SHATSWELL, MacLEOD & COMPANY, P.C.

CERTIFIED PUBLIC ACCOUNTANTS

The Board of Directors and Stockholders
Kinderhook Bank Corp.
Kinderhook, New York

INDEPENDENT AUDITOR'S REPORT

We have audited the accompanying consolidated balance sheets of Kinderhook Bank Corp. and Subsidiaries 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 Financial Statements**

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

**Auditor's Responsibility**

Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the 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 Kinderhook Bank Corp. and Subsidiaries 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.

Shatswell, MacLeod + Company, P.C.

SHATSWELL, MacLEOD & COMPANY, P.C.

West Peabody, Massachusetts
April 22, 2015

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KINDERHOOK BANK CORP. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

December 31, 2014 and 2013

(In Thousands, Except Share Data)

| ASSETS | 2014 | 2013 |
|---|---|---|
| Cash and due from banks | $ 3,946 | $ 4,554 |
| Interest-bearing deposits with Federal Home Loan Bank and Federal Reserve Bank | 2,945 | 807 |
| Total cash and cash equivalents | 6,891 | 5,361 |
| Interest-bearing time deposits with other banks | - | 1,125 |
| Investments in available-for-sale securities (at fair value) | 64,243 | 61,729 |
| Investments in held-to-maturity securities (fair values of $1,145 as of December 31, 2014 and $2,150 as of December 31, 2013) | 1,139 | 2,128 |
| Federal Home Loan Bank stock, at cost | 939 | 355 |
| Federal Reserve Bank stock, at cost | 570 | 450 |
| Loans held-for-sale | - | 10,496 |
| Loans, net | 280,516 | 232,206 |
| Premises and equipment | 7,372 | 5,496 |
| Other real estate owned | 607 | - |
| Goodwill | 931 | 931 |
| Intangible assets | 381 | 582 |
| Cash surrender value of life insurance policies | 8,033 | 7,820 |
| Accrued interest receivable | 1,085 | 1,091 |
| Other assets | 2,188 | 2,294 |
| Total assets | $ 374,895 | $ 332,064 |
| LIABILITIES AND STOCKHOLDERS' EQUITY | | |
| Deposits: | | |
| Noninterest-bearing | $ 42,579 | $ 39,952 |
| Interest-bearing | 270,394 | 253,851 |
| Total deposits | 312,973 | 293,803 |
| Federal Home Loan Bank advances | 14,000 | - |
| Junior subordinated debentures | 2,062 | 2,062 |
| Notes payable | 335 | 368 |
| Securities sold under agreements to repurchase | 178 | 181 |
| Accrued interest payable | 112 | 56 |
| Other liabilities | 3,655 | 2,474 |
| Total liabilities | 333,315 | 298,944 |

The accompanying notes are an integral part of these consolidated financial statements.

KINDERHOOK BANK CORP. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

December 31, 2014 and 2013

(In Thousands, Except Share Data)

(continued)

| | 2014 | 2013 |
|---|---|---|
| Stockholders' equity: | | |
| Preferred stock, par value $25; authorized, 100,000 shares: | | |
| Series A, issued and outstanding, 12,087 shares 6% fixed rate non-cumulative convertible perpetual, liquidation value $350.00 per share as of December 31, 2014, and 2013 | 302 | 302 |
| Series B, issued and outstanding, 7,000 shares senior non-cumulative perpetual, liquidation value $1,000 per share | 175 | 175 |
| Series C, issued and outstanding, 20,687 shares 5.25% fixed rate non-cumulative convertible perpetual, liquidation value $357.15 per share as of December 31, 2014 | 517 | - |
| Common stock, par value $0.83; authorized, 2,000,000 shares; issued and outstanding 730,861.507 and 732,856.507 shares as of December 31, 2014 and 2013, respectively | 606 | 608 |
| Paid-in capital | 22,946 | 16,221 |
| Retained earnings | 16,430 | 15,253 |
| Accumulated other comprehensive income | 547 | 504 |
| Total Kinderhook Bank Corp. stockholders' equity | 41,523 | 33,063 |
| Noncontrolling interest | 57 | 57 |
| Total stockholders' equity | 41,580 | 33,120 |
| Total liabilities and stockholders' equity | $ 374,895 | $ 332,064 |

The accompanying notes are an integral part of these consolidated financial statements.

