ARROW FINANCIAL CORP
Form 10-Q
November 07, 2014

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-Q

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

For the Quarterly Period Ended September 30, 2014

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

Commission File Number: 0-12507

ARROW FINANCIAL CORPORATION

(Exact name of registrant as specified in its charter)

New York	22-2448962
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

250 GLEN STREET, GLENS FALLS, NEW YORK 12801
(Address of principal executive offices) (Zip Code)
Registrant’s telephone number, including area code: (518) 745-1000

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

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of “large accelerated filer,” “accelerated filer” and “smaller reporting company” in Rule 12b-2 of the Exchange Act.
Large accelerated filer Accelerated filer x 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 x No

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

Class	Outstanding as of October 31, 2014
Common Stock, par value $1.00 per share	12,607,102

ARROW FINANCIAL CORPORATION
FORM 10-Q
TABLE OF CONTENTS

PART I - Financial Information

ARROW FINANCIAL CORPORATION AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
(In Thousands, Except Share and Per Share Amounts)
(Unaudited)

	September 30, 2014	December 31, 2013	September 30, 2013
ASSETS			
Cash and Due From Banks	$46,771	$37,275	$47,513
Interest-Bearing Deposits at Banks	17,893	12,705	24,539
Investment Securities:			
Available-for-Sale	374,335	457,606	486,888
Held-to-Maturity (Approximate Fair Value of $302,567 at September 30, 2014; $302,305 at December 31, 2013; and $278,390 at September 30, 2013)	296,522	299,261	273,626
Federal Home Loan Bank and Federal Reserve Bank Stock	3,001	6,281	3,896
Loans	1,381,440	1,266,472	1,243,370
Allowance for Loan Losses	(15,293)	(14,434)	(14,584)
Net Loans	1,366,147	1,252,038	1,228,786
Premises and Equipment, Net	28,206	29,154	29,386
Goodwill	22,003	22,003	22,003
Other Intangible Assets, Net	3,744	4,140	4,270
Other Assets	50,123	43,235	35,951
Total Assets	$2,208,745	$2,163,698	$2,156,858
LIABILITIES			
Noninterest-Bearing Deposits	$296,384	$278,958	$280,326
NOW Accounts	887,865	817,366	839,213
Savings Deposits	524,906	498,779	516,010
Time Deposits of $100,000 or More	69,797	78,928	83,702
Other Time Deposits	156,404	168,299	176,124
Total Deposits	1,935,356	1,842,330	1,895,375
Federal Funds Purchased and Securities Sold Under Agreements to Repurchase	19,654	11,777	15,977
Federal Home Loan Bank Overnight Advances	—	53,000	—
Federal Home Loan Bank Term Advances	10,000	20,000	20,000
Junior Subordinated Obligations Issued to Unconsolidated Subsidiary Trusts	20,000	20,000	20,000
Other Liabilities	23,646	24,437	22,823
Total Liabilities	2,008,656	1,971,544	1,974,175
STOCKHOLDERS' EQUITY			
Preferred Stock, $5 Par Value; 1,000,000 Shares Authorized	—	—	—
Common Stock, $1 Par Value; 20,000,000 Shares Authorized (17,079,376 Shares Issued at September 30, 2014, and 16,744,486 Shares Issued at December 31, 2013 and September 30, 2013)	17,079	16,744	16,744
Additional Paid-in Capital	239,247	229,290	228,622
Retained Earnings	26,240	27,457	24,755

Unallocated ESOP Shares (71,740 Shares at September 30, 2014, and 87,641 Shares at December 31, 2013 and September 30, 2013)	(1,450)	(1,800)	(1,800)
Accumulated Other Comprehensive Loss	(4,284)	(4,373)	(10,293)
Treasury Stock, at Cost (4,402,932 Shares at September 30, 2014; 4,296,723 Shares at December 31, 2013; and 4,327,741 Shares at September 30, 2013)	(76,743)	(75,164)	(75,345)
Total Stockholders' Equity	200,089	192,154	182,683
Total Liabilities and Stockholders' Equity	$2,208,745	$2,163,698	$2,156,858

See Notes to Unaudited Interim Consolidated Financial Statements.

ARROW FINANCIAL CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF INCOME
(In Thousands, Except Per Share Amounts)
(Unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2014	2013	2014	2013
INTEREST AND DIVIDEND INCOME				
Interest and Fees on Loans	$13,460	$12,846	$39,436	$38,279
Interest on Deposits at Banks	12	11	41	57
Interest and Dividends on Investment Securities:				
Fully Taxable	1,919	1,556	5,968	4,991
Exempt from Federal Taxes	1,369	1,461	4,276	4,352
Total Interest and Dividend Income	16,760	15,874	49,721	47,679
INTEREST EXPENSE				
NOW Accounts	386	423	1,345	1,987
Savings Deposits	218	240	663	785
Time Deposits of $100,000 or More	195	297	626	921
Other Time Deposits	335	470	1,085	1,529
Federal Funds Purchased and Securities Sold Under Agreements to Repurchase	6	5	15	14
Federal Home Loan Bank Advances	115	167	387	539
Junior Subordinated Obligations Issued to Unconsolidated Subsidiary Trusts	144	145	427	434
Total Interest Expense	1,399	1,747	4,548	6,209
NET INTEREST INCOME	15,361	14,127	45,173	41,470
Provision for Loan Losses	444	—	1,407	200
NET INTEREST INCOME AFTER PROVISION FOR LOAN LOSSES	14,917	14,127	43,766	41,270
NONINTEREST INCOME				
Income From Fiduciary Activities	1,861	1,688	5,640	5,020
Fees for Other Services to Customers	2,353	2,403	6,924	7,056
Insurance Commissions	2,451	2,404	7,188	6,608
Net Gain on Securities Transactions	137	—	110	540
Net Gain on Sales of Loans	213	166	502	1,271
Other Operating Income	336	278	892	689
Total Noninterest Income	7,351	6,939	21,256	21,184
NONINTEREST EXPENSE				
Salaries and Employee Benefits	7,781	7,856	23,303	23,114
Occupancy Expenses, Net	2,266	1,882	6,923	6,277
FDIC Assessments	273	269	828	800
Other Operating Expense	3,206	3,126	9,675	9,627
Total Noninterest Expense	13,526	13,133	40,729	39,818
INCOME BEFORE PROVISION FOR INCOME TAXES	8,742	7,933	24,293	22,636
Provision for Income Taxes	2,595	2,310	7,302	6,625
NET INCOME	$6,147	$5,623	$16,991	$16,011
Average Shares Outstanding:				
Basic	12,606	12,555	12,601	12,527

