



2014 Annual Report

“One definition for the word “strength” is the capacity to endure”. This was the opening sentence of the letter to shareholders in our 2008 annual report. We are pleased and proud to say that since that time, the strength of Jeff Bank has allowed us to not only endure but to thrive. We did this despite the challenges we faced from the Financial Crisis of 2008 and the global recession that followed it. We became strong through our conservative approach to doing business that built a robust capital base from sustained profitability over our 100 years in operation. We sustained that strength by maintaining that conservative approach while adapting to lower net interest margins, caused by historically low interest rates, by increasing productivity, reducing unnecessary expenses and pursuing controlled growth. Our results for 2014, even excluding a one-time gain from the termination of a post retirement benefit plan, marks our sixth consecutive year of increased net income. Also, excluding the one-time gain, our return on assets of 1.17% is one of the highest in New York State and 40% greater than the state average for commercial banks. In December of 2014, the Company recognized these strong financial results by increasing its quarterly dividend by 7.69%.

Though we are handily outperforming our peer averages in net interest income and therefore most measures of profitability, there are still challenges all financial institutions face in the near future. The Federal Reserve Bank has signaled its intention to raise interest rates, possibly as early as the summer of 2015. On most financial institution balance sheets, assets such as loans and investments have a longer term than liabilities, such as deposits and borrowings. This mismatch, or “repricing gap”, could result in increased net interest margin compression as deposit and borrowing expenses increase faster than loans and investments can reprice higher. As net interest income is by far the largest component of our income, the timing and size of potential interest rate increases will likely be the biggest variable impacting our financial performance in 2015.

Regulatory compliance continues to be a burden for all financial institutions as well. The Dodd Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank), which was enacted by Congress in 2010, has yet to see all of its 200 plus new rules implemented. The Consumer Financial Protection Bureau (CFPB), created by Dodd-Frank, is pursuing an anti-bank agenda, issuing onerous new regulations for mortgages, auto loans, prepaid debit cards and other bank products. While the goal of the CFPB is to protect consumers, its aggressive and punitive actions are causing many banks to limit activities. As a result, their rules may have the unintended consequence of making it more difficult for consumers to access the products and services they desire. While Dodd-Frank was enacted to rein in large banks, community banks such as ours are paying the price as new regulations demand more resources to remain in compliance. We support the efforts of community bank trade groups who have had some success in raising the asset size threshold for compliance with some regulations.

On a positive note, the factors that are leading the Federal Reserve Bank to consider increasing interest rates are tied to an improving economy. The improvement in the economy has helped many of our borrowers to improve their financial prospects. As a result, our levels of substandard and special mention rated loans have decreased significantly, both in absolute numbers and even greater as a percentage of our capital base. The improvement has allowed us to keep provisions for loan losses at lower levels than in the past while maintaining an adequate overall allowance for loan losses. We continue to be proactive in addressing delinquencies in our loan portfolio and we work closely with our customers to prevent adverse actions. As much of our loan portfolio is real estate secured, signs of improvement in the Sullivan County real estate market are a welcome development.

The spark that everyone in Sullivan County has been waiting for has now turned into a flame. In December of 2014, the New York State Gaming Facility Location Board recommended a casino gambling license be granted to Montreign Resort Casino in the Town of Thompson near Monticello, New York. The casino will be part of the \$1.1 billion Adelaar destination resort which will also contain an indoor water park, hotel and entertainment village. The magnitude of the resort development will require improved infrastructure, hopefully expanding internet and cellular services to all areas in the county. It should also create significant employment opportunities that should boost household income, which in turn creates a demand for more services. The location of the resort should help increase land values throughout Sullivan County, which will benefit both homeowners and lenders. Our goal is to be the provider of choice for the financial services that will help grow all of the ancillary businesses spawned by the resort and accommodate the changing demographics of the county. We look forward to providing financial services to businesses looking to expand, new businesses moving into the area, and to help fulfill anticipated home financing needs.

Sullivan County Community College is looking toward expansion through hospitality courses aimed at providing local students with the requisite skills for the jobs to be created by economic growth planned within the county. The Center for Discovery is also broadening their commitment to the county and partnering with the community college to expand their footprint, financial investment and micro-industry initiative. The economic future of Sullivan County looks very promising and Jeff Bank is poised to provide the financial resources to facilitate anticipated growth.

As we look forward to a prosperous 2015, our Board of Directors and Executive Management will continue to follow our Vision Statement by pursuing controlled and profitable growth so that we can remain the company of choice for our investors, customers and employees who value trust, integrity and respect. We will also support our employees as they strive to provide exceptional customer service and proactively satisfy the banking needs of our customers.



Wayne V. Zanetti,
President & Chief Executive Officer



Kenneth C. Klein,
Chairman of the Board



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Independent Auditor's Report

To the Board of Directors and
Stockholders of Jeffersonville Bancorp
Jeffersonville, New York

Report on the Consolidated Financial Statements

We have audited the accompanying consolidated financial statements of Jeffersonville Bancorp and its subsidiary (the "Company"), which comprise the consolidated balance sheets as of December 31, 2014 and 2013, and the related consolidated statements of income, comprehensive income, changes in 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 audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit 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 Jeffersonville Bancorp and its subsidiary as of December 31, 2014 and 2013, 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
March 26, 2014

Jeffersonville Bancorp and Subsidiary
Consolidated Balance Sheets

(In thousands, except share and per share data)

| As of December 31, | 2014 | 2013 |
|---|-------------------|-------------------|
| ASSETS | | |
| Cash and cash equivalents | \$ 21,491 | \$ 19,895 |
| Securities available for sale, at fair value | 104,801 | 108,957 |
| Securities held to maturity, estimated fair value of \$7,489 at December 31, 2014 and \$3,780 at December 31, 2013 | 7,208 | 3,612 |
| Loans, net of allowance for loan losses of \$4,353 at December 31, 2014 and \$4,671 at December 31, 2013 | 273,338 | 269,131 |
| Accrued interest receivable | 1,877 | 1,911 |
| Bank-owned life insurance | 16,996 | 16,581 |
| Foreclosed real estate | 1,680 | 1,098 |
| Premises and equipment, net | 6,160 | 4,557 |
| Restricted investments | 568 | 674 |
| Other assets | <u>6,100</u> | <u>6,063</u> |
| Total Assets | <u>\$ 440,219</u> | <u>\$ 432,479</u> |
| LIABILITIES AND STOCKHOLDERS' EQUITY | | |
| Liabilities | | |
| Deposits: | | |
| Demand deposits (non-interest bearing) | \$ 89,321 | \$ 84,305 |
| NOW and super NOW accounts | 52,628 | 53,229 |
| Savings and insured money market deposits | 120,406 | 111,732 |
| Time deposits | <u>114,136</u> | <u>123,375</u> |
| Total Deposits | 376,491 | 372,641 |
| Other liabilities | <u>7,593</u> | <u>6,807</u> |
| Total Liabilities | <u>384,084</u> | <u>379,448</u> |
| Stockholders' equity | | |
| Series A preferred stock, no par value; 2,000,000 shares authorized, none issued | — | — |
| Common stock, \$0.50 par value; 11,250,000 shares authorized, 4,767,786 shares issued with 4,234,505 outstanding | 2,384 | 2,384 |
| Paid-in capital | 6,483 | 6,483 |
| Treasury stock, at cost; 533,281 shares | (4,965) | (4,965) |
| Retained earnings | 54,191 | 49,440 |
| Accumulated other comprehensive loss | <u>(1,958)</u> | <u>(311)</u> |
| Total Stockholders' Equity | <u>56,135</u> | <u>53,031</u> |
| Total Liabilities and Stockholders' Equity | <u>\$ 440,219</u> | <u>\$ 432,479</u> |

See accompanying notes to consolidated financial statements.

Jeffersonville Bancorp and Subsidiary
Consolidated Statements of Income
(In thousands, except per share data)

| For the Years Ended December 31, | 2014 | 2013 |
|--|-----------------|-----------------|
| INTEREST AND DIVIDEND INCOME | | |
| Loan interest and fees | \$ 14,896 | \$ 15,175 |
| Securities: | | |
| Taxable | 985 | 944 |
| Tax-exempt | 2,299 | 2,347 |
| Other interest and dividend income | 61 | 69 |
| Total Interest and Dividend Income | <u>18,241</u> | <u>18,535</u> |
| INTEREST EXPENSE | | |
| Deposits | 1,107 | 1,269 |
| Federal Home Loan Bank borrowings | — | 179 |
| Total Interest Expense | <u>1,107</u> | <u>1,448</u> |
| Net interest income | 17,134 | 17,087 |
| Provision for loan losses | 400 | 700 |
| Net Interest Income after Provision for Loan Losses | <u>16,734</u> | <u>16,387</u> |
| NON-INTEREST INCOME | | |
| Service charges | 1,337 | 1,331 |
| Fee income | 1,144 | 1,062 |
| Earnings on bank-owned life insurance | 415 | 453 |
| Net gain on sales of securities | 65 | 23 |
| Other non-interest income | 204 | 166 |
| Total Non-Interest Income | <u>3,165</u> | <u>3,035</u> |
| NON-INTEREST EXPENSES | | |
| Salaries and employee benefits | 8,319 | 8,234 |
| Post-retirement plan termination | (3,347) | — |
| Occupancy and equipment expenses | 1,733 | 1,944 |
| Advertising expense | 150 | 199 |
| Foreclosed real estate expense, net | 454 | 152 |
| Other non-interest expenses | 3,098 | 3,216 |
| Total Non-Interest Expenses | <u>10,407</u> | <u>13,745</u> |
| Income before income tax expense | 9,492 | 5,677 |
| Income tax expense | 2,497 | 1,057 |
| Net Income | <u>\$ 6,995</u> | <u>\$ 4,620</u> |
| Basic earnings per common share | <u>\$ 1.65</u> | <u>\$ 1.09</u> |
| Average common shares outstanding | <u>4,235</u> | <u>4,235</u> |
| Cash dividends declared per share | <u>\$ 0.53</u> | <u>\$ 0.52</u> |

See accompanying notes to consolidated financial statements.

Jeffersonville Bancorp and Subsidiary
Consolidated Statements of Comprehensive Income
(In thousands)

| For the Years Ended December 31, | 2014 | 2013 |
|--|-----------------|-----------------|
| Net Income | \$ 6,995 | \$ 4,620 |
| Other comprehensive income (loss): | | |
| Securities available for sale: | | |
| Net unrealized holding gains (losses) | 2,315 | (3,399) |
| Income tax (expense) benefit | <u>(834)</u> | <u>1,224</u> |
| Net unrealized holding gains (losses), net of tax | 1,481 | (2,175) |
| Reclassification adjustment for net realized gains included in income ^{(1) (3)} | (65) | (23) |
| Income tax expense | <u>23</u> | <u>8</u> |
| Reclassification adjustment for net realized gains included in income, net of tax | (42) | (15) |
| Change in pension and post retirement liabilities' ^{(2) (3)} | (4,822) | 2,518 |
| Income tax (expense) benefit | <u>1,736</u> | <u>(906)</u> |
| Amortization of pension and post retirement liabilities' gains (losses), net of tax | <u>(3,086)</u> | <u>1,612</u> |
| Other comprehensive loss, net of tax | <u>(1,647)</u> | <u>(578)</u> |
| Comprehensive income | <u>\$ 5,348</u> | <u>\$ 4,042</u> |

See accompanying notes to consolidated financial statements.

- (1) Amounts are included in net gain on sale of securities on the Consolidated Statements of Income as a separate element in total non-interest income.
- (2) Amounts are included in the computation of net periodic benefit cost and are included in salaries and employee benefits as a separate element within total non-interest expense on the Consolidated Statements of Income.
- (3) Income tax amounts are included in income tax expense on the Consolidated Statements of Income.

Jeffersonville Bancorp and Subsidiary
Consolidated Statements of Changes in Stockholders' Equity
(In thousands, except per share data)

| For the Years Ended December 31, 2014 and 2013 | Common stock | Paid-in capital | Treasury stock | Retained earnings | Accumulated other compre- hensive income (loss) | Total stockholders' equity | Common shares issued and outstanding |
|---|-----------------|--------------------|-------------------|----------------------|---|----------------------------------|--|
| Balance at January 1, 2013 | \$ 2,384 | \$ 6,483 | \$ (4,965) | \$ 47,022 | \$ 267 | \$ 51,191 | 4,235 |
| Net income | — | — | — | 4,620 | — | 4,620 | — |
| Other comprehensive loss | — | — | — | — | (578) | (578) | — |
| Cash dividends (\$0.52 per share) | — | — | — | (2,202) | — | (2,202) | — |
| Balance at December 31, 2013 | 2,384 | 6,483 | (4,965) | 49,440 | (311) | 53,031 | 4,235 |
| Net income | — | — | — | 6,995 | — | 6,995 | — |
| Other comprehensive loss | — | — | — | — | (1,647) | (1,647) | — |
| Cash dividends (\$0.53 per share) | — | — | — | (2,244) | — | (2,244) | — |
| Balance at December 31, 2014 | <u>\$ 2,384</u> | <u>\$ 6,483</u> | <u>\$ (4,965)</u> | <u>\$ 54,191</u> | <u>\$ (1,958)</u> | <u>\$ 56,135</u> | <u>4,235</u> |

See accompanying notes to consolidated financial statements.

