	(32)	-	(32)
Net income (loss) attributable to non-controlling interest and		-	-	13,073	-	-	(117)	12,956

Canandaigua National Corporation								
Total comprehensive income		-	-	13,073	-	(1,447)	(117)	11,509
Purchase of treasury stock	(1,658)	-	-	-	(255)	-	-	(255)
Shares issued as compensation	243	-	17	-	20	-	-	37
Exercise of stock options ($36 tax benefit)	1,212	-	36	(13)	103	-	-	126
Cash dividend - $ 3.11 per share		-	-	(5,869)	-	-	-	(5,869)
Balance at September 30, 2012	1,887,051	$ 9,732	8,887	127,866	(5,044)	(2,902)	2,247	140,786

See accompanying notes to condensed consolidated financial statements.

CANANDAIGUA NATIONAL CORPORATION AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

For the nine-month periods ended September 30, 2013 and 2012 (Unaudited)
(dollars in thousands)

		2013	2012
Cash flow from operating activities:			
Net income attributable to Canandaigua National Corporation	$	15,596	13,073
Adjustments to reconcile net income to			
Net cash provided by operating activities:			
Depreciation, amortization and accretion		5,273	5,443
Provision for loan losses		2,025	3,800
Gain on sale of fixed and other assets and other real estate, net		(238)	(129)
Writedown of other real estate		381	129
Deferred income tax expense (benefit)		17	(1,781)
Income from equity-method investments, net		(86)	(353)
Loss on security transactions, net		94	89
Gain on sale of mortgage loans, net		(2,830)	(2,712)
Originations of loans held for sale		(163,532)	(193,665)
Proceeds from sale of loans held for sale		180,876	190,955
Change in other assets		1,338	(1,420)
Change in all other liabilities		3,963	2,450
Net cash provided by operating activities		42,877	15,879
Cash flow from investing activities:			
Securities available-for-sale:			
Proceeds from maturities and calls		39,331	84,359
Purchases		(49,923)	(71,922)
Securities held to maturity:			
Proceeds from maturities and calls		27,741	30,315
Purchases		(35,322)	(42,144)
Loan originations in excess of principal collections, net		(66,430)	(143,739)
Purchase of premises and equipment, net		(1,651)	(1,471)
Calls of FHLB stock, net of purchases of FHLB and FRB stock		(184)	(86)
Other investments - net		728	67
Proceeds from sale of other real estate		2,201	2,748
Net cash used by investing activities		(83,509)	(141,873)
Cash flow from financing activities:			
Net increase in demand, savings and money market deposits		85,412	146,671
Net decrease in time deposits		(27,626)	(17,602)
Principal repayments of term borrowings		(182)	(2,600)

Proceeds from sale of treasury stock		65	37
Payments to acquire treasury stock		(3,820)	(255)
Proceeds from issuance of treasury stock under stock option plan		-	90
Tax benefit from stock option exercise		-	36
Change in noncontrolling interest, net		(360)	(117)
Dividends paid		(3,176)	(5,869)
Net cash provided by financing activities		50,313	120,391
Net increase (decrease) in cash and cash equivalents		9,681	(5,603)
Cash and cash equivalents - beginning of period		91,159	126,740
Cash and cash equivalents - end of period	$	100,840	121,137
Supplemental disclosure of cash flow information:			
Interest paid	$	5,166	6,537
Income taxes paid		4,980	5,995
Supplemental schedule of noncash investing activities			
Real estate acquired in settlement of loans	$	1,588	1,940

See accompanying notes to condensed consolidated financial statements.

CANANDAIGUA NATIONAL CORPORATION AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements (Unaudited)

(1) Basis of Presentation

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with the instructions to Form 10-Q and applicable regulations of the Securities and Exchange Commission (SEC) and with generally accepted accounting principles for interim financial information. Such principles are applied on a basis consistent with those reflected in the 2012 Annual Report (defined below) of the Company filed with the SEC. Accordingly; they do not include all of the information and footnotes required by accounting principles generally accepted in the United States of America for complete financial statements. Management has prepared the financial information included herein without audit by an independent registered public accounting firm. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included. Operating results for the three- and nine-month periods ended September 30, 2013, are not necessarily indicative of the results that may be expected for the year ending December 31, 2013. For further information, refer to the consolidated financial statements and footnotes thereto included in the Company's Annual Report on Form 10-K for the year ended December 31, 2012 (the 2012 Annual Report).

Amounts in prior periods' condensed consolidated financial statements are reclassified whenever necessary to conform to the current year's presentation.

Management has evaluated the impact of subsequent events on these financial statements to the date of filing of this Form 10-Q with the Securities and Exchange Commission.

(2) Securities

Amortized cost and fair value of available-for-sale and held-to-maturity securities at September 30, 2013 are summarized as follows:

	September 30, 2013			
		Gross Unrealized		
	Amortized Cost [1]	Gains	Losses	Fair Value
<u>Securities Available for Sale:</u>				

U.S. Treasury	$	500	-	-	500
U.S. government sponsored enterprise obligations		80,710	132	(2,640)	78,202
State and municipal obligations		27,431	713	(21)	28,123
Corporate obligations [1]		1,074	19	(147)	946
Equity securities		2,293	156	(32)	2,417
Total Securities Available for Sale	$	112,008	1,020	(2,840)	110,188

[1]Amortized cost includes cumulative write-downs of $360,000 prior to 2010 for other-than-temporary impairment.

Securities Held to Maturity:

U.S. government sponsored enterprise obligations	$	5,970	3	(56)	5,917
State and municipal obligations		175,349	2,219	(660)	176,908
Corporate obligations		719	177	-	896
Total Securities Held to Maturity	$	182,038	2,399	(716)	183,721

CANANDAIGUA NATIONAL CORPORATION AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements (Unaudited)

The amortized cost and fair value of debt securities by years to maturity as of September 30, 2013, follow (in thousands). Maturities of amortizing securities are classified in accordance with their contractual repayment schedules. Expected maturities will differ from contractual maturities since issuers may have the right to call or prepay obligations without penalties.

		Available for Sale		Held to Maturity	
		Amortized Cost [1]	Fair Value	Amortized Cost	Fair Value
Years					
Under 1	$	9,523	9,633	31,283	31,708
1 to 5		23,187	23,781	138,747	139,921
5 to 10		73,244	70,713	11,289	11,196
10 and over		3,761	3,644	719	896
Total	$	109,715	107,771	182,038	183,721

[1] Amortized cost includes cumulative write-downs of $360,000 prior to 2010 for other-than-temporary impairment.

The following table presents the fair value of securities with gross unrealized losses at September 30, 2013, aggregated by category and length of time that individual securities have been in a continuous loss position (in thousands).

		Less than 12 months		Over 12 months		Total	
Securities Available for Sale:		Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
U.S. government sponsored enterprise obligations	$	72,886	2,640	-	-	72,886	2,640
State and municipal obligations		1,805	17	889	4	2,694	21
Corporate obligations		-	-	914	147	914	147
Equity securities		956	32	-	-	956	32
		75,647	2,689	1,803	151	77,450	2,840

Total temporarily impaired securities

Securities Held to Maturity:						
U.S. government sponsored enterprise obligations	$ 2,966	56	-	-	2,966	56
State and municipal obligations	$ 45,668	567	6,093	93	51,761	660
Total temporarily impaired securities	$ 48,634	623	6,093	93	54,727	716

Substantially all of the unrealized losses on the Company's securities were caused by market interest rate changes from those in effect when the specific securities were purchased by the Company. The contractual terms of these securities do not permit the issuer to settle the securities at a price less than par value. Except for certain corporate obligations, all securities rated by an independent rating agency carry an investment grade rating. Because the Company generally does not intend to sell securities and it believes it is not likely to be required to sell the securities before recovery of their amortized cost basis, which may be, and is likely to be, maturity, the Company does not consider these securities to be other-than-temporarily impaired at September 30, 2013.

CANANDAIGUA NATIONAL CORPORATION AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements (Unaudited)

Amortized cost and fair value of available-for-sale and held-to-maturity securities at December 31, 2012 are summarized as follows:

		December 31, 2012		
		Gross Unrealized		
	Amortized Cost [1]	Gains	Losses	Fair Value
Securities Available for Sale:				
U.S. Treasury	$ 500	-	-	500
U.S. government sponsored enterprise obligations	60,158	214	(196)	60,176
State and municipal obligations	37,512	1,196	(22)	38,686
Corporate obligations	1,073	23	(185)	911
Equity securities	2,293	208	-	2,501
Total securities Available for Sale	$ 101,536	1,641	(403)	102,774

[1]Amortized cost includes cumulative write-downs of $360,000 prior to 2010 for other-than-temporary impairment.

Securities Held to Maturity:				
U.S. government sponsored enterprise obligations	$ 5	-	-	5
State and municipal obligations	175,065	3,858	(112)	178,811
Corporate obligations	780	419	-	1,199
Total Securities Held to Maturity	$ 175,850	4,277	(112)	180,015

The following table presents the fair value of securities with gross unrealized losses at December 31, 2012, aggregated by category and length of time that individual securities have been in a continuous loss position (in thousands).

	Less than 12 months		Over 12 months		Total	
Securities Available for Sale:	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses

U.S. government sponsored enterprise obligations	$ 28,787	187	1,615	9	30,402	196
State and municipal obligations	801	8	992	14	1,793	22
Corporate obligations	-	-	873	185	873	185
Total temporarily impaired securities	$ 29,588	195	3,480	208	33,068	403
<u>Securities Held to Maturity:</u>						
State and municipal obligations	$ 10,044	66	5,809	46	15,853	112
Total temporarily impaired securities	$ 10,044	66	5,809	46	15,853	112

(3) Loans and Allowance for Loan Losses

Loans, other than loans designated as held for sale, are stated at the principal amount outstanding, net of deferred origination costs. Interest and deferred fees and costs on loans are credited to income based on the effective interest method. Loans held for sale are carried at the lower of cost or fair value.

The accrual of interest on commercial and real estate loans is generally discontinued, and previously accrued interest is reversed, when the loans become 90 days delinquent or when, in management s judgment, the collection of principal and interest is uncertain. Loans are returned to accrual status when the doubt no longer exists about the loan's collectability and the borrower has demonstrated a sustained period of timely payment history. Specifically, the borrower will have resumed paying the full amount of scheduled interest and principal payments; all principal and interest amounts contractually due (including arrearages) are reasonably assured of repayment within a reasonable period (6 months); and there is a sustained period of repayment performance (generally a minimum of six months) by the borrower, in accordance with the contractual terms involving payments of cash or cash equivalents. Interest on consumer loans is accrued until the loan becomes 120 days past due at which time principal and interest are generally charged off.

Management, considering current information and events regarding the borrowers ability to repay their obligations, considers a loan to be impaired when it is probable that the Company will be unable to collect all amounts due according to the

contractual terms of the loan agreement. When a loan is considered to be impaired, and sufficient information exists to make a reasonable estimate of the inherent loss, the amount of the impairment is measured based on the present value of expected future cash flows, discounted at the loan s effective interest rate; or as a practical expedient, at the loan s observable fair value or the fair value of underlying collateral if the loan is collateral-dependent. In the absence of sufficient, current data to make a detailed assessment of collateral values or cash flows, management measures impairment on a pool basis using historical loss factors experienced with similarly impaired loans. Impairment reserves are included in the allowance for loan losses through a charge to the provision for loan losses. Cash receipts on impaired loans are generally applied to reduce the principal balance outstanding. In considering loans for evaluation of specific impairment, management generally excludes smaller balance, homogeneous loans: residential mortgage loans, home equity loans, and all consumer loans, unless such loans were restructured in a troubled debt restructuring. These loans are collectively evaluated for risk of loss on a pool basis.

Loans

The Company's market area is generally Ontario County and Monroe County of New York State. Substantially all loans are made in this market area. Accordingly, the ultimate collectability of a substantial portion of the Company's loan portfolio is susceptible to changes in the economic conditions in this area. The Company's concentrations of credit risk are as disclosed in the following table of loan classifications. The concentrations of credit risk in related loan commitments and letters of credit parallel the loan classifications reflected. Other than general economic risks, management is not aware of any material concentrations of credit risk to any industry or individual borrower.

The major classifications of loans at September 30, 2013 and December 31, 2012, follow (in thousands), along with a description of their underwriting and risk characteristics:

			September 30, 2013	**December 31, 2012**
Commercial and industrial		$	209,030	213,467
Mortgages:				
	Commercial		538,501	525,413
	Residential - first lien		309,284	286,972
	Residential - junior lien		101,363	100,099
Consumer:				
	Automobile - indirect		313,168	283,836
	Other		18,944	18,323

Other, including loans held for sale		6,599	21,113
Total loans		1,496,889	1,449,223
Plus - Net deferred loan costs		10,553	9,549
Less - Allowance for loan losses		(17,676)	(17,317)
Loans - net	$	1,489,766	1,441,455

Commercial and Industrial Loans: These loans generally include term loans and lines of credit. Such loans are made available to businesses for working capital (including inventory and receivables), business expansion (including acquisition of real estate, expansion and improvements) and equipment purchases. As a general practice, a collateral lien is placed on equipment or other assets owned by the borrower. These loans carry a higher risk than commercial real estate loans by the nature of the underlying collateral, which can be business assets such as equipment and accounts receivable. To reduce the risk, management also attempts to secure secondary collateral, such as real estate, and obtain personal guarantees of the borrowers. To further reduce risk and enhance liquidity, these loans generally carry variable rates of interest, repricing in three- to five-year periods, and have a maturity of five years or less. Lines of credit generally have terms of one year or less and carry floating rates of interest (e.g., prime plus a margin).