Diluted	12,621	12,591	12,613	12,548
Per Common Share:				
Basic Earnings	$0.49	$0.45	$1.35	$1.28
Diluted Earnings	0.49	0.45	1.35	1.28

Share and Per Share Amounts have been restated for the September 2014 2% stock dividend.
See Notes to Unaudited Interim Consolidated Financial Statements.

4

ARROW FINANCIAL CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
(In Thousands)
(Unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2014	2013	2014	2013
Net Income	$6,147	$5,623	$16,991	$16,011
Other Comprehensive Income, Net of Tax:				
Net Unrealized Securities Holding (Losses) Gains Arising During the Period	(770)	1,210	(15)	(2,213)
Reclassification Adjustment for Securities Losses (Gains) Included in Net Income	(82)	—	(66)	(326)
Amortization of Net Retirement Plan Actuarial Loss	70	235	209	707
(Accretion) Amortization of Net Retirement Plan Prior Service Credit	(13)	1	(39)	1
Other Comprehensive Income (Loss)	(795)	1,446	89	(1,831)
Comprehensive Income	$5,352	$7,069	$17,080	$14,180

See Notes to Unaudited Interim Consolidated Financial Statements.

5

ARROW FINANCIAL CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY
(In Thousands, Except Share and Per Share Amounts)
(Unaudited)

	Common Stock	Additional Paid-In Capital	Retained Earnings	Unallo-cated ESOP Shares	Accumu-lated Other Com-prehensive Loss	Treasury Stock	Total
Balance at December 31, 2013	$16,744	$229,290	$27,457	$(1,800)	$(4,373)	$(75,164)	$192,154
Net Income	—	—	16,991	—	—	—	16,991
Other Comprehensive (Loss) Income	—	—	—	—	89	—	89
2% Stock Dividend (334,890 Shares)	335	8,617	(8,952)	—	—	—	—
Cash Dividends Paid, $.74 per Share [1]	—	—	(9,256)	—	—	—	(9,256)
Stock Options Exercised, Net (45,194 Shares)	—	619	—	—	—	444	1,063
Shares Issued Under the Directors' Stock Plan (3,872 Shares)	—	63	—	—	—	38	101
Shares Issued Under the Employee Stock Purchase Plan (14,172 Shares)	—	212	—	—	—	139	351
Stock-Based Compensation Expense	—	270	—	—	—	—	270
Tax Benefit for Disposition of Stock Options	—	22	—	—	—	—	22
Purchase of Treasury Stock (86,710 Shares)	—	—	—	—	—	(2,235)	(2,235)
Acquisition of Subsidiaries (3,595 Shares)	—	56	—	—	—	35	91
Allocation of ESOP Stock (17,308 Shares)	—	98	—	350	—	—	448
Balance at September 30, 2014	$17,079	$239,247	$26,240	$(1,450)	$(4,284)	$(76,743)	$200,089
Balance at December 31, 2012	$16,416	$218,650	$26,251	$(2,150)	$(8,462)	$(74,880)	$175,825
Net Income	—	—	16,011	—	—	—	16,011
Other Comprehensive (Loss) Income	—	—	—	—	(1,831)	—	(1,831)
2% Stock Dividend (328,323 Shares)	328	8,152	(8,480)	—	—	—	—
Cash Dividends Paid, $.72 per Share [1]	—	—	(9,027)	—	—	—	(9,027)
Stock Options Exercised, Net (44,849 Shares)	—	524	—	—	—	441	965
Shares Issued Under the Directors' Stock	—	64	—	—	—	42	106

Plan (4,255 Shares)							
Shares Issued Under the Employee Stock Purchase Plan (14,668 Shares)	—	204	—	—	—	144	348
Shares Issued for Dividend Reinvestment Plans (33,539 Shares)	—	525	—	—	—	326	851
Stock-Based Compensation Expense	—	281	—	—	—	—	281
Tax Benefit for Disposition of Stock Options	—	17	—	—	—	—	17
Purchase of Treasury Stock (61,075 Shares)	—	—	—	—	—	(1,512)	(1,512)
Acquisition of Subsidiaries (9,503 Shares)	—	139	—	—	—	94	233
Allocation of ESOP Stock (16,969 Shares)	—	66	—	350	—	—	416
Balance at September 30, 2013	$16,744	$228,622	$24,755	$ (1,800)	$ (10,293)	$(75,345)	$182,683

[1] Cash dividends paid per share have been adjusted for the September 2014 2% stock dividend.

