Catskill Hudson Bancorp, Inc.

Consolidated Financial Statements

December 31, 2017 and 2016

Catskill Hudson Bancorp, Inc.

Contents

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Independent Auditor's Report

To the Stockholders and Board of Directors
Catskill Hudson Bancorp, Inc.
Kingston, New York

We have audited the accompanying consolidated financial statements of Catskill Hudson Bancorp, Inc. and its subsidiary, which comprise the consolidated statements of financial condition as of December 31, 2017 and 2016, and the related consolidated statements of income, comprehensive income, stockholders' equity, and cash flows for the years then ended, and the related notes to the consolidated financial statements.

Management's Responsibility for the Consolidated Financial Statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Catskill Hudson Bancorp, Inc. and its subsidiary as of December 31, 2017 and 2016, and the results of their operations and their cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

BDO USA, LLP

Harrisburg, Pennsylvania
April 12, 2018

Consolidated Financial Statements

Catskill Hudson Bancorp, Inc.

Consolidated Statements of Financial Condition
(in thousands)

December 31,		**2017**		2016
Assets				
Cash and due from banks	$	**30,267**	$	31,976
Short term certificates of deposits		**240**		480
Securities available-for-sale, at fair value		**122,491**		150,046
Securities held-to-maturity, fair value 2017 $6,265; 2016 $7,202		**6,502**		7,685
Loans, net of allowance for loan losses 2017 $3,165; 2016 $3,383		**274,024**		241,009
Restricted investment in bank stock		**731**		743
Premises and equipment, net		**2,843**		2,895
Accrued interest receivable and other assets		**3,518**		4,702
Bank owned life insurance		**1,814**		1,780
Total Assets	$	**442,430**	$	441,316
Liabilities and Stockholders' Equity				
Liabilities				
Deposits:				
Interest-bearing	$	**336,613**	$	333,700
Noninterest-bearing		**70,621**		74,629
Total deposits		**407,234**		408,329
Subordinated debentures		**10,799**		10,776
Junior subordinated debentures		**3,299**		3,299
Accrued interest payable and other liabilities		**853**		713
Total Liabilities		**422,185**		423,117
Stockholders' Equity				
Preferred stock		**-**		-
Common stock		**708**		703
Treasury stock, (8,416 shares at December 31, 2017 and 2016)		**(152)**		(152)
Paid-in capital		**7,278**		7,221
Retained earnings		**14,131**		12,453
Accumulated other comprehensive loss		**(1,720)**		(2,026)
Total Stockholders' Equity		**20,245**		18,199
Total Liabilities and Stockholders' Equity	$	**442,430**	$	441,316

See accompanying notes to consolidated financial statements.

Catskill Hudson Bancorp, Inc.

Consolidated Statements of Income
(in thousands, except per share data)

Years Ended December 31,		2017		2016
Interest Income				
Loans	$	**11,855**	$	10,910
Investment securities:				
Taxable		**2,616**		3,258
Tax-exempt		**808**		713
Other		**3**		2
Total Interest Income		**15,282**		14,883
Interest Expense				
Deposits		**1,669**		1,492
Borrowings		**900**		221
Total Interest Expense		**2,569**		1,713
Net interest income		**12,713**		13,170
Provision for Loan Losses		**255**		339
Net Interest Income After Provision for Loan Losses		**12,458**		12,831
Noninterest Income				
Service fees		**945**		891
Net realized gains on sales of securities available-for-sale		**113**		215
Other operating income		**77**		98
Total Noninterest Income		**1,135**		1,204
Noninterest Expense				
Salaries and employee benefits		**6,055**		5,747
Occupancy		**1,348**		1,453
Depreciation and amortization		**715**		816
Data processing fees		**533**		757
Stationery, supplies and printing		**170**		231
Professional fees		**264**		356
Bank service fees		**434**		399
Foreclosed real estate activity, net		**3**		5
FDIC insurance		**270**		314
Other operating expense		**1,222**		1,163
Total Noninterest Expense		**11,014**		11,241
Income before income tax expense		**2,579**		2,794
Income Tax Expense		**934**		815
Net income		**1,645**		1,979
Preferred Stock Dividends		**-**		675
Net Income Available to Common Stockholders	$	**1,645**	$	1,304
Earnings Per Common Share				
Basic	$	**2.38**	$	1.89

See accompanying notes to consolidated financial statements.

Catskill Hudson Bancorp, Inc.

Consolidated Statements of Comprehensive Income
(in thousands)

Years Ended December 31,		**2017**		2016
Net Income	**$**	**1,645**	$	1,979
Other Comprehensive Income (Loss), Net of Tax				
Securities available-for-sale:				
Gross unrealized holding gains (losses) arising during the year, net of taxes of $334 and $(551), respectively		**720**		(1,166)
Adjustment for gains realized in net income, net of taxes of $(38) and $(82), respectively [(a)(b)]		**(75)**		(133)
Total other comprehensive income (loss)		**645**		(1,299)
Total Comprehensive Income	**$**	**2,290**	$	680

(a) Amounts are included in net realized gains on sales of securities available-for-sale on the consolidated statements of income in total noninterest income.

(b) Income tax amounts are included in income tax expense on the consolidated statements of income.

See accompanying notes to consolidated financial statements.

Catskill Hudson Bancorp, Inc.

Consolidated Statements of Stockholders' Equity
(in thousands)

	Preferred Stock	Common Stock	Treasury Stock	Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total
Balance, January 1, 2016	$ 9,681	$ 701	$ (152)	$ 7,202	$ 11,343	$ (727)	$ 28,048
Net income	-	-	-	-	1,979	-	1,979
Other comprehensive loss	-	-	-	-	-	(1,299)	(1,299)
Preferred stock dividends	-	-	-	-	(675)	-	(675)
Preferred stock redeemed	(9,681)	-	-	-	-	-	(9,681)
Common stock dividends declared, $0.28 per share	-	-	-	-	(194)	-	(194)
Common stock issued	-	2	-	19	-	-	21
Balance, December 31, 2016	-	703	(152)	7,221	12,453	(2,026)	18,199
Net income	**-**	**-**	**-**	**-**	**1,645**	**-**	**1,645**
Other comprehensive Income	**-**	**-**	**-**	**-**	**-**	**645**	**645**
Change in enacted income tax rate	**-**	**-**	**-**	**-**	**339**	**(339)**	**-**
Common stock dividends declared, $0.44 per share	**-**	**-**	**-**	**-**	**(306)**	**-**	**(306)**
Common stock issued	**-**	**5**	**-**	**57**	**-**	**-**	**62**
Balance, December 31, 2017	**$ -**	**$ 708**	**$ (152)**	**$ 7,278**	**$ 14,131**	**$ (1,720)**	**$ 20,245**

See accompanying notes to consolidated financial statements.

Catskill Hudson Bancorp, Inc.

Consolidated Statements of Cash Flows
(in thousands)

Years Ended December 31,	**2017**	2016
Cash Flows from Operating Activities		
Net income	**$ 1,645**	$ 1,979
Adjustments to reconcile change in net income to net cash provided by operating activities:		
Provision for loan losses	**255**	339
Depreciation and amortization	**761**	836
Net realized gains on sales of securities available-for-sale	**(113)**	(215)
Net amortization of securities	**705**	1,182
Net gain (loss) on sale and valuation of other real estate owned	**77**	(5)
Earnings on bank owned life insurance	**(34)**	(37)
Deferred income tax expense	**351**	311
Decrease (increase) in accrued interest receivable and other assets	**477**	15
Increase in accrued interest payable and other liabilities	**82**	108
Net Cash Provided by Operating Activities	**4,206**	4,513
Cash Flows from Investing Activities		
Purchases of securities available-for-sale	**(171,623)**	(59,203)
Proceeds from sales of securities available-for-sale	**40,692**	20,511
Proceeds from maturities and principal repayments of securities available-for-sale	**158,732**	70,066
Purchases of securities held-to-maturity	**(2,191)**	(3,418)
Proceeds from maturities and principal repayments of securities held-to-maturity	**3,363**	5,272
Net decrease (increase) in short term investments	**240**	(5)
Net increase in loans	**(33,249)**	(17,094)
Net cash received in connection with branch acquisition	**-**	909
Net redemption (purchase) of restricted investment in bank stock	**12**	(64)
Purchases of premises and equipment	**(662)**	(458)
Net proceeds from the sale of other real estate owned	**40**	159
Net Cash (Used in) Provided by Investing Activities	**(4,646)**	16,675
Cash Flows from Financing Activities		
Net decrease in demand, savings, money market and NOW account deposits	**(8,684)**	(5,391)
Net increase (decrease) in time deposits	**7,589**	(1,884)
Issuance of subordinated debt	**-**	11,000
Cost of issuing subordinated debt	**-**	(228)
Payment of subordinated debt	**-**	(1,800)
Redemption of preferred stock	**-**	(9,681)
Preferred stock dividends paid	**-**	(675)
Common stock dividends paid	**(236)**	(194)
Common stock issuance	**62**	21
Net Cash Used In Financing Activities	**(1,269)**	(8,832)
Net (decrease) increase cash and cash equivalents	**(1,709)**	12,356
Cash and Cash Equivalents, Beginning of Year	**31,976**	19,620
Cash and Cash Equivalents, End of Year	**$ 30,267**	$ 31,976

See accompanying notes to consolidated financial statements.