Commercial Mortgages: Commercial real estate loans are made to finance the purchases of real property which generally consists of real estate with completed structures. These commercial real estate loans are secured by first liens on the real estate, which may include apartments, commercial structures housing businesses, healthcare facilities, and other non-owner occupied facilities. These loans are considered by the Company to be less risky than commercial and industrial loans, since they are secured by real estate and buildings. The loans typically have adjustable interest rates, repricing in three- to five-year periods, and require principal payments over a 10- to 25-year period. Many of these loans include call provisions within 10 to 15 years of their origination. The Company s underwriting analysis includes credit verification, independent appraisals, a review of the borrower's financial condition, and the underlying cash flows. These loans are typically originated in amounts of no more than 80% of the appraised value of the property serving as collateral.

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Residential First-Lien Mortgages: We originate adjustable-rate and fixed-rate, one-to-four-family residential real estate loans for the construction, purchase or refinancing of a mortgage. These loans are collateralized by owner- and non-owner-occupied properties located in the Company s market area. They are amortized over five to 30 years. Substantially all residential loans secured by first mortgage liens are originated by CNB Mortgage and sold to either the Bank or third-party investors. Generally, fixed-rate mortgage loans with a maturity or call date of ten years or less and a rate of 4% or more are retained in the Company s portfolio. For longer term, fixed-rate residential mortgages without escrow, the Company generally retains the servicing, but sells the right to receive principal and interest to Federal Home Loan Mortgage Company, also known as Freddie Mac. All loans not retained in the portfolio or sold to Freddie Mac are sold to unrelated third parties with servicing released. This practice allows the Company to manage interest rate risk, liquidity risk, and credit risk. From time to time, the Company may also purchase residential mortgage loans which are originated and serviced by third parties. In an effort to manage risk of loss and strengthen secondary market liquidity opportunities, management typically uses secondary market underwriting, appraisal, and servicing guidelines. Loans on one-to-four-family residential real estate are mostly originated in amounts of no more than 85% of appraised value or have private mortgage insurance. Mortgage title insurance and hazard insurance are normally required. Construction loans have a unique risk, because they are secured by an incomplete dwelling. This risk is reduced through periodic site inspections, including at each loan draw period.

Residential Junior-Lien Mortgages: The Company originates home equity lines of credit and second mortgage loans (loans secured by a second (junior) lien position on one-to-four-family residential real estate). These loans carry a higher risk than first mortgage residential loans as they are in a second position relating to collateral. Risk is reduced through underwriting criteria, which include credit verification, appraisals, a review of the borrower's financial condition, and personal cash flows. A security interest, with title insurance when necessary, is taken in the underlying real estate.

Consumer Automobile- Indirect Loans: The Company funds indirect automobile loans -- loans processed by automobile dealers on behalf of the Bank. These loans carry a fixed rate of interest with principal repayment terms typically ranging from one to seven years, based upon the nature of the automobile, the size of the loan, and the credit score of the borrower. Although secured by a vehicle these loans carry a higher risk of loss than real-estate secured loans, particularly in the early years of the loan, because automobiles are depreciating assets whose value declines over time, and at a more rapid rate than the related loan s principal balance.

Other Consumer Loans: The Company funds a variety of other consumer loans, including automobile loans, recreational vehicle loans, boat loans, aircraft loans, home improvement loans, and personal loans (collateralized and uncollateralized). Most of these loans carry a fixed rate of interest with principal repayment terms typically ranging from one to ten years, based upon the nature of the collateral and the size of the loan. The majority of consumer loans are underwritten on a secured basis using the underlying collateral being financed or a customer's deposit account. A small amount of loans are unsecured, which carry a higher risk of loss.

Loans Held for Sale: These are the Residential First-Lien Mortgages, discussed above, which are sold to Freddie Mac and other third parties. These loans are carried at their lower of cost or fair value, calculated on a loan-by-loan basis.

Allowance for Loan Losses

The allowance for loan losses is a valuation reserve for probable and inherent incurred losses in the loan portfolio. Credit losses arise primarily from the loan portfolio, but may also be derived from other credit-related sources, when drawn upon, such as commitments, guarantees, and standby letters of credit. Additions are made to the allowance through periodic provisions, which are charged to expense. All losses of principal are charged to the allowance when incurred or when a determination is made that a loss is expected. Subsequent recoveries, if any, are credited to the allowance.

The Company has established a process to assess the adequacy of the allowance for loan losses and to identify the risks in the loan portfolio. This process consists of the identification of specific reserves for impaired commercial loans and residential mortgages, and the calculation of general reserves, which is a formula-driven allocation.

The calculation of the general reserve involves several steps. A historical loss factor is applied to each loan by loan type and loan classification. The historical loss factors are calculated using a loan-by-loan, trailing eight-quarter net loss migration analysis for commercial loans. For all other loans, a portfolio-wide, trailing eight-quarter net loss migration analysis is used. Adjustments are then made to the historical loss factors based on current-period quantitative objective elements (delinquency, non-performing assets, classified/criticized loan trends, charge-offs, concentrations of credit, recoveries, etc.) and subjective elements (economic conditions, portfolio growth rate, portfolio management, credit policy, and others). This methodology is applied to the commercial, residential mortgage, and consumer portfolios, and their related off-balance sheet exposures. Any allowance for off-balance sheet exposures is recorded in Other Liabilities.

While management uses available information to recognize losses on loans, future additions to the allowance may be necessary. In addition, various regulatory agencies, as an integral part of their examination process, periodically review the Company s allowance for loan losses. Such agencies may require the Company to recognize additions to the allowance based on their judgments about information available to them at the time of their examination.

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The following tables, for each of the three-month periods presented, provide an analysis of the allowance for loan losses by loan type (in thousands):

Three Months Ended September 30, 2013

		Commercial and industrial	Commercial mortgage	Residential mortgage - first lien	Residential mortgage - junior lien	Consumer - indirect	Consumer - other	Loans held for sale	Unallocated	Total
Beginning Balance	$	3,565	1,320	2,967	499	7,354	960	-	1,121	17,786
Charge-offs		(12)	(285)	(97)	(7)	(310)	(127)	-	-	(838)
Recoveries		81	-	31	18	243	30	-	-	403
Provision		(401)	98	131	(37)	108	(20)	-	446	325
Ending Balance	$	3,233	1,133	3,032	473	7,395	843	-	1,567	17,676

Three months ended September 30, 2012

		Commercial and industrial	Commercial mortgage	Residential mortgage - first lien	Residential mortgage - junior lien	Consumer - indirect	Consumer - other	Loans held for sale	Unallocated	Total
Beginning Balance	$	4,283	1,680	2,119	482	6,517	954	-	1,238	17,273
Charge-offs		(29)	(85)	(236)	(10)	(385)	(116)	-	-	(861)
Recoveries		29	-	2	2	109	86	-	-	228
Provision		852	137	475	22	419	28	-	(433)	1,500
Ending Balance	$	5,135	1,732	2,360	496	6,660	952	-	805	18,140

The balance in the allowance for loan losses declined to $17.7 million at September 30, 2013 from $17.8 million at June 30, 2013 and from $18.1 million at September 30, 2012. The most significant consideration impacting the change in the third quarter of 2013 was growth in the portfolio, particularly in the consumer-indirect category offset by credit quality improvement in the commercial and industrial category. We also experienced stability in net charge-off rates. Conversely, we saw a slight uptick in the ratio of non-performing loans to total loans. Economic conditions were also considered in our determination of the allowance. Given the slow growth in our local economy, we made no changes to the economic qualitative factors that are applied to all portfolio pools for the third quarter. Therefore, the overall balance in the allowance declined slightly. The allocation of the allowance among specific loan categories and the unallocated category changed in the third quarter generally due to a decrease in the base loss factor for the Commercial and Industrial category. This lower allocation was attributed to (a) improvements in quantitative loss factors; (b) the historical eight-quarter net loss migration factor, due to prior losses falling off the migration calculation and (c) the levels of internally classified loans.

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The following tables present an analysis of the allowance for loan losses by loan type, including a summary of the loan types individually and collectively evaluated for impairment as of and for the nine-month periods ended September 30, 2013 and, 2012, respectively (in thousands). Notwithstanding the estimated allocations set forth in any table, the entirety of the allowance is available to absorb losses in any portfolio. Loan balances included in the Unallocated column represent the balance of net deferred loan costs.

September 30, 2013		**Commercial and industrial**	**Commercial mortgage**	**Residential mortgage - first lien**	**Residential mortgage - junior lien**	**Consumer - indirect**	**Consumer - other**	**Loans held for sale**	**Unallocated**	**Total**
Beginning Balance	$	3,261	1,837	2,642	466	6,730	940	-	1,441	17,317
Charge-offs		(238)	(463)	(416)	(83)	(1,408)	(338)	-	-	(2,946)
Recoveries		198	103	36	21	790	132	-	-	1,280
Provision		12	(344)	770	69	1,283	109	-	126	2,025
Ending Balance	$	3,233	1,133	3,032	473	7,395	843	-	1,567	17,676
<u>of which:</u>										
Amount for loans individually evaluated for impairment	$	295	127	107	-	-	-	-	-	529
Amount for loans collectively evaluated for impairment	$	2,938	1,006	2,925	473	7,395	843	-	1,567	17,147
Balance of loans individually evaluated for	$	1,838	6,908	483	43	-	-	-	-	9,272

impairment										
Balance of loans collectively evaluated for impairment	$	207,192	531,593	308,801	101,320	313,168	18,944	6,599	10,553	1,498,170

September 30, 2012		**Commercial and industrial**	**Commercial mortgage**	**Residential mortgage - first lien**	**Residential mortgage - junior lien**	**Consumer - indirect**	**Consumer - other**	**Loans held for sale**	**Unallocated**	**Total**
Beginning Balance	$	6,393	994	1,786	521	4,839	916	-	646	16,095
Charge-offs		(460)	(363)	(465)	(13)	(833)	(392)	-	-	(2,526)
Recoveries		106	3	12	14	419	217	-	-	771
Provision		(904)	1,098	1,027	(26)	2,235	211	-	159	3,800
Ending Balance	$	5,135	1,732	2,360	496	6,660	952	-	805	18,140
<u>of which:</u>										
Amount for loans individually evaluated for impairment	$	1,051	1,367	-	-	-	-	-	-	2,418
Amount for loans collectively evaluated for impairment	$	4,084	365	2,360	496	6,660	952	-	805	15,722
Balance of loans individually evaluated for impairment	$	3,521	10,510	-	80	-	-	-	-	14,111
Balance of loans collectively evaluated for impairment	$	201,555	508,717	283,626	105,410	284,996	17,071	12,978	9,523	1,423,876

The ratio of the allowance to total loans approximated 1.18% at September 30, 2013, 1.19% at December 31, 2012 and 1.27% at September 30, 2012. This year-over year decrease was principally due to improvements in several key credit quality measurements: Internally classified loans (loans rated 6, 7,or 8) decreased, the percentage of non-performing loans to total loans decreased, and the ratio of net charge-offs to average loans declined. These factors offset higher allowance requirements due to year-over-year portfolio growth. Specific reserves for impaired loans of $0.5 million at September 30, 2013 were only slightly lower than the December 31, 2012 level of $0.6 million but much less than the September 30, 2012 level of $2.4 million.

The most significant allowance allocation change as a result of these improvements was a reduction in the base loss factor for Commercial Mortgages. Commercial Mortgages showed declining historical net charge-offs and improvements in other key risk metrics including past due, non-accrual and problem asset measures. Offsetting the reduced allowance for Commercial Mortgages were increases to the Residential Mortgage and Consumer-Indirect pools resulting from loan growth and a higher base loss factor for the Residential Mortgage pool. The Consumer-indirect provision showed a net decrease when compared to the prior year due to slower portfolio growth in 2013, which was somewhat offset by a need for a higher provision due to higher net-chargeoffs in 2013 than in 2012.

Finally, due to modestly improving economic conditions in our market for the year (increased auto sales, increased home sales, stable median home prices, and improving consumer confidence in the Rochester area from last year) a minor reduced economic factor adjustment was applied to the majority of the portfolio pools.