See Notes to Unaudited Interim Consolidated Financial Statements.

6

ARROW FINANCIAL CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
(Dollars in Thousands)
(Unaudited)

	Nine Months Ended September 30,			
Cash Flows from Operating Activities:	2014		2013	
Net Income	$16,991		$16,011	
Adjustments to Reconcile Net Income to Net Cash Provided by Operating Activities:				
Provision for Loan Losses	1,407		200	
Depreciation and Amortization	5,622		6,908	
Allocation of ESOP Stock	448		416	
Gains on the Sale of Securities Available-for-Sale	(137	)	(527	)
Gains on the Sale of Securities Held-to-Maturity	—		(18	)
Losses on the Sale of Securities Held-to-Maturity	—		5	
Losses on the Sale of Securities Available-for-Sale	27		—	
Loans Originated and Held-for-Sale	(16,462	)	(41,545	)
Proceeds from the Sale of Loans Held-for-Sale	15,879		44,057	
Net Gains on the Sale of Loans	(502	)	(1,271	)
Net Losses on the Sale of Premises and Equipment, Other Real Estate Owned and Repossessed Assets	52		87	
Contributions to Retirement Benefit Plans	(656	)	(354	)
Deferred Income Tax Benefit	(418	)	(83	)
Shares Issued Under the Directors' Stock Plan	101		106	
Stock-Based Compensation Expense	270		281	
Net (Increase) Decrease in Other Assets	(1,146	)	2,611	
Net Increase (Decrease) in Other Liabilities	31		(653	)
Net Cash Provided By Operating Activities	21,507		26,231	
Cash Flows from Investing Activities:				
Proceeds from the Sale of Securities Available-for-Sale	49,917		16,284	
Proceeds from the Maturities and Calls of Securities Available-for-Sale	131,861		89,857	
Purchases of Securities Available-for-Sale	(100,684	)	(121,287	)
Proceeds from the Sale of Securities Held-to-Maturity	—		1,181	
Proceeds from the Maturities and Calls of Securities Held-to-Maturity	45,602		35,214	
Purchases of Securities Held-to-Maturity	(43,967	)	(71,573	)
Net Increase in Loans	(115,568	)	(73,948	)
Proceeds from the Sales of Premises and Equipment, Other Real Estate Owned and Repossessed Assets	1,093		1,214	
Purchase of Premises and Equipment	(885	)	(1,935	)
Cash Paid for Subsidiaries, Net	(75	)	(75	)
Net Decrease in Other Investments	3,280		1,896	
Purchase of Bank Owned Life Insurance	(5,245	)	—	
Net Cash Used In Investing Activities	(34,671	)	(123,172	)
Cash Flows from Financing Activities:				
Net Increase in Deposits	93,026		164,220	
Net Decrease in Short-Term Borrowings	(45,123	)	(25,701	)
Repayments of Federal Home Loan Bank Term Advances	(10,000	)	(10,000	)
Purchase of Treasury Stock	(2,235	)	(1,512	)
Stock Options Exercised, Net	1,063		965	

Shares Issued Under the Employee Stock Purchase Plan	351	348
Tax Benefit from Exercise of Stock Options	22	17
Shares Issued for Dividend Reinvestment Plans	—	851
Cash Dividends Paid	(9,256)	(9,027)
Net Cash Provided By Financing Activities	27,848	120,161
Net Increase in Cash and Cash Equivalents	14,684	23,220
Cash and Cash Equivalents at Beginning of Period	49,980	48,832
Cash and Cash Equivalents at End of Period	$64,664	$72,052
Supplemental Disclosures to Statements of Cash Flow Information:		
Interest on Deposits and Borrowings	$4,629	$6,318
Income Taxes	7,035	6,086
Non-cash Investing and Financing Activity:		
Transfer of Loans to Other Real Estate Owned and Repossessed Assets	1,137	764
Acquisition of Subsidiaries	91	233

See Notes to Unaudited Interim Consolidated Financial Statements.

7

NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

Note 1. ACCOUNTING POLICIES

In the opinion of the management of Arrow Financial Corporation (Arrow), the accompanying unaudited consolidated interim financial statements contain all of the adjustments necessary to present fairly the financial position as of September 30, 2014, December 31, 2013 and September 30, 2013; the results of operations for the three and nine-month periods ended September 30, 2014 and 2013; the consolidated statements of comprehensive income for the three and nine-month periods ended September 30, 2014 and 2013; the changes in stockholders' equity for the nine-month periods ended September 30, 2014 and 2013; and the cash flows for the nine-month periods ended September 30, 2014 and 2013. All such adjustments are of a normal recurring nature. Certain prior period amounts have been reclassified to conform to the current presentation. The preparation of financial statements requires the use of management estimates. The unaudited consolidated interim financial statements should be read in conjunction with the audited annual consolidated financial statements of Arrow for the year ended December 31, 2013, included in Arrow's 2013 Form 10-K.