Catskill Hudson Bancorp, Inc.

Consolidated Statements of Cash Flows
(in thousands)

Years Ended December 31,		**2017**		2016
Supplementary Cash Flows Information				
Interest paid	**$**	**2,558**	$	1,731
Income taxes paid		**250**		140
Supplementary Schedule of Noncash Financing Activities				
Loan transfers to other real estate owned	**$**	**-**	$	596
Sale of other real estate owned through loans		**21**		450

See accompanying notes to consolidated financial statements.

1. Summary of Significant Accounting Policies

Nature of Operations

The accounting policies discussed below are followed consistently by Catskill Hudson Bancorp, Inc. (the “Company”). These policies are in accordance with accounting principles generally accepted in the United States of America and conform to common practices in the banking industry.

Catskill Hudson Bancorp, Inc. provides a full range of commercial banking services through its wholly-owned subsidiary, Catskill Hudson Bank (the “Bank”). The Bank’s operations are conducted in thirteen branches located in Counties in Sullivan, Orange, Ulster, Dutchess, Albany and Saratoga. The Bank is regulated by the Federal Deposit Insurance Corporation and the New York State Department of Financial Services. The Company is regulated by the Federal Reserve Bank of New York.

The Company also has another wholly-owned subsidiary, Catskill Hudson Statutory Trust I (“Trust I”). Trust I was formed for the purpose of issuing trust preferred securities, the proceeds of which were advanced to the Company and contributed to the Bank as additional capital.

Basis of Consolidation

The consolidated financial statements include the accounts of the Company and the Bank. All significant intercompany accounts and transactions have been eliminated in consolidation.

The accounts of Trust I are not included in the consolidated financial statements as discussed in Note 9.

Use of Estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. Material estimates that are particularly susceptible to significant change in the near term relate to the determination of the allowance for loan losses, the evaluation of other-than-temporary impairment of investment securities and the valuation of deferred income tax assets.

Investment Securities

Debt securities that management has the positive intent and ability to hold to maturity are classified as “held-to-maturity” and recorded at amortized cost. Securities not classified as held-to-maturity are classified as “available-for-sale” and recorded at fair value, with unrealized gains and losses excluded from earnings and reported in other comprehensive income, net of the related deferred income tax effect. The Company does not maintain a trading portfolio.

Purchase premiums and discounts are recognized in interest income using methods that approximate the interest method over the terms of the securities. Declines in fair value of securities below their cost that are deemed to be other-than-temporary are separated into (a) the amount of the total other-than-temporary impairment related to a decrease in cash flows expected to be collected from the debt security (the credit loss) and (b) the amount of the total other-than-temporary impairment related to all other factors. The amount of the total other-than-temporary impairment related to the credit loss is recognized in earnings. The amount of the total other-than-temporary impairment related to all other factors is recognized in other comprehensive income. In estimating other-than-temporary impairment losses, management considers (1) the length of time and the extent to which the fair value has been less than cost, (2) the financial condition and near-term prospects of the issuer, (3) the intent and ability of the Company to retain its investment in the issuer for a reasonable period of time sufficient to allow for any anticipated recovery in fair value, (4) whether it is likely the Company intends to sell or will have to sell the security prior to recovery, and (5) whether the change in fair value is due to a deterioration in the credit quality of the issuer or is due to non-credit related market conditions. There were no other-than-temporary impairment losses during 2017 or 2016. Gains and losses on the sale of securities are determined using the specific identification method.

Loans

Loans receivable that management has the intent and ability to hold for the foreseeable future or until maturity or payoff are stated at their outstanding unpaid principal balances, net of an allowance for loan losses and any deferred fees or costs. Interest income is accrued on the unpaid principal balance. Loan origination fees, net of certain direct origination costs, are deferred and recognized as an adjustment of the yield (interest income) of the related loans. The Company is generally amortizing these amounts over the contractual life of the loan. Premiums and discounts on purchased loans are amortized as adjustments to interest income using the effective yield method.

The loans receivable portfolio is segmented into commercial and consumer loans. Commercial loans consist of the following classes: commercial and commercial real estate. Consumer loans consist of the following classes: residential mortgage, installment, home equity and other consumer.

For all classes of loans receivable, the accrual of interest is discontinued when the contractual payment of principal or interest has become 90 days past due or management has serious doubts about further collectability of principal or interest, even though the loan is currently performing. A loan may remain on accrual status if it is in the process of collection and is either guaranteed or well secured. When a loan is placed on nonaccrual status, unpaid interest credited to income in the current year is reversed and unpaid interest accrued in prior years is charged against the allowance for loan losses. Interest received on nonaccrual loans including impaired loans generally is either applied against principal or reported as interest income, according to management’s judgment as to the collectability of principal. Generally, loans are restored to accrual status when the obligation is brought current, has performed in accordance with the contractual terms for a reasonable period of time (generally six months) and the ultimate collectability of the total contractual principal and interest is no longer in doubt. The past due status of all classes of loans receivable is determined based on contractual due dates for loan payments.

Allowance for Loan Losses

The allowance for loan losses consists of the allowance for loan losses and the reserve for unfunded lending commitments. The allowance for loan losses represents management's estimate of losses inherent in the loan portfolio as of the balance sheet date and is recorded as a reduction to loans. The reserve for unfunded lending commitments represents management's estimate of losses inherent in its unfunded loan commitments and is recorded in other liabilities, when necessary, on the consolidated statements of financial condition. The reserve for unfunded lending commitments was not significant to the overall consolidated financial statements as of December 31, 2017 and 2016. The allowance for loan losses is increased by the provision for loan losses, and decreased by charge-offs, net of recoveries. Loans deemed to be uncollectible are charged against the allowance for loan losses, and subsequent recoveries, if any, are credited to the allowance. All, or part, of the principal balance of loans receivable are charged off to the allowance as soon as it is determined that the repayment of all, or part, of the principal balance is highly unlikely. Non-residential consumer loans are generally charged off no later than 120 days past due on a contractual basis, earlier in the event of bankruptcy, or if there is an amount deemed uncollectible. Because all identified losses are immediately charged off, no portion of the allowance for loan losses is restricted to any individual loan or groups of loans, and the entire allowance is available to absorb any and all loan losses.

The allowance for loan losses is maintained at a level considered adequate to provide for losses that can be reasonably anticipated. Management performs a quarterly evaluation of the adequacy of the allowance. The allowance is based on the Company's past loan loss experience, known and inherent risks in the portfolio, adverse situations that may affect the borrower's ability to repay, the estimated value of any underlying collateral, composition of the loan portfolio, current economic conditions and other relevant factors. This evaluation is inherently subjective as it requires material estimates that may be susceptible to significant revision as more information becomes available.

The allowance consists of specific, general and unallocated components. The specific component relates to loans that are classified as impaired. For loans that are classified as impaired, an allowance is established when the discounted cash flows (or collateral value or observable market price) of the impaired loan is lower than the carrying value of that loan. The general component covers pools of loans by loan class including commercial loans not considered impaired, as well as smaller balance homogeneous loans, such as residential mortgage loans, installment loans, home equity and other consumer loans. These pools of loans are evaluated for loss exposure based upon historical loss rates for each of these classes of loans, when necessary historical loss rates are adjusted by a qualitative factor, as deemed appropriate. This qualitative risk factor encompasses:

1. Lending policies and procedures, including underwriting standards and collection, charge-off, and recovery practices.
2. National, regional, and local economic and business conditions as well as the condition of various market segments, including the value of underlying collateral for collateral dependent loans.
3. Nature and volume of the portfolio and terms of loans.
4. Experience, ability, and depth of lending management and staff.
5. Volume and severity of past due, classified and nonaccrual loans as well as and other loan modifications.
6. Quality of the Company's loan review system, and the degree of oversight by the Company's Board of Directors.

7. Existence and effect of any concentrations of credit and changes in the level of such concentrations.
8. Effect of external factors, such as competition and legal and regulatory requirements.

Each factor is incorporated as part of qualitative adjustments to the allowance based on management's best judgment using relevant information available at the time of the evaluation. The qualitative adjustments are supported through documentation of changes in conditions in a narrative accompanying the allowance for loan loss calculation.