In monitoring the credit quality of the portfolio, management applies a credit quality indicator to substantially all commercial loan relationships over $250,000. These quality indicators, as more fully described in the 2012 Annual Report, range from 1 through 8 in increasing risk of loss. These ratings are used as inputs to the calculation of the allowance for loan losses. Loans rated 1 through 4 are generally allocated a lesser percentage allocation in the allowance for loan losses than loans rated from 5 through 8. Residential Mortgage and Consumer Loans are generally rated 9, unless they are used to partially collateralize commercial loans, in which case they carry the rating of the respective commercial loan relationship; or if management wishes to recognize a well defined weakness or loss potential to more accurately reflect credit risk. Unrated loans, including performing commercial loan relationships less than $250,000, are allocated a percentage of the allowance for loan losses on a pooled basis.

The following tables present the loan portfolio as of September 30, 2013 and December 31, 2012 by credit quality indicator (in thousands). Except for loans in the 9 and unrated categories, credit quality indicators are reassessed for each applicable loan at least annually, generally upon the anniversary of the loan s origination or receipt and analysis of the borrower s financial statements, when applicable, or in the event that information becomes available that would cause us to re-evaluate. Loans in category 9 and unrated are evaluated for credit quality after origination based upon delinquency status. (See Aging Analysis table.)

Credit Quality Indicator Analysis as of September 30, 2013

		Commercial and industrial	Commercial mortgage	Residential mortgage - first lien	Residential mortgage - junior lien	Consumer - indirect	Consumer - other	Loans held for sale	Deferred Fees and Costs	Total
1-Superior	$	15,104	400	-	-	-	275	-	-	15,779
2-Good		21,981	32,502	1,269	-	-	874	-	-	56,626
3-Satisfactory		55,575	230,183	2,114	87	-	-	-	-	287,959
4-Watch		44,237	199,471	7,974	293	-	-	-	-	251,975
5-Special Mention		5,570	16,491	-	-	-	-	-	-	22,061
6-Substandard		15,086	14,139	5,367	413	-	-	-	-	35,005
7-Doubtful		-	-	-	-	-	-	-	-	-
8-Loss		-	-	-	-	-	-	-	-	-
Subtotal	$	157,553	493,186	16,724	793	-	1,149	-	-	669,405
9 and not rated		51,477	45,315	292,560	100,570	313,168	17,795	6,599	10,553	838,037
Total	$	209,030	538,501	309,284	101,363	313,168	18,944	6,599	10,553	1,507,442

Credit Quality Indicator Analysis as of December 31, 2012

		Commercial and industrial	Commercial mortgage	Residential mortgage - first lien	Residential mortgage - junior lien	Consumer - indirect	Consumer - other	Loans held for sale	Deferred Fees and Costs	Total
1-Superior	$	15,422	-	-	-	-	386	-	-	15,808
2-Good		15,422	28,236	1,409	-	-	974	-	-	46,041
3-Satisfactory		76,473	219,748	1,506	253	-	-	-	-	297,980
4-Watch		44,633	213,267	6,192	389	-	-	-	-	264,481
5-Special Mention		9,527	21,581	-	-	-	-	-	-	31,108
6-Substandard		17,164	16,895	5,063	377	-	-	-	-	39,499
7-Doubtful		-	-	-	-	-	-	-	-	-
8-Loss		-	-	-	-	-	-	-	-	-
Subtotal	$	178,641	499,727	14,170	1,019	-	1,360	-	-	694,917
9 and not rated		34,826	25,686	272,802	99,080	283,836	16,963	21,113	9,549	763,855
Total	$	213,467	525,413	286,972	100,099	283,836	18,323	21,113	9,549	1,458,772

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The table below presents a summary of information regarding nonaccruing loans and other nonperforming assets as of the end of the respective periods (in thousands):

		September 30, 2013	December 31, 2012	September 30, 2012
Accruing loans 90 days or more delinquent	$	947	722	417
Nonaccruing loans		14,526	17,770	18,817
Total nonperforming loans		15,473	18,492	19,234
Other real estate owned		3,147	3,759	3,679
(less write-down of other real estate owned)		(247)	(203)	(181)
Total nonperforming assets	$	18,373	22,048	22,732

The following tables present, as of September 30, 2013 and December 31, 2012, additional details about the loan portfolio in the form of an aging analysis. Amounts exclude deferred fees and costs (in thousands).

Aging Analysis as of September 30, 2013

		30-59 Days Past Due	60-89 Days Past Due	90 Days Or Greater	Total Past Due	Current	Total Loans	> 90 Days and Accruing	Non-Accrual Loans
Commercial and industrial	$	7,362	56	1,950	9,368	199,662	209,030	112	1,838
Commercial mortgages		2,921	126	7,034	10,081	528,420	538,501	126	6,908
Residential - first lien		45	1,631	5,707	7,383	301,901	309,284	340	5,367
		1,202	295	432	1,929	99,434	101,363	19	413

Residential - junior lien									
Consumer:									
Automobile - Indirect		2,804	574	345	3,723	309,445	313,168	345	-
Other		130	49	5	184	18,760	18,944	5	-
Loans held-for-sale		-	-	-	-	6,599	6,599	-	-
	$	14,464	2,731	15,473	32,668	1,464,221	1,496,889	947	14,526

Aging Analysis as of December 31, 2012

		30-59 Days Past Due	60-89 Days Past Due	90 Days Or Greater	Total Past Due	Current	Total Loans	> 90 Days and Accruing	Non-Accrual Loans
Commercial and industrial	$	2,478	3,811	2,475	8,764	207,703	213,467	46	2,429
Commercial mortgages		1,365	1,167	10,116	12,648	512,765	525,413	-	10,116
Residential - first lien		4,369	1,013	5,048	10,430	276,542	286,972	201	4,847
Residential - junior lien		616	511	427	1,554	98,545	100,099	49	378
Consumer:									
Automobile - indirect		2,758	701	412	3,871	279,965	283,836	412	-
Other		308	114	14	436	17,887	18,323	14	-
Loans held-for-sale		-	-	-	-	21,113	21,113	-	-
Total	$	11,894	7,317	18,492	37,703	1,414,520	1,449,223	722	17,770

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A summary of information regarding impaired loans follows (in thousands):

		As of and for the nine-month period ended September 30, 2013	As of and for the year ended December 31, 2012	As of and for the nine-month period ended September 30, 2012
Recorded investment at period end	$	14,526	17,770	18,817
Impaired loans with specific related allowance at period end	$	1,388	1,200	5,398
Amount of specific related allowance at period end	$	529	603	2,418
Average investment during the period	$	16,742	19,014	18,898
Interest income recognized on a cash basis during the period	$	90	433	216

The details of impaired loans follow (in thousands). Recorded investment , Unpaid Principal Balance , and Specific Related Allowance are as of the periods ended September 30, 2013 and December 31, 2012 , respectively. Average Recorded Investment is a four-quarter rolling average for the respective periods. Interest Income Recognized is for the respective year-to-date periods:

September 30, 2013

With no specific allowance		**Recorded Investment**	**Unpaid Principal Balance**	**Specific Related Allowance**	**Average Recorded Investment**	**Interest Income Recognized**
Commercial and industrial	$	1,349	2,106	-	1,483	19
Commercial mortgage		6,278	7,549	-	7,538	44
Residential mortgage - first lien		5,098	5,384	-	4,902	22
Residential mortgage - junior lien		413	435	-	405	5
Subtotal		13,138	15,474	-	14,328	90
With specific allowance						
Commercial and industrial		489	603	295	997	-

Commercial mortgage		630	853	127	1,350	-
Residential mortgage - first lien		269	269	107	67	-
Subtotal		1,388	1,725	529	2,414	-
Total	$	14,526	17,199	529	16,742	90
Summary by portfolio:						
Commercial	$	8,746	11,111	422	11,368	63
Residential		5,780	6,088	107	5,374	27
Total	$	14,526	17,199	529	16,742	90

December 31, 2012

With no specific allowance		**Recorded Investment**	**Unpaid Principal Balance**	**Specific Related Allowance**	**Average Recorded Investment**	**Interest Income Recognized**
Commercial and industrial	$	1,592	2,042	-	1,604	202
Commercial mortgage		9,753	11,407	-	8,830	112
Residential mortgage - first lien		4,847	5,110	-	4,663	84
Residential mortgage - junior lien		378	391	-	329	33
Consumer - indirect		-	-	-	-	2
Subtotal		16,570	18,950	-	15,426	433
With specific allowance						
Commercial and industrial		837	924	515	1,759	-
Commercial mortgage		363	445	88	1,829	-
Subtotal		1,200	1,369	603	3,588	-
Total	$	17,770	20,319	603	19,014	433
Summary by portfolio:						
Commercial	$	12,545	14,818	603	14,022	314
Residential		5,225	5,501	-	4,992	117
Consumer and other		-	-	-	-	2
Total	$	17,770	20,319	603	19,014	433

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Troubled Debt Restructurings (TDR)

As of September 30, 2013, there was one commercial relationship totaling $4.1 million that was considered a TDR due to the nature of the concessions granted to the borrower. We have established no impairment reserve for the relationship in light of the value of underlying collateral and management s recovery expectations. The balances of the underlying loans are included in non-performing loans. For this relationship, we renegotiated certain terms of their loans in 2010. The significant term modified was the monthly principal and interest payment amount. We agreed to forbear our rights under default provisions in the loan agreements on the condition that the borrower made monthly payments which were significantly less than those required under the terms of the original loan agreements. The customer complied with the terms of the initial forbearance agreement, and has been in compliance with all subsequent agreements, which have called for increasingly higher monthly payments.

During 2013, one additional commercial and industrial loan totaling $0.1 million and two residential loans totaling $0.5 million were newly classified as a TDRs. One residential loan totaling $0.3 million, previously classified as a TDR was paid-off in the second quarter of 2012.

(4) Loan Servicing Assets

The Company services first-lien, residential loans for the Federal Home Loan Mortgage Company (FHLMC), also known as Freddie Mac, and certain commercial loans as lead participant. The associated servicing rights (assets) entitle the Company to a future stream of cash flows based on the outstanding principal balance of the loans and contractual servicing fees. Failure to service the loans in accordance with contractual requirements may lead to a termination of the servicing rights and the loss of future servicing fees.

The Company services all loans for FHLMC on a non-recourse basis; therefore, its credit risk is limited to temporary advances of funds to FHLMC, while FHLMC retains all credit risk associated with the loans. Commercial loans are serviced on a non-recourse basis, whereby the Company is subject to credit losses only to the extent of the proportionate share of the loan s principal balance owned. The Company s contract to sell loans to FHLMC and to the Federal Housing Administration (FHA) via third-parties contain certain representations and warranties that if not met by the Company would require the repurchase of such loans. The Company has not historically been subject to a material volume of repurchases.

Gross servicing fees earned by the Company for the nine-month periods ended September 30, 2013 and 2012, respectively, amounted to $1,227,000 and $1,066,000. Gross servicing fees earned by the Company for the three-month periods ended September 30, 2013 and 2012, respectively, amounted to $422,000 and $354,000. These fees are included in loan servicing income, net on the statements of income.

The following table presents the changes in loan servicing assets for the nine-month periods ended September 30, 2013 and 2012, respectively, as well as the estimated fair value of the assets at the beginning and end of the period (in thousands).

	2013		2012	
	Book Value	Estimated Fair Value	Book Value	Estimated Fair Value
Balance at January 1,	$ 3,221	$ 3,382	$ 2,489	$ 3,244
Originations	684		927	
Amortization	(545)		(436)	
Balance at September 30,	$ 3,360	$ 3,613	$ 2,980	$ 3,564

(5) Dividend

On July 17, 2013, the Board of Directors declared a semi-annual $1.68 per share dividend on common stock to shareholders of record on July 27, 2013. The dividend was paid on August 1, 2013. No dividend on common stock was paid in February 2013. The $1.63 per share dividend paid in December 2012 was accelerated from the semi-annual dividend payment that would have been paid in February 2013.

CANANDAIGUA NATIONAL CORPORATION AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements (Unaudited)

(6) Earnings Per Share

Basic earnings per common share is calculated by dividing net income available to common shareholders by the weighted average number of shares outstanding during the period. Diluted earnings per share includes the maximum dilutive effect of stock issuable upon conversion of stock options. Calculations for the three- and nine-month periods ended September 30, 2013 and 2012 follow (dollars in thousands, except per share data):

		Three-months Ended September 30,			Nine-months Ended September 30,	
		2013	**2012**		**2013**	**2012**
Basic Earnings Per Share:						
Net income applicable to common shareholders	$	6,357	4,988	$	15,596	13,073
Weighted average common shares outstanding		1,886,735	1,886,868		1,898,138	1,887,052
Basic earnings per share	$	3.37	2.64	$	8.22	6.93
Diluted Earnings Per Share:						
Net income applicable to common shareholders	$	6,357	4,988	$	15,596	13,073
Weighted average common shares outstanding		1,886,735	1,886,868		1,898,138	1,887,052
Effect of assumed exercise of stock options		32,465	44,950		32,538	43,451
Total		1,919,200	1,931,818		1,930,676	1,930,503
Diluted earnings per share	$	3.31	2.58	$	8.08	6.77

(7) Segment Information

The Company is organized into four reportable segments: the Company and its banking and Florida trust subsidiaries (Bank), CNB Mortgage Company (CNBM), Genesee Valley Trust Company (GVT), and WBI OBS Financial, LLC and its subsidiaries (OBS). These have been segmented due to differences in their distribution channels, the volatility of their earnings, and internal and external financial reporting requirements. The interim period reportable segment information for the three- and nine-month periods ended September 30, 2013 and 2012 follows (dollars in thousands).