New Accounting Standards Updates (ASU): During 2014, through the date of this report, the FASB issued fifteen accounting standards updates, only three of which apply to Arrow.
ASU 2014-01 "Investments-Equity Method and Joint Ventures" allows an entity that invests in affordable housing projects that qualify for low-income housing tax credits to make an accounting policy election to account for their investments in qualified affordable housing projects using the proportional amortization method if certain conditions are met. Under the proportional amortization method, an entity amortizes the initial cost of the investment in proportion to the tax credits and other tax benefits received and recognizes the net investment performance in the income statement as a component of income tax expense. The standard is effective for annual years beginning after December 15, 2014, with earlier adoption allowed. We adopted the proportional amortization method in the first quarter of 2014. The adoption did not have a material impact on our financial condition or results of operations.
ASU 2014-04 "Receivables - Trouble Debt Restructurings by Creditors" provides additional guidance on when an in-substance repossession or foreclosure occurs and is effective for annual periods beginning after December 15, 2014. We are evaluating the impact of adopting this standard, and we do not expect that it will have a material impact on our financial condition or results of operations.
ASU 2014-14 "Receivables - Trouble Debt Restructurings by Creditors - Classification of Certain Government-Guaranteed Mortgage Loans upon Foreclosure" requires an entity to report a separate other receivable for the amount of the expected guarantee upon foreclosure. For Arrow, the standard is effective for the first quarter of 2015. The adoption will not have a material impact on our financial condition or results of operations.

Note 2. INVESTMENT SECURITIES (In Thousands)

The following table is the schedule of Available-For-Sale Securities at September 30, 2014, December 31, 2013 and September 30, 2013:
Available-For-Sale Securities

	U.S. Agency Obligations	State and Municipal Obligations	Mortgage-Backed Securities - Residential	Corporate and Other Debt Securities	Mutual Funds and Equity Securities	Total Available-For-Sale Securities
September 30, 2014						
Available-For-Sale Securities, at Amortized Cost	$134,485	$91,799	$126,108	$17,027	$1,120	$370,539
Available-For-Sale Securities,	134,051	92,150	130,101	16,756	1,277	374,335

at Fair Value						
Gross Unrealized Gains	1	355	4,046	9	157	4,568
Gross Unrealized Losses	435	4	53	280	—	772
Available-For-Sale Securities, Pledged as Collateral						292,850
Maturities of Debt Securities, at Amortized Cost:						
Within One Year	—	35,472	6,465	—		41,937
From 1 - 5 Years	128,653	54,172	107,842	16,027		306,694
From 5 - 10 Years	5,832	1,515	11,801	—		19,148
Over 10 Years	—	640	—	1,000		1,640
Maturities of Debt Securities, at Fair Value:						
Within One Year	—	35,539	6,529	—		42,068
From 1 - 5 Years	128,247	54,438	111,100	15,956		309,741
From 5 - 10 Years	5,804	1,533	12,472	—		19,809
Over 10 Years	—	640	—	800		1,440

8

Available-For-Sale Securities	U.S. Agency Obligations	State and Municipal Obligations	Mortgage-Backed Securities - Residential	Corporate and Other Debt Securities	Mutual Funds and Equity Securities	Total Available-For-Sale Securities
Securities in a Continuous Loss Position, at Fair Value:						
Less than 12 Months	$90,968	$450	$5,528	$—	$—	$96,946
12 Months or Longer	27,994	2,665	4,515	10,752	—	45,926
Total	$118,962	$3,115	$10,043	$10,752	$—	$142,872
Number of Securities in a Continuous Loss Position	35	18	7	15	—	75
Unrealized Losses on Securities in a Continuous Loss Position:						
Less than 12 Months	$296	$—	$18	$—	$—	$314
12 Months or Longer	139	4	35	280	—	458
Total	$435	$4	$53	$280	$—	$772
December 31, 2013						
Available-For-Sale Securities, at Amortized Cost	$136,868	$127,224	$171,321	$17,142	$1,120	$453,675
Available-For-Sale Securities, at Fair Value	136,475	127,389	175,778	16,798	1,166	457,606
Gross Unrealized Gains	2	306	4,714	10	46	5,078
Gross Unrealized Losses	395	141	257	354	—	1,147
Available-For-Sale Securities, Pledged as Collateral						243,769
Securities in a Continuous Loss Position, at Fair Value:						
Less than 12 Months	$60,664	$29,967	$15,190	$7,375	$—	$113,196
12 Months or Longer	33,849	4,597	11,841	6,063	—	56,350
Total	$94,513	$34,564	$27,031	$13,438	$—	$169,546
Number of Securities in a Continuous Loss Position	26	107	13	19	—	165
Unrealized Losses on Securities in a Continuous Loss Position:						
Less than 12 Months	$336	$120	$108	$92	$—	$656
12 Months or Longer	59	21	149	262	—	491
Total	$395	$141	$257	$354	$—	$1,147
September 30, 2013						
Available-For-Sale Securities, at Amortized Cost	$150,184	$134,059	$179,235	$17,180	$1,120	$481,778

Available-For-Sale Securities, at Fair Value	149,774	133,919	185,215	16,798	1,182	486,888
Gross Unrealized Gains	2	175	6,041	—	62	6,280
Gross Unrealized Losses	412	315	61	382	—	1,170
Available-For-Sale Securities, Pledged as Collateral						314,693
Securities in a Continuous Loss Position, at Fair Value:						
Less than 12 Months	$105,517	$58,710	$8,482	$15,998	$—	$188,707
12 Months or Longer	4,992	3,513	—	800	—	9,305
Total	$110,509	$62,223	$8,482	$16,798	$—	$198,012