KINDERHOOK BANK CORP. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF INCOME

Years Ended December 31, 2014 and 2013

(In Thousands, Except Share Data)

| | 2014 | 2013 |
|---|---|---|
| Interest and dividend income: | | |
| Interest and fees on loans | $ 12,364 | $ 11,413 |
| Interest on debt securities: | | |
| Taxable | 548 | 489 |
| Tax-exempt | 589 | 569 |
| Dividends | 49 | 47 |
| Other interest | 7 | 9 |
| Total interest and dividend income | 13,557 | 12,527 |
| Interest expense: | | |
| Interest on deposits | 1,369 | 1,265 |
| Interest on other borrowed funds | - | 1 |
| Interest on advances from Federal Home Loan Bank | 8 | 18 |
| Interest on notes payable | 25 | 24 |
| Interest on junior subordinated debentures | 85 | 118 |
| Total interest expense | 1,487 | 1,426 |
| Net interest and dividend income | 12,070 | 11,101 |
| Provision for loan losses | 628 | 594 |
| Net interest and dividend income after provision for loan losses | 11,442 | 10,507 |
| Noninterest income: | | |
| Customer service charges and fees | 1,108 | 1,032 |
| Gain on sales of loans | 276 | 271 |
| Gain on sales of available-for-sale securities | 10 | 6 |
| Insurance commissions and fees | 1,204 | 1,536 |
| Increase in cash surrender value life insurance | 213 | 225 |
| Other income | 59 | 40 |
| Total noninterest income | 2,870 | 3,110 |
| Noninterest expense: | | |
| Salaries and employee benefits | 6,279 | 5,715 |
| Occupancy expense | 929 | 796 |
| Equipment expense | 424 | 434 |
| Professional and assessment fees | 502 | 407 |
| Director fees | 213 | 208 |
| Advertising | 308 | 238 |
| Data processing | 477 | 438 |
| FDIC assessment | 229 | 185 |
| Other expense | 1,696 | 1,560 |
| Total noninterest expense | 11,057 | 9,981 |
| Income before income tax expense | 3,255 | 3,636 |
| Income tax expense | 942 | 1,093 |
| Net income attributable to noncontrolling interest and Kinderhook Bank Corp. | 2,313 | 2,543 |
| Less: Net income attributable to noncontrolling interest | 6 | 6 |
| Net income | $ 2,307 | $ 2,537 |
| Earnings per common share, basic | $ 2.32 | $ 2.67 |
| Earnings per common share, assuming dilution | $ 2.23 | $ 2.67 |

The accompanying notes are an integral part of these consolidated financial statements.

KINDERHOOK BANK CORP. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

Years Ended December 31, 2014 and 2013

(In Thousands)

| | 2014 | 2013 |
|---|---|---|
| Net income | $ 2,307 | $ 2,537 |
| Other comprehensive (loss) income, net of tax: | | |
| Net change in unrealized holding gain on available-for-sale securities, net of tax | 27 | (595) |
| Net change in unrealized loss on derivative, net of tax | 16 | 33 |
| Other comprehensive income (loss) , net of tax | 43 | (562) |
| Comprehensive income | $ 2,350 | $ 1,975 |

The accompanying notes are an integral part of these consolidated financial statements.

KINDERHOOK BANK CORP. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY

Years Ended December 31, 2014 and 2013

(In Thousands, Except Share Data)

| | Preferred Stock | | | Common | Paid-in | Retained | Accumulated Other Comprehensive | Noncontrolling | |
|---|---|---|---|---|---|---|---|---|---|
| | Series A | Series B | Series C | Stock | Capital | Earnings | Income | Interest | Total |
| Balance, December 31, 2012 | $ 302 | $ 175 | $ | $ 608 | $ 16,219 | $ 13,860 | $ 1,066 | $ 57 | $ 32,287 |
| Net income | | | | | | 2,537 | | | 2,537 |
| Other comprehensive loss, net of tax | | | | | | | (562) | | (562) |
| Preferred stock amortization | | | | | 2 | (2) | | | - |
| Dividends declared ($0.77 per common share) | | | | | | (564) | | | (564) |
| Dividends declared preferred stock | | | | | | (578) | | | (578) |
| Balance, December 31, 2013 | 302 | 175 | - | 608 | 16,221 | 15,253 | 504 | 57 | 33,120 |
| Net income | | | | | | 2,307 | | | 2,307 |
| Other comprehensive income, net of tax | | | | | | | 43 | | 43 |
| Proceeds from issuance of preferred stock, net | | | 517 | | 6,794 | | | | 7,311 |
| Preferred stock amortization | | | | | 2 | (2) | | | - |
| Forfeit of contingent shares | | | | (2) | (71) | 73 | | | - |
| Dividends declared ($0.81 per common share) | | | | | | (592) | | | (592) |
| Dividends declared preferred stock | | | | | | (609) | | | (609) |
| Balance, December 31, 2014 | $ 302 | $ 175 | $ 517 | $ 606 | $ 22,946 | $ 16,430 | $ 547 | $ 57 | $ 41,580 |

The accompanying notes are an integral part of these consolidated financial statements.