Three months ended September 30,				**2013**			
		Bank	**CNBM**	**GVT**	**OBS**	**Intersegment**	**Total**
Net interest income	$	16,714	1	2	(17)	(3)	16,697
Non-interest income		7,681	1,543	1,011	738	(1,564)	9,409
Total revenues		24,395	1,544	1,013	721	(1,567)	26,106
Provision for loan losses		325	-	-	-	-	325
Intangible amortization		41	-	143	129	-	313
Other operating expenses		14,091	695	853	657	(147)	16,149
Total expenses		14,457	695	996	786	(147)	16,787
Income (loss) before tax		9,938	849	17	(65)	(1,420)	9,319
Income tax		3,011	320	7	(52)	(327)	2,959
Net income (loss) attributable to noncontrolling interests and Canandaigua National Corporation		6,927	529	10	(13)	(1,093)	6,360
Net income (loss) attributable to noncontrolling interests		6	-	-	(4)	-	2
Net income (loss) attributable to Canandaigua National Corporation	$	6,921	529	10	(9)	(1,093)	6,358
Total identifiable assets	$	1,931,722	6,392	16,325	10,005	(10,939)	1,953,505

CANANDAIGUA NATIONAL CORPORATION AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements (Unaudited)

Three months ended September 30,				2012			
		Bank	CNBM	GVT	OBS	Intersegment	Total
Net interest income	$	16,430	2	2	(73)	(4)	16,357
Non-interest income		5,587	2,059	906	892	(534)	8,910
Total revenues		22,017	2,061	908	819	(538)	25,267
Provision for loan losses		1,500	-	-	-	-	1,500
Intangible amortization		46	-	157	287	-	490
Other operating expenses		14,050	705	760	678	9	16,202
Total expenses		15,596	705	917	965	9	18,192
Income (loss) before tax		6,421	1,356	(9)	(146)	(547)	7,075
Income tax		2,138	538	(3)	-	(535)	2,138
Net income (loss) attributable to noncontrolling interests and Canandaigua National Corporation	$	4,283	818	(6)	(146)	(12)	4,937
Net income (loss) attributable to noncontrolling interests		-	-	-	(51)	-	(51)
Net income (loss) attributable to Canandaigua National Corporation		4,283	818	(6)	(95)	(12)	4,988
Total identifiable assets	$	1,873,621	11,715	16,378	10,607	(14,938)	1,897,383

Nine months ended September 30,				2013			
		Bank	CNBM	GVT	OBS	Intersegment	Total
Net interest income	$	49,370	3	5	(51)	(8)	49,319
Non-interest income		22,647	4,885	2,985	1,648	(5,495)	26,670
Total revenues		72,017	4,888	2,990	1,597	(5,503)	75,989

Provision for loan losses	2,025	-	-	-	-	2,025
Intangible amortization	124	-	429	386	-	939
Other operating expenses	43,484	2,189	2,638	2,396	(441)	50,266
Total expenses	45,633	2,189	3,067	2,782	(441)	53,230
Income (loss) before tax	26,384	2,699	(77)	(1,185)	(5,062)	22,759
Income tax	7,684	1,044	(30)	(174)	(1,014)	7,510
Net income (loss) attributable to noncontrolling interest and Canandaigua National Corporation	18,700	1,655	(47)	(1,011)	(4,048)	15,249
Net income (loss) attributable to noncontrolling interests	6	-	-	(354)	-	(348)
Net income (loss) attributable to Canandaigua National Corporation	$ 18,694	1,655	(47)	(657)	(4,048)	15,597
Total identifiable assets	$ 1,931,722	6,392	16,325	10,005	(10,939)	1,953,505

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CANANDAIGUA NATIONAL CORPORATION AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements (Unaudited)

Nine months ended September 30,		**2012**					
		Bank	**CNBM**	**GVT**	**OBS**	**Intersegment**	**Total**
Net interest income	$	48,609	5	7	(73)	(12)	48,536
Non-interest income		17,274	5,109	2,718	2,210	(1,461)	25,850
Total revenues		65,883	5,114	2,725	2,137	(1,473)	74,386
Provision for loan losses		3,800	-	-	-	-	3,800
Intangible amortization		137	-	472	585	-	1,194
Other operating expenses		45,037	2,063	2,288	1,886	(441)	50,833
Total expenses		48,974	2,063	2,760	2,471	(441)	55,827
Income (loss) before tax		16,909	3,051	(35)	(334)	(1,032)	18,559
Income tax		5,603	1,209	(13)	-	(1,196)	5,603
Net income (loss) attributable to noncontrolling interest and Canandaigua National Corporation	$	11,306	1,842	(22)	(334)	164	12,956
Net income (loss) attributable to noncontrolling interests		-	-	-	(117)	-	(117)
Net income (loss) attributable to Canandaigua National Corporation		11,306	1,842	(22)	(217)	164	13,073
Total identifiable assets	$	1,873,621	11,715	16,378	10,607	(14,938)	1,897,383

(8) Junior Subordinated Debentures and Interest Rate Swap Agreements

In September 2007, the Company issued $20,619,000 of unsecured, 30-year junior subordinated deferrable interest debentures (T3) through a wholly-owned business trust. The debentures carried a fixed interest rate of 6.32% per annum for the initial five years, then converted to an adjustable rate for the remaining twenty-five years at LIBOR plus 1.44%, adjustable quarterly. The debentures' final maturity is December 2037, and became callable, in whole or in part, at par beginning December 2012 at the Company's option, and subject to Federal Reserve Bank of New York approval. Interest is payable quarterly. Interest payments can be deferred for up to five years, but would restrict the Company's ability to pay dividends. At September 30, 2013, these debentures were considered Tier I Capital for regulatory purposes.

In December 2012, the Company became exposed to interest rate risk as a result of the timing of changes in interest rates associated with T3. In consideration of the end of the fixed-rate period, the Company entered into a forward interest rate swap agreement, which became effective on December 15, 2012 and expires on December 15, 2022. This interest rate swap agreement modifies the repricing characteristics of the debenture from a floating-rate debt (LIBOR +1.44%) to a fixed-rate debt (3.859%).

In June, 2006, the Company issued $30,928,000 of unsecured, 30-year floating rate junior subordinated deferrable interest debentures (T2) through a wholly-owned business trust. The debentures carry an interest rate of 3-month LIBOR plus 1.40%. Other significant terms of the debenture are similar to T3, except the debentures' final maturity is June 2036, and became callable, in whole or in part, at par after June 2012.

As with T3, the Company is exposed to interest rate risk for T2. In order to reduce this risk, the Company has entered into a series of interest rate swap agreements since 2007 with the current agreement effective as of June 15, 2011 and expiring on June 15, 2021. The agreement modifies the repricing characteristics of T2 from a floating-rate debt (LIBOR +1.40%) to a fixed-rate debt (4.81%).

With both swap agreements the Company designated them as a cash flow hedges, and they are intended to protect against the variability of cash flows associated with the debentures. Therefore, the effective portion of the swap s unrealized gain or loss is recorded as a component of other comprehensive income. The ineffective portion of the unrealized gain or loss, if any, is reported in other operating income. The swap agreements are carried at fair value in other liabilities on the Statement of Condition. Amounts receivable or payable are recognized as accrued under the terms of the agreements, and the net differential is recorded as an adjustment to interest expense.

(9) Fair Values of Financial Instruments

Current accounting pronouncements require disclosure of the estimated fair value of financial instruments. Fair value is generally defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly, non-distressed sale between market participants at the measurement date. With the exception of certain marketable securities and one-to-four-family residential mortgage loans originated for sale, the Company s financial instruments are not readily marketable and market prices do not exist. The Company, in attempting to comply with accounting disclosure pronouncements, has not attempted to market its financial instruments to potential buyers, if any exist. Since negotiated prices in illiquid markets depend upon the then present motivations of the buyer and seller, it is reasonable to assume that actual sales prices could vary widely from any estimate of fair value made without the benefit of negotiations. Additionally, changes in market interest rates can dramatically impact the value of financial instruments in a short period of time. Finally, the Company expects to retain substantially all assets and liabilities measured at fair value to their maturity or call date. Accordingly, the fair values disclosed herein are unlikely to represent the instruments liquidation values, and do not, with the exception of securities, consider exit costs, since they cannot be reasonably estimated by management.

Accounting principles establish a three-level valuation hierarchy for fair value measurements. The valuation hierarchy is based upon the transparency of inputs to the valuation of an asset or liability as of the measurement date. A financial instrument s categorization within the valuation hierarchy is based upon the lowest level of input that is significant to the fair value measurement. The three levels are defined as follows.

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Level 1 inputs to the valuation methodology are quoted prices (unadjusted) for identical assets or liabilities in active markets.

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Level 2 inputs to the valuation methodology include quoted prices for similar assets and liabilities in active markets, and inputs that are observable for the asset or liability, either directly or indirectly, for substantially the full term of the financial instrument.

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Level 3 inputs to the valuation methodology are unobservable and significant to the fair value measurement.

The estimated fair values and the valuation hierarchy of the Company's financial instruments are as follows (in thousands):

			September 30, 2013		December 31, 2012	
Financial Assets:	**Fair Value Hierarchy**		**Carrying Amount**	**Fair Value**	**Carrying Amount**	**Fair Value**
Cash and equivalents	1	$	100,840	100,840	91,159	91,159
Securities, available-for-sale	1, 2, 3	$	110,188	110,188	102,774	102,774
Securities, held-to-maturity	2	$	182,038	183,721	175,850	180,015
FHLB stock and Federal Reserve Bank stock[a]	3	$	2,917	2,917	2,733	2,733
Loans-net	3	$	1,489,766	1,533,157	1,441,455	1,505,003
Loan servicing assets	3	$	3,360	3,613	3,221	3,382
Financial Liabilities:						
Deposits:						
Demand, savings and money market accounts	3	$	1,377,922	1,377,922	1,292,510	1,292,510
Time deposits	3	$	342,727	343,139	370,353	372,226
Borrowings	2	$	4,165	4,140	4,296	4,312
Junior subordinated debentures	2	$	51,547	51,547	51,547	51,547
Other financial instruments:						
Interest rate swap agreements	2	$	(2,301)	(2,301)	(6,162)	(6,162)
Letters of credit	2	$	(218)	(218)	(192)	(192)

[a]Includes the Company's required investments in Federal Reserve Bank stock and Federal Home Loan Bank stock.

The following methods and assumptions were used to estimate the fair value of each class of financial instrument:

Cash and Equivalents

For these short-term instruments that generally mature in 90 days or less, or carry a market rate of interest, the carrying value approximates fair value.

CANANDAIGUA NATIONAL CORPORATION AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements (Unaudited)

Securities

Fair values for securities are determined using independent pricing services and market-participating brokers, or matrix models using observable inputs. The pricing service and brokers use a variety of techniques to arrive at fair value including market maker bids, quotes and pricing models. Inputs to their pricing models include recent trades, benchmark interest rates, spreads, and actual and projected cash flows. Management obtains a single market quote or price estimate for each security. None of the quotes or estimates is considered a binding quote, as management would only request a binding quote if management had the positive intent to sell the securities in the foreseeable future and management believed the price quoted represented one from a market participant with the intent and the ability to purchase. Management evaluates the supplied price quotes against expectations of general price trends associated with changes in the yield curve and by comparing prices to the last period s price quote. Management employs an internal matrix model for non-traded municipal securities. The matrix model considers observable inputs, such as benchmark interest rates and spreads.

Certain securities fair values are determined using unobservable inputs and include bank-debt-based collateralized debt obligations (CDOs). There is a very limited market and limited demand for these CDOs due to imbalances in marketplace liquidity and the uncertainty in evaluating the credit risk in these securities. In determining fair value for these securities, management considered various inputs. Management considered fair values from brokerage firms which were determined using assumptions as to expected cash flows and approximate risk-adjusted discount rates.

There is no market for stock issued by the Federal Home Loan Bank or the Federal Reserve Bank. Member banks are required to hold this stock. Shares can only be sold to the issuer at par. Fair value is estimated to equal book value.

Loans

Fair values are estimated for portfolios of loans with similar financial characteristics. Loans are segregated by interest type such as floating, adjustable, and fixed-rate, and by portfolios such as commercial, mortgage, and consumer.

The fair value of performing loans is calculated by discounting scheduled cash flows through the loans' estimated maturity using estimated market discount rates that reflect the credit and interest rate risk inherent in the loan category. The estimate of maturity is based on the average maturity for each loan classification.

Delinquent loans (not in foreclosure) are valued using the method noted above, and also consider the fair value of collateral for collateral-dependent loans. While credit risk is a component of the discount rate used to value loans, delinquent loans are presumed to possess additional risk. Therefore, the calculated fair value of loans is reduced by the allowance for loan losses.

The fair value of loans held for sale is estimated based on outstanding investor commitments or in the absence of such commitments, is based on current yield requirements or quoted market prices.