Jeffersonville Bancorp and Subsidiary
Consolidated Statements of Cash Flows
(In thousands)

| For the Years Ended December 31, | 2014 | 2013 |
|---|------------------|------------------|
| OPERATING ACTIVITIES: | | |
| Net income | \$ 6,995 | \$ 4,620 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| Provision for loan losses | 400 | 700 |
| Depreciation and amortization | 339 | 620 |
| Net gain (loss) on sale of premise and equipment | 23 | (4) |
| Net (gain) loss on revaluation and sale of foreclosed real estate | 61 | (323) |
| Earnings on bank-owned life insurance | (415) | (453) |
| Net gain on sales of securities | (65) | (23) |
| Deferred income tax expense | 1,706 | 97 |
| Decrease in accrued interest receivable | 34 | 147 |
| (Increase) decrease in other assets | (842) | 761 |
| Increase (decrease) in other liabilities | (4,035) | 202 |
| Net Cash Provided by Operating Activities | <u>4,201</u> | <u>6,344</u> |
| INVESTING ACTIVITIES: | | |
| Proceeds from maturities and calls: | | |
| Securities available for sale | 16,908 | 19,780 |
| Securities held to maturity | 1,323 | 1,536 |
| Proceeds from sales of securities available for sale | 1,391 | 25 |
| Purchases: | | |
| Securities available for sale | (11,828) | (27,040) |
| Securities held to maturity | (4,919) | (620) |
| Net increase in loans | (5,620) | (7,045) |
| Net redemption of restricted investments | 106 | 1,485 |
| Purchases of premises and equipment | (1,965) | (101) |
| Proceeds from sales of foreclosed real estate | 393 | 2,006 |
| Net Cash Used in Investing Activities | <u>(4,211)</u> | <u>(9,974)</u> |
| FINANCING ACTIVITIES: | | |
| Net increase in deposits | 3,850 | 13,868 |
| Repayments of Federal Home Loan Bank borrowings | — | (10,000) |
| Cash dividends paid | (2,244) | (2,202) |
| Net Cash Provided by Financing Activities | <u>1,606</u> | <u>1,666</u> |
| Net Increase (Decrease) in Cash and Cash Equivalents | 1,596 | (1,964) |
| Cash and Cash Equivalents at Beginning of Year | 19,895 | 21,859 |
| Cash and Cash Equivalents at End of Year | <u>\$ 21,491</u> | <u>\$ 19,895</u> |
| SUPPLEMENTAL INFORMATION: | | |
| Cash paid for interest | \$ 1,115 | \$ 1,510 |
| Cash paid for income taxes | 1,321 | 811 |
| Transfer of loans to foreclosed real estate | 1,013 | 1,442 |

See accompanying notes to consolidated financial statements.

(1) Summary of Significant Accounting Policies

Basis of Presentation

The consolidated financial statements of Jeffersonville Bancorp (the Parent Company) include its wholly owned subsidiary, Jeff Bank (the Bank). Collectively, Jeffersonville Bancorp and its subsidiary are referred to herein as the "Company" with all significant intercompany transactions having been eliminated.

The Parent Company is a bank holding company whose principal activity is the ownership of all outstanding shares of the Bank's stock. The Bank is a commercial bank providing community banking services to individuals, small businesses, and local municipal governments primarily in Sullivan County, New York. Management makes operating decisions and assesses performance based on an ongoing review of the Bank's community banking operations, which constitute the Company's only operating segment for financial reporting purposes.

The consolidated financial statements have been prepared, in all material respects, in conformity with accounting principles generally accepted in the United States of America. In preparing the consolidated financial statements, management is required to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues, and expenses. Material estimates that are particularly susceptible to near-term change include the allowance for loan losses, the evaluation of other than temporary impairment of investment securities and the assets, liabilities and expenses associated with benefit plans which are described below. Actual results could differ from these estimates.

For purposes of the consolidated statements of cash flows, the Company considers cash, due from banks, and federal funds sold, if any, to be cash equivalents.

Reclassifications have been made to prior year's consolidated financial statements whenever necessary to conform to the current year's presentation. These reclassifications, if any, had no impact on net income or stockholders equity.

The Company has evaluated subsequent events and transactions occurring through March 26, 2015; the date these consolidated financial statements were available for issuance.

Investment Securities

Management determines the appropriate classification of securities at the time of purchase. If management has the positive intent and ability to hold debt securities to maturity, they are classified as securities held to maturity and are stated at amortized cost. All other debt and marketable equity securities are classified as securities available for sale and are reported at fair value. Net unrealized gains or losses on securities available for sale are reported (net of income taxes) in stockholders' equity as a component of accumulated other comprehensive income (loss). Restricted investments, which are nonmarketable equity securities, are carried at cost.

Gains and losses on sales of securities are based on the net proceeds and the amortized cost of the securities sold, using the specific identification method. The amortization of premium and accretion of discount on debt securities is calculated using the level-yield interest method to the earlier of the call date or maturity date.

A security is considered impaired when its amortized cost basis exceeds its fair value at the consolidated balance sheet date. All securities are evaluated on at least a quarterly basis, and more frequently when market conditions warrant such an evaluation, to determine whether the impairment is other-than-temporary. To determine whether an impairment is other-than-temporary, management utilizes criteria such as the reasons underlying the impairment, and the magnitude and duration of the impairment. The Company follows accounting guidance related to recognition and presentation of other-than-temporary impairment. This guidance specifies that (a) if an entity does not have the intent to sell a debt security prior to recovery and (b) it is more likely than not that it will not have to sell the debt security prior to recovery, the security would not be considered other-than-temporarily impaired unless there is a credit loss. The term "other-than-temporary" is not intended to indicate that the decline is permanent, but indicates that the prospects for a near-term recovery of value are not necessarily favorable, or that there is a lack of evidence to support a realizable value equal to or greater than the carrying value of the security. In addition, the total impairment for debt securities is separated into the amount of the impairment related to (a) credit loss and (b) the amount of the impairment related to all other factors, such as interest rate changes. The amount of credit loss, if any, is calculated as the difference between the present value of the cash flows expected to be collected and the amortized cost basis of a security. Once an impairment is determined to be other-than-temporary, the impairment related to credit loss, if any, is charged to income and the amount of the impairment related to all other factors is recognized in other comprehensive income (loss). No impairment charge was recognized during the years ended December 31, 2014 or 2013. For further discussion see Note 3.

Loans

Loans are stated at unpaid principal balances, less deferred loan fees and costs, and the allowance for loan losses. Deferred loan fees and costs are accreted into income using a level-yield interest method. Interest income is recognized on the accrual basis of accounting. When, in the opinion of management, the collection of interest or principal is in doubt, the loan is classified as nonaccrual. Loans past due more than 90 days are classified as nonaccrual except for residential mortgages that are well secured (loan to value 60% or less) and in the process of collection. Thereafter, no interest is recognized as income until it is received in cash, and the loan's collateral is adequate to support both the interest recognized and the loan balance, or until the borrower demonstrates the ability to make scheduled payments of interest and principal, and the loan has remained current for a period of at least six months. For further discussion see Note 5.

Allowance for Loan Losses

The allowance for loan losses is established through a provision for loan losses charged to expense. Loans are charged off against the allowance when management believes that the collectability of all or a portion of the principal is unlikely. Recoveries of loans previously charged off are credited to the allowance when realized.

A loan is considered to be impaired when, based on current information and events, it is probable that the Company will be unable to collect all principal and interest contractually due. Impaired loan disclosures and classification apply to loans that are individually evaluated for collectability in accordance with the Company's ongoing loan review procedures, principally commercial mortgage loans and commercial loans. Smaller balance, homogeneous loans, which are collectively evaluated, such as consumer and residential mortgage loans, are specifically excluded from the classification of impaired loans. Impaired loans are measured based on (i) the present value of expected future cash flows discounted at the loan's effective interest rate, (ii) the loan's observable market price or (iii) the fair value of the collateral if the loan is collateral dependent. Impairment for a majority of the Company's impaired loans is based on the value of the underlying collateral. If the approach used results in a measurement that is less than an impaired loan's recorded investment, an impairment loss is recognized as part of the allowance for loan losses.

The allowance for loan losses is maintained at a level deemed adequate by management based on an evaluation of such factors as economic conditions in the Company's market area, past loan loss experience, the financial condition of individual borrowers, and underlying collateral values based on independent appraisals. While management uses available information to recognize losses on loans, future additions to the allowance for loan losses may be necessary based on changes in economic conditions, particularly in Sullivan County. 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, which may not be currently available to management. For further discussion see Note 5.

Bank-Owned Life Insurance

The investment in bank-owned life insurance, which covers certain officers of the Bank, is carried at the policies' cash surrender value. Additional investments are initially recorded at cost. Increases in the cash surrender value of bank-owned life insurance, net of premiums paid, are included in non-interest income. Liabilities and related compensation costs for employees that are not limited to the employee's active service period are recognized according to ASC Topic 715 *Compensation-Retirement Benefits*.

The Company follows accounting guidance for deferred compensation and postretirement aspects of endorsement and split dollar life insurance arrangements. This guidance applies to life insurance arrangements that provide an employee with a specified benefit that is not limited to the employee's active service period, including certain bank-owned life insurance policies, and requires an employer to recognize a liability and related compensation costs for future benefits that extend to postretirement periods.

Foreclosed Real Estate

Foreclosed real estate consists of properties acquired through foreclosure or voluntary forfeiture and is stated on an individual-asset basis at fair value less estimated costs to sell at initial foreclosure, establishing a new cost basis. When a property is acquired, any excess of the loan balance over the fair value of the property is charged to the allowance for loan losses. If necessary, subsequent write downs to reflect further declines in fair value are included in non-interest expense. Fair value estimates are based on independent appraisals and other available information. While management estimates losses

on foreclosed real estate using the best available information, such as independent appraisals, future write downs may be necessary based on changes in real estate market conditions and the results of regulatory examinations. Operating costs associated with the properties are charged to expense as incurred and any rental income received from these properties is recognized as foreclosed real estate income in the period collected.

Premises and Equipment

Premises and equipment are stated at cost, less accumulated depreciation and amortization. Depreciation and amortization are provided over the estimated useful lives of the assets using straight-line or accelerated methods. Leasehold improvements are amortized over the shorter of their estimated useful lives or their respective lease terms. For further discussion see Note 6.

Restricted Investments

As a member institution of the Federal Home Loan Bank of New York ("FHLB"), Federal Reserve Bank and other institutions, the Bank is required to hold a certain amount of these equity stocks. For further discussion see Note 4.

Advertising Costs

Advertising costs are expensed as incurred and are included in non-interest expenses.

Income Taxes

Deferred tax assets and liabilities are recognized for the future tax consequences attributable to temporary differences between the consolidated financial statement carrying amounts of existing assets and liabilities reported in the consolidated financial statements and their respective tax bases. Deferred tax assets are reduced by a valuation allowance when management determines that it is more likely than not that all or a portion of the deferred tax assets will not be realized. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date.

The Company recognizes the benefit of an uncertain tax position in the financial statements only after determining that the relevant tax authority would more likely than not sustain the position following an audit. For tax positions meeting the more-likely-than-not threshold, the amount recognized in the consolidated financial statements is the largest benefit that has a greater than 50 percent likelihood of being realized upon ultimate settlement with the relevant taxing authority. For these analyses, the Company may engage attorneys to provide opinions related to the positions. The Company applies this policy to all tax positions for which the statute of limitations remains open. There are no uncertain tax positions that materially impact the Company's consolidated balance sheet or statement of operations. The Company records any interest and penalties related to uncertain tax positions in income tax (benefit) expense in the consolidated statement of operations in the year assessed. For further discussion see Note 10.

Earnings Per Common Share

The Company has a simple capital structure. Basic earnings per share is computed by dividing net income by the weighted average number of common shares outstanding for the period.

Recent Accounting Pronouncements

In January 2014, the The Emerging Issues Task Force reached a final consensus on the following issue and a final Accounting Standards Update (ASU) is expected to be issued in 2014. ASU states that a creditor will be considered to have physical possession of residential real estate property that is collateral for a residential mortgage loan and therefore should reclassify the loan to other real estate owned when it obtains legal title to the collateral or it completes a deed in lieu of foreclosure or similar legal agreement. The amendments are effective for all entities for annual periods and interim reporting periods within those annual periods, beginning after December 15, 2014. Early adoption is permitted. The Company is reviewing the potential effects of this ASU on its consolidated financial statements.

In May 2014, the FASB issued ASU 2014-09, *Revenue from Contracts with Customers (Topic 606)*. This standards update provides a framework that replaces most existing revenue recognition guidance. The guidance requires an entity to recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the company expects to be entitled in exchange for those goods or services. ASU 2014-09 is effective for interim and annual reporting periods beginning after December 15, 2016. Early adoption is not permitted. The Company is currently evaluating the impact of the adoption of this guidance on its consolidated financial statements.

The FASB had proposed guidance in October 2014 with a comment deadline of December 15, 2014 on an Accounting Standards Update, *Compensation—Retirement Benefits (Topic 715) - “Practical Expedient for the Measurement Date of an Employer’s Defined Benefit Obligation and Plan Assets”*. The amendments in this proposed Update would

provide a practical expedient for employers with fiscal year-ends that do not fall on a month-end by permitting those employers to measure defined benefit plan assets and obligations as of the month-end that is closest to the entity’s fiscal year-end and to follow that measurement date methodology consistently from year to year. If a contribution to plan assets is made between the date used to measure plan assets and benefit obligations and an entity’s fiscal year-end, the entity would adjust the funded status recognized in its statement of financial position to reflect the contribution. Additionally, the classes of plan assets and the fair value hierarchy would not be adjusted for the effects of the contribution. An entity would be required to disclose the policy election and the alternative date for measuring defined benefit plan assets and obligations.

Other accounting standards that have been issued or proposed by the FASB or other standards-setting bodies are not expected to have a material impact on the Company’s consolidated financial position, results of operations or cash flows.

(2) Cash and Cash Equivalents

The Bank is required to maintain certain reserves in the form of vault cash and/or deposits with the Federal Reserve Bank (FED). The amount of this reserve requirement, which is included in cash and due from banks, was \$366,000 at December 31, 2013. There was no requirement at December 31, 2014. Cash and due from banks includes interest earning deposits at the FED. The interest earning balance at the FED was \$9.0 million and \$6.8 million at December 31, 2014 and December 31, 2013, respectively. As of December 31, 2014 and 2013, the Bank has deposits with correspondent banks in excess of federally insured limits in the amount of \$3.9 million and \$2.4 million respectively.