KINDERHOOK BANK CORP. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS

Years Ended December 31, 2014 and 2013

(In Thousands)

| | 2014 | 2013 |
|---|---|---|
| Cash flows from operating activities: | | |
| Net income | $ 2,307 | $ 2,537 |
| Adjustments to reconcile net income to net cash provided by (used in) operating activities: | | |
| Amortization on securities, net | 644 | 731 |
| Gain on sales of available-for-sale securities | (10) | (6) |
| Provision for loan losses | 628 | 594 |
| Change in deferred costs/fees, net | (67) | 173 |
| Decrease (increase) in loans held-for-sale | 7,129 | (4,669) |
| Depreciation and amortization | 347 | 339 |
| Deferred tax benefit | (127) | (326) |
| Decrease (increase) in interest receivable | 6 | (68) |
| Increase (decrease) in interest payable | 56 | (34) |
| Increase in other liabilities | 907 | 789 |
| Amortization of intangible assets | 125 | 188 |
| Amortization of deferred gain on sale of customer lists | (24) | - |
| Decrease (increase) in other assets | 306 | (60) |
| Decrease (increase) in income taxes receivable | 239 | (151) |
| Increase in cash surrender value of life insurance policies | (213) | (225) |
| Net cash provided by (used in) operating activities | 12,253 | (188) |
| Cash flows from investing activities: | | |
| Proceeds from maturities of interest-bearing time deposits in other banks | 1,125 | - |
| Purchases of available-for-sale securities | (21,741) | (7,202) |
| Proceeds from maturities, paydowns and calls of available-for-sale securities | 12,825 | 6,567 |
| Proceeds from sales of available-for-sale securities | 5,813 | 4,217 |
| Proceeds from maturities of held-to-maturity securities | 2,128 | 1,077 |
| Purchases of held-to-maturity securities | (1,139) | (2,127) |
| Purchases of Federal Home Loan Bank stock | (2,082) | (1,866) |
| Redemption of Federal Home Loan Bank stock | 1,498 | 1,845 |
| Purchases of Federal Reserve Bank stock | (120) | - |
| Payments received on notes receivable | 60 | 15 |
| Loan originations and principal collections, net | (37,558) | (22,196) |
| Loans purchased | (8,582) | (3,000) |
| Recoveries of loans previously charged off | 29 | 21 |
| Capital expenditures | (2,223) | (166) |
| Net cash used in investing activities | (49,967) | (22,815) |

KINDERHOOK BANK CORP. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS

Years Ended December 31, 2014 and 2013

(In Thousands)

(continued)

| | 2014 | 2013 |
|---|---|---|
| Cash flows from financing activities: | | |
| Net increase in demand deposits, NOW and savings accounts | 23,286 | 21,916 |
| Net decrease in time deposits | (4,116) | (6,176) |
| Net change in short-term advances | 14,000 | - |
| Payments made on notes payable | (33) | (31) |
| Decrease in securities sold under agreements to repurchase | (3) | (514) |
| Proceeds from issuance of preferred stock, net of offering costs | 7,311 | - |
| Dividends paid – preferred stock | (609) | (578) |
| Dividends paid – common stock | (592) | (564) |
| Net cash provided by financing activities | 39,244 | 14,053 |
| Net increase (decrease) in cash and cash equivalents | 1,530 | (8,950) |
| Cash and cash equivalents at beginning of year | 5,361 | 14,311 |
| Cash and cash equivalents at end of year | $ 6,891 | $ 5,361 |
| Supplemental disclosures: | | |
| Interest paid | $ 1,431 | $ 1,460 |
| Income taxes paid | 830 | 1,570 |
| Notes received in exchange for sale of customer lists and settlement of commissions receivable | 400 | 262 |
| Increase in deferred gain on sale of customer lists included in other liabilities | 282 | 98 |
| Loan transferred to other real estate owned | 607 | - |
| Transfer of loans held-for-sale to loans receivable | 3,367 | - |

The accompanying notes are an integral part of these consolidated financial statements.

KINDERHOOK BANK CORP. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Years Ended December 31, 2014 and 2013

## NOTE 1 - NATURE OF OPERATIONS

Kinderhook Bank Corp. (Company) is a New York corporation that was organized in 1996 to become the holding company of The National Union Bank of Kinderhook (Bank). The Company's primary activity is to act as the holding company for the Bank. On February 3, 2009, Kinderhook Bank Corp. acquired The Kleeber Agency, Inc., an insurance agency, which became a subsidiary of the Company. The Bank is a nationally chartered bank, headquartered in Kinderhook, New York. The Bank operates its business from seven banking offices located in New York. The Bank is engaged principally in the business of attracting deposits from the general public and investing those deposits in business and consumer loans, and in residential and commercial real estate loans.

## NOTE 2 - ACCOUNTING POLICIES

The accounting and reporting policies of the Company and its subsidiaries conform to accounting principles generally accepted in the United States of America (GAAP) and predominant practices within the banking industry. The consolidated financial statements were prepared using the accrual basis of accounting. The significant accounting policies are summarized below to assist the reader in better understanding the consolidated financial statements and other data contained herein.

### USE OF ESTIMATES:

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

### BASIS OF PRESENTATION:

The consolidated financial statements include the accounts of the Company and its wholly-owned subsidiaries, the Bank and The Kleeber Agency, Inc., and the Bank's wholly-owned subsidiary, Kinderhook Realty Holding Corp. The Kleeber Agency, Inc., an insurance agency, was acquired on February 3, 2009. Kinderhook Realty Holding Corp., a real estate investment trust, was formed to hold real estate mortgage loans. All significant intercompany accounts and transactions have been eliminated in the consolidation.