Loan Servicing Assets

Fair value is determined through estimates provided by a third party. To estimate the fair value, the third party considers market prices for similar assets, and the present value of expected future cash flows associated with the servicing assets calculated using assumptions that market participants would use in estimating future servicing income and expense. Such assumptions include estimates of the cost of servicing loans, loan default rates, an appropriate discount rate, and prepayment speeds. The key economic assumptions used to determine the fair value of mortgage servicing rights and the sensitivity of such values to changes in those assumptions are summarized in Note 6 of the 2012 Annual Report.

Deposits

The fair value of demand deposits, savings accounts, and money market accounts is the amount payable on demand at the reporting date. The fair value of fixed maturity time deposits is estimated using a discounted cash flow approach that applies current market rates to a schedule of aggregated expected maturities of time deposits.

Borrowings

The fair value of borrowings is based on quoted market prices for the identical debt when traded as an asset in an active market. If a quoted market price is not available, fair value is calculated by discounting scheduled cash flows through the borrowings' estimated maturity using current market rates.

CANANDAIGUA NATIONAL CORPORATION AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements (Unaudited)

Junior Subordinated Debentures

There is no active trading market for the Company s debentures. Therefore the fair value of junior subordinated debentures is determined using an expected present value technique. The fair value of adjustable-rate debentures approximates their face amount, while the fair value of fixed-rate debentures is calculated by discounting scheduled cash flows through the debenture s estimated maturity using current market rates.

Interest Rate Swap Agreements (Swaps)

The fair value of swaps is the amount the Company would expect to pay to terminate the agreements and is based upon the present value of expected future cash flows using the LIBOR swap curve, the basis for the underlying interest rates.

Other Financial Instruments

The fair values of letters of credit and unused lines of credit approximate the fee charged to make the commitments.

(10) Fair Values Measurements

The following table presents for each of the fair-value hierarchy levels discussed in the previous Note the Company s assets and liabilities that are measured at fair value on a recurring and non-recurring basis at September 30, 2013, by caption on the Consolidated Balance Sheet (dollars in thousands).

Internal models

		Quoted market prices in active markets (Level 1)	Internal models with significant observable market parameters (Level 2)	with significant unobservable market parameters (Level 3)	Total carrying value in the Consolidated Balance Sheet
Measured on a recurring basis:					
Assets					
Securities available-for-sale:					
U.S. Treasury	$	500	-	-	500
U.S. government sponsored enterprise obligations		-	78,202	-	78,202
State and municipal obligation		-	28,123	-	28,123
All other		-	3,222	141	3,363
Total assets	$	500	109,547	141	110,188
Liabilities					
Interest rate swap agreement	$	-	2,301	-	2,301
Letters of credit		-	218	-	218
Total liabilities	$	-	2,519	-	2,519
Measured on a non-recurring basis:					
Assets					
Loans					
Loans-held-for-sale	$	-	6,599	-	6,599
Collateral dependent impaired loans		-	-	1,388	1,388
Other assets					
Other real estate owned		-	-	2,900	2,900
Loan servicing assets		-	-	3,360	3,360
Total assets	$	-	6,599	7,648	14,247

The Company values impaired loans and other real estate owned at the time the loan is identified as impaired or when title to the property passes to the Company. The fair values of such loans and real estate owned are estimated using Level 3 inputs in the fair value hierarchy. Each loan s collateral and real estate property has a unique appraisal and management s consideration of any discount of the value is based on factors unique to each impaired loan and real estate property. In estimating fair value, management may use the most recent available appraisal or may obtain an updated appraisal when, in management s judgment, conditions have changed such that the most recent appraisal may not be reflective of current fair value. The significant unobservable input in determining the fair value is management s subjective discount on appraisals of the collateral securing the loan or real estate property, which ranges from 10%-50%. Collateral for impaired loans may consist of real estate and/or business assets including equipment, inventory and/or accounts receivable and the value of these assets is determined based on appraisals by qualified licensed appraisers hired by the Company. Appraised and reported values

may be discounted based on management s historical knowledge, changes in market conditions from the time of valuation, estimated costs to sell, and/or management s expertise and knowledge of the client and the client s business.

As more fully described in the prior Note, the Company evaluates and values loan servicing assets on a quarterly basis at their lower of amortized cost or fair value. The fair values of these assets are estimated using Level 3 inputs in the fair value hierarchy. Fair value is determined through estimates provided by a third party or by management by reference to rights sold on similar loans during the quarter. When values are estimated by management using market prices for similar servicing assets, certain discounts may be applied to reflect the differing rights underlying the loan servicing contract. These discounts may range from 25 to 75 basis points of the principal balance of the underlying loan. Such discounts represent the significant unobservable input.

The following table shows a reconciliation of the beginning and ending balances for assets measured at fair value on a recurring basis using significant unobservable inputs (Level 3) for the three- and nine-month periods ended September 30, 2013 (in thousands).

		Three Months Ended September 30, 2013		**Nine Months Ended September 30, 2013**
Securities available for sale, beginning of period	$	126	$	120
Unrealized gain included in other comprehensive income		15		21
Securities available for sale, end of period	$	141	$	141

The following table presents for each of the fair-value hierarchy levels the Company s assets and liabilities that are measured at fair value on a recurring and non-recurring basis at December 31, 2012, by caption on the Consolidated Balance Sheet (dollars in thousands).

	Quoted market prices in active	**Internal models with significant observable market**	**Internal models with significant unobservable market**	**Total carrying value in the**

		markets (Level 1)	parameters (Level 2)	parameters (Level 3)	Consolidated Balance Sheet
Measured on a recurring basis:					
Assets					
Securities available-for-sale:					
U.S. Treasury	$	500	-	-	500
U.S. government sponsored enterprise obligations		-	60,176	-	60,176
State and municipal obligation		-	38,686	-	38,686
All other		-	3,292	120	3,412
Total assets	$	500	102,154	120	102,774
Liabilities					
Interest rate swap agreement	$	-	6,162	-	6,162
Letters of credit		-	192	-	192
Total liabilities	$	-	6,354	-	6,354
Measured on a non-recurring basis:					
Assets					
Loans					
Loans-held-for-sale	$	-	21,113	-	21,113
Collateral dependent impaired loans		-	-	1,200	1,200
Other assets					
Other real estate owned		-	-	3,556	3,556
Loan servicing assets		-	-	3,221	3,221
Total assets	$	-	21,113	7,977	29,090

The following table shows a reconciliation of the beginning and ending balances for assets measured at fair value on a recurring basis using significant unobservable inputs (Level 3) for the three- and nine-month periods ended September 30, 2012 (in thousands). During the first quarter of 2012 certain securities were transferred to Level 2 classification. These securities showed an active trading market, which resulted in fair values with significant observable elements.

	Three Months Ended September 30, 2012	Nine Months Ended September 30, 2012
Securities available for sale, beginning of period	$ 120	$ 799
Securities transferred to Level 2 during period	-	(704)
Unrealized gain included in other comprehensive income	4	29
Securities available for sale, end of period	$ 124	$ 124

(11) Accounting Pronouncements Implemented in the Current Year

We implemented the following Accounting Standards Updates (ASU) as of January 1, 2013 with no material impact to our financial condition or results of operations:

ASU 2011-11 Disclosures about Offsetting Assets and Liabilities, issued December 2011, and *ASU 2013-01 Clarifying the Scope of Disclosures about Offsetting Assets and Liabilities*, issued January 2013. The amendments in these Updates require an entity to disclose information about offsetting and related arrangements to enable users of its financial statements to understand the effect of those arrangements on its financial position. The amendments are intended to bring closer convergence of US GAAP with International Financial Reporting Standards (IFRS). The ASU applies to derivatives accounted for in accordance with Topic 815, Derivatives and Hedging, including bifurcated embedded derivatives, repurchase agreements and reverse repurchase agreements, and securities borrowing and securities lending transactions that are either offset in accordance with Section 210-20-45 or Section 815-10-45 or subject to an enforceable master netting arrangement or similar agreement. The Company does not currently engage in these types of transactions.

ASU 2012-02 Testing Indefinite-Lived Intangible Assets for Impairment, issued July 2012. The amendments in this update permit an entity first to assess qualitative factors to determine whether it is more likely than not that an indefinite-lived intangible asset is impaired as a basis for determining whether it is necessary to perform the quantitative impairment test in accordance with Subtopic 350-30, Intangibles Goodwill and Other General Intangibles Other than Goodwill. The more-likely-than-not threshold is defined as having a likelihood of more than 50 percent. Previous guidance in Subtopic 350-30 required an entity to test indefinite-lived intangible assets for impairment, on at least an annual basis, by comparing the fair value of the asset with its carrying amount. If the carrying amount of the intangible asset exceeds its fair value, an entity should recognize an impairment loss in the amount of that excess. In accordance with the amendments in this Update, an entity will have an option not to calculate annually the fair value of an indefinite-lived intangible asset if the entity determines that it is not more likely than not that the asset is impaired. Permitting an entity to assess qualitative factors when testing indefinite-lived intangible assets for impairment results in guidance that is similar to the goodwill impairment testing guidance in Update 2011-08. The Company has recorded no indefinite-lived intangible assets.

ASU 2013-02 Reporting of Amounts Reclassified Out of Accumulated Other Comprehensive Income, issued February 2013. The amendments in this Update seek to improve the reporting of reclassifications out of accumulated other comprehensive income by requiring an entity to report the effect of significant reclassifications out of accumulated other comprehensive income on the respective line items in net income if the amount being reclassified is required under U.S. generally accepted accounting principles (GAAP) to be reclassified in its entirety to net income. For other amounts that are not required under U.S. GAAP to be reclassified in their entirety to net income in the same reporting period, an entity is required to cross-reference other disclosures required under U.S. GAAP that provide additional detail about those amounts. This would be the case when a portion of the amount reclassified out of accumulated other comprehensive income is reclassified to a balance sheet account (for example, inventory) instead of directly to income or expense in the same reporting period. The amendments do not change the current requirements for accounting or reporting net income or other comprehensive income in financial statements.

In addition to the Updates enumerated above, the Financial Accounting Standards Board issues, from time to time, updates containing technical amendments. These updates are generally effective immediately upon their issuance, but have no practical impact on our financial condition or results of operations. Because these are technical in nature, and have no material impact, a summary is not included herein.

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

The following is our discussion and analysis of certain significant factors which have affected the Company's financial position and operating results during the periods included in the accompanying condensed consolidated financial statements. This discussion and analysis supplements our *Management's Discussion and Analysis of Financial Condition and Results of Operations* in our 2012 Annual Report.

Critical Accounting Estimates

We are instructed, pursuant to SEC guidance, to evaluate and disclose those accounting estimates that we judge to be critical - those most important to the portrayal of the Company's financial condition and results, and that require our most difficult, subjective and complex judgments. We consider the Allowance for Loan Losses (allowance) as critical given the inherent uncertainty in evaluating the levels of the allowance required to reflect credit losses in the portfolio. We also consider the valuation of investment securities for Other-Than-Temporary-Impairment (OTTI) as critical in the current market environment given the lack of an active and liquid market for a small number of our holdings. There has been no change in our methodology for estimating the allowance or securities valuation, which is fully described within the 2012 Annual Report.

Significant Corporate Events

In August 2013, we completed our tender offer to purchase all shares of the Company s common stock held by persons owning 99 shares or fewer on the close of business as of June 26, 2013. The tender offer was successful in reducing the number of shareholders below 1,200. Accordingly, on September 3, 2013, the Corporation filed for deregistration under the Securities Exchange Act of 1934 (Act). We anticipate this Quarterly Report will be the Corporation s final financial filing under the Act.

Financial Overview

Total assets at September 30, 2013 were $1,953.5 million compared to $1,903.1 million at June 30, 2013 and $1,887.0 million at December 31, 2012. Diluted earnings per common share for the third quarter of 2013 was $3.31 and was 28.3% higher than the same quarter of 2012. Net income in each of these periods was $6.4 million and $5.0 million, respectively.

Total quarterly revenues increased $0.8 million (3.3%) year-over year, and operating expenses were lower. Improvements in credit quality and a slower pace of portfolio growth resulted in a $1.2 million lower provision for loan losses. Despite a general decline in asset yields, net interest income grew due to higher volumes of earning assets and a decline in interest costs.

Compared to June 30, 2013 period end balances, we experienced both investment portfolio and loan growth through September 30, 2013. Concurrently, during this same period, we saw our federal funds sold position decline due to growth in these higher-yielding portfolios. Deposits grew (2.7%), thus loan growth was funded partially by deposits, and the remainder with fed funds sold. Off-balance sheet, both the book value and fair value of Assets under Administration grew from the second quarter, reflecting strong customer growth, and positive stock market performance.

Financial Condition ***(three months ended September 30, 2013 compared to June 30, 2013)***

At September 30, 2013, total assets were $1,953.5 million, up $50.4 million or 2.7% from $1,903.1 million at June 30, 2013.

Cash and cash equivalents (cash, balances with other financial institutions, and federal funds sold) were $100.8 million at September 30, 2013, changing little in this quarter.