(3) Investment Securities

The amortized cost and estimated fair value of available for sale and held to maturity securities at December 31 are as follows (in thousands):

| December 31, 2014 Investment Securities | Amortized cost | Gross unrealized gains | Gross unrealized losses | Estimated fair value |
|---|-------------------|------------------------------|-------------------------------|-------------------------|
| Securities Available for Sale: | | | | |
| Obligations of states and political subdivisions – New York State | \$ 68,687 | \$ 2,068 | \$ (78) | \$ 70,677 |
| Mortgage-backed securities and collateralized mortgage obligations – GSE residential | 20,361 | 363 | (204) | 20,520 |
| Corporate debt – financial services industry | 11,325 | 144 | (2) | 11,467 |
| | 100,373 | 2,575 | (284) | 102,664 |
| Equity securities – financial services industry | 1,962 | 175 | — | 2,137 |
| Total securities available for sale | <u>\$ 102,335</u> | <u>\$ 2,750</u> | <u>\$ (284)</u> | <u>\$ 104,801</u> |
| Securities Held to Maturity – Obligations of states and political subdivisions | <u>\$ 7,208</u> | <u>\$ 281</u> | <u>\$ —</u> | <u>\$ 7,489</u> |

| December 31, 2013 Investment Securities | Amortized cost | Gross unrealized | | Estimated fair value |
|---|-------------------|---------------------|-------------------|-------------------------|
| | | gains | losses | |
| Securities Available for Sale: | | | | |
| Obligations of states and political subdivisions – New York State | \$ 72,281 | \$ 1,458 | \$ (1,214) | \$ 72,525 |
| Mortgage-backed securities and collateralized mortgage obligations – GSE residential | 21,057 | 414 | (530) | 20,941 |
| Corporate debt – financial services industry | 12,993 | 194 | (37) | 13,150 |
| Certificates of deposit – financial services industry | 98 | — | — | 98 |
| | 106,429 | 2,066 | (1,781) | 106,714 |
| Equity securities – financial services industry | 2,312 | 15 | (84) | 2,243 |
| Total securities available for sale | <u>\$ 108,741</u> | <u>\$ 2,081</u> | <u>\$ (1,865)</u> | <u>\$ 108,957</u> |
| Securities Held to Maturity – Obligations of states and political subdivisions | | | | |
| | <u>\$ 3,612</u> | <u>\$ 168</u> | <u>\$ —</u> | <u>\$ 3,780</u> |

Included in securities available for sale are Government Sponsored Enterprises (GSE) including securities of the Federal Home Loan Bank (FHLB), Federal Home Loan Mortgage Corporation (FHLMC or "Freddie Mac"), Government National Mortgage Association (GNMA or "Ginnie Mae"), and Federal National Mortgage Association (FNMA or "Fannie Mae"). FHLB, FHLMC, and FNMA securities are not backed by the full faith of the U.S. government. Substantially all mortgage-backed securities and collateralized mortgage obligations consist of residential mortgage securities and are securities guaranteed by Ginnie Mae, Freddie Mac, or Fannie Mae. Obligations of state and political subdivisions are general obligation and revenue bonds of New York State municipalities, agencies, and authorities. General obligation bonds must have a nationally recognized statistical rating organization (NRSRO) investment grade rating in the top four categories (S&P "BBB-" or higher). Revenue bonds must have an NRSRO rating in the top three categories (S&P "A" or higher). Corporate debt securities are comprised of bonds with an NRSRO rating in the top four investment grades (S&P "BBB-" or higher).

The contractual terms of the government sponsored enterprise securities and the obligations of state and political subdivisions require the issuer to settle the securities at par upon maturity of the investment. The contractual cash flows of the mortgage-backed securities and collateralized mortgage obligations are guaranteed by various government agencies or government sponsored enterprises such as FHLMC, FNMA, and GNMA.

Securities held to maturity consist of obligations of state and political subdivisions which are general obligation bonds of municipalities local to the Company and are typically not rated by the NRSRO. In accordance with federal regulations, the Company performs an analysis of the finances of the municipalities to determine that the bonds are the credit equivalent of investment grade bonds.

There were no sales of securities held to maturity during the years ended December 31, 2014 or 2013. Proceeds from sale, gross gains and gross losses realized on sales of securities available for sale were as follows for the years ended December 31 (in thousands).

| Net Security Gains | 2014 | 2013 |
|--------------------------------|--------------|--------------|
| Gross proceeds | \$ 1,391 | \$ 25 |
| Gross realized gains | \$ 83 | \$ 23 |
| Gross realized losses | (18) | — |
| Net gain on sale of securities | <u>\$ 65</u> | <u>\$ 23</u> |

The amortized cost and estimated fair value of debt securities available for sale and held to maturity at December 31, 2014, by remaining period to contractual maturity, are shown in the following table (in thousands). Actual maturities will differ from contractual maturities because of security prepayments and the right of certain issuers to call or prepay their obligations.

| Available for Sale Securities | Amortized cost | Estimated fair value |
|-------------------------------|-------------------|-------------------------|
| Within one year | \$ 12,430 | \$ 12,553 |
| One to five years | 52,257 | 53,890 |
| Five to ten years | 14,255 | 14,496 |
| Over ten years | 1,070 | 1,205 |
| | 80,012 | 82,144 |
| Mortgage-backed securities | 20,361 | 20,520 |
| | <u>\$ 100,373</u> | <u>\$ 102,664</u> |

| Held to Maturity Securities | Amortized cost | Estimated fair value |
|-----------------------------|-------------------|-------------------------|
| Within one year | \$ 935 | \$ 977 |
| One to five years | 3,115 | 3,249 |
| Five to ten years | 3,139 | 3,242 |
| Over ten years | 19 | 21 |
| | <u>\$ 7,208</u> | <u>\$ 7,489</u> |

Securities available for sale with an estimated fair value of \$34,793,000, and \$75,999,000 at December 31, 2014 and 2013 respectively, were pledged to secure public funds on deposit and for other purposes.

Investment securities in a continuous unrealized loss position are reflected in the following table which groups individual securities by length of time that they have been in a continuous unrealized loss position and then details by investment category the number of instruments aggregated with their gross unrealized losses and fair values at December 31, 2014 and 2013 (dollars in thousands):

| Investment Securities | Less than 12 months | | | 12 months or more | | | Total | | |
|--|---------------------|----------------------|-------------------|-------------------|----------------------|-------------------|------------|----------------------|-------------------|
| | No. | Estimated fair value | Unrealized losses | No. | Estimated fair value | Unrealized losses | No. | Estimated fair value | Unrealized losses |
| December 31, 2014 | | | | | | | | | |
| Securities Available for Sale: | | | | | | | | | |
| Debt Securities: | | | | | | | | | |
| Obligations of states and political sub-divisions - New York State | 12 | \$ 1,871 | \$ 7 | 29 | \$ 5,796 | \$ 71 | 41 | \$ 7,667 | \$ 78 |
| Mortgage-backed securities and collateralized mortgage obligations – GSE residential | 2 | 1,309 | \$ 2 | 8 | 7,271 | 202 | 10 | 8,580 | 204 |
| Corporate debt – financial services industry | <u>3</u> | <u>1,551</u> | <u>2</u> | <u>—</u> | <u>—</u> | <u>—</u> | <u>3</u> | <u>1,551</u> | <u>2</u> |
| Total securities available for sale | <u>17</u> | <u>\$ 4,731</u> | <u>\$ 11</u> | <u>37</u> | <u>\$ 13,067</u> | <u>\$ 273</u> | <u>54</u> | <u>\$ 17,798</u> | <u>\$ 284</u> |
| December 31, 2013 | | | | | | | | | |
| Securities Available for Sale: | | | | | | | | | |
| Debt Securities: | | | | | | | | | |
| Obligations of states and political sub-divisions - New York State | 154 | \$ 26,500 | \$ 1,058 | 18 | \$ 2,245 | \$ 156 | 172 | \$ 28,745 | \$ 1,214 |
| Mortgage-backed securities and collateralized mortgage obligations – GSE residential | 14 | 11,995 | \$ 530 | — | — | — | 14 | 11,995 | 530 |
| Corporate debt – financial services industry | <u>9</u> | <u>1,994</u> | <u>37</u> | <u>—</u> | <u>—</u> | <u>—</u> | <u>9</u> | <u>1,994</u> | <u>37</u> |
| Total debt securities | 177 | 40,489 | 1,625 | 18 | 2,245 | 156 | 195 | 42,734 | 1,781 |
| Equity securities – financial services industry | <u>4</u> | <u>1,024</u> | <u>81</u> | <u>1</u> | <u>197</u> | <u>3</u> | <u>5</u> | <u>1,221</u> | <u>84</u> |
| Total securities available for sale | <u>181</u> | <u>\$ 41,513</u> | <u>\$ 1,706</u> | <u>19</u> | <u>\$ 2,442</u> | <u>\$ 159</u> | <u>200</u> | <u>\$ 43,955</u> | <u>\$ 1,865</u> |

Management evaluates securities for other-than-temporary impairment (“OTTI”) at least on a quarterly basis and more frequently when economic or market conditions warrant such an evaluation. Based on the amount of the unrealized loss on an individual security basis, certain of the Company’s investment securities classified as available for sale or held to maturity are evaluated for OTTI. The Company’s equity securities are primarily debt instruments. Securities identified as other-than-temporarily impaired are written down to their current fair market value. For debt and equity securities that are intended to be sold, or that management believes will more-likely-than-not be required to be sold prior to recovery, the full impairment is recognized immediately in earnings. An impairment charge will also be recorded if there is credit related loss regardless of whether or not there is the intent to sell the securities. There are numerous factors to be considered when estimating whether a credit loss exists and the period over which the debt security is expected to recover. Indicators of a possible credit loss include, but are not limited to: the failure of the issuer of the security to make scheduled interest or principal payments; any changes to the rating of the security by a rating agency; additional declines in fair value after the balance sheet date. In determining whether a credit loss exists, the Company uses its best estimate of the present value of cash flows expected to be collected from the debt security by discounting the expected cash flows at the effective interest

rate implicit in the security at the date of acquisition. The deficiencies between the present value of the cash flows expected to be collected and the amortized cost basis of a security is considered to be the credit loss. Once an impairment is determined to be other-than-temporary, the impairment related to credit loss, if any, is charged to income and the amount of the impairment related to all other factors is recognized in other comprehensive loss.

Management believes that none of the unrealized losses on debt or equity securities at December 31, 2014 are due to the underlying credit quality of the issuers of the securities, but instead are primarily related to market interest rates, and the full value of the securities will be realized. Additionally, the Company does not intend to sell the securities and it is more-likely-than-not that the Company will not be required to sell the securities before recovery of their amortized cost. Therefore, no other-than-temporary impairment charge was recognized on these securities. For the years ended December 31, 2014 or, 2013 no impairment charge was recorded. Management believes the unrealized losses related to the five equity securities held at December 31, 2013 do not represent other-than-temporary impairment as losses are believed to be due to market fluctuations and not credit concerns with regard to the issuers.

(4) Restricted Investments

Restricted investments include stock held in correspondent banks and the Federal Reserve Bank. As a member of the Federal Home Loan Bank of New York (FHLB), the Company is required to purchase and hold stock in the FHLB to satisfy membership and borrowing requirements. This stock is restricted in that it can only be sold to the FHLB or to another member institution and all sales of FHLB stock must be at par value. As a result of these restrictions, FHLB stock is unlike the Company's other investment securities insofar as there is no trading market for FHLB stock and the transfer price is determined by FHLB membership rules, not by market participants. As of December 31, 2014 and 2013, FHLB stock totaled \$358,000 and \$464,000, respectively, and is included as a part of restricted investments on the consolidated balance sheets.

FHLB stock is held as a long-term investment and its value is determined based on the ultimate recoverability of the par value. The Company evaluates impairment quarterly. The decision of whether impairment exists is a matter of judgment that reflects our view of the FHLB's long-term performance, which includes factors such as:

- its operating performance;
- the severity and duration of declines in the fair value of its net assets related to its capital stock amount;
- its commitment to make payments required by law or regulation and the level of such payments in relation to its operating performance;
- the impact of legislative and regulatory changes on the FHLB, and accordingly, on the members of FHLB; and
- its liquidity and funding position.

After evaluating all of these considerations, the Company concluded that the par value of its investment in FHLB stock will be recovered. Accordingly, no impairment charge was recorded on these securities in 2014 or 2013. Our evaluation of the factors described above, in future periods, could result in the recognition of impairment charges on FHLB stock. The Company has also determined that no impairment charges were required in 2014 or 2013 on the remaining restricted stock balances.

(5) Loans

The major classifications of loans are as follows at December 31 (in thousands):

| Loans, Net | 2014 | 2013 |
|-------------------------------------|-------------------|-------------------|
| Commercial | | |
| Commercial real estate loans: | | |
| Commercial mortgage | \$ 102,352 | \$ 98,392 |
| Farm land | 6,303 | 6,224 |
| Construction | <u>2,628</u> | <u>2,583</u> |
| Total commercial real estate loans | <u>111,283</u> | <u>107,199</u> |
| Other commercial loans: | | |
| Commercial loans | 35,955 | 29,974 |
| Agricultural loans | <u>1,086</u> | <u>1,481</u> |
| Total other commercial loans | <u>37,041</u> | <u>31,455</u> |
| Total commercial loans | <u>148,324</u> | <u>138,654</u> |
| Consumer | | |
| Consumer real estate loans: | | |
| Residential mortgage | 98,913 | 100,653 |
| Home equity | 24,704 | 27,084 |
| Construction | <u>1,031</u> | <u>2,529</u> |
| Total residential real estate loans | <u>124,648</u> | <u>130,266</u> |
| Other consumer loans: | | |
| Consumer installment loans | 3,382 | 3,541 |
| Other consumer loans | <u>1,337</u> | <u>1,341</u> |
| Total other loans | <u>4,719</u> | <u>4,882</u> |
| Total consumer loans | <u>129,367</u> | <u>135,148</u> |
| Total gross loans | <u>277,691</u> | <u>273,802</u> |
| Allowance for loan losses | <u>(4,353)</u> | <u>(4,671)</u> |
| Total loans, net | <u>\$ 273,338</u> | <u>\$ 269,131</u> |

Included in the above loan amounts are deferred loan fees and origination costs of \$355,000 and \$293,000 as of December 31, 2014 and 2013, respectively.

The Company originates consumer and commercial loans primarily to borrowers in Sullivan County, New York and surrounding areas. A substantial portion of the loan portfolio is secured by real estate properties located in that area. The ability of the Company's borrowers to make principal and interest payments is dependent upon, among other things, the level of overall economic activity and the real estate market conditions prevailing within the Company's concentrated lending area.

Nonperforming Loans

Nonperforming loans are loans where the collection of interest or principal is in doubt, or loans that are past due more than 90 days and still considered an accruing loan with the exception of residential mortgages that are well secured and in the process of collection. Impaired loan disclosures and classification apply to loans that are individually evaluated for collectability. A loan is impaired when, based on current information and events, it is probable that a creditor will be unable to collect all amounts due according to the contractual terms of the loan agreement. Loans restructured under the guidelines of ASC 310-40 *Receivables Troubled Debt Restructures by Creditors* are classified as impaired.