Kinderhook Capital Trust, an affiliate of the Company, was formed to sell capital securities to the public through a third party trust pool. In accordance with ASC 810-10, "Consolidation - Overall," this affiliate has not been included in the consolidated financial statements.

### CASH AND CASH EQUIVALENTS:

For purposes of reporting cash flows, cash and cash equivalents include cash on hand, cash items, due from banks and interest-bearing deposits with Federal Home Loan Bank and Federal Reserve Bank.

### SECURITIES:

Investments in debt securities are adjusted for amortization of premiums and accretion of discounts computed so as to approximate the interest method. Gains or losses on sales of investment securities are computed on a specific identification basis.

The Company classifies debt and equity securities into one of three categories: held-to-maturity, available-for-sale, or trading. These security classifications may be modified after acquisition only under certain specified conditions. In general, securities may be classified as held-to-maturity only if the Company has the positive intent and ability to hold them to maturity. Trading securities are defined as those bought and held principally for the purpose of selling them in the near term. All other securities must be classified as available-for-sale.

-- Held-to-maturity securities are measured at amortized cost in the consolidated balance sheets. Unrealized holding gains and losses are not included in earnings or in a separate component of stockholders' equity. They are merely disclosed in the notes to the consolidated financial statements.

-- Available-for-sale securities are carried at fair value on the consolidated balance sheets. Unrealized holding gains and losses are not included in earnings, but are reported as a net amount (less expected tax) in a separate component of stockholders' equity until realized.

-- Trading securities are carried at fair value on the consolidated balance sheets. Unrealized holding gains and losses for trading securities are included in earnings.

For any debt security with a fair value less than its amortized cost basis, the Company will determine whether it has the intent to sell the debt security or whether it is more likely than not it will be required to sell the debt security before the recovery of its amortized cost basis. If either condition is met, the Company will recognize a full impairment charge to earnings. For all other debt securities that are considered other-than-temporarily impaired and do not meet either condition, the credit loss portion of impairment will be recognized in earnings as realized losses. The other-than-temporary impairment related to all other factors will be recorded in other comprehensive income.

Declines in marketable equity securities below their cost that are deemed other than temporary are reflected in earnings as realized losses.

As a member of the Federal Home Loan Bank (FHLB), the Company is required to acquire and hold shares of FHLB Class B stock. The Company's holding requirement varies based on its activities, primarily its outstanding borrowings, with the FHLB. The Company's investment in FHLB stock is carried at cost. The Company conducts a periodic review and evaluation of its FHLB stock to determine if any impairment exists. Based on its most recent analysis of the FHLB of New York as of December 31, 2014, management deems its investment in FHLB of New York stock to be not other-than-temporarily impaired.

LOANS:

Loans receivable that management has the intent and ability to hold until maturity or payoff are reported at their outstanding principal balances adjusted for amounts due to borrowers on unadvanced loans, any charge-offs, the allowance for loan losses and net of any deferred fees or costs on originated loans, or unamortized premiums or discounts on purchased loans.

Interest on loans is recognized on a simple interest basis.

Loan origination and commitment fees and certain direct origination costs are deferred, and the net amount amortized as an adjustment of the related loan's yield. The Company is amortizing these amounts over the contractual life of the related loans.

Residential real estate loans are generally placed on nonaccrual when reaching 90 days past due or in process of foreclosure. All closed-end consumer loans 90 days or more past due and any equity line in the process of foreclosure are placed on nonaccrual status. Secured consumer loans are written down to realizable value and unsecured consumer loans are charged off before reaching 90 days past due depending on the type of loan. Commercial real estate loans and commercial business loans and leases which are 90 days or more past due are generally placed on nonaccrual status, unless secured by sufficient cash or other assets immediately convertible to cash. When a loan has been placed on nonaccrual status, previously accrued and uncollected interest is reversed against interest on loans. A loan can be returned to accrual status when collectibility of principal is reasonably assured and the loan has performed for a period of time, generally six months.

Cash receipts of interest income on impaired loans is credited to principal to the extent necessary to eliminate doubt as to the collectibility of the net carrying amount of the loan. Some or all of the cash receipts of interest income on impaired loans is recognized as interest income if the remaining net carrying amount of the loan is deemed to be fully collectible. When recognition of interest income on an impaired loan on a cash basis is appropriate, the amount of income that is recognized is limited to that which would have been accrued on the net carrying amount of the loan at the contractual interest rate. Any cash interest payments received in excess of the limit and not applied to reduce the net carrying amount of the loan are recorded as recoveries of charge-offs until the charge-offs are fully recovered.