Seasonally, municipal securities mature or are called in June, corresponding with the fiscal year-end of the entities. Thus for the third quarter of 2013, we were engaged in rebuilding the portfolio. As a result, our portfolio balance increased. The securities portfolio grew to $292.2 million, a $18.3 million increase from last quarter end.

The securities portfolio consists principally of New York State municipal obligations (70% of total at September 30, 2013) with the remainder mostly in US government sponsored enterprise obligations. Over the past several quarters, our portfolio allocation has shifted away from municipal obligations due to a decrease in available inventory in the market. The total fair value of both the available-for-sale and the held-to-maturity securities portfolios approximates amortized cost. In past quarters, fair value had exceeded amortized cost. However, as a result of rates on longer-maturity treasuries increasing during recent months, the excess of market over book value shrunk. In both portfolios we hold some securities with fair values below their amortized cost and we concluded at September 30, 2013, that there are none considered to be other than temporarily impaired.

During the weak economic cycle that began in late 2008, a handful of municipalities across the country have declared bankruptcy. Most recently, in July 2013, the City of Detroit, Michigan filed for bankruptcy. Much continues to be written about high debt loads and unrecorded pension obligations of many municipalities and other government entities and concern remains about the possibility of additional defaults given the budget pressures, including structural deficits that many municipalities face. Our Company is an investor in state and municipal obligations. We invest only in New York State-based obligors. These investments are used to re-cycle the deposits of our local municipalities, and since we invest in New York State obligations, the money stays local and earns a tax-advantaged return. Prior to purchasing an investment, our Treasury team performs a financial analysis of the obligor or the obligation using such tools as internal models, particularly for non-rated issuances, third-party analyses, and rating agency guidance. In addition we monitor the obligors on a recurring basis. At September 30, 2013, 97% of the municipal portfolio was rated A or better, 2% BBB, and 1% was unrated. In addition, 62% of the obligations were backed by third-party credit support, and 38% were general obligations of the municipalities with unlimited taxing authority. We found no evidence of credit deterioration in the portfolio at September 30, 2013.

In the available-for-sale portfolio, the Company holds four issuances of bank trust-preferred securities with a carrying value totalling less than $1.0 million and an adjusted cost basis of $1.1 million. These securities are backed by debt obligations of banks, with approximately $0.8 million of the securities backed by two of the largest U.S. banks and $0.1 million backed by a pool of banks debt in the form of a collateralized debt obligation (CDO). As a result of market upheaval, a lack of regular trading market in these securities, and bank failures, the fair value of these securities had fallen sharply in 2008 and continued to fall in the first half of 2009. The Company recognized cumulative other-than-temporary impairment (OTTI) amounting to $0.9 million on one CDO over several years. Management sold a portion of this security in 2011 and intends to sell the remainder in whole or in part over time. Although we do not have current plans to sell the other three securities, we would consider so if pricing was advantageous on an after-tax basis.

Portfolio loans, excluding loans held for sale, grew $39.9 million during the third quarter of 2013. But, due to a decrease in loans held for sale, the gross portfolio grew a total of $31.6 million and totaled $1,496.9 million at quarter end compared to $1,465.3 million at June 30, 2013. The increase in portfolio loans continues multiple quarters of net growth. During this quarter, as expected, we saw an increase in residential mortgages given the strength in our pipeline and the home buying season. We also saw strong growth in the indirect automobile portfolio, which accommodated the slower pace of growth in the commercial portfolios. Looking to the fourth quarter, we expect to see continued intense competition from banks, finance companies, and credit unions. With respect to our balance sheet, we expect all loan portfolios to show continued moderate increases.

Please see the section entitled Impaired Loans and Non-Performing Assets for a discussion of loan credit quality.

Total deposits at September 30, 2013, were $1,720.6 million and were up $44.8 million from June 30, 2013. Growth occurred in non-interest bearing demand accounts and low interest-bearing transaction accounts with declines seen in interest-bearing demand and time deposit categories. By customer type, most of the net growth was seen in commercial deposits while consumer and municipal deposits grew to a lesser extent. We continued to experience declines in time deposits, both consumer and business, and expect that to trend throughout 2013 as a result of the generally low interest rate environment in which depositors prefer to keep excess funds liquid, awaiting higher rates and investment returns. Since most of these matured time deposits are redeposited in other deposit types, there was no impact on overall liquidity. However, the total cost of deposits (interest expense) did fall due to lower reinvestment rates available to depositors. Looking to the coming quarter, total deposits are expected to grow modestly and their costs to remain at historically low levels.

Borrowings of $4.2 million reflect future, discounted payments due to the seller of OBS, and were relatively unchanged from the second quarter-end in 2013. As more fully discussed in the 2012 Annual Report, $3.5 million matures and is due in November 2013, with the remainder due over time as a proportion of OBS s gross revenue growth. With the exception of our likely refinancing of this $3.5 million obligation, we do not expect to incur other long-term borrowings or need to access overnight borrowings for the foreseeable future, because the balance of federal funds sold and the strength of deposit inflows should be sufficient to fund the increases we expect in earning assets.

Results of Operations (*three months ended September 30, 2013 compared to the same period in 2012*)

Net interest income grew $0.3 million or 2.1% for the quarter compared to the same quarter in 2012, reflecting the impact of higher earning assets offset by lower net interest margin and spread. Average earning asset balances grew 2.8% or $48.8 million with most of the increase invested in loans. With general interest rates remaining low we have seen both asset yields and liability costs fall year over year as maturing products are replaced at lower interest rates. Given the length of this very low interest rate environment, we are not likely to find opportunities to significantly lower rates on deposit products, yet falling rates on earning assets will continue to negatively impact interest rate spread and margin. Thus we can anticipate the growth rate of net interest income will be less than the growth rate of average earning assets.

On a tax-equivalent basis, compared to the same quarter in 2012, the overall net growth in interest-earning assets and interest-bearing liabilities had a $0.7 million positive impact on net interest income, and the change in rates had a $0.4 million negative impact. Net interest margin was 3.84% for the third quarter of 2013, down from 3.90% for the same quarter in 2012, but up from 3.82% for the June 30, 2013 quarter. Net interest spread fell 4 basis points from 2012. As we discussed in our 2012 Annual Report, we expect full-year net interest income (revenue) to increase year-on-year due to expected balance sheet growth, but we expect little positive impact from rate changes given the current interest rate environment and our anticipation of continued low interest rates for the remainder of the year.

Summary tax-equivalent net interest income information for the three-month periods ended September 30, 2013 and 2012 follows (dollars in thousands).

	2013			2012		
	Average Balance	Interest	Annualized Average Rate	Average Balance	Interest	Annualized Average Rate
Interest-bearing deposits and fed funds sold	$ 63,134	$ 36	0.23 %	$ 86,384	$ 51	0.24 %
Securities	281,094	1,989	2.83	270,640	2,350	3.47
Loans, net	1,455,583	16,882	4.64	1,393,959	16,793	4.82
Total interest-earning assets	1,799,811	$ 18,907	4.20 %	1,750,983	$ 19,194	4.38 %
Non interest-earning assets	110,103			119,242		
Total assets	$ 1,909,914			$ 1,870,225		
Total deposits	$ 1,376,703	$ 1,042	0.30 %	$ 1,370,252	$ 1,397	0.41 %
Total debt	55,707	600	4.31	51,594	727	5.64
Total interest-bearing liabilities	1,432,410	$ 1,642	0.46 %	1,421,846	$ 2,124	0.60 %
Non-interest bearing liabilities	326,633			309,568		
Equity	150,871			138,811		
Total liabilities and equity	$ 1,909,914			$ 1,870,225		
Interest rate spread			3.74 %			3.78 %
Net interest margin		$ 17,265	3.84 %		$ 17,070	3.90 %

The provision for loan losses was $0.3 million for the 2013 third quarter, about 78% lower than the same quarter last year. The provision for both periods was primarily driven by a higher overall loan portfolio balance, coupled with improving asset quality and stable net charge-offs. Details of the allowance for loan losses and net charge-offs for the year to date is presented in Footnote 3 to the Condensed Consolidated Financial Statements.

Total non-interest income for the quarter ended September 30, 2013 increased 5.6% to $9.4 million from $8.9 million in 2012. Service charges on deposit accounts improved with growth from service fees and account activities fees due to our recent pricing changes, and from higher revenues from electronic banking services due to customer transaction activity. We expect a continued year over year increase in the last quarter of 2013 due to our pricing changes.

Trust and investment services income grew to $4.0 million for the third quarter of 2013, a 25.2% increase compared to the same quarter in 2012. Total assets under administration (see table below) have grown year to year due to both organic growth in underlying accounts and higher fair value of assets within the accounts resulting from improved equity and bond markets. In addition, income during this quarter was bolstered by non-recurring estate fees. We anticipate book value growth to continue throughout 2013 with year-over-year growth rates expected to be in the 5% range.

The following table presents information about period-end book value and fair value of assets under administration (dollars in thousands).

Assets Under Administration
as of
(in thousands)

		September 30, 2013	June 30, 2013	March 31, 2013	December 31, 2012	September 30, 2012
Book value	$	1,956,627	1,916,678	1,920,086	1,879,397	1,766,387
Fair value	$	2,305,083	2,211,017	2,231,909	2,115,346	2,029,880

Brokerage and investment subadvisory services income primarily reflects revenues from OBS s operations. These showed a decline year over year mostly due to higher costs of sales to new customers in 2013 relative to 2012. We expect these costs to fall on a relative basis in the coming quarters. During the quarter we sold of a portion of the brokerage operations for a net gain of $0.2 million, impacting quarter-over-quarter revenues. In the coming quarter, excluding the impact of this sale, we should see quarter over quarter revenue growth.

The net gain on sale of mortgages in the third quarter 2013 was much lower than in 2012. The total volume of closed loans was about 21% lower in 2013 (See table below), with a substantial reduction in higher profit refinance loans. Last quarter s increases in the ten-year treasury rates translated into higher mortgage offering rates, the effect of which has been to curtail refinance activity. For the next quarter we will no longer be in the heavy home buying season for our region, and with only a slight decline in long-term rates, we expect closed loan volume to slow considerably, negatively impacting the comparable quarter s mortgage banking revenues.

CNB Mortgage Closed Loans by Type
For the three-month periods ended September 30,
(dollars in thousands)

		2013	2012
Purchase money mortgages	$	49,633	53,313
Refinance mortgages		23,670	39,695
Total mortgage originations	$	73,303	93,008
Percentage of loans retained in portfolio		34.4 %	26.0 %

Loan servicing fee income was higher in 2013 than in 2012 with higher gross revenue offset by higher amortization of servicing rights caused by a higher year-over-year amortizable balance. We expect this historical level of income for the Company to remain as long as we continue to sell loans with servicing retained. The heavy mortgage refinance activity during the past few years had led us to sell more originations to third parties rather than add these low-rate, long-term assets to our portfolio. We service many of these originated loans on behalf of Freddie Mac. The balance of loans serviced for Freddie Mac stood at $575.5 million at September 30, 2013 compared to $554.5 million at December 31, 2012, and $509.6 million at September 30, 2012. We also earn servicing fees from sold commercial loan participations. The total balance of participations sold was $104.8 million at September 30, 2013 compared to $109.4 million at December 31, 2012, and $117.8 million at September 30, 2012.

All other non-interest income grew for the quarter compared to the same quarter in 2012, and can fluctuate from time to time depending upon earnings from our nonmarketable investments, and other real estate owned (ORE) activity. We experienced a revenue decline during this quarter relative to 2012 s from lower gains on sale and lower operating income from ORE due to our sales of several properties over the past twelve months. Concurrently, we experienced lower ORE-related operating expenses. On the other hand we recorded the aforementioned gain from our brokerage activities. In the coming quarters we expect to see continued lower year-over-year revenues from ORE due to property liquidation as well as lower income from our nonmarketable investments.

Total operating expenses fell $0.2 million or 1.4% for the quarter ended September 30, 2013 compared to the same three-month period in 2012. Of this, over 100% occurred in salaries and employee benefits due to lower stock appreciation rights accruals. In each of the other categories we saw various dollar fluctuations mainly due to seasonal activities. Overall, for the remainder of 2013 we expect operating expenses to increase consistent with our business growth goals. However, we are engaged in on-going evaluations of operating expenses and operational processes to search for and eliminate costs providing little to no value to our customers, community or shareholders.

The quarterly effective tax rate was 31.8% in 2013 and 30.2% in 2012. The change in the effective rate is attributable to the ratio of tax-exempt income to total income. It is likely this rate will settle in the 31% - 35% range through 2013 due to lower tax-exempt income from declining interest rates on tax-exempt bonds.

Financial Condition and Results of Operations (nine months ended September 30, 2013)

At September 30, 2013, total assets of the Company were up $66.5 million or 3.5% from December 31, 2012. Cash and equivalents (cash, balances with other financial institutions, and federal funds sold) increased as a result of net income and net deposit growth in excess of net changes in the loan and securities portfolios. Securities grew $13.6 million as we worked to rebuild the portfolio following heavy call and maturities activities. Loans grew $48.3 million or 3.4%. Increases were seen in all categories with the largest increase in indirect automobile loans. Total deposits at September 30, 2013, were up $57.8 million or 3.5% with growth coming from all customer types.