Commercial lending, including commercial real estate loans, generally present a higher level of risk than residential mortgage loans. This greater risk is due to several factors, including the concentration of principal in a limited number of loans and borrowers, the effect of general economic conditions on income producing properties and the increased difficulty of evaluating and monitoring these types of loans. Furthermore, the repayment of loans secured by commercial real estate is typically dependent upon the successful operation of the related real estate project or business. If the cash flow from the project is reduced, the borrower's ability to repay the loan may be impaired. Consumer loans may entail greater credit risk than do residential mortgage loans, particularly in the case of consumer loans which are unsecured or are secured by rapidly depreciable assets, such as automobiles. In such cases, any repossessed collateral for a defaulted consumer loan may not provide an adequate source of repayment of the outstanding loan balance as a result of the greater likelihood of damage, loss or depreciation. In addition, consumer loan collections are dependent on the borrower's continuing financial stability, and thus are more likely to be affected by adverse personal circumstances. Furthermore, the application of various federal and state laws, including bankruptcy and insolvency laws, may limit the amount which can be recovered on such loans.

An unallocated component is maintained to cover uncertainties that could affect management's estimate of probable losses. The unallocated component of the allowance reflects the margin of imprecision inherent in the underlying assumptions used in the methodologies for estimating specific and general losses in the portfolio.

A loan is considered impaired when, based on current information and events, it is probable that the Company will be unable to collect the scheduled payments of principal or interest when due according to the contractual terms of the loan agreement. Factors considered by management in determining impairment include payment status, collateral value and the probability of collecting scheduled principal and interest payments when due. Loans that experience insignificant payment delays and payment shortfalls generally are not classified as impaired. Management determines the significance of payment delays and payment shortfalls on a case-by-case basis, taking into consideration all of the circumstances surrounding the loan and the borrower, including the length of the delay, the reasons for the delay, the borrower's prior payment record and the amount of the shortfall in relation to the principal and interest owed. Impairment is measured on a loan by loan basis for commercial and commercial real estate loans and commercial construction loans by either the present value of expected future cash flows discounted at the loan's effective interest rate or the fair value of the collateral if the loan is collateral dependent.

An allowance for loan losses is established for an impaired loan if its carrying value exceeds its estimated fair value. The estimated fair values of substantially all of the Company's impaired loans are measured based on the estimated fair value of the loan's collateral.

For commercial loans secured by real estate, estimated fair values are determined primarily through third-party appraisals. When a real estate secured loan becomes impaired, a decision is made regarding whether an updated certified appraisal of the real estate is necessary. This decision is based on various considerations, including the age of the most recent appraisal, the loan-to-value ratio based on the original appraisal and the condition of the property. Appraised values are discounted to arrive at the estimated selling price of the collateral, which is considered to be the estimated fair value. The discounts also include estimated costs to sell the property.

For commercial loans secured by non-real estate collateral, such as accounts receivable, inventory and equipment, estimated fair values are determined based on the borrower's financial statements, inventory reports, accounts receivable agings or equipment appraisals or invoices. Indications of value from these sources are generally discounted based on the age of the financial information or the quality of the assets.

Large groups of smaller balance homogeneous loans are collectively evaluated for impairment. Accordingly, the Company does not separately identify individual residential mortgage loans, installment loans, home equity loans and other consumer loans for impairment disclosures, unless such loans are the subject of a troubled debt restructuring agreement.

Loans whose terms are modified are classified as troubled debt restructurings if the Company grants such borrowers concessions and it is deemed that those borrowers are experiencing financial difficulty. Concessions granted under a troubled debt restructuring generally involve a temporary reduction in interest rate or an extension of a loan's stated maturity date at a below market interest rate based on the credit risk associated with the loan. Non-accrual troubled debt restructurings are restored to accrual status if principal and interest payments, under the modified terms, are current for six consecutive months after modification. Loans classified as troubled debt restructurings are designated as impaired.

The allowance calculation methodology includes further segregation of loan classes into risk rating categories. The borrower's overall financial condition, repayment sources, guarantors and value of collateral, if appropriate, are evaluated annually for commercial loans or when credit deficiencies arise, such as delinquent loan payments, for commercial and consumer loans. Credit quality risk ratings include regulatory classifications of special mention, substandard, doubtful and loss. Loans classified special mention have potential weaknesses that deserve management's close attention. If uncorrected, the potential weaknesses may result in deterioration of the repayment prospects. Loans classified substandard have a well-defined weakness or weaknesses that jeopardize the liquidation of the debt. They include loans that are inadequately protected by the current sound net worth and paying capacity of the obligor or of the collateral pledged, if any. Loans classified doubtful have all the weaknesses inherent in loans classified substandard with the added characteristic that collection or liquidation in full, on the basis of current conditions and facts, is highly improbable. Loans classified as a loss are considered uncollectible and are charged to the allowance for loan losses. Loans not classified are rated pass.

In addition, regulatory agencies, as an integral part of their examination process, periodically review the Company's allowance for loan losses and 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. Based on management's comprehensive analysis of the loan portfolio, management believes the allowance for loan losses at December 31, 2017 is adequate.

Restricted Investment in Bank Stock

Restricted investment in bank stock, which represents required investments in the common stock of correspondent banks, is carried at cost and consists of the common stock of the Federal Home Loan Bank ("FHLB"), Atlantic Community Bancshares, Inc. ("ACBI") and BBN Financial Corporation ("BBN").

Premises and Equipment

Premises and equipment are recorded at cost and are depreciated using the straight line method over the estimated useful lives of the assets. In the case of leasehold improvements, depreciation is recorded over the shorter of the lease term or the estimated useful life of the related assets, as follows:

	Years
Buildings and leasehold improvements	10 - 30
Furniture, fixtures and equipment	3 - 7
Software	3 - 5

Foreclosed Real Estate

Real estate properties acquired through, or in lieu of, loan foreclosure are initially recorded at fair value less estimated selling costs at the date of foreclosure, establishing a new cost basis. Any write-downs based on the asset's fair value at date of acquisition are charged to the allowance for loan losses. After foreclosure, property held for sale is carried at the lower of the new basis that was established at the time of foreclosure or fair value less any costs to sell. Costs of significant property improvements are capitalized, whereas costs relating to holding property are expensed. Valuations are periodically performed by management, and any subsequent write-downs are recorded as a charge to operations, if necessary, to reduce the carrying value of the property to the lower of its cost or fair value less cost to sell. The Company had foreclosed assets of $0 as of December 31, 2017 and $129,000 as of December 31, 2016. None of the foreclosed assets were residential real estate. There is one residential real estate loan in the process of foreclosure of $28,000 at December 31, 2017. Foreclosed assets are included in accrued interest receivable and other assets in the consolidated statements of financial condition.

Bank Owned Life Insurance

The Bank invests in bank owned life insurance ("BOLI") as a source of funding for employee and director benefit expenses. BOLI involves the purchasing of life insurance by the Bank on a chosen group of employees. The Bank is the owner and beneficiary of the policies. This life insurance investment is carried at the cash surrender value of the underlying policies on the consolidated statements of financial condition. Income from the increase in the cash surrender value of the policies is included with other operating income on the consolidated statements of income.

Service Charges and Fees

Generally, service charges and fees are recognized into income as received.

Advertising Costs

The Company follows the policy of charging the costs of advertising to expense as incurred. Advertising costs totaled $58,000 and $23,000 for years ended December 31, 2017 and 2016, respectively.

Income Taxes

Current income tax accounting guidance results in two components of income tax expense: current and deferred. Current income tax expense reflects taxes to be paid or refunded for the current period by applying the provisions of the enacted tax law to the taxable income or excess of deductions over revenues. The Company determines deferred income taxes using the liability (or balance sheet) method. Under this method, the net deferred tax asset or liability is based on the tax effects of the differences between the book and tax bases of assets and liabilities, and enacted changes in tax rates and laws are recognized in the period in which they occur.

Deferred income tax expense (benefit) results from changes in deferred tax assets and liabilities between periods. Deferred tax assets are reduced by a valuation allowance if, based on the weight of evidence available, it is more likely than not that some portion or all of a deferred tax asset will not be realized.

The Company accounts for income taxes in accordance with current income tax accounting guidance for uncertainty in income taxes, which sets out a consistent framework to determine the appropriate level of tax reserves to maintain for uncertain tax positions.

Uncertain tax positions are recognized if it is more likely than not, based on the technical merits, that the tax position will be realized or sustained upon examination. The term more likely than not means a likelihood of more than 50 percent; the terms examined and upon examination also include resolution of the related appeals or litigation processes, if any. A tax position that meets the more-likely-than-not recognition threshold is initially and subsequently measured as the largest amount of tax benefit that has a greater than 50 percent likelihood of being realized upon settlement with a taxing authority that has full knowledge of all relevant information. The determination of whether or not a tax position has met the more-likely-than-not recognition threshold considers the facts, circumstances, and information available at the reporting date and is subject to management's judgment.

The Company recognizes interest and penalties on income taxes, if any, as a component of income tax expense. Tax years subject to examination by tax authorities are the years ended December 31, 2016, 2015 and 2014.

Earnings Per Share

Earnings per share is computed by dividing net income available to common stockholders by the weighted average number of shares outstanding during the year. The average number of shares outstanding during 2017 and 2016 was 694,793 and 693,192, respectively.

Statements of Cash Flows

For the purpose of presentation in the consolidated statements of cash flows, cash and cash equivalents are defined as cash and due from banks.