9

Available-For-Sale Securities

	U.S. Agency Obligations	State and Municipal Obligations	Mortgage-Backed Securities - Residential	Corporate and Other Debt Securities	Mutual Funds and Equity Securities	Total Available-For-Sale Securities
Number of Securities in a Continuous Loss Position	30	230	4	22	—	286
Unrealized Losses on Securities in a Continuous Loss Position:						
Less than 12 Months	$405	$304	$61	$182	$—	$952
12 Months or Longer	7	11	—	200	—	218
Total	$412	$315	$61	$382	$—	$1,170

The following table is the schedule of Held-To-Maturity Securities at September 30, 2014, December 31, 2013 and September 30, 2013:

Held-To-Maturity Securities

	State and Municipal Obligations	Mortgage-Backed Securities - Residential	Corporate and Other Debt Securities	Total Held-To Maturity Securities
September 30, 2014				
Held-To-Maturity Securities, at Amortized Cost	$178,699	$116,823	$1,000	$296,522
Held-To-Maturity Securities, at Fair Value	184,116	117,451	1,000	302,567
Gross Unrealized Gains	5,535	672	—	6,207
Gross Unrealized Losses	118	44	—	162
Held-To-Maturity Securities, Pledged as Collateral				277,636
Maturities of Debt Securities, at Amortized Cost:				
Within One Year	33,517	—	—	33,517
From 1 - 5 Years	86,414	61,257	—	147,671
From 5 - 10 Years	56,509	55,566	—	112,075
Over 10 Years	2,259	—	1,000	3,259
Maturities of Debt Securities, at Fair Value:				
Within One Year	33,608	—	—	33,608
From 1 - 5 Years	89,028	61,578	—	150,606
From 5 - 10 Years	59,121	55,873	—	114,994
Over 10 Years	2,359	—	1,000	3,359
Securities in a Continuous Loss Position, at Fair Value:				

Less than 12 Months	$2,289	$9,221	$—	$11,510
12 Months or Longer	13,058	4,366	—	17,424
Total	$15,347	$13,587	$—	$28,934
Number of Securities in a Continuous Loss Position	58	5	—	63
Unrealized Losses on Securities in a Continuous Loss Position:				
Less than 12 Months	$15	$32	$—	$47
12 Months or Longer	103	12	—	115
Total	$118	$44	$—	$162

10

Held-To-Maturity Securities

	State and Municipal Obligations	Mortgage-Backed Securities - Residential	Corporate and Other Debt Securities	Total Held-To Maturity Securities
December 31, 2013				
Held-To-Maturity Securities, at Amortized Cost	$198,206	$100,055	$1,000	$299,261
Held-To-Maturity Securities, at Fair Value	202,390	98,915	1,000	302,305
Gross Unrealized Gains	4,762	24	—	4,786
Gross Unrealized Losses	578	1,164	—	1,742
Held-To-Maturity Securities, Pledged as Collateral				298,261
Securities in a Continuous Loss Position, at Fair Value:				
Less than 12 Months	$23,633	$85,339	$—	$108,972
12 Months or Longer	5,111	—	—	5,111
Total	$28,744	$85,339	$—	$114,083
Number of Securities in a Continuous Loss Position	101	36	—	137
Unrealized Losses on Securities in a Continuous Loss Position:				
Less than 12 Months	$519	$1,164	$—	$1,683
12 Months or Longer	59	—	—	59
Total	$578	$1,164	$—	$1,742
September 30, 2013				
Held-To-Maturity Securities, at Amortized Cost	$194,065	$78,561	$1,000	$273,626
Held-To-Maturity Securities, at Fair Value	198,548	78,842	1,000	278,390
Gross Unrealized Gains	5,018	314	—	5,332
Gross Unrealized Losses	535	33	—	568
Held-To-Maturity Securities, Pledged as Collateral				272,626
Securities in a Continuous Loss Position, at Fair Value:				
Less than 12 Months	$27,814	$29,714	$—	$57,528
12 Months or Longer	171	—	—	171
Total	$27,985	$29,714	$—	$57,699
Number of Securities in a Continuous Loss Position	97	13	—	110
Unrealized Losses on				

Securities in a Continuous Loss Position:				
Less than 12 Months	$532	$33	$—	$565
12 Months or Longer	2	—	—	2
Total	$534	$33	$—	$567

In the tables above, maturities of mortgage-backed-securities - residential are included based on their expected average lives. Actual maturities will differ from the table below because issuers may have the right to call or prepay obligations with or without prepayment penalties.