Compared to the same period in 2012, net interest income was up $0.8 million or 1.6% in the first nine months of 2013. Net interest margin was positively impacted by a net increase in balances, but this was offset by the negative impact of falling rates in interest-earning assets. Summary tax-equivalent net interest income information for the nine-month periods ended September 30, 2013 and 2012 follows:

	2013			2012		
	Average Balance	**Interest**	**Annualized Average Rate**	**Average Balance**	**Interest**	**Annualized Average Rate**
Interest-bearing deposits and fed funds sold	$ 67,434	$ 115	0.51 %	$ 71,316	$ 124	0.53 %
Securities	281,759	6,400	6.82	274,350	7,654	8.37
Loans, net	1,436,858	49,806	4.62	1,346,330	49,586	4.91
Total interest-earning assets	1,786,051	$ 56,321	4.20 %	1,691,996	$ 57,364	4.52 %
Non interest earning assets	112,187			116,474		
Total assets	$ 1,898,238			$ 1,808,470		
Total deposits	$ 1,385,978	$ 3,312	0.32 %	$ 1,344,405	$ 4,356	0.43 %
Total debt	55,995	1,803	4.29	51,828	2,177	5.60
Total interest-bearing liabilities	1,441,973	$ 5,115	0.47 %	1,396,233	$ 6,533	0.62 %
	306,967			275,514		

Non-interest bearing liabilities						
Equity	149,298			136,723		
Total liabilities and equity	$ 1,898,238			$ 1,808,470		
Interest rate spread			3.73 %			3.90 %
Net interest margin		$ 51,206	3.82 %		$ 50,831	4.01 %

The provision for loan losses was $2.0 million for the first nine months of 2013, which was $1.8 million lower than the first nine months of 2012. The reasons are discussed in the three-month section above.

Total non-interest income for the nine months ended September 30, 2013, increased 3.2% to $26.7 million from $25.9 million in 2012. Similar factors impacting the three-month period impacted the nine month period results.

Mortgage closings fell 17.2% for the nine month period ended September 30, 2013 compared to the same period in 2012 due to a reduction in both purchase money mortgages and in refinance loans. For purchase loans the first nine months of 2012 saw higher marketplace home sales due to temperate weather conditions. In 2013, our region had more snow and cold days than the prior year, resulting in lower home sales. Refinance volume slowed in 2013 relative to 2012 due to a reduction in borrowers opportunities to refinance. Two factors caused this: (1) interest rates rose in the latter part of the second quarter, and (2) most of our borrowers who had the opportunity to refinance their loans have already done so. Despite the overall decrease in volume the net gain on the sale of mortgage loans increased year-over-year due to changes in our pricing practices.

A summary of originations follows (dollars in thousands):

CNB Mortgage Closed Loans by Type
For the nine-month period ended September 30,
(dollars in thousands)

		2013	2012
Purchase money mortgages	$	118,345	128,561
Refinance mortgages		95,564	129,812
Total mortgage originations	$	213,909	258,373
Percentage of loans retained in portfolio		23.6 %	25.0 %

Operating expenses decreased 1.6% or $0.8 million for the nine months ended September 30, 2013, over the same period in 2012. The reasons are the same as those discussed in the three-month section above.

The Company's effective tax rate for the year to date in 2013 increased to 33.0% from 30.2% in 2012. The change in the effective rate is attributable to the ratio of tax-exempt income to total income.

Liquidity

There has been no material change from December 31, 2012 in our available sources of wholesale liquidity from either the Federal Home Loan Bank of New York (FHLB) or the Federal Reserve Bank of New York. At September 30, 2013 we had no overnight or short-term borrowings outstanding, and during the quarter we did not utilize any overnight or short-term borrowings. Given our high level of federal funds sold and continued deposit inflows, we foresee no borrowings in the coming quarter; though we might consider raising medium- or long-term borrowings for interest rate risk management purposes or for refinancing debt due to the seller of OBS.

For the nine months ended September 30, 2013, cash flows from all activities provided $9.7 million in net cash and cash equivalents versus using $5.7 million for the same period in 2012. In both years the principal source of cash inflows was deposits and the principal use was lending activities.

Net cash provided by operating activities was $42.9 million in 2013 versus $15.9 million in 2012. Both the largest source and use of operating cash during each year were loans held for sale with activity slightly lower in 2013. Excluding the effect of loans held for sale, operating activities provided $28.4 million and $21.3 million cash for each of the nine-month periods in 2013 and 2012, respectively.

During the first three quarters of 2013, investing activities used $83.5 million in cash and equivalents compared to using $141.9 million during the same period of 2012. Securities activities used $18.2 million cash in 2013, while in 2012 these activities provided $0.6 million. Loan activities used significant amounts of cash in 2012 ($143.7 million) while in 2013 loan activities used considerably less ($66.4 million). For the remainder of the year we expect both securities and loan activities to utilize cash.

Cash provided by financing activities was $50.3 million in the first nine months of 2013 versus $120.4 million in the same period of 2012. The main contributor in both periods was deposit activity.

For the remainder of 2013, cash for growth is expected to come primarily from operating activities and customer deposits. Customer deposit growth is expected to come from all depositor types.

Contractual obligations and commitments

Less material, but a part of our ongoing operations, and expected to be funded through normal operations, are liquidity uses such as lease obligations, long-term debt repayments, and other funding commitments. There has been no material change from the information disclosed in our 2012 Annual Report.

Also, as discussed more fully in our 2012 Annual Report, in the normal course of business, various commitments and contingent liabilities are outstanding. Because many commitments and almost all letters of credit expire without being funded in whole or in part, the notional amounts are not estimates of future cash flows. The following table presents the notional amount of the Company's significant commitments. Most of these commitments are not included in the Company's consolidated balance sheet (in thousands).

		September 30, 2013 Notional Amount	December 31, 2012 Notional Amount
Commitments to extend credit:			
Commercial lines of credit	$	146,187	134,054
Commercial real estate and construction	$	49,607	36,257
Residential real estate at fixed rates	$	7,469	5,261
Home equity lines of credit	$	234,901	210,236
Unsecured personal lines of credit	$	17,341	23,492
Standby and commercial letters of credit	$	14,311	13,100
Commitments to sell real estate loans	$	6,599	21,113

Capital Resources

Regulatory Capital:

Under the regulatory framework for prompt corrective action, as of September 30, 2013, the Company and Bank are categorized as "well-capitalized." This is unchanged from June 30, 2013, and management anticipates no change in this classification for the foreseeable future.

On July 2, 2013, the Board of Governors of the Federal Reserve System voted in favor of final rules implementing Basel III. These final rules differ from those proposed by the banking regulators in June 2012, and, we believe, represent a significant improvement. The rules are quite complicated and will increase required regulatory capital. However, based upon our most recent analysis we expect to meet all well-capitalized requirements upon their effective dates beginning on January 1, 2015. A summary follows of the most significant changes from existing rules:

.

Minimum regulatory capital ratio requirements

o

A newly-introduced common equity tier 1 ratio of 4.5% (CET1),

o

A newly-introduced capital conservation buffer of 2.5%,

o

Tier 1 capital ratio of 6% (increased from the current requirement of 4%),

o

Total capital ratio of 8% of risk-weighted assets (unchanged from the current requirement)

o

Tier 1 leverage ratio of 4%

o

Trust preferred securities will still be included in Tier 1 capital, and

o

TARP equity (of which the Company has none) would be grandfathered permanently.

While the rule will be effective as of January 1, 2015 for our Company, full compliance with most aspects of the rule would not be required until January 1, 2019.

?

Capital conservation buffer: To avoid restrictions on capital distributions (e.g. dividends) and discretionary bonus payments to executive officers, a bank will be required to hold an additional buffer of common equity Tier 1 capital in an amount above 2.5% of total risk-weighted assets in addition to the minimum common equity Tier 1, Tier 1, and total capital risk-based capital ratios.

?

Capital is Redefined: What is included in Tier 1 capital will change:

o

The final rule permits smaller banks (ours included) a one time opportunity to opt out of including certain unrealized gains and losses in Accumulated Other Comprehensive Income from CET1.

o

Deferred tax assets (DTAs) arising from operating losses and tax credit carry forwards will be deducted;

o

Mortgage servicing assets (MSAs), DTAs arising from temporary differences that an organization could not realize through net operating loss carry backs, and the common stock of unconsolidated financial institutions each would be individually limited to 10% of common equity Tier 1 capital, and, in the aggregate, to 15% of common equity Tier 1 capital;

o

The amount of minority interests permitted in capital will be more limited.

?

Asset risk-weighting:

o

Certain commercial real estate loans, principally non-permanent financing for acquisition, development, and construction loans, are assigned a 150% risk weight.

o

Nonaccrual loans and loans greater than 90 days past due are assigned a 150% risk weight unless they are residential loans, which are assigned a 100% risk weight

o

Unused portions of a commitment with an original maturity of one year or less that is not unconditionally cancellable is assigned a 20% risk weighting, up from 0%.

o

The risk weighting of non-deducted MSAs, DTAs, and certain investments in unconsolidated subsidiaries will carry a 250% risk weight.

Common Stock Tender Offer:

On July 1, 2013, we commenced an offering to purchase all of the common stock held by persons owning 99 or fewer shares as of the close of business on June 26, 2013. Shareholders who owned more than 99 shares as of this record date were not eligible to participate in this offer.

Our principal purpose in making the offer was to reduce the number of our record shareholders to fewer than 1,200 which is the number of shareholders required to deregister with the Securities and Exchange Commission. The tender was successful. Thus, as planned, the Board of Directors instructed management to deregister the Company s common stock with the Securities and Exchange Commission (SEC). As a result, the Company will no longer be obligated to file periodic reports and proxy statements with the SEC. Canandaigua National Corporation and its subsidiaries will continue to be regulated by the Federal and State banking authorities. Our Board has determined that the costs for registration compliance, which we estimate at $250,000 per year are overly burdensome on the Company and not beneficial to our shareholders or customers. By reducing the number of our shareholders and deregistering with the SEC, the Company will substantially reduce its accounting, legal, and other costs associated with SEC reporting and audit requirements. In addition, this will allow the Company s management to focus on business opportunities for the Company, as well as the needs of its shareholders and customers.

The Company offered to purchase these odd-lot shares for a purchase price of $161.00 per share. This price represented a $29.00 or 22.0% premium over the last share sales price of our common stock ($132.00) as reported on the OTC Bulletin Board on the last trade prior to the close of business on June 26, 2013, the record date. This price also represented an $18.74 or 13.2% premium over the sealed-bid auction price of our common stock ($142.26) at the last shareholder auction of our common stock on June 20, 2013. In addition, Canandaigua National offered a $50.00 bonus, per eligible shareholder, for all properly executed transmittal letters and stock certificates or other documents received prior to the tender offer expiration date.

The immediate impact of the transaction was not material to the Company s financial condition or results of operations. A total of 9,806 shares were tendered and purchased into treasury at a cost of $1.6 million. Future operating results will benefit from the approximate $0.3 million in annual cost savings.

Credit-Related Information

Allowance for Loan Losses , Net Charge-offs, and Non-performing Loans

Credit-related statistics follow (dollars in thousands):

	Nine-Months Ended September 30, 2013	**Six-Months Ended June 30, 2013**	**Three-Months Ended March 31, 2013**	**Year Ended December 31, 2012**	**Nine-Months Ended September 30, 2012**
Allowance as a percentage of total period end loans	1.18 %	1.21 %	1.21 %	1.19 %	1.27 %
	114.24 %	117.62 %	106.72 %	93.65 %	91.27 %

Allowance as a percentage of non-performing loans					
Net charge-offs to average loans (annualized)	0.15 %	0.17 %	0.17 %	0.23 %	0.17 %
Non-performing loans to total period-end loans	1.03 %	1.02 %	1.13 %	1.28 %	1.39 %
Non-performing assets to total period-end loans and other real estate	1.23 %	1.22 %	1.35 %	1.52 %	1.63 %

The provision for loan losses for the nine-month period ended September 30, 2013 was lower than the same period in 2012, due to substantially lower net loan growth. The balance in the allowance for loan losses increased year over year and was impacted by portfolio growth and changes in quantitative factors from the eight-quarter net loss migration factor applied to the residential mortgage and the consumer indirect portfolio. Conversely the allowance associated with commercial mortgages was reduced due to lower quantitative factors. As discussed more fully in the 2012 Annual Report, we determine the amount necessary in the allowance for loan losses based upon a number of factors. Based on our current assessment of the loan portfolio, we believe the amount of the allowance for loan losses at September 30, 2013 is appropriate at $17.7 million. However, should non-performing and non-accrual loans increase, or should we experience declines in customers credit quality measured through loan impairment or internal loan classifications, we may need to establish a higher allowance for loan losses as a percentage of total loans, which would necessitate an increase to the provision for loan losses.