Off-Balance-Sheet Financial Instruments

In the ordinary course of business, the Bank has entered into off-balance-sheet financial instruments consisting of commitments to extend credit and standby letters of credit. Such financial instruments are recorded in the consolidated financial statements when they are funded or related fees are incurred or received.

Reclassifications

Certain amounts appearing in the prior years' consolidated financial statements may have been reclassified to conform with the current year's presentation. These reclassifications, if any, did not have any impact on stockholders' equity or net income.

Comprehensive Income

Accounting principles generally require that recognized revenue, expenses, gains and losses be included in net income. Although certain changes in assets and liabilities, such as unrealized gains and losses on available-for-sale securities, are reported as a separate component of the stockholders' equity section of the consolidated statements of financial condition, such items along with net income are components of comprehensive income.

Subsequent Events

The Company has evaluated events and transactions occurring subsequent to the balance sheet date of December 31, 2017 for items that should potentially be recognized or disclosed in these financial statements. The evaluation was conducted through April 12, 2018 the date these financial statements were available to be issued.

Branch Acquisition

On April 22, 2016, the Bank acquired a branch in Halfmoon New York from Community Bank, N. A. There was $4,717,000 in loans acquired and $5,902,000 in deposits assumed as well as an immaterial amount of equipment and core deposit premium intangible acquired. The net amount of cash transferred to the Company in connection with the acquisition was $909,000.

2. Cash and Due from Banks

The Bank is required to maintain reserve funds in cash and/or on deposit with the Federal Reserve Bank. The required reserve at December 31, 2017 and 2016 was satisfied by vault cash. The Bank maintains cash deposits in other depository institutions that occasionally exceed the amount of deposit insurance available. Management periodically assesses the financial condition of these institutions and believes that the risk of any possible credit loss is minimal.

3. Investment Securities

The amortized cost and fair value of investment securities, with gross unrealized gains and losses, are as follows at December 31, 2017 and 2016 (in thousands):

December 31, 2017	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Available-for-sale:				
U.S. treasuries	**$ 24,988**	**$ 1**	**$ -**	**$ 24,989**
U.S. agencies mortgage-backed securities	**73,150**	**4**	**(1,816)**	**71,339**
State and local municipal	**26,529**	**208**	**(574)**	**26,163**
	$ 124,667	**$ 213**	**$ (2,390)**	**$ 122,491**
Held-to-maturity:				
State and local municipal	**$ 6,502**	**$ 6**	**$ (243)**	**$ 6,265**

December 31, 2016	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Available-for-sale:				
U.S. agencies mortgage-backed securities	$ 116,544	$ 108	$ (2,253)	$ 114,399
State and local municipal	36,620	213	(1,186)	35,647
	$ 153,164	$ 321	$ (3,439)	$ 150,046
Held-to-maturity:				
State and local municipal	$ 7,685	$ 1	$ (484)	$ 7,202

The following table sets forth the Company's investment in securities with unrealized losses of less than twelve months and unrealized losses of twelve months or more at December 31, 2017 and 2016 (in thousands):

December 31, 2017	Less than 12 Months		12 Months or Longer		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Available-for-sale:						
U.S. treasuries	$ -	$ -	$ -	$ -	$ -	$ -
U.S. agencies mortgage-backed securities	**10,743**	**(114)**	**59,849**	**(1,702)**	**70,592**	**(1,816)**
State and local municipal	**1,169**	**(15)**	**10,970**	**(559)**	**12,139**	**(574)**
	$ 11,912	**$ (129)**	**$ 70,819**	**$ (2,261)**	**$ 82,731**	**$ (2,390)**
Held-to-maturity:						
State and local municipal	**$ 1,044**	**$ (114)**	**$ 4,418**	**$ (129)**	**$ 5,462**	**$ (243)**

December 31, 2016	Less than 12 Months		12 Months or Longer		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Available-for-sale:						
U.S. Treasuries	$ -	$ -	$ -	$ -	$ -	$ -
U.S. agencies mortgage-backed securities	100,408	(2,187)	2,052	(66)	102,460	(2,253)
State and local municipal	20,105	(1,186)	-	-	20,105	(1,186)
	$ 120,513	$ (3,373)	$ 2,052	$ (66)	$ 122,565	$ (3,439)
Held-to-maturity:						
State and local municipal	$ 3,724	$ (187)	$ 3,170	$ (297)	$ 6,894	$ (484)

The total number of securities with an unrealized loss of 12 months or more was 65 and 17 at December 31, 2017 and 2016, respectively. The total number of securities with an unrealized loss of less than 12 months was 14 and 93 at December 31, 2017 and 2016, respectively.

Unrealized losses on these securities have not been recognized into earnings because the issuers of the securities are of high credit quality, management has the ability and intent to hold these securities for the foreseeable future and does not believe they will have to sell the securities or be required to sell the securities, and the declines in fair value are largely due to market interest rates and not a result of credit risk. The fair values of these securities are expected to recover as they approach maturity and/or market interest rates fluctuate.

The amortized cost and fair value of debt securities at December 31, 2017, by contractual maturity are shown below (in thousands). Expected maturities will differ from contractual maturities because borrowers may have the right to call or repay obligations with or without call or prepayment penalties.

December 31, 2017	Available-for-Sale		Held-to-Maturity	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
Due in one year or less	$ 27,218	$ 27,227	$ 318	$ 318
Due after one year through five years	2,215	2,239	951	934
Due after five years through ten years	4,623	4,668	2,476	2,387
Due after ten years	17,461	17,018	2,757	2,626
Mortgage-backed securities	73,150	71,339	-	-
	$ 124,667	$ 122,491	$ 6,502	$ 6,265

Debt securities with a carrying value of $107,102,000 and $127,050,000 were pledged to secure public deposits at December 31, 2017 and 2016, respectively. Proceeds from sales of securities available-for-sale during 2017 and 2016 were $40,692,000 and $20,511,000, respectively. Gross realized gains on securities available-for-sale that were sold during 2017 and 2016 totaled $216,000 and $245,000, respectively. Gross realized losses on securities available-for-sale that were sold during 2017 and 2016 totaled $103,000 and $30,000, respectively.

4. Loans and Allowance for Loan Losses

Loans consist of the following at December 31, 2017 and 2016 (in thousands):

	2017	2016
Commercial loans:		
Commercial	$ 47,567	$ 57,473
Commercial real estate	213,616	166,583
Consumer loans:		
Residential mortgage	4,894	5,999
Installment	3,283	5,418
Home equity	7,083	8,069
Other consumer	88	169
	276,531	243,711
Allowance for loan losses	(3,165)	(3,383)
Net deferred loan costs	658	681
	$ 274,024	$ 241,009

The following table presents the classes of the loan portfolio summarized by the aggregate pass rating and the classified ratings of special mention, substandard and doubtful within the Company's internal risk rating system as of December 31, 2017 and 2016 (in thousands):

December 31, 2017	Pass	Special Mention	Substandard	Doubtful	Total
Commercial	**$ 45,715**	**$ 460**	**$ 1,392**	**$ -**	**$ 47,567**
Commercial real estate	**204,909**	**3,276**	**5,431**	**-**	**213,616**
Residential mortgage	**4,063**	**466**	**365**	**-**	**4,894**
Installment	**3,276**	**-**	**7**	**-**	**3,283**
Home equity	**7,083**	**-**	**-**	**-**	**7,083**
Other consumer	**88**	**-**	**-**	**-**	**88**
	$ 265,134	**$ 4,202**	**$ 7,195**	**$ -**	**$ 276,531**

December 31, 2016	Pass	Special Mention	Substandard	Doubtful	Total
Commercial	$ 55,220	$ 695	$ 1,558	$ -	$ 57,473
Commercial real estate	159,108	675	6,800	-	166,583
Residential mortgage	5,100	506	393	-	5,999
Installment	5,418	-	-	-	5,418
Home equity	7,975	-	94	-	8,069
Other consumer	169	-	-	-	169
	$ 232,990	$ 1,876	$ 8,845	$ -	$ 243,711

The following table summarizes information in regards to impaired loans by loan portfolio class as of December 31, 2017 and 2016 (in thousands):

December 31, 2017	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Interest Income Recognized
With no related allowance recorded:					
Commercial	**$ 7**	**$ 7**	**$ -**	**$ 43**	**$ 9**
Commercial real estate	**3,547**	**3,547**	**-**	**3,762**	**177**
Residential mortgage	**-**	**-**	**-**	**-**	**-**
Installment	**7**	**7**	**-**	**8**	**-**
Home equity	**218**	**218**	**-**	**287**	**15**
Other consumer	**-**	**-**	**-**	**-**	**-**
With an allowance recorded:					
Commercial	**$ 500**	**$ 800**	**$ 300**	**$ 627**	**$ 39**
Commercial real estate	**143**	**203**	**60**	**125**	**15**
Residential mortgage	**-**	**-**	**-**	**-**	**-**
Installment	**-**	**-**	**-**	**-**	**-**
Home equity	**-**	**-**	**-**	**-**	**-**
Other consumer	**-**	**-**	**-**	**-**	**-**
Total:					
Commercial	**$ 507**	**$ 807**	**$ 300**	**$ 670**	**$ 48**
Commercial real estate	**3,690**	**3,750**	**60**	**3,887**	**192**
Residential mortgage	**-**	**-**	**-**	**-**	**-**
Installment	**7**	**7**	**-**	**8**	**-**
Home equity	**218**	**218**	**-**	**287**	**15**
Other consumer	**-**	**-**	**-**	**-**	**-**