Information on nonperforming loans is summarized as follows at December 31 (in thousands):

| Nonperforming Loans | Total Loans | Commercial Real Estate | Commercial Other | Residential Real Estate |
|---|--------------------|-----------------------------------|-----------------------------|------------------------------------|
| December 31, 2014 | | | | |
| Nonaccrual loans | \$ 7,490 | \$ 5,229 | \$ 118 | \$ 2,143 |
| Troubled debt restructures | <u>1,501</u> | <u>593</u> | <u>—</u> | <u>908</u> |
| Total nonaccrual loans | 8,991 | 5,822 | 118 | 3,051 |
| Loans past due 90 days or more and still accruing interest | <u>815</u> | <u>320</u> | <u>—</u> | <u>495</u> |
| Total nonperforming loans | <u>\$ 9,806</u> | <u>\$ 6,142</u> | <u>\$ 118</u> | <u>\$ 3,546</u> |
| December 31, 2013 | | | | |
| Nonaccrual loans | \$ 8,344 | \$ 6,655 | \$ 187 | \$ 1,502 |
| Troubled debt restructures | <u>1,237</u> | <u>400</u> | <u>—</u> | <u>837</u> |
| Total nonaccrual loans | 9,581 | 7,055 | 187 | 2,339 |
| Loans past due 90 days or more and still accruing interest | <u>1,303</u> | <u>535</u> | <u>5</u> | <u>763</u> |
| Total nonperforming loans | <u>\$ 10,884</u> | <u>\$ 7,590</u> | <u>\$ 192</u> | <u>\$ 3,102</u> |

There were no nonperforming loans in the other consumer loans classes at December 31, 2014 or 2013.

The nonaccrual loan income recognition policy of the Bank is that interest is not recognized as income until it is received in cash and the loan's collateral is adequate to support both the interest recognized plus the loan balance, or until the borrower demonstrates the ability to make scheduled payments of interest and principal and the loan has remained current for a period of at least six months. Until such time, these cash payments are applied to the principal balance of the loan.

Impaired loans are also included in nonperforming loans in the table above. The table below presents impaired loans, including trouble debt restructurings, as of December 31, 2014 and December 31, 2013 and their effect on interest income for the periods then ended (in thousands).

| Impaired Loans | Total Loans | Commercial Real Estate | Commercial Other | Residential Real Estate |
|--|--------------------|-------------------------------|-------------------------|--------------------------------|
| December 31, 2014 | | | | |
| Unpaid principal balance | \$ 8,873 | \$ 7,248 | \$ 431 | \$ 1,194 |
| Recorded investment | 7,089 | 6,010 | 118 | 961 |
| Average balance | 8,819 | 7,384 | 382 | 1,053 |
| Interest income: | | | | |
| Interest contractually due at original rates | 601 | 514 | 28 | 59 |
| Interest income recognized | 480 | 395 | 32 | 53 |
| Impaired loans: | | | | |
| With no allowance | \$ 6,603 | \$ 5,642 | \$ — | \$ 961 |
| With an allowance recorded | \$ 486 | \$ 368 | \$ 118 | \$ — |
| Related specific allowance | \$ 152 | \$ 34 | \$ 118 | \$ — |
| December 31, 2013 | | | | |
| Unpaid principal balance | \$ 10,006 | \$ 8,006 | \$ 513 | \$ 1,487 |
| Recorded investment | 8,551 | 7,182 | 187 | 1,182 |
| Average balance | 8,309 | 6,679 | 667 | 963 |
| Interest income: | | | | |
| Interest contractually due at original rates | 592 | 502 | 35 | 55 |
| Interest income recognized | 410 | 309 | 34 | 67 |
| Impaired loans: | | | | |
| With no allowance | \$ 8,302 | \$ 6,933 | \$ 187 | \$ 1,182 |
| With an allowance recorded | \$ 249 | \$ 249 | \$ — | \$ — |
| Related specific allowance | \$ 33 | \$ 33 | \$ — | \$ — |

Loans restructured under the guidelines of ASC 310-40 *Receivables Troubled Debt Restructures by Creditors* are disclosed below as of and for the years ended December 31, 2014 and 2013 (in thousands):

| Troubled Debt Restructuring | Pre-Modification Recorded | Post-Modification recorded | Current recorded |
|--------------------------------------|----------------------------------|-----------------------------------|-------------------------|
| December 31, 2014 | | | |
| Commercial: | | | |
| Real estate | 3 \$ 642 | \$ 655 | \$ 593 |
| Consumer: | | | |
| Real estate | 7 1,062 | 1,152 | 961 |
| For the year ended December 31, 2014 | | | |
| Commercial: | | | |
| Real estate | 1 \$ 225 | \$ 225 | \$ 219 |
| Consumer: | | | |
| Real estate | 1 \$ 106 | \$ 115 | \$ 83 |
| December 31, 2013 | | | |
| Commercial: | | | |
| Real estate | 2 \$ 417 | \$ 430 | \$ 400 |
| Consumer: | | | |
| Real estate | 6 956 | 1,037 | 892 |

| Troubled Debt Restructuring | Pre-Modification Recorded | Post-Modification recorded | Current recorded |
|------------------------------------|----------------------------------|-----------------------------------|-------------------------|
|------------------------------------|----------------------------------|-----------------------------------|-------------------------|

Continued:

For the year ended December 31, 2013

Commercial:

| | | | | |
|-------------|------|------|------|---|
| Real estate | — \$ | — \$ | — \$ | — |
|-------------|------|------|------|---|

Consumer:

| | | | | |
|-------------|------|--------|--------|-----|
| Real estate | 1 \$ | 190 \$ | 183 \$ | 172 |
|-------------|------|--------|--------|-----|

A loan is classified as a troubled debt restructuring ("TDR") when a concession that the Bank would not otherwise have considered is granted to a borrower experiencing financial difficulty. Most of the Bank's TDRs involve the restructuring of loan terms to reduce the total payment amount in order to assist those borrowers who are experiencing temporary financial difficulty. In a TDR, the Bank may also increase loan balances for unpaid interest and fees or acquire additional collateral to secure its position. During the year ending December 31, 2014 the Bank had one new consumer and one new commercial real estate mortgage qualify as TDRs. For the year ended December 31, 2013, the Bank had one new loan that qualified as a TDR which was a consumer real estate loan. As of December 31, 2013 and 2014 the Bank had total charge offs of \$289,000 for borrowers whose loan terms have been modified as TDRs. There were no additional charge offs during 2014. At December 31, 2014 and 2013,

the Bank had a total of \$1,554,000 and \$1,292,000, respectively, in TDRs which did not require a specific reserve. The Bank has not committed to lend any additional funds to customers whose loans are classified as a TDR as of December 31, 2014. The Bank evaluates TDRs that are over 60 days past due to determine whether or not they are in default. However, all TDRs over 90 days past due are reported as "in default". For both the years ended December 31, 2014 and 2013 there were no TDRs considered to be in default for loans restructured in the preceding twelve months.

Loan Credit Quality Information

The Bank's management and board of directors are actively engaged in the underwriting and monitoring of loans. Loans are underwritten and reviewed in conjunction with a board of directors' approved loan credit policy with the balanced goal of maintaining underwriting, documentation, and review standards with satisfactory interest income and minimal credit losses. Loans are reviewed and approved at various levels depending upon the amount of credit exposure including: board of directors, board loan committee, senior loan committee, and individual officer level. At underwriting, consumer loan approval is based upon an independent analysis of the applicant's financial strength. Commercial loans are underwritten and reviewed consistent with the Bank's loan credit policy. The Bank monitors the commercial loan portfolio based upon a board of directors approved loan review and risk identification policy. The policy dictates the process for internal loan risk identification, periodic annual review of larger commercial loan relationships, and external loan review.

The credit policy of the Bank ensures conformity in loan pricing, sets forth standards for distribution of loans by class, types of credit, limitations on concentrations of credit, maximum maturities by types of credit, legal documentation requirements, commercial loan underwriting standards, acceptable forms of collateral, use of financial covenants for commercial loans, financial statement requirements, loan participations, and appraisal standards, among many other items.

At underwriting, all unsecured commercial loans in excess of \$10,000 and secured commercial loans in excess of \$25,000 are assigned a risk rating in conformity with the loan review and risk identification policy. All commercial loans with aggregate relationship exposure of \$100,000 or

more are required to be reviewed annually. The analysis is compared to any financial covenants to ensure conformity. If the analysis reveals non-conformity, the applicable lending officer or loan committee may recommend corrective action including a revised loan risk rating, non-renewal of lines of credit, reduction in lines of credit, or collection action. Once a loan is underwritten, the risk rating is updated if the lending officer notes either positive or negative characteristics in the loan.

The Bank has a loan rating system that ranges from "Pass" to "Loss" based upon the commensurate severity of credit risk. "Pass" rated loans are generally loans to un-leveraged borrowers with strong liquidity, available cash flow to service debt obligations, and the ability to make payments as agreed. "Pass watch" loans are stronger than loans in the special mention category, as discussed below, but would not fall in the "Pass" category for reasons such as the following: the loans are to financially strong individuals not meeting agreed upon repayment programs, are unseasoned smaller loans, or have excessive vulnerability to competition or other dependencies. "Special mention" loans currently have a protected credit position but are potentially weak. These loans have relatively minor credit risk; however, in light of circumstances, they constitute undue and unwarranted risks, but not to the point of justifying a classification of substandard. The loan may have potential weaknesses which may, if not checked or corrected, weaken the loan or inadequately protect the Bank's credit position at some future date. "Substandard" loans have a well-defined weakness that jeopardizes the liquidity of the debt. They are characterized by the distinct possibility that the Bank will sustain some loss if the deficiencies are not corrected. "Doubtful" loans have all the weaknesses inherent in a loan classified as substandard, with the added characteristics that the weaknesses make collection or liquidation in full, on the basis of currently existing facts, conditions, and values, highly questionable and improbable. The possibility of loss is extremely high, but because of certain important and reasonably specific pending factors which may work to the advantage and strengthening of the assets, the loan's classification as a loss is deferred until its more exact status may be determined. Loans which become "Loss" rated are fully charged off as they are considered uncollectible. Their continuance as bankable assets is no longer warranted and are therefore excluded below. Loans that are non-reviewed on an ongoing basis are consumer loans and small balance commercial loans which pose less of a credit risk.

Management reviews risk ratings on a monthly basis and the following illustrates total loans by credit risk profiles based on internally assigned grades and category as of December 31 (in thousands):

| Loans by Risk Ratings | Total | Commercial | | Consumer | | |
|-----------------------|-------------------|-------------------|------------------|-------------------|-----------------|-----------------|
| | | Real Estate | Other | Real Estate | Installment | Other |
| December 31, 2014 | | | | | | |
| Pass | \$ 61,779 | \$ 44,290 | \$ 17,489 | | | |
| Pass watch | 67,757 | 50,729 | 17,028 | | | |
| Special mention | 4,178 | 3,254 | 924 | | | |
| Substandard | 12,653 | 11,869 | 784 | | | |
| Doubtful | 155 | 34 | 121 | | | |
| Non-reviewed | 131,169 | 1,107 | 695 | \$ 124,648 | \$ 3,382 | \$ 1,337 |
| Total | <u>\$ 277,691</u> | <u>\$ 111,283</u> | <u>\$ 37,041</u> | <u>\$ 124,648</u> | <u>\$ 3,382</u> | <u>\$ 1,337</u> |
| December 31, 2013 | | | | | | |
| Pass | \$ 54,769 | \$ 38,983 | \$ 15,786 | | | |
| Pass watch | 60,902 | 48,368 | 12,534 | | | |
| Special mention | 5,276 | 4,543 | 733 | | | |
| Substandard | 16,928 | 15,259 | 1,669 | | | |
| Doubtful | 36 | 36 | - | | | |
| Non-reviewed | 135,891 | 10 | 733 | \$ 130,266 | \$ 3,541 | \$ 1,341 |
| Total | <u>\$ 273,802</u> | <u>\$ 107,199</u> | <u>\$ 31,455</u> | <u>\$ 130,266</u> | <u>\$ 3,541</u> | <u>\$ 1,341</u> |

The following table illustrates the aging of past due loans by category as of December 31 (in thousands):

| Category of loans | 30-59 Days past due | 60-89 Days past due | Greater than 90 Days | Total past due | Current | Total loans | Over 90 and accruing |
|-------------------------|---------------------|---------------------|----------------------|------------------|-------------------|-------------------|----------------------|
| 2014 | | | | | | | |
| Commercial real estate | \$ 2,429 | \$ 878 | \$ 1,682 | \$ 4,989 | \$ 106,294 | \$ 111,283 | \$ 320 |
| Residential real estate | 2,758 | 1,435 | 2,552 | 6,745 | 117,903 | 124,648 | 495 |
| Commercial other | 538 | — | 118 | 656 | 36,385 | 37,041 | — |
| Consumer installment | 24 | 17 | — | 41 | 3,341 | 3,382 | — |
| Other consumer | 3 | — | — | 3 | 1,334 | 1,337 | — |
| Total | <u>\$ 5,752</u> | <u>\$ 2,330</u> | <u>\$ 4,352</u> | <u>\$ 12,434</u> | <u>\$ 265,257</u> | <u>\$ 277,691</u> | <u>\$ 815</u> |
| 2013 | | | | | | | |
| Commercial real estate | \$ 2,754 | \$ 1,326 | \$ 3,831 | \$ 7,911 | \$ 99,288 | \$ 107,199 | \$ 535 |
| Residential real estate | 1,752 | 2,121 | 2,044 | 5,917 | 124,349 | 130,266 | 763 |
| Commercial other | 254 | 14 | 5 | 273 | 31,182 | 31,455 | 5 |
| Consumer installment | 75 | 12 | — | 87 | 3,454 | 3,541 | — |
| Other consumer | 4 | — | — | 4 | 1,337 | 1,341 | — |
| Total | <u>\$ 4,839</u> | <u>\$ 3,473</u> | <u>\$ 5,880</u> | <u>\$ 14,192</u> | <u>\$ 259,610</u> | <u>\$ 273,802</u> | <u>\$ 1,303</u> |

As of December 31, 2014 and 2013, nonaccrual loans included \$5.4 million and \$5.0 million of loans, respectively, which are paying currently but have not met the specific criteria to be placed on accrual status.