Net charge-offs during the first nine months of 2013 were slightly lower than the same period of 2012, and remain at historically low levels. Net charge-offs to average loans for the first nine months in 2013 and 2012 were 15 basis points and were well below 2012 s full year figure of 23 basis points. In the coming quarter, we anticipate annualized net charge-offs in the 20-25 basis points range if we experience no significant portfolio deterioration.

Total non-performing loans were $15.5 million at September 30, 2013, down from $18.5 million at December 31, 2012, and down from $19.2 million at September 30, 2012. The general decline in non-performing loans since a year ago came mainly in commercial-related loans.

Other real-estate owned has fallen $0.7 million since December 31, 2012 to $2.9 million at September 30, 2013, due to property liquidations, and is also lower than the balance at September 30, 2012. Given the current economic climate, we can expect additional foreclosures in the coming periods, as well as liquidations of existing real-estate owned.

Impaired Loans

Total impaired loans have exhibited a positive trend during the past twelve months, having declined to $14.5 million at September 30, 2013 from $18.8 million at September 30, 2012 due to improvements in commercial and industrial loans. Since year end 2012, total impaired loans decreased $3.2 million mostly due to improvements in commercial real-estate loans.

At September 30, 2013 we identified 80 loans totaling $14.5 million that were considered impaired. Of these, 35, with an aggregate balance outstanding of $9.3 million were analyzed on a loan-by-loan basis, 6 of which, with an aggregate balance of $1.4 million, had specific reserves calculated amounting to $0.5 million. The remaining 45 loans totaling $5.2 million were evaluated for impairment on a collective basis.

Regional economic conditions continue to improve slowly. Despite this, as in all economic cycles, we can anticipate more loans, though we know of no material ones, which will become impaired in the coming quarters. Concurrently, we expect some loans, which are currently impaired, to improve over this same period, and we will likely see some impaired loans decline to loss status. Accordingly we do not expect the level of impaired loans to substantially change throughout the rest of 2013.

Impact of Financial Regulation Legislation

Management continues to navigate the myriad regulations and pronouncements resulting from the July 21, 2010 enactment of the *Dodd-Frank Wall Street Reform and Consumer Protection Act* (Financial Reform Act). Most of the major regulations have yet to be adopted, but planning and managing their implementation requires considerable forethought. Our employees are working tirelessly to develop cost-effective solutions. The provisions expected to most significantly impact us are more fully described in the 2012 Annual Report, except for the new capital rules, which are discussed in the Capital Resources section of this document.

Recent Accounting Standards to be implemented in Future Periods

During the first three quarters of 2013, the Financial Accounting Standards Board issued a number of Accounting Standards Updates (ASU s) none of which are expected to impact the Company upon their effective dates.

Item 3. Quantitative and Qualitative Disclosures about Market Risk

Interest Rate Sensitivity and Asset / Liability Management Review

As set forth in our 2012 Annual Report, we expected market interest rates for 2013 would remain fairly steady for most of the year at current historic lows with no measurable increase expected until 2015. Although rates on longer term treasuries ticked up in the latter part of June 2013, and have settled at rates higher than we saw earlier in the year, we have no reason to change our expectation of comparatively low market interest rates for the foreseeable future.

We measure net interest income at-risk by estimating the changes in net interest income resulting from instantaneous and sustained parallel shifts in interest rates of plus- or minus- 200 basis points over a twelve-month period. This provides a basis or benchmark for our Asset/Liability Committee to manage our interest rate risk profile. Presented below is a table showing our interest rate risk profile at September 30, 2013 and December 31, 2012.

Changes in Interest Rates (basis points)	**Estimated Percentage Change in Future Net Interest Income**	
	2013	**2012**
200	(3)%	- %
100	(3)	(2)
No change	-	-
-100	(1)	-
-200	(2)	-

Our model suggests our interest rate risk has increased slightly from year end for both upward and downward changes in rates. Our exposure to increasing rates grew, because longer-term earning assets will be slower to reprice in amount and magnitude than shorter-term deposit liabilities, and interest rates on these assets have declined due to currently the low interest rate cycle. Our exposure to downward rate movements has increased, because already very low cost deposits have little room to decline further, while asset yields, particularly (short-term maturity) securities and indirect loans may fall further.

Item 4. Controls and Procedures

The Company's Chief Executive Officer and Chief Financial Officer have concluded, based on their evaluation as of September 30, 2013, that the Company's disclosure controls and procedures (as defined in Securities Exchange Act Rules 13a-14(c) and 15d-14(c)) are effective to ensure that information required to be disclosed in the reports that the Company files or submits under the Securities Exchange Act of 1934 is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission's rules and forms.

Also, there have been no changes in the Company's internal control over financial reporting identified in connection with that evaluation, or that occurred during the third quarter of 2013, that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

PART II -- OTHER INFORMATION

CANANDAIGUA NATIONAL CORPORATION AND SUBSIDIARIES

Item 1. Legal proceedings

The Company and its subsidiaries are, from time to time, parties to or otherwise involved in legal proceedings arising in the normal course of business as either plaintiffs or defendants. Management does not believe that there is any pending or threatened proceeding against the Company or its subsidiaries which, if determined adversely, would have a material effect on the Company's business, results of operations, or financial condition.

Item 1A. Risk Factors

There has been no material change to the risk factors disclosed in the 2012 Annual Report.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

From time to time, shares of our common stock are purchased by The Canandaigua National Bank and Trust Company (Bank) for the Arthur S. Hamlin Award, the Canandaigua National Corporation Employee Stock Ownership Plan (ESOP) and the Canandaigua National Corporation for treasury. The Bank and the ESOP are considered an affiliated purchaser of the Company under Item 703 of Regulation S-K. Shares repurchased by Company are not part of a publicly announced plan or program with the exception of the odd-lot tender offer. Except for shares purchased in the odd-lot tender offer, which has a specified price, the Bank, ESOP, and Company purchase prices per share are determined based on the most recent price established at the sealed-bid auction immediately preceding the purchase. Purchases occur on an ad-hoc basis when shares become available in the marketplace and the Company is interested in purchasing these shares for the corporate purposes discussed above. Sales of shares to the Bank and the ESOP occur when corporate needs require the use of shares and there are none available in the market at the time.

The Company s odd-lot tender offer to holders of 99 or fewer shares as of June 26, 2013, expired on August 26, 2013. A total of 9,806 shares were purchased at a price of $161.00 per share, plus a $50.00 per-holder bonus, which are included in the table below.

The following table sets forth, for the monthly periods in 2013, a summary of these transactions.

Date	Total Shares Purchased (Sold) (#)		Average Price Per Share ($)	Purpose
March	990	$	141.61	Treasury
May	(392)	$	142.25	Compensation
June	14,401	$	144.77	Treasury
June	(62)	$	144.10	Compensation
August	9,806	$	162.61	Tender Offer
Total purchases	25,197			
Total sales	(454)			

Item 3. Defaults Upon Senior Securities

None

Item 4. Mine Safety Disclosures

Not Applicable

Item 5. Other information

<u>Unresolved Staff Comments</u>

None

Common Stock Trades

While the Company's stock is not actively traded, from time to time, shareholders sell shares to interested persons in sealed-bid public auctions administered by the Bank s Trust Department at the request of selling shareholders. Our stock is not listed with a national securities exchange. Due to the limited number of transactions, the quarterly high, low and weighted average sale prices may not be indicative of the actual market value of the Company's common stock. The following table sets forth a summary of transactions by selling shareholders and bidders in the Company's common stock during each period for transactions that were administered by the Bank s Trust Department:

Date of Transaction	Number of Shares Sold	Average Price Per Share	Highest Accepted Bid	Lowest Accepted Bid
January 24, 2013	2,219	$ 141.61	$ 165.00	$ 135.00
March 28, 2013	2,690	$ 142.25	$ 175.00	$ 135.01
May 26, 2013	3,336	$ 146.06	$ 155.00	$ 137.50
June 20, 2013	2,605	$ 142.26	$ 150.50	$ 138.00
October 17, 2013	2,646	$ 147.12	$ 152.00	$ 145.00

Although the Company s common stock is not listed with a national securities exchange, it trades sporadically on the Over-the-Counter Bulletin Board System under the symbol CNND or CNND.OB. The following table sets forth a summary of information about these trades. Due to the limited number of transactions, the quarterly high, low and weighted average bid/ask prices may not be indicative of the actual market value of the Company's stock.

The OTC Bulletin Board® (OTCBB) is a regulated quotation service that displays real-time quotes, last-sale prices, and volume information in over-the-counter (OTC) equity securities. An OTC equity security generally is any equity that is not listed or traded on NASDAQ® or a national securities exchange. The OTCBB is a quotation medium for subscribing members, not an issuer listing service, and should not be confused with The NASDAQ Stock Market℠. Investors must contact a broker/dealer to trade OTCBB securities. Investors do not have direct access to the OTCBB service. The Securities and Exchange Commission's Order-Handling Rules which apply to NASDAQ-listed securities do not apply to OTCBB securities. The OTCBB market quotations set forth below reflect inter-dealer prices, without retail mark-up, mark-down or commission and may not necessarily represent actual transactions.

Period	**Number of Shares Transacted**	**Quarterly Average Sales Price**	**Quarterly High Sales Price**	**Quarterly Low Sales Price**
1st Quarter, 2013	1,526	$ 128.56	$ 136.00	$ 122.25
2nd Quarter, 2013	1,207	$ 131.17	$ 135.00	$ 122.25
3rd Quarter, 2013	3,755	$ 140.79	$ 150.00	$ 125.00

Item 6. Exhibits

	Exhibit	**Where exhibit may be found (incorporated by reference to the extent not filed herewith):**
(2.1)	Stock purchase Agreement, dated September 6, 2007, by and among Canandaigua National Corporation, Genesee Valley Trust Company	Filed as Exhibit 2.1 to Form 10-Q for the period ended June 30, 2010*
(2.2)	Asset Purchase Agreement, dated December 22, 2008, by and among The Canandaigua National Bank and Trust Company, Greentree Capital Management, LLC, Peter J Gaess, and T.C. Lewis	Filed as Exhibit 2.2 to Form 10-Q for the period ended June 30, 2010*
(2.3)	Amendment to Asset Purchase Agreement, dated December 31, 2008, by and among The Canandaigua National Bank and Trust Company, Greentree Capital Management, LLC, Peter J. Gaess, and T.C. Lewis	Filed as Exhibit 2.3 to Form 10-Q for the period ended June 30, 2010*
(3.i)	Certificate of Incorporation of the Registrant, as amended	Filed as Exhibit 3.i to Form 10-Q for the period ended March 31, 2011
(3.ii.)	By-laws of the Registrant, as amended	Filed as Exhibit 3.ii to Form 10-Q for the period ended March 31, 2011
(11)	Calculations of Basic Earnings Per Share and Diluted Earnings Per Share	Note 7 to the Condensed Consolidated Financial Statements
(31.1)	Certification of Chief Executive Officer under Section 302 of the Sarbanes-Oxley Act of 2002	Filed Herewith
(31.2)	Certification of Chief Financial Officer under Section 302 of the Sarbanes-Oxley Act of 2002	Filed Herewith
(32)	Certification of Chief Executive Officer and Chief Financial Officer under 18 U.S.C. Section 1350 pursuant	Furnished Herewith

to Section 906 of the Sarbanes-Oxley Act of 2002

(101)** The following materials from the Company s Quarterly Report on Form 10-Q for the quarter ended September 30, 2013, formatted in XBRL (eXtensible Business Reporting Language): (i) Condensed Consolidated Statements of Condition as of September 30, 2013 and December 31, 2012; (ii) Condensed Consolidated Statements of Income for the three- and nine- months ended September 30, 2013 and 2012; (iii) Condensed Consolidated Statements of Cash Flows for the nine-months ended September 30, 2013 and 2012; (iv) Condensed Consolidated Statements of Comprehensive Income for the three- and nine-months ended September 30, 2013 and 2012; (v) Condensed Consolidated Statements of Changes in Shareholders Equity for the nine-months ended September 30, 2013 and 2012; and, (vi) Notes to Unaudited Condensed Consolidated Financial Statements.

Notes

*Certain portions of these agreements have been granted confidential treatment by the Securities and Exchange Commission. Confidential information is omitted from these agreements and filed separately with the Commission

** Pursuant to Rule 406T of Regulation S-T, the Interactive Data Files on Exhibit 101 hereto are deemed not filed or part of a registration statement or prospectus for purposes of Sections 11 and 12 of the Securities Act of 1933, as amended, are deemed not filed for purposes of Section 18 of the Securities Exchange Act of 1934, as amended, and otherwise are not subject to liability under those sections

SIGNATURES
CANANDAIGUA NATIONAL CORPORATION AND SUBSIDIARIES

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

CANANDAIGUA NATIONAL CORPORATION
(Registrant)

November 8, 2013	/s/ Frank H. Hamlin, III
Date	Frank H. Hamlin, III
	President and Chief Executive Officer
November 8, 2013	/s/ Lawrence A. Heilbronner
Date	Lawrence A. Heilbronner
	Executive Vice President and
	Chief Financial Officer