December 31, 2016	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Interest Income Recognized
With no related allowance recorded:					
Commercial	$ 255	$ 340	$ -	$ 1,367	$ -
Commercial real estate	7,300	7,495	-	7,754	396
Residential mortgage	333	416	-	328	9
Installment	-	-	-	-	-
Home equity	279	279	-	378	17
Other consumer	-	-	-	-	-
With an allowance recorded:					
Commercial	$ 1,949	$ 2,177	$ 664	$ 3,156	$ 133
Commercial real estate	714	714	133	1,043	20
Residential mortgage	-	-	-	-	-
Installment	-	-	-	-	-
Home equity	-	-	-	3	-
Other consumer	-	-	-	-	-
Total:					
Commercial	$ 2,204	$ 2,517	$ 664	$ 4,523	$ 133
Commercial real estate	8,014	8,209	133	8,797	416
Residential mortgage	333	416	-	328	9
Installment	-	-	-	3	-
Home equity	279	279	-	378	17
Other consumer	-	-	-	-	-

The following table presents nonaccrual loans by classes of the loan portfolio as of December 31, 2017 and 2016 (in thousands):

	2017	2016
Commercial	**$ 6**	$ 433
Commercial real estate	**586**	1,940
Residential mortgage	**68**	145
Installment	**7**	-
Home equity	**-**	94
Other consumer	**-**	-
	$ 667	$ 2,612

The performance and credit quality of the loan portfolio is also monitored by the analyzing the age of the loans receivable as determined by the length of time a recorded payment is past due. The following table presents the classes of the loan portfolio summarized by the past due status as of December 31, 2017 and 2016 (in thousands):

December 31, 2017	30-59 Days Past Due	60-89 Days Past Due	Greater Than 90 Days	Total Past Due	Current	Total Loans Receivables	Loans Receivable >90 Days and Accruing
Commercial	$ -	$ 39	$ 6	$ 45	$ 47,522	$ 47,567	$ -
Commercial real estate	1,941	-	1,026	2,967	210,649	213,616	440
Residential mortgage	-	-	133	133	4,761	4,894	65
Installment	30	-	7	37	3,246	3,283	-
Home equity	-	-	-	-	7,083	7,083	-
Other consumer	-	-	-	-	88	88	-
	$ 1,971	$ 38	$ 1,173	$ 3,182	$ 273,349	$ 276,531	$ 505

December 31, 2016	30-59 Days Past Due	60-89 Days Past Due	Greater Than 90 Days	Total Past Due	Current	Total Loans Receivables	Loans Receivable >90 Days and Accruing
Commercial	$ 326	$ -	$ 689	$ 1,015	$ 56,458	$ 57,473	$ 256
Commercial real estate	-	-	2,341	2,341	164,242	166,583	401
Residential mortgage	201	-	212	413	5,586	5,999	67
Installment	88	21	-	109	5,309	5,418	-
Home equity	-	-	94	94	7,975	8,069	-
Other consumer	-	-	-	-	169	169	-
	$ 615	$ 21	$ 3,336	$ 3,972	$ 239,739	$ 243,711	$ 724

The following table summarizes the activity in the allowance for loan losses by loan class for the years ended December 31, 2017 and 2016 and information in regards to the allowance for loan losses and the recorded investment in loans receivable by loan class as of December 31, 2017 and 2016 (in thousands):

December 31, 2017			Allowance for Loan Losses				
	Beginning Balance	Charge-offs	Recoveries	Provisions	Ending Balance	Ending Balance: Individually Evaluated for Impairment	Ending Balance: Collectively Evaluated for Impairment
Commercial	$ 1,682	$ (278)	$ 56	$ (606)	$ 854	$ 300	$ 554
Commercial real estate	1,370	(222)	24	487	1,659	60	1,599
Residential mortgage	6	(17)	-	28	17	-	17
Installment	56	(33)	2	9	34	-	34
Home equity	18	-	-	21	39	-	39
Other consumer	1	(5)	-	5	1	-	1
Unallocated	250	-	-	311	561	-	561
	$ 3,383	$ (557)	$ 82	$ 255	$ 3,165	$ 360	$ 2,805

December 31, 2017	Loans Receivable		
	Ending Balance	Ending Balance: Individually Evaluated for Impairment	Ending Balance: Collectively Evaluated for Impairment
Commercial	**$ 47,567**	**$ 507**	**$ 47,060**
Commercial real estate	**213,616**	**3,690**	**209,926**
Residential mortgage	**4,894**	**-**	**4,894**
Installment	**3,283**	**7**	**3,276**
Home equity	**7,083**	**218**	**6,865**
Other	**88**	**-**	**88**
	$ 276,531	**$ 4,782**	**$ 271,749**

December 31, 2016	Allowance for Loan Losses						
	Beginning Balance	Charge-offs	Recoveries	Provisions	Ending Balance	Ending Balance: Individually Evaluated for Impairment	Ending Balance: Collectively Evaluated for Impairment
Commercial	$ 2,903	$ (848)	$ 18	$ (391)	$ 1,682	$ 664	$ 1,018
Commercial real estate	1,205	(404)	46	523	1,370	133	1,237
Residential mortgage	11	(8)	-	3	6	-	6
Installment	34	(82)	1	103	56	-	56
Home equity	18	(20)	-	20	18	-	18
Other consumer	2	(5)	-	4	1	-	1
Unallocated	173	-	-	77	250	-	250
	$ 4,346	$ (1,367)	$ 65	$ 339	$ 3,383	$ 797	$ 2,586

December 31, 2016	Loans Receivable		
	Ending Balance	Ending Balance: Individually Evaluated for Impairment	Ending Balance: Collectively Evaluated for Impairment
Commercial	$ 57,473	$ 2,204	$ 55,269
Commercial real estate	166,583	8,014	158,569
Residential mortgage	5,999	333	5,666
Installment	5,418	-	5,418
Home equity	8,069	279	7,790
Other	169	-	169
	$ 243,711	$ 10,830	$ 232,881

The Company may grant a concession or modification for economic or legal reasons related to a borrower's financial condition that it would not otherwise consider resulting in a modified loan which is then identified as a troubled debt restructuring (“TDR”). The Company may modify loans through rate reductions, extensions of maturity at a below market interest rate, given the related credit risk, interest only payments, or payment modifications to better match the timing of cash flows due under the modified terms with the cash flows from the borrowers' operations. Loan modifications are intended to minimize the economic loss and to avoid foreclosure or repossession of the collateral. All TDRs are considered impaired loans for purposes of calculating the Company's allowance for loan losses and are classified as impaired loans for the purpose of financial reporting.

The Company identifies loans for potential restructure primarily through direct communication with the borrower and evaluation of the borrower's financial statements, revenue projections, tax returns, and credit reports. Even if the borrower is not presently in default, management will consider the likelihood that cash flow shortages, adverse economic conditions, and negative trends may result in a payment default in the near future.

There were no loans whose terms have been modified under troubled debt restructurings during the year ended December 31, 2017.

The following table shows loans whose terms have been modified under troubled debt restructurings during the year ended December 31, 2016 (dollars in thousands):

December 31, 2016	Number of Contracts	Pre-Modification Outstanding Recorded Investments	Post-Modification Outstanding Recorded Investments
Commercial real estate	1	$ 1,630	$ 1,630

The loan modified in 2016 was given a deferment of principal and interest payments for 12 months.

There were no defaults during the years ended December 31, 2017 and 2016 for troubled debt restructurings that defaulted within 12 months of the restructuring.

5. Premises and Equipment

Premises and equipment consist of the following at December 31, 2017 and 2016 (in thousands):

	2017	2016
Buildings	**$ 1,269**	$ 1,238
Data processing equipment	**2,457**	3,509
Office and other equipment	**1,669**	1,835
Leasehold improvements	**1,424**	1,210
Land	**168**	168
	6,987	7,960
Accumulated depreciation and amortization	**(4,144)**	(5,065)
	$ 2,843	$ 2,895

At December 31, 2017, the Company leased branch facilities and its corporate office under noncancelable operating leases. Future minimum rental payments under these leases are as follows (in thousands):

Year ending December 31,		
2018	$	1,044
2019		1,046
2020		931
2021		620
2022		408
Thereafter		1,160
	$	5,209

Rent expense under the operating leases totaled $689,000 in 2017 and $765,000 in 2016.

6. Deposits

Time deposits in denominations of $250,000 and over were $22,566,000 and $19,093,000 at December 31, 2017 and 2016, respectively.