Allowance for Loan Losses

The allowance for loan losses is a valuation allowance that management has determined to be necessary to absorb probable incurred credit losses inherent in the loan portfolio. The allowance is established through provisions for losses charged to earnings. Loan losses are charged against the allowance when management believes the uncollectability of a loan balance is confirmed. Subsequent recoveries, if any, are credited to the allowance. Management evaluates the allowance quarterly using past loan loss experience to establish base allowance pool rates for commercial real estate, other commercial loans, residential real estate loans, consumer installment,

and other consumer loans. Reviewed and Pass-rated commercial mortgage/loan pool rates are determined based on adjusted pool rates, which include weighted three-year average loss percentages adjusted for the eight risk factors as discussed below.

Special mention and substandard pool rates are determined by the greater of the Bank's weighted three-year average loss percentages or historical loss rolling average of the prior eight quarters. The method used in this calculation collects all commercial loans and mortgages from one year ago, observes their status and rating at the current time, and computes the historical loss rolling average for these rating

categories by using the losses experienced by those particular loans over the past year. These allowance pool rates are then adjusted based on management's current assessment of eight risk factors. These risk factors are:

1. Changes in lending policies and procedures, including underwriting standards and collection, charge-off, and recovery practices.
2. Changes in 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. Changes in the nature and volume of the portfolio and terms of loans.
4. Changes in the experience, ability, and depth of lending management and staff.
5. Changes in volume and severity of past due, classified and nonaccrual loans as well as other loan modifications.
6. Changes in the quality of the Bank's loan review system and the degree of oversight by the Bank's board of directors.
7. The existence and effect of any concentrations of credit and changes in the level of such concentrations.
8. The effect of external factors, such as competition and legal and regulatory requirements.

Each factor is assigned a value to reflect improving, stable or declining conditions based on management's best judgment using relevant information available at the time of the evaluation. Adjustments to the factors are supported through documentation of changes in conditions in a narrative accompanying the allowance for loan loss calculation. Several specific factors are believed to have more impact on a loan's risk rating, such as those related to national and local economic trends, lending management and staff, volume of past dues and nonaccruals, and concentrations of credit. Therefore, due to the increased risk inherent in criticized and classified loans, the values of these specific factors are increased proportionally. Management believes these increased factors provide adequate coverage for the additional perceived risk. Doubtful loans by definition have inherent losses in which the precise amounts are dependent on likely future events. These particular loans are reserved at higher pool rates (25%) unless specifically reviewed and deemed impaired as described below. An unallocated component of the allowance for loan losses has been established to reflect the inherent imprecision involved in calculating the allowance for loan losses.

The commercial portfolio segment is comprised of commercial real estate and other commercial loans. This segment is subject to all of the risk factors considered in management's assessment of the allowance. Examples of specific risks applicable to the entire segment include changes in economic conditions that reduce business and consumer spending leading to a loss of revenue, concentrations of credit in business categories that are disproportionately impacted by current economic conditions, the quality of the Bank's loan review system and its ability to identify potential problem loans, and the availability of acceptable new loans to replace maturing, amortizing, and refinanced loans. In addition, risks specific to commercial mortgages and secured commercial loans would include economic conditions that lead to

declines in property and other collateral values. Prior to applying the allowance pool rate, commercial real estate and other commercial loans in nonaccrual status or those with a minimum substandard rating and loan relationships of \$500,000 or more and all trouble debt restructures ("TDR") are individually considered for impairment. Loans that are considered individually for impairment and not determined to be impaired are returned to their original pools for allowance purposes. If a loan is determined to be impaired, it is evaluated under guidance which dictates that a creditor shall measure impairment based on the present value of expected future cash flows discounted at the loan's effective interest rate, the loan's observable market price, or the fair value of the collateral less estimated costs to sell if the loan is collateral dependent. If the measure of the impaired loan, such as the collateral value, is less than the recorded investment in the loan, a specific reserve is established in the allowance for loan losses. An uncollectible loan is charged off after all reasonable means of collection are exhausted and the recovery of the principal through the disposal of the collateral is not reasonably expected to cover the costs. Commercial real estate and other commercial loans with an original principal balance under \$10,000 for unsecured loans or under \$25,000 for secured loans are also not individually considered for impairment. Instead, the appropriate allowance pool rate is applied to the aggregate balance of these pools.

The consumer portfolio segment is comprised of consumer real estate, consumer installment, and other consumer loans. This segment is also subject to all of the risk factors considered in management's assessment of the allowance. Examples of specific risks applicable to the entire segment include changes in economic conditions that increase unemployment which reduces a consumer's ability to repay their debt, changes in legal and regulatory requirements that make it more difficult to originate new loans and collect on existing loans, and competition from non-local lenders who originate loans in the Bank's market area at lower rates than the Bank can profitably offer. In addition, risks specific to residential mortgages and secured consumer loans would include economic conditions that lead to declines in property and other collateral values. Residential real estate, consumer installment, and other consumer loans are considered homogenous pools and are generally not individually considered for impairment. Instead, the appropriate allowance pool rate is applied to the aggregate balance of these pools. The other portfolio segment is comprised primarily of check-loans and loans in-process. These loans are considered homogenous pools and are not individually considered for impairment. A pool rating is applied to the aggregate balance of these pools. Loans restructured under a trouble debt restructuring are individually evaluated for impairment.

The amount of the allowance is based on estimates, and the ultimate losses may vary from such estimates as more information becomes available or as later events occur or circumstances change. Allocations of the allowance may be made for specific loans, but the entire allowance is available for any loan that, in management's judgment, should be charged off. Modifications to the methodology used in the allowance for loan losses evaluation may be necessary in the future based on economic and real estate market conditions, new information obtained regarding known problem loans, regulatory guidelines and examinations, the identification of additional problem loans, changes in generally accepted accounting principles or other factors.

Changes in the allowance for loan losses and the related loans evaluated for impairment are summarized as follows as of and for the years ended December 31 (in thousands):

| Allowance for Loan Losses | Total | Commercial | | | Consumer | | |
|---|-------------------|-------------------|------------------|-------------------|-----------------|-----------------|---------------|
| | | Real Estate | Other | Real Estate | Installment | Other | Unallocated |
| December 31, 2014: | | | | | | | |
| Beginning balance January 1 | \$ 4,671 | \$ 2,040 | \$ 598 | \$ 1,614 | \$ 62 | \$ 48 | \$ 309 |
| Charge-offs | (1,099) | (807) | (49) | (161) | (19) | (63) | — |
| Recoveries | 381 | 212 | 40 | 39 | 55 | 35 | — |
| Provision | 400 | 403 | 63 | (20) | (73) | 21 | 6 |
| Ending balance December 31 | <u>\$ 4,353</u> | <u>\$ 1,848</u> | <u>\$ 652</u> | <u>\$ 1,472</u> | <u>\$ 25</u> | <u>\$ 41</u> | <u>\$ 315</u> |
| Ending balance as related to allowance: | | | | | | | |
| Evaluated collectively | | | | | | | |
| [general reserve] | \$ 4,201 | \$ 1,814 | \$ 534 | \$ 1,472 | \$ 25 | \$ 41 | \$ 315 |
| Evaluated individually | | | | | | | |
| [specific reserve] | 152 | 34 | 118 | — | — | — | — |
| Total Allowance for Loan Losses | <u>\$ 4,353</u> | <u>\$ 1,848</u> | <u>\$ 652</u> | <u>\$ 1,472</u> | <u>\$ 25</u> | <u>\$ 41</u> | <u>\$ 315</u> |
| Ending balance as related to loans: | | | | | | | |
| Loans evaluated collectively | \$ 270,602 | \$ 105,273 | \$ 36,923 | \$ 123,687 | \$ 3,382 | \$ 1,337 | |
| Loans evaluated individually | 7,089 | 6,010 | 118 | 961 | — | — | |
| Total Loans | <u>\$ 277,691</u> | <u>\$ 111,283</u> | <u>\$ 37,041</u> | <u>\$ 124,648</u> | <u>\$ 3,382</u> | <u>\$ 1,337</u> | |
| December 31, 2013: | | | | | | | |
| Beginning balance January 1 | \$ 5,035 | \$ 2,615 | \$ 625 | \$ 1,416 | \$ 70 | \$ 49 | \$ 260 |
| Charge-offs | (1,301) | (514) | (301) | (335) | (88) | (63) | — |
| Recoveries | 237 | 88 | 66 | 10 | 43 | 30 | — |
| Provision | 700 | (149) | 208 | 523 | 37 | 32 | 49 |
| Ending balance December 31 | <u>\$ 4,671</u> | <u>\$ 2,040</u> | <u>\$ 598</u> | <u>\$ 1,614</u> | <u>\$ 62</u> | <u>\$ 48</u> | <u>\$ 309</u> |
| Ending balance as related to allowance: | | | | | | | |
| Evaluated collectively | | | | | | | |
| [general reserve] | \$ 4,638 | \$ 2,007 | \$ 598 | \$ 1,614 | \$ 62 | \$ 48 | \$ 309 |
| Evaluated individually | | | | | | | |
| [specific reserve] | 33 | 33 | — | — | — | — | — |
| Total Allowance for Loan Losses | <u>\$ 4,671</u> | <u>\$ 2,040</u> | <u>\$ 598</u> | <u>\$ 1,614</u> | <u>\$ 62</u> | <u>\$ 48</u> | <u>\$ 309</u> |
| Ending balance as related to loans: | | | | | | | |
| Loans evaluated collectively | \$ 265,251 | \$ 100,017 | \$ 31,268 | \$ 129,084 | \$ 3,541 | \$ 1,341 | |
| Loans evaluated individually | 8,551 | 7,182 | 187 | 1,182 | — | — | |
| Total Loans | <u>\$ 273,802</u> | <u>\$ 107,199</u> | <u>\$ 31,455</u> | <u>\$ 130,266</u> | <u>\$ 3,541</u> | <u>\$ 1,341</u> | |

There are no commitments to lend additional funds on the above noted non-performing loans. Management has determined that the majority of these non-performing loans remain well collateralized. Based on its comprehensive analysis of the loan portfolio, and since the Company has no exposure to subprime loans, management believes the current level of the allowance for loan losses is adequate. However, 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, which may not be currently available to management.

(6) Premises and Equipment

The major classifications of premises and equipment were as follows at December 31 (in thousands):

| Premise and Equipment, Net | 2014 | 2013 |
|--|-----------------|-----------------|
| Land | \$ 1,907 | \$ 1,100 |
| Buildings and improvements | 8,032 | 7,504 |
| Furniture and fixtures | 380 | 371 |
| Equipment | <u>3,900</u> | <u>3,842</u> |
| Total premises and equipment | 14,219 | 12,817 |
| Less accumulated depreciation and amortization | <u>(8,059)</u> | <u>(8,260)</u> |
| Premises and equipment, net | <u>\$ 6,160</u> | <u>\$ 4,557</u> |

Depreciation and amortization expense was \$339,000 and \$620,000 in 2014 and 2013, respectively.

The Company has three leases for branches located in Monticello, Callicoon, and Wurtsboro which expire in 2016, 2017, and 2020, respectively. A renewal option exists for Callicoon for an additional 10 years. Total rent expense for the years ended December 31, 2014 and 2013 was \$93,000 and \$86,000, respectively. The Company's contractual obligation on future minimum non-cancellable lease payments as of December 31, 2014, is as follows (in thousands):

Future Minimum Lease Payments, for the years ending:

| | |
|---------------------|---------------|
| 2015 | \$ 93 |
| 2016 | 75 |
| 2017 | 25 |
| 2018 | 25 |
| 2019 | 6 |
| 2020 and thereafter | <u>—</u> |
| | <u>\$ 224</u> |

(7) Time Deposits

The following is a summary of time deposits at December 31, 2014 by remaining period to contractual maturity (in thousands):

| | |
|---------------------|-------------------|
| Within one year | \$ 79,581 |
| One to two years | 21,675 |
| Two to three years | 7,128 |
| Three to four years | 2,694 |
| Four to five years | 3,058 |
| Over five years | <u>—</u> |
| Total time deposits | <u>\$ 114,136</u> |

Time deposits of \$100,000 or more totaled \$43,364,000 and \$47,868,000 at December 31, 2014 and 2013, respectively. Interest expense related to time deposits over \$100,000 was \$310,000 and \$382,000 for 2014 and 2013, respectively.

(8) Short-Term Borrowings

There were no short-term borrowings as of December 31, 2014 or 2013. At December 31, 2014, the Bank maintained unsecured lines of credit with Atlantic Central Bankers Bank for \$7.0 million and First Tennessee Bank for \$5.0 million. The Bank has access to a primary credit line with the Federal Reserve Discount Window (Discount Window) which would be available upon collateralization by securities held in trust. Currently there is no available credit. The Bank, as a member of the FHLB, has access to a line of credit program with a maximum borrowing capacity of \$47.9 million as of December 31, 2014 which is collateralized by mortgage loans and FHLB stock. During both 2014 and 2013, the Bank had no borrowings.

(9) Federal Home Loan Bank Borrowings

As of December 31, 2014 and December 31, 2013, the Bank had no Federal Home Loan Bank Borrowings.

The Bank has a blanket security agreement with FHLB to secure borrowings with FHLB stock (see Note 4) and by maintaining as collateral, certain qualifying assets (principally residential mortgage loans) not otherwise pledged.