ALLOWANCE FOR LOAN LOSSES:

The allowance for loan losses is established as losses are estimated to have occurred through a provision for loan losses charged to earnings. Loan losses are charged against the allowance when management believes the uncollectibility of a loan balance is confirmed. Subsequent recoveries, if any, are credited to the allowance.

The allowance for loan losses is evaluated on a regular basis by management and is based upon management's periodic review of the collectibility of the loans in light of historical experience, the nature and volume of the loan portfolio, adverse situations that may affect the borrower's ability to repay, estimated value of any underlying collateral and prevailing economic conditions. This evaluation is inherently subjective as it requires estimates that are susceptible to significant revision as more information becomes available.

The Company's loan portfolio includes residential real estate, commercial real estate, construction, commercial and consumer segments. Residential real estate loans include classes for 1-4 family owner occupied, second mortgages and equity lines of credit. Consumer loans include classes for personal and credit card loans. Loans that management has the intent and ability to hold for the foreseeable future or until maturity or pay-off generally are reported at their outstanding unpaid principal balances adjusted for charge-offs, the allowance for loan losses, and any deferred fees or costs on originated loans. Interest income is accrued on the unpaid principal balance. Loan origination fees, net of certain direct origination costs, are deferred and recognized as an adjustment of the related loan yield using the interest method.

The accrual of interest on all loans is discontinued at the time the loan is 90 days past due unless the credit is well-secured and in process of collection. Past due status is based on contractual terms of the loan. In all cases, loans are placed on nonaccrual if collection of principal or interest is considered doubtful. All interest accrued but not collected for loans that are placed on nonaccrual is reversed against interest income. The interest on these loans is accounted for on the cash-basis or cost-recovery method, until qualifying for return to accrual. Loans are returned to accrual status when all the principal and interest amounts contractually due are brought current and future payments are reasonably assured.

The allowance for loan losses is established as losses are estimated to have occurred through a provision for loan losses charged to earnings. Loan losses are charged against the allowance when management believes the uncollectibility of a loan balance is confirmed. Subsequent recoveries, if any, are credited to the allowance.

The allowance for loan losses is evaluated on a regular basis by management. This evaluation is inherently subjective as it requires estimates that are susceptible to significant revision as more information becomes available. The allowance consists of general, allocated and unallocated components, as further described below.

*General Component:*

The general component of the allowance for loan losses is based on historical loss experience adjusted for qualitative factors stratified by the following loan segments: residential real estate, commercial real estate, commercial and consumer. Management uses a rolling average of historical losses based on a time frame appropriate to capture relevant loss data for each loan segment. This historical loss factor is adjusted for the following qualitative factors: levels/trends in delinquencies; trends in volume and terms of loans; effects of changes in risk selection and underwriting standards and other changes in lending policies, procedures and practices; experience/ability/depth of lending management and staff; and national and local economic trends and conditions. There were no changes in the Company's policies or methodology pertaining to the general component of the allowance for loan losses during 2014.

The qualitative factors are determined based on the various risk characteristics of each loan segment. Risk characteristics relevant to each portfolio segment are as follows:

Residential real estate secured by first mortgages - The Company generally does not originate loans with a loan-to-value ratio greater than 90 percent and does not grant subprime loans. All loans in this segment are collateralized by owner-occupied residential real estate and repayment is dependent on the credit quality of the individual borrower. The overall health of the economy, including unemployment rates and housing prices, will have an effect on the credit quality in this segment.

Home equity loans and lines - Loans in this segment are generally secured by a second lien position on owner-occupied residential real estate. Lines of credit do not amortize during the draw period of the loan.

Commercial real estate - Loans in this segment are primarily income-producing properties throughout upstate New York. The underlying cash flows generated by the properties are adversely impacted by a downturn in the economy as evidenced by increased vacancy rates, which in turn, will have an effect on the credit quality in this segment. Management obtains rent rolls annually and continually monitors the cash flows of these loans.

Commercial loans - Loans in this segment are made to businesses and are generally secured by assets of the business. Repayment is expected from the cash flows of the business. A weakened economy, and resultant decreased consumer spending, will have an effect on the credit quality in this segment.

Consumer and other loans - Loans in this segment are generally unsecured and repayment is dependent on the credit quality of the individual borrower.

*Allocated Component:*

The allocated component relates to loans that are classified as impaired. Impairment is measured on a loan by loan basis for commercial, commercial real estate and certain other loans by either the present value of expected future cash flows discounted at the loan's effective interest rate or the fair value of the collateral if the loan is collateral dependent. An allowance is established when the discounted cash flows (or collateral value) of the impaired loan are lower than the carrying value of that loan. Large groups of smaller balance homogeneous loans are collectively evaluated for impairment. Although the Company evaluates individual consumer and residential real estate loans for impairment, such loans are not disclosed as impaired unless subject to a troubled debt restructuring agreement.

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

The Company periodically may agree to modify the contractual terms of loans. When a loan is modified and a concession is made to a borrower experiencing financial difficulty, the modification is considered a troubled debt restructuring (TDR). All TDRs are initially classified as impaired.