The aggregate amount of demand deposits overdrafts that were reclassified as loans were $33,000 and $112,000 as of December 31, 2017 and 2016, respectively.

At December 31, 2017, scheduled maturities of time deposits are as follows (in thousands):

Year ending December 31,		
2018	$	65,828
2019		20,128
2020		7,392
2021		5,664
2022		756
	$	99,768

7. Borrowings

The Bank has arranged for a $3,500,000 overnight line of credit with a correspondent bank. The line bears interest at the federal funds rate in effect at the time of the borrowing plus 3/8%. The terms of the line, which is generally unsecured, require the Bank to identify and segregate in a separate account specific securities pledged as collateral for any amounts borrowed over $1,500,000. The collateral must consist of securities with a market value of at least 125%, marked to market on a daily basis, of borrowings in excess of the unsecured limit. There were no borrowings on the line at December 31, 2017 and 2016.

The Bank has arranged for four unsecured federal funds overnight lines of credit with four correspondent banks. The lines bear interest at the federal funds rate. The maximum available credit is $3,000,000 for two of the lines, $2,800,000 on another line and one line has a maximum available credit of $5,000,000. There were no borrowings on any of the lines at December 31, 2017 and 2016.

The Company has a borrowing agreement with the Federal Home Loan Bank of New York ("FHLB") with an available funding capacity for overnight advances of approximately $221,111,000 as of December 31, 2017. This limit is further restricted by the Company's ability to provide eligible collateral to support its obligations to the FHLB as well as the ability to meet the FHLB's stock purchase requirement. Advances from the FHLB are collateralized by a blanket lien against the Company's qualifying assets with variable interest rates according to the current rate of the Overnight Advance Program of the FHLB.

8. Subordinated Debentures

The Bank had issued $1,800,000 in subordinated debentures. Interest is payable semi-annually. The debentures matured on January 1, 2016 and were paid in full.

The Company issued $11,000,000 in new subordinated debentures on October 28, 2016. The debentures bear interest at a fixed rate of 7.25%. Interest is payable quarterly. The debentures mature on October 28, 2026. The debentures may be redeemed in whole or in part on or after the 5th anniversary date of October 28, 2021 at 100% of the principal amount plus accrued interest. At December 31, 2017, the amount of the subordinated debentures net of amortized acquisition costs totaling $201,000 is $10,799,000.

9. Junior Subordinated Debentures

The Company has issued $3,299,000 in junior subordinated debentures due December 15, 2036, to Trust I. The Company owns all of the $99,000 in common equity of the trust and the debentures are the sole asset of the trust. The trust issued $3,200,000 of floating-rate trust capital securities in a non-public offering. The floating-rate capital securities provide for quarterly distributions at a variable coupon rate, reset quarterly, based on three-month LIBOR plus 1.75%. The interest rate was 3.34% and 2.71% at December 31, 2017 and 2016, respectively. The securities are callable by the Company, subject to any required regulatory approval, at par, after five years. The Company unconditionally guarantees the trust capital securities. The terms of the junior subordinated debentures and the common equity of the trust mirror the terms of the trust capital securities issued by the trust. The Company used the net proceeds from this offering to fund an additional $3,200,000 capital investment in the Bank to fund its operations and future growth.

In accordance with FASB ASC 810, *Consolidation of Variable Interest Entities*, the accounts of Trust I are not included in the consolidated financial statements of the Company. However, for regulatory purposes, the trust capital securities qualify as Tier I capital of the Company subject to a 25% of capital limitation under risk-based capital guidelines. The portion that exceeds the 25% of capital limitation qualifies as Tier II capital. At December 31, 2017 and 2016, all of the Company's trust capital securities qualified as Tier I capital.

10. Stockholders' Equity

Preferred stock of the Company was redeemed on October 28, 2016 and was as follows prior to the redemption:

Authorized shares, $1.00 par value; $1,000 liquidation preference	200,000
Issued and outstanding shares	9,681
Aggregate liquidation preference value	$ 9,681

In 2011, as part of the Treasury Small Business Lending Fund ("SBLF") program, the Company entered into a Securities Purchase Agreement ("SBLF Purchase Agreement") with the United States Department of the Treasury ("Treasury") pursuant to which the Company sold to the Treasury, for an aggregate purchase price of $9,681,000, 9,681 shares of senior non-cumulative, perpetual preferred stock, Series E, $1,000 liquidation value, $1.00 par value ("SBLF Preferred Stock"). The preferred stock was issued pursuant to the SBLF program, a $30 billion fund established under the Small Business Lending Jobs Act of 2010 that was created to encourage lending to small businesses by providing capital to qualified community banks with assets of less than $10 billion.

The SBLF Preferred Stock qualified as Tier 1 regulatory capital and paid quarterly non-cumulative dividends. The dividend rate fluctuated for the first nine quarters based upon changes in the Bank's level of "Qualified Small Business Lending" or "QSBL" (as defined in the SBLF Purchase Agreement). The dividend rate was able to be adjusted between one percent (1%) and five percent (5%) per annum to reflect the amount of change in the Company's level of QSBL. For the tenth calendar quarter through four and one half years after issuance, the dividend rate was fixed at between one percent (1%) and seven percent (7%) based upon the increase in QSBL as compared to the baseline (as defined in the SBLF Purchase Agreement). After four and one half years from issuance, the dividend rate increased to 9%. From January 1, 2016 to October 28, 2016 the Company paid 9%. The dividend rate during 2015 was 1%.

Common stock of the Company is as follows at December 31, 2017 and 2016:

	2017	2016
Authorized shares, $1 par value	**1,000,000**	1,000,000
Issued shares	**707,500**	702,500
Outstanding shares	**699,084**	694,084

11. Retirement Plan

The Bank has a 401(k) defined contribution retirement plan covering substantially all of its employees as they become eligible. Employer matching contributions to the plan are allowed under the plan. Matching contributions totaled $80,000 and $87,000 for 2017 and 2016, respectively. Additional contributions to the plan are permitted based on management's discretion.

12. Income Taxes

Income tax expense in the consolidated statements of income are comprised of (in thousands):

		2017		2016
Current	$	**583**	$	504
Deferred		**351**		311
	$	**934**	$	815

The provision for income taxes differs from that computed by applying statutory rates to income before income taxes primarily due to the effects of tax-exempt income and state taxes.

On December 22, 2017, the enacted income tax rate changed from 34 percent to 21 percent for tax years beginning on or after January 1, 2018 as a result of the Tax Cuts and Jobs Act. Included in Deferred expense for 2017 is $293,000 related to the write-down of net deferred tax assets from the historic 34 percent to the newly enacted 21 percent tax rate on December 22, 2017.

Deferred income tax assets and liabilities resulting from temporary differences are summarized as follows (in thousands):

		2017		2016
Deferred tax assets:				
Allowance for loan losses	$	**66**	$	63
Federal AMT credit		**821**		973
Core Deposit Premium		**5**		5
Available-for-sale securities		**457**		1,091
Total Deferred Tax Assets		**1,349**		2,132
Deferred tax liabilities:				
Premises and equipment		**(7)**		(50)
Deferred loan fees		**(138)**		(232)
Total Deferred Tax Liabilities		**(145)**		(282)
Net Deferred Tax Asset	$	**1,204**	$	1,850

US GAAP requires a valuation allowance against deferred tax assets if, based on the weight of available evidence, it is more likely than not that some or all of the deferred tax assets will not be realized. The full realization of the tax benefits associated with the carryforwards depends predominately upon the recognition of ordinary income during the carryforward period. Management has concluded that no valuation allowance for deferred tax assets was required at December 31, 2017 and 2016.

The Company did not have any uncertain tax positions at December 31, 2017 and 2016.

13. Related Party Transactions

In the ordinary course of business, the Bank has and expects to continue to have transactions, including loans and deposit accounts with the Company's and the Bank's executive officers and directors, and their affiliates. The aggregate amount of loans to such related parties at December 31, 2017 and 2016 was $6,752,000 and $6,019,000, respectively. During 2017, there were $228,000 in new loans to such related parties, additional advances on existing loans were $2,425,000, and repayments amounted to $2,368,000, and other reductions due to change in composition of related parties of $-0-. During 2016, there were $272,000 in new loans to such related parties, additional advances on existing loans were $1,705,000, and repayments amounted to $1,597,000, and other reductions due to changes in the composition of related parties of $3,100,000.

The Bank held deposits of $9,212,000 and $6,868,000 for related parties at December 31, 2017 and 2016, respectively.