(10) Income Taxes

Income taxes for the years ended December 31 consisted of the following (in thousands):

| Income Tax Expense | 2014 | 2013 |
|--------------------|-----------------|-----------------|
| Current: | | |
| Federal | \$ 692 | \$ 844 |
| State | 99 | 116 |
| Deferred | <u>1,706</u> | <u>97</u> |
| | <u>\$ 2,497</u> | <u>\$ 1,057</u> |

Items creating the differences between income tax expense and taxes computed by applying the statutory Federal tax rate of 34% to income before income taxes are as follows (dollars in thousands):

| Income Tax Expense (Benefit) | 2014 | | 2013 | |
|---|-----------------|------------------|-----------------|------------------|
| | Amount | % ⁽¹⁾ | Amount | % ⁽¹⁾ |
| Tax at statutory rate | \$ 3,227 | 34% | \$ 1,930 | 34% |
| State taxes, net of Federal Tax benefit | 188 | 2 | 77 | 1 |
| Tax-exempt interest and dividends | (769) | (8) | (801) | (14) |
| Interest expense allocated to tax-exempt securities | 13 | — | 17 | 1 |
| Bank-owned life insurance | (141) | (1) | (154) | (3) |
| Other adjustments | <u>(21)</u> | <u>(1)</u> | <u>(12)</u> | <u>—</u> |
| Income tax expense | <u>\$ 2,497</u> | <u>26%</u> | <u>\$ 1,057</u> | <u>19%</u> |

⁽¹⁾ Percentage is of pre-tax income

The tax effects of temporary differences that give rise to deferred tax assets and liabilities at December 31 are presented below (in thousands):

| Deferred Tax Asset, Net | 2014 | 2013 |
|-------------------------------------|-----------------|-----------------|
| Deferred tax assets: | | |
| Allowance for loan losses in excess | | |
| of tax bad debt reserve | \$ 1,327 | \$ 1,468 |
| Retirement benefits | 489 | 1,973 |
| Alternative minimum tax | | |
| credit carryforward | 360 | 407 |
| Depreciation | 530 | 564 |
| Foreclosed real estate | 115 | 214 |
| Other comprehensive income | | |
| (retirement benefits) | 1,989 | 1,086 |
| Other | <u>152</u> | <u>40</u> |
| Total deferred tax assets | <u>4,962</u> | <u>5,752</u> |
| Deferred tax liabilities: | | |
| Prepaid expenses | (79) | (66) |
| Other comprehensive income: | | |
| Retirement benefits | — | (833) |
| Unrealized gain on securities | | |
| available for sale | <u>(888)</u> | <u>(78)</u> |
| Total deferred tax liabilities | <u>(967)</u> | <u>(977)</u> |
| Net deferred tax asset | | |
| (included in other assets) | <u>\$ 3,995</u> | <u>\$ 4,775</u> |

In assessing the ability to realize the Company's total deferred tax assets, management considers whether it is more likely than not that some portion or all of those assets will not be realized. Based upon management's consideration of historical and anticipated future pre-tax income, as well as the reversal period for the items giving rise to the deferred tax assets and liabilities, a valuation allowance for deferred tax assets was not considered necessary at December 31, 2014 and 2013.

No unrecognized tax benefits are expected to arise within the next twelve months. The Company files income tax returns in the both the US Federal and New York State tax jurisdictions. The Company is no longer subject to examination by the US Federal for years before 2012 and NYS taxing authorities for years before 2011.

(11) Regulatory Capital Requirements

State-chartered, nonmember banks are required to maintain minimum levels of regulatory capital in accordance with regulations of the Federal Deposit Insurance Corporation ("FDIC"). FDIC regulations require a minimum leverage ratio of Tier I capital to total adjusted assets of 4.0%, and minimum ratios of Tier I and total capital to risk-weighted assets of 4.0% and 8.0%, respectively.

Under its prompt corrective action regulations, the FDIC is required to take certain supervisory actions (and may take additional discretionary actions) with respect to an undercapitalized bank. Such actions could have a direct material effect on banks' financial statements. The regulations establish a framework for the classification of banks into five categories: well capitalized, adequately capitalized, undercapitalized, significantly undercapitalized, and critically undercapitalized. Generally, a bank is considered well capitalized if it has a leverage (Tier I) capital ratio of at least 5.0%, a Tier I risk-based capital ratio of at least 6.0%, and a total risk-based capital ratio of at least 10.0%.

The foregoing capital ratios are based in part on specific quantitative measures of assets, liabilities and certain off-balance-sheet items as calculated under regulatory accounting practices. Capital amounts and classifications are also subject to qualitative judgments by the regulators about capital components, risk weightings and other factors.

Management believes that, as of December 31, 2014 and 2013, the Bank met all capital adequacy requirements to which it is subject. Further, the most recent FDIC notification categorized the Bank as a well-capitalized bank under the prompt corrective action regulations. There have been no conditions or events since that notification that management believes have changed the Bank's capital classification.

The following is a summary of the actual capital amounts and ratios as of December 31, 2014 and 2013 for the Bank compared to the required ratios for minimum capital adequacy and for classification as well-capitalized (dollars in thousands):

| Regulatory Capital | Actual | | Required Ratios | |
|---------------------------|----------|-------|--------------------------|------------------|
| | Amount | Ratio | Minimum capital adequacy | Well capitalized |
| December 31, 2014: | | | | |
| Leverage (Tier I) capital | \$51,398 | 11.6% | 4.0% | 5.0% |
| Risk-based capital: | | | | |
| Tier I | 51,398 | 17.7 | 4.0 | 6.0 |
| Total | 55,032 | 19.0 | 8.0 | 10.0 |
| December 31, 2013: | | | | |
| Leverage (Tier I) capital | \$48,346 | 11.3% | 4.0% | 5.0% |
| Risk-based capital: | | | | |
| Tier I | 48,346 | 17.0 | 4.0 | 6.0 |
| Total | 51,909 | 18.3 | 8.0 | 10.0 |

Jeffersonville Bancorp is a small bank holding company, and is exempt from regulatory capital requirements administered by the Federal banking agencies.

(12) Stockholders' Equity

Dividend Restrictions

Dividends paid by the Bank are the primary source of funds available to the Parent Company for payment of dividends to its stockholders and for working capital needs. Applicable Federal and state statutes, regulations and guidelines impose restrictions on the amount of dividends that may be declared by the Bank. Under these restrictions, the dividends declared and paid by the Bank to the Parent Company may not exceed the total amount of the Bank's net profit retained in the current year plus its retained net profits, as defined, from the two preceding years. The Bank's retained net profits available for dividends at December 31, 2014 totaled \$4,823,000.

(13) Comprehensive Income

Comprehensive income represents the sum of net income and items of other comprehensive income (loss) which are reported directly in stockholders' equity, such as the net unrealized gain or loss on securities available for sale and changes in liabilities associated with the Company's defined benefit pension plan, other postretirement benefit plans, and the supplemental retirement plans. These items are reflected in the consolidated statements of comprehensive income, net of income taxes.

At December 31, 2014 and 2013, the components of accumulated other comprehensive income (loss) reflected on the consolidated balance sheets are as follows (in thousands):

| Accumulated Other Comprehensive Income Loss, Net of Tax | 2014 | 2013 |
|--|-------------------|-----------------|
| Supplemental executive retirement plan | \$ (619) | \$ (704) |
| Postretirement benefits | — | 2,314 |
| Defined benefit pension liability | (4,906) | (2,312) |
| Net unrealized holding gains on securities available for sale | <u>2,466</u> | <u>216</u> |
| Accumulated other comprehensive loss, before income tax | (3,059) | (486) |
| Income tax related to accumulated other comprehensive loss | <u>1,101</u> | <u>175</u> |
| | <u>\$ (1,958)</u> | <u>\$ (311)</u> |

(14) Related Party Transactions

Certain directors and executive officers of the Company, as well as certain affiliates of these directors and officers, have engaged in loan transactions with the Company. Such loans were made in the ordinary course of business at the Company's normal terms, including interest rates and collateral requirements, and do not represent more than normal risk of collection. Outstanding loans to these related parties are summarized as follows at December 31 (in thousands):

| Related Party Transactions | 2014 | 2013 |
|------------------------------------|-----------------|-----------------|
| Directors | \$ 3,343 | \$ 3,108 |
| Executive officers (non-directors) | <u>438</u> | <u>472</u> |
| | <u>\$ 3,781</u> | <u>\$ 3,580</u> |

During 2014, total advances to these directors and officers were \$918,000, and total payments made on these loans were \$717,000. Directors and officers had unused lines of credit with the Company of \$543,000 and \$347,000 at December 31, 2014 and 2013, respectively.

(15) Employee Benefit Plans

Pension and Other Postretirement Benefits

The Company has a noncontributory defined benefit pension plan covering substantially all of its employees. The plan was amended on September 30, 2011 to be closed to new participants hired after September 30, 2011. The Company's funding policy is to contribute annually an amount sufficient to satisfy the minimum funding requirements of the Employee Retirement Income Security Act, but not greater than the maximum amount that can be deducted for Federal income tax purposes. Contributions are intended to provide not only for benefits attributed to service to date, but also for benefits expected to be earned in the future.

The Company had also sponsored a postretirement medical, dental and life insurance benefit plan for retirees included in the pension plan. Employees attaining age 55 or later, and whose age plus service is greater than or equal to 85 were eligible for postretirement benefits. The plan was unfunded and was terminated in 2014.

The Company has no minimum required pension contribution for 2015, however the Company expects to contribute \$500,000 to its pension plan in 2015. Benefits, which reflect estimated future employee service, are expected to be paid as follows (in thousands):

| Estimated Future Benefits | Pension benefit |
|----------------------------------|------------------------|
| 2015 | \$ 733 |
| 2016 | 730 |
| 2017 | 725 |
| 2018 | 721 |
| 2019 | 723 |
| Years 2020-2024 | 3,732 |

The following is a summary of changes in the benefit obligations and plan assets for the pension plan and the postretirement benefit plan for the December 31, 2014 and 2013 measurement dates, together with a reconciliation of each plan's funded status to the amounts recognized in the consolidated balance sheets (in thousands).

Changes in Benefit Obligations, Plan

| Assets and Funded Status | Pension benefit | | Postretirement benefit | |
|--|------------------------|-------------------|-------------------------------|-----------------|
| | 2014 | 2013 | 2014 | 2013 |
| As of the Measurement Date, December 31, | | | | |
| Change in benefit obligation: | | | | |
| Beginning of year | \$ 11,756 | \$ 13,088 | \$ 1,513 | \$ 1,641 |
| Service cost | 332 | 395 | 35 | 50 |
| Interest cost | 580 | 522 | 62 | 66 |
| Actuarial (gain) loss | 2,839 | (1,537) | — | (183) |
| Settlement | — | — | (1,169) | — |
| Benefits paid and expected expenses | (734) | (712) | (455) | (80) |
| Contributions by plan participants | — | — | 14 | 19 |
| End of year | <u>14,773</u> | <u>11,756</u> | <u>—</u> | <u>1,513</u> |
| Changes in fair value of plan assets: | | | | |
| Beginning of year | 11,442 | 9,823 | — | — |
| Actual return on plan assets | 912 | 1,538 | — | — |
| Settlement | — | — | 394 | — |
| Employer contributions | 500 | 800 | 47 | 61 |
| Contributions by plan participants | — | — | 14 | 19 |
| Benefits paid and actual expenses | (739) | (719) | (455) | (80) |
| End of year | <u>12,115</u> | <u>11,442</u> | <u>—</u> | <u>—</u> |
| Funded status at end of year, recognized in | | | | |
| Other liabilities on the balance sheet | \$ (2,658) | \$ (314) | \$ — | \$ (1,513) |
| Amounts recognized in accumulated other comprehensive income (loss) consists of: | | | | |
| Unrecognized actuarial gain (loss) | \$ (4,906) | \$ (2,312) | \$ — | \$ 376 |
| Unrecognized prior service credit | — | — | — | 1,938 |
| Net amount recognized | <u>\$ (4,906)</u> | <u>\$ (2,312)</u> | <u>\$ —</u> | <u>\$ 2,314</u> |

The projected benefit obligation for the pension plan was \$14,773,000 and \$11,756,000 at December 31, 2014 and 2013, respectively. The accumulated benefit obligation for the pension plan was \$14,348,000 and \$11,537,000 at December 31, 2014 and 2013, respectively.

The components of the net periodic benefit cost for the years ended December 31, for these plans were as follows (in thousands):

| Net Periodic Benefit Cost For the year ended December 31, | Pension benefit | | Postretirement benefit | |
|--|-------------------|-------------------|------------------------|----------------|
| | 2014 | 2013 | 2014 | 2013 |
| Net periodic benefit cost: | | | | |
| Service cost | \$ 332 | \$ 395 | \$ 35 | \$ 50 |
| Interest cost | 580 | 522 | 62 | 66 |
| Expected return on plan assets | (746) | (642) | — | — |
| Amortization of prior service cost | — | — | (131) | (157) |
| Recognized net actuarial (gain) loss | 85 | 268 | (9) | (2) |
| Net Periodic Benefit Cost (Benefit) | <u>\$ 251</u> | <u>\$ 543</u> | <u>\$ (43)</u> | <u>\$ (43)</u> |
| Net gain (loss) | \$ (2,679) | \$ 2,425 | \$ — | \$ 183 |
| Settlement | — | — | (2,217) | — |
| Amortization of net (gain) loss | 85 | 268 | (9) | (2) |
| Amortization of prior service credit | — | — | (131) | (157) |
| Total recognized in other comprehensive loss | <u>\$ (2,594)</u> | <u>\$ 2,693</u> | <u>\$ (2,357)</u> | <u>\$ 24</u> |
| Total recognized in net periodic benefit cost and other comprehensive loss | <u>\$ 2,845</u> | <u>\$ (2,150)</u> | <u>\$ 2,314</u> | <u>\$ (67)</u> |

The estimated net loss for the defined benefit pension plan that will be amortized from accumulated other comprehensive loss into net periodic benefit cost during 2014 is \$261,000.

The Company changed the mortality table it uses to measure its pension obligation from RP-2000 with generational projection Scale AA to RP-2000 with generational projection Scale BB for its pension plan remeasurement at December 31, 2014. The change in mortality assumption resulted in an increase to the pension plan's accumulated benefit obligation of \$616,000.

Assumptions used to determine benefit obligations for the pension plan and for the other postretirement benefits plan as of the December 31 measurement date were as follows:

| Benefit Obligation Assumptions | Pension benefits | | Postretirement benefits | |
|--------------------------------|------------------|-------|-------------------------|-------|
| | 2014 | 2013 | 2014 | 2013 |
| Discount rate | 4.03% | 5.10% | 5.10% | 5.10% |
| Rate of compensation increase | 3.00 | 3.00 | — | — |

As of December 31, 2014 the pension plan discount rate decreased resulting from observations of estimates inherent in market data.

Assumptions used to determine net periodic benefit cost were as follows:

| Net Periodic Benefit Cost Assumptions | Pension benefits | | Postretirement benefits | |
|--|------------------|-------|-------------------------|-------|
| | 2014 | 2013 | 2014 | 2013 |
| Discount rate | 5.10% | 4.11% | 4.11% | 4.11% |
| Expected long-term rate of return on plan assets | 6.75 | 6.75 | — | — |
| Rate of compensation increase | 3.00 | 3.00 | — | — |

The Company's expected long-term rate of return on plan assets reflects long-term earnings expectations and was determined based on historical returns earned by existing plan assets adjusted to reflect expectations of future returns as applied to the plan's targeted allocation of assets.