11

In the available-for-sale category at September 30, 2014, U.S. agency obligations consisted solely of U.S. Government Agency securities with an amortized cost of $134.5 million and a fair value of $134.1 million. Mortgage-backed securities - residential consisted of U.S. Government Agency securities with an amortized cost of $26.0 million and a fair value of $26.6 million and government sponsored entity (GSE) securities with an amortized cost of $100.1 million and a fair value of $103.5 million. In the held-to-maturity category at September 30, 2014, mortgage-backed securities-residential consisted of U.S Government Agency securities with an amortized cost of $4.5 million and a fair value of $4.6 million and GSE securities with an amortized cost of $112.3 million and a fair value of $112.9 million.
In the available-for-sale category at December 31, 2013, U.S. agency obligations consisted solely of U.S. Government Agency securities with an amortized cost of $136.9 million and a fair value of $136.5 million. Mortgage-backed securities-residential consisted of U.S. Government Agency securities with an amortized cost of $31.5 million and a fair value of $32.2 million and GSE securities with an amortized cost of $139.8 million and a fair value of $143.6 million. In the held-to-maturity category at December 31, 2013, mortgage-backed securities-residential consisted of U.S. Government Agency securities with an amortized cost of $4.9 million and a fair value of $4.7 million and GSE securities with an amortized cost of $95.2 million and a fair value of $94.2 million.
In the available-for-sale category at September 30, 2013, U.S. agency obligations consisted solely of U.S. Government Agency securities with an amortized cost of $150.2 million and a fair value of $149.8 million. Mortgage-backed securities-residential consisted of US Government Agency securities with an amortized cost of $32.5 million and a fair value of $33.6 million and GSE securities with an amortized cost of $146.7 million and a fair value of $151.6 million. In the held-to-maturity category at September 30, 2013, mortgage-backed securities-residential consisted of U.S. Government Agency securities with an amortized cost of $5.0 million and a fair value of $4.9 million and GSE securities with an amortized cost of $73.6 million and a fair value of $73.9 million.
Securities in a continuous loss position, in the tables above for September 30, 2014, December 31, 2013 and September 30, 2013, do not reflect any deterioration of the credit worthiness of the issuing entities. U.S. Agency issues, including agency-backed collateralized mortgage obligations and mortgage-backed securities, are all rated at least Aaa by Moody's or AA+ by Standard and Poor's. The state and municipal obligations are general obligations supported by the general taxing authority of the issuer, and in some cases are insured. Obligations issued by school districts are supported by state aid. For any non-rated municipal securities, credit analysis is performed in-house based upon data that has been submitted by the issuers to the NY State Comptroller. That analysis reflects satisfactory credit worthiness of the municipalities. Corporate and other debt securities continue to be rated above investment grade according to Moody's and Standard and Poor's. Subsequent to September 30, 2014, and through the date of filing this report, there were no securities downgraded below investment grade.
The unrealized losses on these temporarily impaired securities are primarily the result of changes in interest rates for fixed rate securities where the interest rate received is less than the current rate available for new offerings of similar securities, changes in market spreads as a result of shifts in supply and demand, and/or changes in the level of prepayments for mortgage related securities.   Because we do not currently intend to sell any of our temporarily impaired securities, and because it is not more likely-than-not that we would be required to sell the securities prior to recovery, the impairment is considered temporary.

Note 3. LOANS (In Thousands)

Loan Categories and Past Due Loans

The following table presents loan balances outstanding as of September 30, 2014, December 31, 2013 and September 30, 2013 and an analysis of the recorded investment in loans that are past due at these dates. Generally, Arrow considers a loan past due 30 or more days if the borrower is two or more payments past due. Loans held-for-sale of $1,149, $64 and $1,561 as of September 30, 2014, December 31, 2013 and September 30, 2013, respectively, are included in the residential real estate balances for current loans.

Past Due Loans

	Commercial	Commercial Construction	Commercial Real Estate	Other Consumer	Automobile	Residential	Total
September 30, 2014							
Loans Past Due 30-59 Days	$109	$—	$—	$24	$2,938	$389	$3,460
Loans Past Due 60-89 Days	210	—	232	8	1,058	1,379	2,887
Loans Past Due 90 or more Days	485	—	1,832	9	257	3,064	5,647
Total Loans Past Due	804	—	2,064	41	4,253	4,832	11,994
Current Loans	96,042	26,709	311,835	7,372	415,300	512,188	1,369,446
Total Loans	$96,846	$26,709	$313,899	$7,413	$419,553	$517,020	$1,381,440
Loans 90 or More Days Past Due and Still Accruing Interest	$328	$—	$—	$—	$—	$243	$571
Nonaccrual Loans	$241	$—	$2,073	$10	$428	$4,296	$7,048
December 31, 2013							
Loans Past Due 30-59 Days	$304	$—	$200	$37	$3,233	$529	$4,303
Loans Past Due 60-89 Days	601	—	1,200	19	1,041	1,527	4,388
Loans Past Due 90 or more Days	177	—	2,034	—	98	3,113	5,422
Total Loans Past Due	1,082	—	3,434	56	4,372	5,169	14,113
Current Loans	86,811	27,815	284,685	7,593	389,832	455,623	1,252,359
Total Loans	$87,893	$27,815	$288,119	$7,649	$394,204	$460,792	$1,266,472
Loans 90 or More Days Past Due and Still Accruing Interest	$28	$—	$—	$—	$—	$624	$652
Nonaccrual Loans	$352	$—	$2,048	$—	$219	$3,860	$6,479
September 30, 2013							
Loans Past Due 30-59 Days	$595	$—	$—	$50	$2,230	$200	$3,075
Loans Past Due 60-89 Days	750	—	1,173	4	654	1,999	4,580
Loans Past Due 90 or more Days	53	—	1,847	—	133	2,721	4,754
Total Loans Past Due	1,398	—	3,020	54	3,017	4,920	12,409
Current Loans	85,719	33,960	260,084	7,516	389,335	454,347	1,230,961
Total Loans	$87,117	$33,960	$263,104	$7,570	$392,352	$459,267	$1,243,370

Loans 90 or More Days Past Due and Still Accruing Interest	$—	$—	$—	$—	$11	$916	$927
Nonaccrual Loans	$269	$—	$1,930	$3	$240	$3,729	$6,171

The Company disaggregates its loan portfolio into the following six categories:

Commercial - The Company offers a variety of loan options to meet the specific needs of our commercial customers including term loans, time notes and lines of credit. Such loans are made available to businesses for working capital needs such as inventory and receivables, business expansion and equipment purchases. Generally, 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 due to the nature of the underlying collateral, which can be business assets such as equipment and accounts receivable and generally have a lower liquidation value than real estate. In the event of default by the borrower, the Company may be required to liquidate collateral at deeply discounted values. To reduce the risk, management usually obtains personal guarantees of the borrowers.