14. Commitments and Contingent Liabilities

The Bank is a party to financial instruments with off-balance-sheet risk in the normal course of business to meet the financing needs of its customers. These financial instruments include commitments to extend credit and standby letters of credit. These instruments involve, to varying degrees, elements of credit and interest rate risk in excess of the amounts recognized in the statements of financial condition. The Bank uses the same credit policies in making commitments and conditional obligations as it does for on-balance-sheet instruments. The Bank's exposure to credit loss in the event of nonperformance by the other party to the financial instrument for commitments to extend credit and standby letters of credit is represented by the contractual notional amount of those instruments summarized as follows at December 31, 2017 and 2016 (in thousands):

	2017	2016
Commitments to extend credit:		
Commitments to grant loans	**$ 20,049**	$ 26,469
Unfunded commitments under commercial lines of credit	**43,663**	39,707
Unfunded commitments under consumer lines of credit	**4,104**	3,634
Standby letters of credit	**1,893**	1,126

Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. Since many of the commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements.

The Bank evaluates each customer's credit worthiness on a case-by-case basis. The amount and type of collateral obtained, if deemed necessary by the Bank upon extension of credit, varies and is based on management's credit evaluation of the counterparty.

Standby letters of credit are conditional lending commitments issued by the Bank to guarantee the performance of a customer to a third party. These letters of credit are primarily issued to support public and private borrowing arrangements. Generally, letters of credit issued have expiration dates within one year. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loan facilities to customers. The Bank's policy for obtaining collateral, and the nature of such collateral, is essentially the same as that involved in making commitments to extend credit. The Bank generally holds collateral supporting those commitments. The amount of the liability related to guarantees under standby letters of credit was not material at December 31, 2017 and 2016.

The terms of the Subordinated Debentures discussed in Note 8 and the Junior Subordinated Debentures discussed in Note 9 contain certain covenants. Management believes the Company has complied with all covenants during 2017 and 2016.

15. Concentrations of Credit

Most of the Bank's business activity is with customers in the Bank's market area. The majority of those customers are depositors of the Bank. Investments in state and local government securities also involve governmental entities within the Bank's market area. The concentrations of credit by type of loan are set forth in Note 4. The distribution of commitments to extend credit is set forth in Note 14. The Bank, as matter of policy, does not extend credit to any single borrower, or group of related borrowers in excess of its legal lending limit.

16. Regulatory Matters

The Bank is subject to various regulatory capital requirements administered by federal banking agencies. Failure to meet minimum capital requirements can initiate certain mandatory, and possibly additional discretionary, actions by regulators that, if undertaken, could have a direct material effect on the Company's financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, the Bank must meet specific capital guidelines that involve quantitative measures of the Bank's assets, liabilities, and certain off-balance-sheet items as calculated under regulatory accounting practices. The Bank's capital amounts and classification are also subject to qualitative judgments by the regulators about components, risk weightings, and other factors.

The Bank is subject to legal limitations on the amount of dividends that can be paid to the Company. With the exception of the restrictions described above, at December 31, 2017, approximately $3,792,000 was available for the declaration of dividends. For all practical purposes, the Company could not declare dividends in excess of this amount.

In July 2013, the Federal Reserve Board approved final rules (the "U.S. Basel III Capital Rules") establishing a new comprehensive capital framework for U.S. banking organizations and implementing the Basel Committee on Banking Supervision's December 2010 framework for strengthening international capital standards. The U.S. Basel III Capital Rules substantially revise the risk-based capital requirements applicable to bank holding companies and depository institutions.

The new minimum regulatory capital requirements established by the U.S. Basel III Capital Rules became effective for the Bank on January 1, 2015, and will be fully phased in on January 1, 2019.

The U.S. Basel III Capital Rules requires the Bank to:

- Meet a new minimum Common Equity Tier 1 capital ratio of 4.50% of risk-weighted assets and a Tier 1 capital ratio of 6.00% of risk-weighted assets;

- Continue to require the current minimum total capital ratio of 8.00% of risk-weighted assets and the minimum Tier 1 leverage capital ratio of 4.00% of average assets; and

- Comply with a revised definition of capital to improve the ability of regulatory capital instruments to absorb losses. Certain non-qualifying capital instruments, including cumulative preferred stock and trust preferred securities, are being phased out as a component of Tier 1 capital for institutions of the Bank's size.

When fully phased in on January 1, 2019, the Bank will also be required to maintain a "capital conservation buffer" of 2.50% above the minimum risk-based capital requirements, which must be maintained to avoid restrictions on capital distributions and certain discretionary bonus payments. The capital conservation buffer will be phased in over 4 years and began on January 1, 2016, with a maximum buffer of 0.625% of risk weighted assets for 2016, 1.25% for 2017, 1.875% for 2018, and 2.5% for 2019 and thereafter. Failure to maintain the required capital conservation buffer will result in limitations on capital distributions and on discretionary bonuses to executive officers.

The U.S. Basel III Capital Rules use a standardized approach for risk weightings that expands the risk-weightings for assets and off-balance sheet exposures from the previous 0%, 20%, 50% and 100% categories to a much larger and more risk-sensitive number of categories, depending on the nature of the assets and off-balance sheet exposures and resulting in higher risk weights for a variety of asset categories.

As of December 31, 2017, the Bank met the applicable minimum requirements of the U.S. Basel III Capital Rules, and each of the Bank's capital ratios exceeded the amounts required to be considered "well capitalized" as defined in the regulations. As of December 31, 2017, the Bank's capital levels also met the fully-phased in minimum capital requirements.

Quantitative measures established by regulation to ensure capital adequacy require the Bank to maintain minimum amounts and ratios (set forth below) of total, Tier 1, common equity Tier 1 capital (as defined in the regulations) to risk-weighted assets and of Tier 1 capital to assets. Management believes, as of December 31, 2017, that the Bank meets all capital adequacy requirements to which it is subject.

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As of the most recent notification from its regulators, the Bank was categorized as "well capitalized." There are no conditions or events since the notification that management believes have changed the institution's category. The Bank's capital amounts and ratios are also presented in the table below (dollar amounts in thousands):

December 31, 2017	Actual		For Capital Adequacy Purposes		For Capital Adequacy with Capital Buffer		To Be Well Capitalized Under Prompt Corrective Action Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio	Amount	Ratio
Total capital (to risk-weighted assets)	**$ 38,088**	**12.48%**	**$ ≥24,415**	**≥8.0%**	**$ ≥28,230**	**≥9.25%**	**$ ≥30,519**	**≥10.0%**
Common equity Tier 1 capital (to risk-weighted assets)	**34,923**	**11.45%**	**≥18,300**	**≥6.0%**	**≥22,112**	**≥7.25%**	**≥24,401**	**≥ 8.0%**
Tier 1 capital (to risk-weighted assets)	**34,923**	**11.45%**	**≥13,725**	**≥4.5%**	**≥17,538**	**≥5.75%**	**≥19,825**	**≥ 6.5%**
Tier 1 capital (to average assets)	**34,923**	**7.61%**	**≥18,356**	**≥4.0%**	**N/A**	**N/A**	**≥22,945**	**≥ 5.0%**

December 31, 2016	Actual		For Capital Adequacy Purposes		For Capital Adequacy with Capital Buffer		To Be Well Capitalized Under Prompt Corrective Action Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio	Amount	Ratio
Total capital (to risk-weighted assets)	$ 36,367	12.74%	$ ≥22,837	≥8.0%	$ ≥24,621	≥8.625%	$ ≥28,547	≥10.0%
Common equity Tier 1 capital (to risk-weighted assets)	32,984	11.55%	≥17,128	≥6.0%	≥17,127	≥6.625%	≥22,837	≥ 8.0%
Tier 1 capital (to risk-weighted assets)	32,984	11.55%	≥12,846	≥4.5%	≥14,630	≥5.125%	≥18,555	≥ 6.5%
Tier 1 capital (to average assets)	32,984	7.04%	≥18,740	≥4.0%	N/A	N/A	≥23,426	≥ 5.0%

17. Fair Value Measurements

Management uses its best judgment in estimating the fair value of the Company's financial instruments; however, there are inherent weaknesses in any estimation technique. Therefore, for substantially all financial instruments, the fair value estimates herein are not necessarily indicative of the amounts the Company could have realized in a sales transaction on the dates indicated. The estimated fair value amounts have been measured as of their respective year-ends and have not been re-evaluated or updated for purposes of these financial statements subsequent to those respective dates. As such, the estimated fair values of these financial instruments subsequent to the respective reporting dates may be different than the amounts reported at each year-end.

The Company follows current fair value measurement in accordance with accounting principles generally accepted in the United States of America ("GAAP"). This guidance defines fair value, establishes a framework for measuring fair value under GAAP, and expands disclosures about fair value measurements. It applies to other accounting pronouncements that require or permit fair value measurements.

Fair value is defined as the price that would be received to sell the asset or transfer the liability in an orderly transaction (that is, not a forced liquidation or distressed sale) between market participants at the measurement date under current market conditions. Additional guidance is provided in determining fair value when the volume and level of activity for the asset or liability has significantly decreased, including guidance on identifying circumstances when a transaction may not be considered orderly.

A reporting entity should determine whether there has been a significant decrease in the volume and level of activity for the asset or liability in relation to normal market activity for the asset or liability. When the reporting entity concludes there has been a significant decrease in the volume and level of activity for the asset or liability, further analysis of the information from that market is needed and significant adjustments to the related prices may be necessary to estimate fair value.