*Unallocated Component:*

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

PREMISES AND EQUIPMENT:

Premises and equipment are stated at cost, less accumulated depreciation and amortization. Cost and related allowances for depreciation and amortization of premises and equipment retired or otherwise disposed of are removed from the respective accounts with any gain or loss included in income or expense. Depreciation and amortization are calculated principally on the straight-line method over the estimated useful lives of the assets.

OTHER REAL ESTATE OWNED AND IN-SUBSTANCE FORECLOSURES:

Other real estate owned includes properties acquired through foreclosure and properties classified as in-substance foreclosures in accordance with ASC 310-40, "Receivables - Troubled Debt Restructuring by Creditors." These properties are held for sale and are initially recorded at fair value less cost to sell at the date of foreclosure or transfer, establishing a new cost basis. Subsequent to foreclosure or transfer, valuations are periodically performed by management and the assets are carried at the lower of carrying amount or fair value less cost to sell. Any writedown from cost to estimated fair value required at the time of foreclosure or classification as in-substance foreclosure is charged to the allowance for loan losses. Expenses incurred in connection with maintaining these assets, subsequent writedowns and gains or losses recognized upon sale are included in other expense.

In accordance with ASC 310-10-35, "Receivables - Overall - Subsequent Measurement," the Company classifies loans as in-substance repossessed or foreclosed if the Company receives physical possession of the debtor's assets regardless of whether formal foreclosure proceedings take place.

ADVERTISING:

The Company directly expenses costs associated with advertising as they are incurred.

INCOME TAXES:

The Company recognizes income taxes under the asset and liability method. Under this method, deferred tax assets and liabilities are established for the temporary differences between the accounting basis and the tax basis of the Company's assets and liabilities at enacted tax rates expected to be in effect when the amounts related to such temporary differences are realized or settled.

FAIR VALUES OF FINANCIAL INSTRUMENTS:

ASC 825, "Financial Instruments," requires that the Company disclose estimated fair value for its financial instruments. Fair value methods and assumptions used by the Company in estimating its fair value disclosures are as follows:

Cash and cash equivalents: The carrying amounts reported in the consolidated balance sheets for cash and cash equivalents approximate those assets' fair values.

Interest-bearing time deposits with other banks: The fair value of interest bearing time deposits with other banks was determined by discounting the cash flows associated with these instruments using current market rates for deposits with similar characteristics.

Securities (including mortgage-backed securities): Fair values for securities are based on quoted market prices, where available. If quoted market prices are not available, fair values are based on quoted market prices of comparable instruments.

Loans held-for-sale: Fair values for loans held-for-sale are estimated based on outstanding investor commitments, or in the absence of such commitments, are based on current investor yield requirements.

Loans receivable: For variable-rate loans that reprice frequently and with no significant change in credit risk, fair values are based on carrying values. The fair values for other loans are estimated using discounted cash flow analyses, using interest rates currently being offered for loans with similar terms to borrowers of similar credit quality.

Accrued interest receivable: The carrying amount of accrued interest receivable approximates its fair value.

Deposit liabilities: The fair values disclosed for interest and non-interest checking, passbook and statement 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 on certificates to a schedule of aggregated expected monthly maturities on time deposits.

Federal Home Loan Bank advances: Fair values for Federal Home Loan Bank advances are estimated using a discounted cash flow technique that applies interest rates currently being offered on advances to a schedule of aggregated expected monthly maturities on Federal Home Loan Bank advances.

Junior subordinated debentures: Fair values of junior subordinated debentures are estimated using discounted cash flow analyses, using interest rates currently being offered for debentures with similar terms.

Notes payable: Fair values of notes payable are estimated using discounted cash flow analyses, using interest rates currently offered for borrowings with similar terms.

Securities sold under agreements to repurchase: The carrying amounts reported on the consolidated balance sheets for securities sold under agreements to repurchase approximate their fair values.

Accrued interest payable: The carrying amount of accrued interest payable approximates its fair value.

Derivative financial instruments: The fair value for interest rate swap agreements is based upon the amounts required to settle the contracts.

Off-balance sheet instruments: The fair value of commitments to originate loans is estimated using the fees currently charged to enter similar agreements, taking into account the remaining terms of the agreements and the present creditworthiness of the counterparties. For fixed-rate loan commitments and the unadvanced portion of loans, fair value also considers the difference between current levels of interest rates and the committed rates. The fair value of letters of credit is based on fees currently charged for similar agreements or on the estimated cost to terminate them or otherwise settle the obligation with the counterparties at the reporting date.

EARNINGS PER COMMON SHARE:

Basic earnings per common share (EPS) excludes dilution and is computed by dividing income available to common stockholders by the weighted-average number of common shares outstanding for the period. Diluted EPS reflects the potential dilution that could occur if securities or other contracts to issue common stock were exercised or converted into common stock or resulted in the issuance of common stock that then shared in the earnings of the entity.