Commercial Construction - The Company offers commercial construction and land development loans to finance projects, primarily within the communities that we serve. Many projects will ultimately be used by the borrowers' businesses, while others are developed for resale.

These real estate loans are secured by first liens on the real estate, which may include apartments, commercial structures, housing businesses, healthcare facilities, and both owner-occupied and nonowner-occupied facilities. There is enhanced risk during the construction period, since the loan is secured by an incomplete project.

Commercial Real Estate - The Company offers commercial real estate loans to finance real estate purchases, refinancings, expansions and improvements to commercial properties. 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 both owner and non owner-occupied facilities. These loans are typically less risky than commercial loans, since they are secured by real estate and buildings, and are generally originated in amounts of no more than 80% of the appraised value of the property.

Other Consumer Loans - The Company offers a variety of consumer installment loans to finance personal expenditures. Most of these loans carry a fixed rate of interest with principal repayment terms typically ranging from one to five years, based upon the nature of the collateral and the size of the loan. In addition to installment loans, the Company also offers personal lines of credit and overdraft protection. Several loans are unsecured, which carry a higher risk of loss.

Automobile - The Company primarily finances the purchases of automobiles indirectly through dealer relationships located throughout upstate New York and Vermont. Most of these loans carry a fixed rate of interest with principal repayment terms typically ranging from three to seven years. Indirect consumer loans are underwritten on a secured basis using the underlying collateral being financed.

Residential Real Estate Mortgages - Residential real estate loans consist primarily of loans secured by first or second mortgages on primary residences. We originate adjustable-rate and fixed-rate one-to-four-family residential real estate loans for the construction, purchase or refinancing of an existing mortgage. These loans are collateralized primarily by owner-occupied properties generally located in the Company's market area. Loans on one-to-four-family residential real estate are generally originated in amounts of no more than 85% of the purchase price or appraised value (whichever is lower), or have private mortgage insurance. The Company's underwriting analysis for residential mortgage loans typically includes credit verification, independent appraisals, and a review of the borrower's financial condition. Mortgage title insurance and hazard insurance are normally required. It is our general practice to underwrite our residential real estate loans to secondary market standards. Construction loans have a unique risk, because they are secured by an incomplete dwelling. This risk is reduced through periodic site inspections, including one at each loan draw period. In addition, the Company offers fixed home equity loans as well as home equity lines of credit to consumers to finance home improvements, debt consolidation, education and other uses. Our policy allows for a maximum loan to value ratio of 80%, although periodically higher advances are allowed. 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). Risk is generally 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.

Allowance for Loan Losses

The following table presents a roll-forward of the allowance for loan losses and other information pertaining to the allowance for loan losses:

Allowance for Loan Losses

	Commercial	Commercial Construction	Commercial Real Estate	Other Consumer	Automobile	Residential	Unallocated	Total

Roll-forward of the Allowance for Loan Losses for the Quarterly Periods:								
June 30, 2014	$2,055	$445	$3,770	$266	$4,414	$3,133	$953	$15,036
Charge-offs	(26)	—	—	(8)	(185)	(46)	—	(265)
Recoveries	24	—	—	3	51	—	—	78
Provision	90	(45)	(19)	(7)	256	187	(18)	444
September 30, 2014	$2,143	$400	$3,751	$254	$4,536	$3,274	$935	$15,293
June 30, 2013	$1,552	$646	$3,293	$299	$4,357	$3,408	$1,123	$14,678
Charge-offs	(62)	—	—	(7)	(114)	—	—	(183)
Recoveries	8	—	—	2	79	—	—	89
Provision	209	4	15	(29)	(14)	(159)	(26)	—
September 30, 2013	$1,707	$650	$3,308	$265	$4,308	$3,249	$1,097	$14,584

Allowance for Loan Losses

	Commercial	Commercial Construction	Commercial Real Estate	Other Consumer	Automobile	Residential	Unallocated	Total
Roll-forward of the Allowance for Loan Losses for the Year-to-Date Periods:								
December 31, 2013	$1,886	$417	$3,545	$272	$4,206	$3,026	$1,082	$14,434
Charge-offs	(192)	—	—	(34)	(452)	(91)	—	(769)
Recoveries	49	—	—	4	168	—	—	221
Provision	400	(17)	206	12	614	339	(147)	1,407
September 30, 2014	$2,143	$400	$3,751	$254	$4,536	$3,274	$935	$15,293
December 31, 2012	$2,344	$601	$3,050	$304	$4,536	$3,405	$1,058	$15,298
Charge-offs	(850)	—	(11)	(20)	(284)	—	—	(1,165)
Recoveries	48	—	—	2	201	—	—	251
Provision	165	49	269	(21)	(145)	(156)	39	200
September 30, 2013	$1,707	$650	$3,308	$265	$4,308	$3,249	$1,097	$14,584
September 30, 2014								
Allowance for loan losses - Loans Individually Evaluated for Impairment	$—	$—	$—	$—	$—	$82	$—	$82
Allowance for loan losses - Loans Collectively Evaluated for Impairment	$2,143	$400	$3,751	$254	$4,536	$3,192	$935	$15,211
Ending Loan Balance - Individually Evaluated for Impairment	$201	$—	$1,493	$—	$123	$2,200	$—	$4,017
Ending Loan Balance - Collectively Evaluated for Impairment	$96,645	$26,709	$312,406	$7,413	$419,430	$514,820	$—	$1,377,423
December 31, 2013								
Allowance for loan losses - Loans Individually	$—	$—	$—	$—	$—	$—	$—	$—