The Company's pension plan asset allocation at December 31, by asset category is as follows:

| Pension Plan Asset Allocation | 2014 | 2013 |
|-------------------------------|------|------|
| Asset category: | | |
| Equity securities | 44% | 44% |
| U.S. Government securities | 7 | 4 |
| Debt securities | 13 | 14 |
| Mutual funds | 34 | 36 |
| Other | 2 | 2 |

The following table presents pension plan assets measured at fair value on a recurring basis by their level within the fair value hierarchy as of December 31, 2014 and 2013, dollars in thousands. Financial assets are classified based on the lowest level of input that is significant to their fair value measurement.

| Fair Value Hierarchy For Pension Plan Assets | Total | (Level 1) Quoted Prices in Active Markets for Identical Assets | (Level 2) Significant Other Observable Inputs | (Level 3) Significant Unobservable Inputs |
|---|------------------|--|---|--|
| Asset category as of December 31, 2014: | | | | |
| Cash and cash equivalents | \$ 179 | \$ 179 | \$ — | \$ — |
| Bonds: | | | | |
| U.S. government agency | 901 | — | 901 | — |
| Municipal | 642 | — | 642 | — |
| U.S. corporate | 720 | — | 720 | — |
| Foreign corporate | 213 | — | 213 | — |
| Equity securities: | | | | |
| U.S. companies | 5,135 | 5,135 | — | — |
| International companies | 155 | 155 | — | — |
| Mutual funds: | | | | |
| U.S. companies | 804 | 804 | — | — |
| International companies | 494 | 494 | — | — |
| U.S. companies – fixed income | 2,619 | 2,619 | — | — |
| International companies - fixed income | 253 | 253 | — | — |
| | <u>\$ 12,115</u> | <u>\$ 9,639</u> | <u>\$ 2,476</u> | <u>\$ —</u> |
| Asset category as of December 31, 2013: | | | | |
| Cash and cash equivalents | \$ 198 | \$ 198 | \$ — | \$ — |
| Bonds: | | | | |
| U.S. government agency | 481 | — | 481 | — |
| Municipal | 730 | — | 730 | — |
| U.S. corporate | 729 | — | 729 | — |
| Foreign corporate | 211 | — | 211 | — |
| Equity securities: | | | | |
| U.S. companies | 4,867 | 4,867 | — | — |
| International companies | 146 | 146 | — | — |
| Mutual funds: | | | | |
| U.S. companies | 1,080 | 1,080 | — | — |
| International companies | 395 | 395 | — | — |
| U.S. companies – fixed income | 2,075 | 2,075 | — | — |
| International companies - fixed income | 530 | 530 | — | — |
| | <u>\$ 11,442</u> | <u>\$ 9,291</u> | <u>\$ 2,151</u> | <u>\$ —</u> |

The Company has a Funding Agreement with RBS Citizens, NA (Citizens) to act as the Funding Agent of the assets of the Plan. Citizens has been given discretion by the Company to determine the appropriate strategic asset allocation as governed by the Company's Investment Policy Statement and Guidelines which provides specific targeted asset allocations for each investment category as follows:

| <u>Asset Allocation Targets</u> | <u>Allocation Range</u> |
|---------------------------------|-------------------------|
| Large Cap Domestic Equity | 30% - 40% |
| Mid Cap Domestic Equity | 5% - 15% |
| Small Cap Domestic Equity | 0% - 10% |
| International Equity | 5% - 20% |
| Real Estate | 0% - 10% |
| Core Investment Grade Bonds | 15% - 30% |
| Mortgages | 0% - 15% |
| Money Market | 0% - 10% |

Directors Survival Insurance

The Company maintains a separate insurance program for Directors. The benefits accrued under this plan totaled \$139,000 at December 31, 2014 and \$129,000 at December 31, 2013 and are unfunded. The Company recorded an expense \$10,000 relating to this plan during both the years ended December 31, 2014 and 2013.

Profit Incentive Program

The Company maintains a profit incentive program for all employees. There were no accrued benefits at December 31, 2014 or 2013 as benefits are paid in the year earned. The Company recorded an expense of \$594,000, and \$410,000 relating to this plan during the years ended December 31, 2014 and 2013, respectively.

Tax-Deferred Savings Plan

The Company maintains a qualified 401(k) plan for all employees, which permits tax-deferred employee contributions up to the greater of 75% of salary or the maximum allowed by law and provides for matching contributions by the Company. The Company matches 100% of employee contributions up to 4% of the employee's salary and 25% of the next 2% of the employee's salary. The Company incurred annual expenses of \$216,000 and \$192,000 in 2014 and 2013, respectively.

Supplemental Executive Retirement Plan

The Company maintains a Supplemental Executive Retirement Plan for certain executive officers primarily to restore benefit reductions in certain employee benefit plans due to Internal Revenue Service regulations. The benefits accrued under this plan totaled \$2,973,000 at December 31, 2014 and \$2,827,000 at December 31, 2013 and are unfunded. The Company recorded an expense of \$405,000 and \$365,000 relating to this plan during the years ended December 31, 2014 and 2013, respectively.

Director Retirement Plan

The Company established a Director Retirement Plan in order to provide certain retirement benefits to participating directors. Generally, each participating director receives an annual retirement benefit of eighty percent of their average annual cash compensation during the three highest calendar years, as defined in the plan. This annual retirement benefit is payable until death and may not exceed \$40,000 per year. The benefits accrued under this plan totaled \$710,000 and \$694,000 at December 31, 2014 and 2013, respectively, and are unfunded. The Company recorded an expense of \$67,000 and \$68,000, relating to this plan during the years ended December 31, 2014 and 2013, respectively.

(16) Commitments and Contingent Liabilities

Legal Proceedings

The Company and the Bank are, from time to time, defendants in routine legal proceedings relating to the ordinary conduct of their business. In the best judgment of management, the consolidated financial position and results of operations of the Company will not be affected materially by the outcome of any pending legal proceedings.

Off-Balance-Sheet Financial Instruments

The Company is a party to certain financial instruments with off-balance-sheet risk in the normal course of business to meet the financing needs of its customers. These are limited to commitments to

extend credit and standby letters of credit which involve, to varying degrees, elements of credit risk in excess of the amounts recognized in the consolidated balance sheets. The contract amounts of these instruments reflect the extent of the Company's involvement in particular classes of financial instruments.

The Company's maximum exposure to credit loss, in the event of nonperformance by the other party to these instruments, would be the contract amount, assuming that they are fully funded at a later date and any collateral proves to be worthless. The Company uses the same credit policies in making commitments as it does for on-balance-sheet extensions of credit.

Contractual amounts of financial instruments that represent agreements to extend credit are as follows at December 31 (in thousands):

| Off-Balance Sheet Financial Instruments | 2014 | 2013 |
|--|------------------|------------------|
| Loan origination commitments and unused lines of credit: | | |
| Commercial and residential mortgages | \$ 2,584 | \$ 2,465 |
| Commercial loans | 23,564 | 19,653 |
| Home equity lines | <u>7,014</u> | <u>7,765</u> |
| | 33,162 | 29,883 |
| Standby letters of credit | <u>274</u> | <u>308</u> |
| | <u>\$ 33,436</u> | <u>\$ 30,191</u> |

These agreements to extend credit have been granted to customers within the Company's lending area described in note 5 and relate primarily to fixed and variable rate loans.

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

The Company evaluates each customer's creditworthiness on a case-by-case basis. Mortgage commitments are secured by liens on real estate. Collateral on extensions of credit for commercial loans varies but may include accounts receivable, equipment, inventory, livestock, and income-producing commercial property.

The Company does not issue any guarantees that would require liability-recognition or disclosure, other than its standby letters of credit. The Company has issued unconditional commitments in the form of standby letters of credit to guarantee payment on behalf of a customer and guarantee the performance of a customer to a third party. Standby letters of credit generally arise in connection with lending relationships. The credit risk involved in issuing these instruments is essentially the same as that involved in extending loans to customers. Contingent obligations under standby letters of credit totaled \$274,000 and \$308,000 at December 31, 2014 and 2013, respectively, and represent the maximum potential future payments the Company could be required to make. Typically, these instruments have terms of twelve months or less and expire unused; therefore, the total amounts do not necessarily

represent future cash requirements. Each customer is evaluated individually for creditworthiness under the same underwriting standards used for commitments to extend credit and on-balance-sheet instruments. Company policies governing loan collateral apply to standby letters of credit at the time of credit extension. Loan-to-value ratios are generally consistent with loan-to-value requirements for other commercial loans secured by similar types of collateral. The fair value of the Company's standby letters of credit at December 31, 2014 and 2013 was not significant.

(17) Fair Values of Financial Instruments

The Company follows ASC Topic 820 *Fair Value Measurements and Disclosures* ("ASC 820"), which provides a framework for measuring and disclosing fair value under generally accepted accounting principles. ASC 820 requires disclosures about the fair value of assets and liabilities recognized in the consolidated balance whether the measurements are made on a recurring basis (for example, available-for-sale investment securities) or on a nonrecurring basis (for example, impaired loans).

ASC 820 defines fair value as the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. ASC 820 also establishes a fair value hierarchy which requires an entity to maximize the use of observable inputs and minimize the use of

unobservable inputs when measuring fair value. The standard established 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:* Unadjusted quoted prices in active markets that are accessible at the measurement date for identical, unrestricted assets or liabilities. Since valuations are based on quoted prices that are readily and regularly available in an active market, valuation of these products does not entail a significant degree of judgment.
- Level 2:* Quoted 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).

In instances where inputs used to measure fair value fall into different levels in the above fair value hierarchy, an asset's or liability's level is based on the lowest level of input that is significant to the fair value measurement

For assets measured at fair value on a recurring and non-recurring basis, the fair value measurements by level within the fair value hierarchy used at December 31, 2014 and 2013, respectively are as follows (in thousands):

| Fair Value Hierarchy For Assets Valued on a Recurring and Non-recurring Basis | Total | (Level 1) Quoted Prices in Active Markets for Identical Assets | (Level 2) Significant Other Observable Inputs | (Level 3) Significant Unobservable Inputs |
|--|-------------------|--|---|--|
| December 31, 2014: | | | | |
| Recurring: | | | | |
| Available for sale securities | | | | |
| Obligations of state and political subdivisions – New York state ^(a) | \$ 70,677 | \$ — | \$ 70,677 | \$ — |
| Mortgage backed securities and collateralized mortgage obligations – GSE residential ^(a) | 20,520 | — | 20,520 | — |
| Corporate debt – financial services industry | 11,467 | — | 11,467 | — |
| Equity securities – financial services industry | 2,137 | 2,137 | — | — |
| | <u>\$ 104,801</u> | <u>\$ 2,137</u> | <u>\$ 102,664</u> | <u>\$ —</u> |
| Non-recurring: | | | | |
| Foreclosed real estate | \$ 877 | \$ — | \$ — | \$ 877 |
| Impaired loans | 2,647 | — | — | 2,647 |
| | <u>\$ 3,524</u> | <u>\$ —</u> | <u>\$ —</u> | <u>\$ 3,524</u> |
| December 31, 2013: | | | | |
| Recurring: | | | | |
| Available for sale securities | | | | |
| Obligations of state and political subdivisions – New York state ^(a) | \$ 72,525 | \$ — | \$ 72,525 | \$ — |
| Mortgage backed securities and collateralized mortgage obligations – GSE residential ^(a) | 20,941 | — | 20,941 | — |
| Corporate debt – financial services industry | 13,150 | — | 13,150 | — |
| Certificates of deposit – financial services industry | 98 | 98 | — | — |
| Equity securities – financial services industry | 2,243 | 2,243 | — | — |
| | <u>\$ 108,957</u> | <u>\$ 2,341</u> | <u>\$ 106,616</u> | <u>\$ —</u> |
| Non-recurring: | | | | |
| Foreclosed real estate | \$ 803 | \$ — | \$ — | \$ 803 |
| Impaired loans | 2,599 | — | — | 2,599 |
| | <u>\$ 3,402</u> | <u>\$ —</u> | <u>\$ —</u> | <u>\$ 3,402</u> |

(a) Based on its analysis of the nature and risks of these investments, the Company has determined that presenting them as a single class is appropriate.

There were no transfers of assets between Level 1 and Level 2 for recurring assets.

Foreclosed assets consist primarily of commercial real estate and are not revalued on a recurring basis. At the time of foreclosure, foreclosed real estate assets are adjusted to fair value less estimated costs to sell upon transfer of the loans, establishing a new cost basis. Occasionally, additional valuation adjustments are made based on updated appraisals and other factors and are recorded as recognized. At that time, they are reported in the Company's fair value disclosures in the non-recurring table above.

ASC Topic 825 *Financial Instruments* ("ASC 825") requires disclosure of fair value information about financial instruments whether or not recognized on the balance sheet, for which it is practicable to estimate

fair value. Fair value estimates are made as of a specific point in time based on the characteristics of the financial instruments and the relevant market information. Where available, quoted market prices are used. In other cases, fair values are based on estimates using present value or other valuation techniques. These techniques involve uncertainties and are significantly affected by the assumptions used and the judgments made regarding risk characteristics of various financial instruments, discount rates, prepayments, estimates of future cash flows, future expected loss experience and other factors. Changes in assumptions could significantly affect these estimates. Derived fair value estimates cannot be substantiated by comparison to independent markets and, in many cases, may or may not be realized in an immediate sale of the instrument.

Under ASC 825, fair value estimates are based on existing financial

instruments without attempting to estimate the value of anticipated future business and the value of the assets and liabilities that are not financial instruments. Accordingly, the aggregate fair value amounts of existing financing instruments do not represent the underlying value of those instruments on the books of the Company.

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 the Company's financial instruments at December 31, 2014 and December 31, 2013:

Cash and Cash Equivalents

The carrying amounts reported in the consolidated balance sheet for cash and short-term instruments 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. The carrying values for securities maturing within 90 days approximate fair values because there is little interest rate or credit risk associated with these instruments.