INTEREST RATE SWAP AGREEMENTS:

The Company may use interest rate swap agreements to hedge various exposures or to modify interest rate characteristics of various balance sheet accounts. Such derivatives are used as part of the asset/liability management process and are linked to specific assets or liabilities, and have high correlation between the contract and the underlying item being hedged, both at inception and throughout the hedge period.

Under ASC 815, “Derivatives and Hedging,” the gain or loss on a derivative designated and qualifying as a fair value hedging instrument, as well as the offsetting gain or loss on the hedged item attributable to the risk being hedged, is recognized currently in earnings in the same accounting period. The effective portion of the gain or loss on a derivative designated and qualifying as a cash flow hedging instrument is initially reported as a component of other comprehensive income and subsequently reclassified into earnings in the same period or periods during which the hedged transaction affects earnings. The ineffective portion of the gain or loss on the derivative instrument, if any, is recognized currently in earnings.

Interest rate derivative financial instruments receive hedge accounting treatment only if they are designated as a hedge and are expected to be, and are, effective in substantially reducing interest rate risk arising from the assets and liabilities identified as exposing the Company to risk. Those derivative financial instruments that do not meet the hedging criteria discussed below would be classified as trading activities and would be recorded at fair value with changes in fair value recorded in income. Derivative hedge contracts must meet specific effectiveness tests (i.e., over time the change in their fair values due to the designated hedge risk must be within 80 to 125 percent of the opposite change in the fair values of the hedged assets or liabilities). Changes in fair value of the derivative financial instruments must be effective at offsetting changes in the fair value of the hedged items due to the designated hedge risk during the term of the hedge. Further, if the underlying financial instrument differs from the hedged asset or liability, there must be a clear economic relationship between the prices of the two financial instruments. If periodic assessment indicates derivatives no longer provide an effective hedge, the derivatives contracts would be closed out and settled or classified as a trading activity.

In accordance with ASC 815, hedges of variable-rate debt are accounted for as cash flow hedges, with changes in fair value recorded in derivative assets or liabilities and other comprehensive income. The net settlement (upon close out or termination) that offsets changes in the value of the hedged debt is deferred and amortized into net interest income over the life of the hedged debt. The portion, if any, of the net settlement amount that did not offset changes in the value of the hedged asset or liability is recognized immediately in non-interest income.

Cash flows resulting from the derivative financial instruments that are accounted for as hedges of assets and liabilities are classified in the cash flow statement in the same category as the cash flows of the items being hedged.

NONCONTROLLING INTEREST

Noncontrolling interest represents the portion of ownership and interest expense that is attributable to the minority owners of Kinderhook Realty Holding Corp. The minority ownership is in the form of preferred stock. (see Note 11, "NONCONTROLLING INTEREST IN SUBSIDIARY")

RECENT ACCOUNTING PRONOUNCEMENTS:

In May 2014, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2014-09, "Revenue from Contracts with Customers (Topic 606)." The objective of this ASU is to clarify principles for recognizing revenue and to develop a common revenue standard for GAAP and International Financial Reporting Standards. The guidance in this ASU affects any entity that either enters into contracts with customers to transfer goods or services or enters into contracts for the transfer of nonfinancial assets unless those contracts are within the scope of other standards. The core principal of the guidance is that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. The amendments in this update are effective for annual reporting periods beginning after December 15, 2017, and interim periods within annual periods beginning after December 15, 2018. Early application is permitted, but no earlier than an annual reporting period beginning after December 15, 2016, including interim periods within that reporting period. The Company is currently reviewing this ASU to determine if it will have an impact on its consolidated financial statements.

In June 2014, the FASB issued ASU No. 2014-12, "Compensation - Stock Compensation (Topic 718): Accounting for Share-Based Payments When the Terms of an Award Provide That a Performance Target Could be Achieved after the Requisite Service Period." The amendments in this ASU require that a performance target that affects vesting and that could be achieved after the requisite service period be treated as a performance condition. A reporting entity should apply existing guidance in Topic 718 as it relates to awards with performance conditions that affect vesting to account for such awards. This ASU is effective for annual periods, and interim periods within those annual periods, beginning after December 15, 2015. Earlier adoption is permitted. ASU 2014-12 may be adopted either (a) prospectively to all awards granted or modified after the effective date or (b) retrospectively to all awards with performance targets that are outstanding as of the beginning of the earliest annual period presented in the financial statements, and to all new or modified awards thereafter. If retrospective transition is adopted, the cumulative effect of applying this update as of the beginning of the earliest annual period presented in the financial statements should be recognized as an adjustment to the opening retained earnings balance at that date. The Company is currently reviewing this ASU to determine if it will have an impact on its consolidated financial statements.