Evaluated for Impairment								
Allowance for loan losses - Loans Collectively Evaluated for Impairment	$1,886	$417	$3,545	$272	$4,206	$3,026	$1,082	$14,434
Ending Loan Balance - Individually Evaluated for Impairment	$221	$—	$1,785	$—	$173	$2,309	$—	$4,488
Ending Loan Balance - Collectively Evaluated for Impairment	$87,672	$27,815	$286,334	$7,649	$394,031	$458,483	$—	$1,261,984
September 30, 2013								
Allowance for loan losses - Loans Individually Evaluated for Impairment	$—	$—	$—	$—	$—	$—	$—	$—
Allowance for loan losses - Loans Collectively Evaluated for Impairment	$1,707	$650	$3,308	$265	$4,308	$3,249	$1,097	$14,584
Ending Loan Balance - Individually Evaluated for Impairment	$25	$—	$1,497	$—	$169	$1,720	$—	$3,411
Ending Loan Balance - Collectively Evaluated for Impairment	$87,092	$33,960	$261,607	$7,570	$392,183	$457,547	$—	$1,239,959

15

Through the provision for loan losses, an allowance for loan losses is maintained that reflects our best estimate of the inherent risk of loss in the Company's loan portfolio as of the balance sheet date. Additions are made to the allowance for loan losses through a periodic provision for loan losses. Actual loan losses are charged against the allowance for loan losses when loans are deemed uncollectible and recoveries of amounts previously charged off are recorded as credits to the allowance for loan losses.

Our loan officers and risk managers meet at least quarterly to discuss and review the conditions and risks associated with certain criticized and classified commercial-related relationships. In addition, our independent internal loan review department performs periodic reviews of the risk ratings on individual loans in our commercial loan portfolio.

We use a two-step process to determine the provision for loan losses and the amount of the allowance for loan losses. We measure impairment on our impaired loans on a quarterly basis. Our impaired loans are generally nonaccrual loans over $250 thousand and all troubled debt restructured loans. Our impaired loans are generally considered to be collateral dependent with the specific reserve, if any, determined based on the value of the collateral less estimated costs to sell.

The remainder of the portfolio is evaluated on a pooled basis. For each homogeneous loan pool, we estimate a total loss factor based on the historical net loss rates adjusted for applicable qualitative factors. We update the total loss factors assigned to each loan category on a quarterly basis. For the commercial, commercial construction, and commercial real estate categories, we further segregate the loan categories by credit risk profile (pools of loans graded satisfactory, special mention and substandard). Additional description of the credit risk classifications is detailed in the Credit Quality Indicators section of this note.

We determine the annualized historical net loss rate for each loan category using a trailing three-year net charge-off average. While historical net loss experience provides a reasonable starting point for our analysis, historical net losses, or even recent trends in net losses, do not by themselves form a sufficient basis to determine the appropriate level of the allowance for loan losses. Therefore, we also consider and adjust historical net loss factors for qualitative factors that impact the inherent risk of loss associated with our loan categories within our total loan portfolio. These include:

- Changes in the volume and severity of past due, nonaccrual and adversely classified loans
- Changes in the nature and volume of the portfolio and in the terms of loans
- Changes in the value of the underlying collateral for collateral dependent loans
- Changes in lending policies and procedures, including changes in underwriting standards and collection, charge-off, and recovery practices not considered elsewhere in estimating credit losses
- Changes in the quality of the loan review system
- Changes in the experience, ability, and depth of lending management and other relevant staff
- Changes in international, national, regional, and local economic and business conditions and developments that affect the collectibility of the portfolio
- The existence and effect of any concentrations of credit, and changes in the level of such concentrations
- The effect of other external factors such as competition and legal and regulatory requirements on the level of estimated credit losses in the existing portfolio or pool

Further, due to the imprecise nature of the loan loss estimation process, the risk attributes of our loan portfolio may not be fully captured in data related to the determination of loss factors used to determine our analysis of the adequacy of the allowance for loan losses. Management, therefore, has established an unallocated portion within the allowance for loan losses reflecting the imprecision that naturally exists in the allowance for loan loss estimation process. The unallocated allowance for loan losses is not considered a significant component of the overall allowance for loan loss estimation process.

16

Credit Quality Indicators

The following table presents the credit quality indicators by loan category at September 30, 2014, December 31, 2013 and September 30, 2013:

Loan Credit Quality Indicators

	Commercial	Commercial Construction	Commercial Real Estate	Other Consumer	Automobile	Residential	Total
September 30, 2014							
Credit Risk Profile by Creditworthiness Category:							
Satisfactory	$82,232	$26,709	$289,686				$398,627
Special Mention	4,969	—	7,032				12,001
Substandard	9,645	—	17,181				26,826
Doubtful	—	—	—				—
Credit Risk Profile Based on Payment Activity:							
Performing				$7,403	$419,125	$512,481	939,009
Nonperforming				10	428	4,539	4,977
December 31, 2013							
Credit Risk Profile by Creditworthiness Category:							
Satisfactory	79,966	27,815	267,612				375,393
Special Mention	204	—	634				838
Substandard	7,723	—	19,873				27,596
Doubtful	—	—	—				—
Credit Risk Profile Based on Payment Activity:							
Performing							