Loans

Fair values are estimated for portfolios of loans with similar financial characteristics. Loans are segregated by type such as commercial, consumer, real estate and other loans. Each loan category is further segregated into fixed and adjustable rate interest terms and by performing and nonperforming categories. The fair values of performing loans are calculated by discounting scheduled cash flows through estimated maturity using estimated market discount rates that reflect the credit and interest rate risks inherent in the loans. Estimated maturities are based on contractual terms and repricing opportunities.

Impaired Loans

Impaired loans, which are predominately commercial real estate loans where it is probable that the Bank will be unable to collect all amounts due per the contractual terms of the loan agreement, are those in which the Bank 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, liquidation value 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. Impaired loans are transferred out of the Level 3 fair value hierarchy when

payments reduce the outstanding loan balance below the fair value of the loan's collateral or the loan is foreclosed upon. If the financial condition of the borrower improves such that collectability of all contractual amounts due is probable, and payments are current for nine months, the loan is transferred out of impaired status. As of December 31, 2014 the fair values of collateral-dependent impaired loans were calculated using an outstanding balance of \$486,000 with a specific valuation allowance of \$152,000. At December 31, 2013, the fair values of collateral-dependent impaired loans were calculated using an outstanding balance of \$249,000, with a specific valuation allowance of \$33,000. Impaired loans not requiring an allowance represent loans for which the fair value of the expected repayments or collateral exceed the recorded investments in such loans.

Accrued Interest Receivable and Payable

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

Restricted Investments

The carrying amount of restricted investments approximates fair value and considers the limited marketability of such securities.

Deposit Liabilities

The fair values disclosed for demand deposits (e.g., interest and noninterest checking, passbook savings 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.

Short-Term Debt

The carrying amounts of short-term debt approximate their fair values.

Federal Home Loan Bank Borrowings

Fair values of FHLB borrowings are estimated using discounted cash flow analysis, based on quoted prices for new FHLB borrowings with similar credit risk characteristics, terms and remaining maturity. These prices obtained from this active market represent a market value that is deemed to represent the transfer price if the liability were assumed by a third party.

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. For fixed rate loan commitments, fair value estimates also consider the difference between current market interest rates and the committed rates. At December 31, 2014 and December 31, 2013, the fair values of these financial instruments approximated the related carrying values which were not significant.

The following table presents additional quantitative information about assets measured at fair value on a nonrecurring basis for which the Company has computed fair value based on Level 3 values:

| Nonrecurring Assets | Fair value estimate As of December 31, | | Valuation techniques | Unobservable input | Range |
|------------------------|---|--------|--|---|--------------------------|
| | 2014 | 2013 | | | |
| Foreclosed real estate | \$ 877 | \$ 803 | Appraisal of collateral ^(a) | Appraisal adjustments ^(b) Liquidation expenses ^(b) | 0% to -10% 0% to -20% |
| Impaired loans | \$ 334 | \$ 216 | Appraisal of collateral ^(a) | Appraisal adjustments ^(b) Liquidation expenses ^(b) | 0% to -10% 0% to -20% |

(a) Fair value is generally determined through independent appraisals of the underlying collateral, which generally includes various level 3 inputs which are not identifiable.

(b) Appraisals may be adjusted by management for qualitative factors such as economic conditions and desired turn-over rate. Liquidation expenses are determined on an asset by asset basis and include expenses such as realtor fees, legal fees, transfer tax and other costs.

The following table presents financial assets and financial liabilities that were measured or disclosed at carrying and fair value on a recurring and nonrecurring basis by level within the fair value hierarchy as of December 31, 2014.

| Financial Assets and Liabilities (in thousands) | Carrying Value | Fair Value | (Level 1) Quoted Prices in Active Markets for Identical Assets | (Level 2) Significant Other Observable Inputs | (Level 3) Significant Unobservable Inputs |
|--|-------------------|---------------|--|---|--|
| | | | | | |
| December 31, 2014 | | | | | |
| Financial assets: | | | | | |
| Cash and cash equivalents | \$ 21,491 | \$ 21,491 | \$ 21,491 | \$ — | \$ — |
| Securities available for sale | 104,801 | 104,801 | 2,137 | 102,664 | — |
| Securities held to maturity | 7,208 | 7,489 | — | 7,489 | — |
| Loans, net | 273,338 | 274,609 | — | — | 274,609 |
| Accrued interest receivable | 1,877 | 1,877 | — | 1,877 | — |
| Restricted investments | 568 | 568 | — | 568 | — |
| Financial liabilities: | | | | | |
| Savings, money market and checking accounts | 262,355 | 262,355 | — | 262,355 | — |
| Time deposits | 114,136 | 114,220 | — | 114,220 | — |
| Accrued interest payable | 73 | 73 | — | 73 | — |
| December 31, 2013 | | | | | |
| Financial assets: | | | | | |
| Cash and cash equivalents | \$ 19,895 | \$ 19,895 | \$ 19,895 | \$ — | \$ — |
| Securities available for sale | 108,957 | 108,957 | 2,341 | 106,616 | — |
| Securities held to maturity | 3,612 | 3,780 | — | 3,780 | — |
| Loans, net | 269,131 | 269,070 | — | — | 269,070 |
| Accrued interest receivable | 1,911 | 1,911 | — | 1,911 | — |
| Restricted investments | 674 | 674 | — | 674 | — |
| Financial liabilities: | | | | | |
| Savings, money market and checking accounts | 249,266 | 249,266 | — | 249,266 | — |
| Time deposits | 123,375 | 123,546 | — | 123,546 | — |
| Accrued interest payable | 81 | 81 | — | 81 | — |

DIRECTORS

David W. Bodenstein,
President
Mike Preis, Inc.

Phil Coombe, III
Owner
Coombe Financial Services, Inc.
Partner
Coombe Bender & Company,
LLC

John W. Galligan, Surveyor
John W. Galligan Company

John K. Gempler
President
Callicoon Co-operative
Insurance Company

Kenneth C. Klein, Esquire
Kenneth C. Klein, Esq.

Donald L. Knack, CPA
Knack, Pavloff & Company, LLP

James F. Roche
Principal
Roche's Garage, Inc.

Fred W. Stabbert, III
President
Catskill Delaware Publications
Publisher
Sullivan County Democrat

Edward T. Sykes
President & Chairman of the
Board
Southern Tier Title Agency, LLC

Raymond L. Walter
Retired

Wayne V. Zanetti
President
Chief Executive Officer
Jeffersonville Bancorp

OFFICERS

Wayne V. Zanetti
President
Chief Executive Officer

George Kinne, Jr
Executive Vice President

John A. Russell
Senior Vice President
Chief Financial Officer

Tatiana Hahn
Senior Vice President
Chief Lending Officer

Rhonda Decker
Senior Vice President
Branch Administrator
Security Officer

Jaclene Austin
Marketing Coordinator

Amber Benson
Compliance Officer

Margaret Blaut
Branch Manager
Eldred / Narrowsburg

Michelle Brockner
Training Officer

Krista Brink
Branch Manager
Wal-Mart

Linda Browne
Branch Manager
White Lake

Melanie Dirie
Deposit Operations Supervisor

Bertha Donohue
Assistant Vice President
Branch Manager
Monticello

Stephanie Doyle
Assistant Branch Manager
Jeffersonville

Linda Fisk
Assistant Vice President
Branch Manager
Livingston Manor / Liberty

Bryan Flynn
Commercial Portfolio Adminis-
trator

Karen Gibbons
Assistant Branch Manager
Loch Sheldrake

Marisa Heisler
Vice President
IS Manager

Florence Horecky
Vice President
Operations Officer

Stephanie Hoefling
Branch Manager
Bloomingburg

Dawn Kaplan
Branch Manager
Loch Sheldrake

Stacey Kuhn
Assistant Vice President
Branch Manager
Sales Coordinator
Jeffersonville

Diane McGrath
Assistant Vice President
Loan Servicing Manager

Juliette McKerrell
Credit Origination Processor

Tanja McKerrell
Vice President
Senior Loan Officer

Sherry McNutt
Assistant Branch Manager
Monticello

Catherine Mickelson
Teller Training Coordinator /
Float Manager

Anna Milucky
Vice President
Business Banker

Deborah Muzuruk
Assistant Vice President
Executive Assistant
Facility Manager

Jillian Oakley
Assistant Branch Manager
Eldred

Patricia Olsen
Loan Origination Processor

Abigail Opper
Auditor

Valerie Panich
Assistant Vice President
Loan Origination Manager

LeighAnne Pfriender
Assistant Vice President
Credit Administrator

Sherri Rhyne
Assistant Branch Manager
Livingston Manor

Sandra Ross
Branch Manager
Callicoon

Virginia Sanborn
Controller
Assistant Cashier

Sandra Sipple
Assistant Vice President
Commercial Loan Administrator

Stacey Stephenson
Assistant Branch Manager
Liberty

Heinrich Strauch
Commercial Loan Officer

Leanne Stuhlmiller
BSA Officer

Claire Taggart
Vice President
Human Resources

Kimberly White
Branch Manager
Wurtsboro

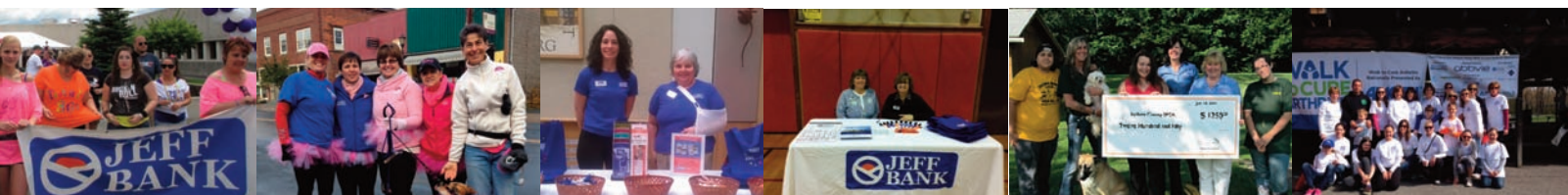
STAFF

| | | | |
|--------------------|------------------|----------------------|---------------------|
| Chelsea Abplanalp | Dawn Feinman | Kristin Lockwood | Kelsey Ritz |
| Donna Abplanalp | Ashley Freestone | Robert Lohr | John Rudy |
| Rosa Arballes | Rebecca Gagnon | Margaret Lynch | Alicia Ryder |
| Jill Atkins | Linda Giese | Kerry Madison | Jonathan Sager |
| Kristin Barila | Terriesa Giglio | Billy McKerrell, Jr. | Amber Sayers |
| Alexis Baum-Conley | Jill Goodall | Carla Meigel | Therese Schanil |
| Deborah Berger | Jessica Guard | Ewa Mierzwa | Wendy Schenck |
| Tim Bernhardt | Justina Havre | Debra Murphy | Leslie Schwamberger |
| Debra Bieske | Cathy Horan | Edwin Neumann | Danielle Shaffer |
| Paul Brockner | Carl Huber | Madeleine Oakley | Leonid Sharshukov |
| Brandon Carlsen | Audra Hubert | Gloryvet Olivo | Angelica Shencavitz |
| Danielle Chudik | Jenna Keesler | Christine Olsen | Denise Smestad |
| Dina Conklin | Jean Kelly | Kayla Olsen | Kelli Sparling |
| Jennifer Court | Jessica Kenyon | Ariel Pabon | Kara Spencer |
| Ursula Curry | Renee Kortright | Bruce Pecs, Jr. | Mckenzie Stoddard |
| Nancie Davis | Pamela Knapp | Donna Peters | Matthew Sush |
| Jessica Doyle | Jessica Latimer | Barbara Pietrucha | Lale Perez |
| Lisa Dymond | Patricia Latimer | Taylor Pilny | Tammie Vargas |
| Tara Everett | Brandy Leonardo | Margaret Porter | Carlos Vega |
| Peter Feinberg | Frank Leonardo | Cassandra Rhodes | Everett Williams |

SHAREHOLDER INFORMATION

The Company's common stock is traded on the OTC Markets Group OTCQB Marketplace under the symbol JFBC. The following companies are known to make a market in our stock: Stifel, Nicolaus & Company, Incorporated, Monroe Financial Partners, Inc., Canaccord Genuity Inc., Citadel Securities. The following table shows the range of high and low sale prices for the Company's stock and cash dividends paid for the quarters indicated.

| For the Quarter Ended: | Sales Low | Sales High | Cash Dividends Paid |
|-----------------------------------|----------------------|-----------------------|------------------------------------|
| December 31, 2014 | \$12.15 | \$13.50 | \$ 0.14 |
| September 30, 2014 | \$11.90 | \$12.75 | \$ 0.13 |
| June 30, 2014 | \$11.60 | \$12.40 | \$ 0.13 |
| March 31, 2014 | \$11.35 | \$13.99 | \$ 0.13 |
| December 31, 2013 | \$10.90 | \$11.65 | \$ 0.13 |
| September 30, 2013 | \$10.76 | \$11.48 | \$ 0.13 |
| June 30, 2013 | \$10.75 | \$11.90 | \$ 0.13 |
| March 31, 2013 | \$10.22 | \$11.78 | \$ 0.13 |



JEFF BANK BRANCHES

Bloomingsburg Office

85 Main Street, Bloomingsburg, New York 12721 (845) 733-2270

Callicoon Office

4499 State Route 17B, Callicoon, New York 12723 (845) 887-4866

Eldred Office

561 State Route 55, Eldred, New York 12732 (845) 557-8513

Jeffersonville Office

4864 State Route 52, Jeffersonville, New York 12748 (845) 482-4000

Liberty Office

19 Church Street, Liberty, New York 12754 (845) 292-6300

Livingston Manor Office

33 Main Street, Livingston Manor, New York, 12758 (845) 439-8123

Loch Sheldrake Office

1278 State Route 52, Loch Sheldrake, New York 12759 (845) 434-1180

Monticello Office

19 Forestburgh Road, Monticello, New York 12701 (845) 791-4000

Narrowsburg Office

155 Kirk Road, Narrowsburg, New York 12764 (845) 252-6570

Wal Mart Office

33 Anawana Lake Road, Monticello, New York 12701 (845) 794-3988

White Lake Office

1460 State Route 17B, White Lake, New York 12786 (845) 583-4074

Wurtsboro Office

230 State Route 209, Wurtsboro, New York 12790 (845) 888-5890



4866 State Route 52 - P.O. Box 398 Jeffersonville, NY 12748