A reporting entity must determine if the decrease in the volume and level of activity for the asset or liability, suggests the transactions may not be orderly. In those situations, the entity must evaluate the weight of the evidence to determine whether the transaction is orderly, considering the circumstances that indicate that a transaction is not orderly. A transaction price that is not associated with an orderly transaction is given little weight, if any, when estimating fair value.

The guidance establishes a fair value hierarchy that prioritizes the inputs to valuation methods used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1 measurements) and the lowest priority to unobservable inputs (Level 3 measurements). The three levels of the fair value hierarchy are as follows:

Level 1 - Adjusted quoted prices in active markets that are accessible at the measurement date for identical, unrestricted assets or liabilities.

Level 2 - Noted prices in markets that are not active, or inputs that are observable either directly or indirectly, for substantially the full term of the asset or liability.

Level 3 - Prices or valuation techniques that require inputs that are both significant to the fair value measurement and unobservable (i.e., supported with little or no market activity).

An asset's or liability's level within the fair value hierarchy is based on the lowest level of input that is significant to the fair value measurement.

For financial assets measured at fair value on a recurring basis, the fair value measurements by level within the fair value hierarchy used at December 31, 2017 and 2016 are as follows (in thousands):

December 31, 2017	Total	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Securities available-for-sale:				
U.S. treasuries	$ **24,989**	$ -	$ **24,989**	$ -
U.S. agencies mortgage-backed securities	**71,339**	-	**71,339**	-
State and local municipal	**26,163**	-	**26,163**	-
	$ **122,491**	$ -	$ **122,491**	$ -

December 31, 2016	Total	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Securities available-for-sale:				
U.S. treasuries	$ -	$ -	$ -	$ -
U.S. agencies mortgage-backed securities	114,399	-	114,399	-
State and local municipal	35,647	-	35,647	-
	$ 150,046	$ -	$ 150,046	$ -

For financial assets measured at fair value on a nonrecurring basis, the fair value measurements by level within the fair value hierarchy used at December 31, 2017 and 2016 are as follows (in thousands):

December 31, 2017	Total	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Impaired loans	**$ 1,267**	**-**	**-**	**1,267**
December 31, 2016				
Impaired loans	$ 2,891	$ -	$ -	$ 2,891

The following table presents additional quantitative information about assets measured on a nonrecurring basis and for which the Company has utilized Level 3 inputs to determine fair value:

December 31, 2017	Fair Value	Valuation Technique	Unobservable Input	Range (Weighted Average)
Impaired loans	**$ 1,267**	Appraisal of collateral [(1)(2)]	Collateral discounts [(2)]	25-50% (38.6)%
December 31, 2016				
Impaired loans	$ 2,891	Appraisal of collateral [(1)(2)]	Collateral discounts [(2)]	10-20% (18.5)%

(1) Fair value is generally determined through independent appraisals of the underlying collateral.

(2) Appraisals may be adjusted by management for qualitative factors such as economic conditions and estimated liquidation expenses. The range of liquidation expenses and other appraisal adjustments are presented as a percent of the appraisal.

The following information should not be interpreted as an estimate of the fair value of the entire Company since a fair value calculation is only provided for a limited portion of the Company's assets and liabilities. Due to a wide range of valuation techniques and the degree of subjectivity used in making the estimates, comparisons between the Company's disclosures and those of other companies may not be meaningful. The following methods and assumptions were used to estimate the fair values of certain of the Company's assets and liabilities at December 31, 2017 and 2016:

Cash and Cash Equivalents (Carried at Cost)

The carrying amounts reported in the statements of financial condition for cash and cash equivalents approximate those assets' fair values.

Securities

The fair value of securities available-for-sale (carried at fair value) and held-to-maturity (carried at amortized cost) are determined by obtaining quoted market prices on nationally recognized securities exchanges (Level 1), or matrix pricing (Level 2), which is a mathematical technique used widely in the industry to value debt securities without relying exclusively on quoted market prices for the specific securities but rather by relying on the securities' relationship to other benchmark quoted prices. For certain securities which are not traded in active markets or are subject to transfer restrictions, valuations are adjusted to reflect illiquidity and/or non-transferability, and such adjustments are generally based on available market evidence (Level 3). In the absence of such evidence, management's best estimate is used. The Company had no Level 1 or 3 investments at December 31, 2017 and 2016.

Loans (Carried at Cost)

The fair values of loans are estimated using discounted cash flow analyses, using market rates at the balance sheet date that reflect the credit and interest rate-risk inherent in the loans. Projected future cash flows are calculated based upon contractual maturity or call dates, projected repayments and prepayments of principal. Generally, for variable rate loans that reprice frequently and with no significant change in credit risk, fair values are based on carrying values.

Impaired Loans (Generally Carried at Fair Value)

Impaired loans are those that are accounted for under FASB ASC 310-10-35, *Accounting by Creditors for Impairment of a Loan*, in which the Company has measured impairment generally based on the fair value of the loan's collateral. Fair value is generally determined based upon independent third-party appraisals of the properties, or discounted cash flows based upon the expected proceeds. These assets are included as Level 3 fair values, based upon the lowest level of input that is significant to the fair value measurements.

Restricted Investment in Bank Stock (Carried at Cost)

The carrying amount of restricted investment in bank stock approximates fair value, and considers the limited marketability of such securities.

Accrued Interest Receivable and Payable (Carried at Cost)

The carrying amount of accrued interest receivable and accrued interest payable approximates its fair value.

Deposit Liabilities (Carried at Cost)

The fair values disclosed for demand deposits (e.g., interest and noninterest checking and money market accounts) are, by definition, equal to the amount payable on demand at the reporting date (i.e., their carrying amounts). Fair values for fixed-rate certificates of deposit are estimated using a discounted cash flow calculation that applies interest rates currently being offered in the market on certificates to a schedule of aggregated expected monthly maturities on time deposits.

Subordinated Debentures (Carried at Cost)

Fair values of subordinated debentures approximate their carrying value, due to adjustable interest rate terms.

Junior Subordinated Debentures (Carried at Cost)

Fair values of junior subordinated debentures are estimated using discounted cash flow analysis, based on market rates currently offered on such debt with similar credit risk characteristics, terms and remaining maturity.

Off-Balance Sheet Financial Instruments

Fair values for the Bank’s off-balance sheet financial instruments (lending commitments and letters of credit) are based on fees currently charged in the market to enter into similar agreements, taking into account, the remaining terms of the agreements and the counterparties’ credit standing.

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The carrying amounts and estimated fair values of the Company's financial instruments at December 31, 2017 and 2016 are as follows:

December 31, 2017	Carrying Amount	Fair Value	Level 1	Level 2	Level 3
Financial assets:					
Cash and due from banks	$ **30,267**	$ **30,267**	$ **30,267**	$ **-**	$ **-**
Short term certificates of deposits	**240**	**240**	**240**		
Securities available-for-sale	**122,491**	**122,491**	**-**	**122,491**	**-**
Securities held-to-maturity	**6,502**	**6,265**	**-**	**6,265**	**-**
Loans receivable	**274,024**	**268,722**	**-**	**-**	**268,722**
Restricted investment in bank stock	**731**	**731**	**-**	**731**	**-**
Accrued interest receivable	**1,188**	**1,188**	**-**	**1,188**	**-**
Financial liabilities:					
Deposits	**407,234**	**407,743**	**-**	**407,743**	**-**
Subordinated debentures	**10,799**	**10,579**	**-**	**10,579**	**-**
Junior subordinated debentures	**3,299**	**3,299**	**-**	**3,299**	**-**
Accrued interest payable	**76**	**76**	**-**	**76**	**-**
Off-balance sheet items:					
Commitments to extend credit and standby letters of credit	**-**	**-**	**-**	**-**	**-**

December 31, 2016	Carrying Amount	Fair Value	Level 1	Level 2	Level 3
Financial assets:					
Cash and due from banks	$ 31,976	$ 31,976	$ 31,976	$ -	$ -
Short term certificates of deposits	480	480	480		
Securities available-for-sale	150,046	150,046	-	150,046	-
Securities held-to-maturity	7,685	7,202	-	7,202	-
Loans receivable	241,009	239,375	-	-	239,375
Restricted investment in bank stock	743	743	-	743	-
Accrued interest receivable	1,355	1,355	-	1,355	-
Financial liabilities:					
Deposits	408,329	394,825	-	394,825	-
Subordinated debentures	10,776	10,452	-	10,452	-
Junior subordinated debentures	3,299	3,299	-	3,299	-
Accrued interest payable	65	65	-	65	-
Off-balance sheet items:					
Commitments to extend credit and standby letters of credit	-	-	-	-	-

18. Subsequent Events

During March 2018, the Bank entered into contracts to purchase two real estate properties to be used as part of normal operations. Each of the transactions is expected to close during the second quarter of 2018 and the aggregate purchase price is expected to be approximately $2.8 million. The real estate properties expected to be acquired are located in Chester, New York and Monticello, New York.