In August 2014, the FASB issued ASU 2014-14, "Receivables - Troubled Debt Restructurings by Creditors (Subtopic 310-40): Classification of Certain Government - Guaranteed Mortgage Loans upon Foreclosure." The amendments in this ASU require that a mortgage loan be derecognized and that a separate other receivable be recognized upon foreclosure if the following conditions are met:

1. the loan has a government guarantee that is not separable from the loan before foreclosure;
2. at the time of foreclosure, the creditor has the intent to convey the real estate property to the guarantor and make a claim on the guarantee, and the creditor has the ability to recover under that claim; and
3. at the time of foreclosure, any amount of the claim that is determined on the basis of the fair value of the real estate is fixed.

Upon foreclosure, the separate other receivable should be measured based on the amount of the loan balance (principal and interest) expected to be recovered from the guarantor. The amendments in this ASU are effective for annual periods ending after December 15, 2015, and interim periods beginning after December 15, 2015. The Company anticipates that the adoption of this ASU will not have a material impact on its consolidated financial statements.

In December 2014, the FASB issued ASU 2014-18, "Business Combinations (Topic 805): Accounting for Identifiable Intangible Assets in a Business Combination, a consensus of the Private Company Council. The new guidance allows entities, except for public business entities and not-for-profit entities, to elect an accounting alternative for the recognition of certain intangible assets acquired in a business combination. In this alternative, the entity would no longer recognize the following separate from goodwill:

1. Customer-related intangible assets unless they are capable of being sold or licensed independently from the other assets of the business, and
2. Noncompetition agreements

An entity that elects the accounting alternative in this Update must adopt the private company alternative to amortize goodwill as described in FASB ASU No. 2014-02, "Intangibles - Goodwill and Other (Topic 350): Accounting for Goodwill." However, an entity that elects the accounting alternative in Update 2014-02 is not required to adopt the amendments in this ASU.

Many customer-related intangible assets, because they are not capable of being sold or licensed independently from the other assets of the business, would not be separately recognized under this accounting alternative. However, some customer-related intangible assets that are capable of being sold or licensed independently would continue to be separately recognized - such as mortgage servicing rights, commodity supply contracts, core deposits and customer information (for example, names and contact information).

The decision to adopt the accounting alternative must be made upon the occurrence of the first transaction within the scope of this accounting alternative. If the transaction occurs in the first fiscal year beginning after December 15, 2015, the adoption will be effective for that fiscal year and all periods thereafter. If the transaction occurs in fiscal years beginning after December 15, 2016, the adoption will be effective in the interim period that includes the date of that first transaction and all periods thereafter. Early application is permitted for any interim and annual financial statements that have not yet been made available for issuance. The Company anticipates that the adoption of this ASU will not have a material impact on its results of operations or financial position.

In April 2015, the FASB issued ASU No. 2015-03, "Interest - Imputation of Interest (Subtopic 835-30): Simplifying the Presentation of Debt Issuance Costs." The amendments in this ASU require that debt issuance costs related to a debt liability be presented in the balance sheet as a direct deduction from the carrying value of the associated debt liability, consistent with debt discounts. The recognition and measurement guidance for debt issuance costs are not affected by the amendments in this ASU. The standard is effective for financial statements issued for fiscal years beginning after December 15, 2015, and interim periods beginning after December 15, 2016 with early adoption permitted. The guidance should be applied on a retrospective basis. The Company is currently reviewing this ASU to determine if it will have an impact on its consolidated financial statements.

NOTE 3 - INVESTMENTS IN SECURITIES

Debt securities have been classified in the consolidated balance sheets according to management's intent. The amortized cost of securities and their approximate fair values are as follows as of December 31:

| | Amortized Cost Basis | Gross Unrealized Gains | Gross Unrealized Losses | Fair Value |
|---|---|---|---|---|
| | | (In Thousands) | | |
| Available-for-sale securities: | | | | |
| December 31, 2014: | | | | |
| Debt securities issued by U.S. government corporations and agencies | $ 43,296 | $ 151 | $ 53 | $ 43,394 |
| Debt securities issued by states of the United States and political subdivisions of the states | 19,404 | 809 | 41 | 20,172 |
| Mortgage-backed securities | 646 | 31 | - | 677 |
| | $ 63,346 | $ 991 | $ 94 | $ 64,243 |
| December 31, 2013: | | | | |
| Debt securities issued by U.S. government corporations and agencies | $ 44,579 | $ 232 | $ 140 | $ 44,671 |
| Debt securities issued by states of the United States and political subdivisions of the states | 15,473 | 818 | 95 | 16,196 |
| Mortgage-backed securities | 825 | 37 | - | 862 |
| | $ 60,877 | $ 1,087 | $ 235 | $ 61,729 |
| Held-to-maturity securities: | | | | |
| December 31, 2014: | | | | |
| Debt securities issued by states of the United States and political subdivisions of the states | $ 1,139 | $ 6 | $ - | $ 1,145 |
| December 31, 2013: | | | | |
| Debt securities issued by states of the United States and political subdivisions of the states | $ 2,128 | $ 22 | $ - | $ 2,150 |

The scheduled maturities of debt securities were as follows as of December 31, 2014:

| | Available-For-Sale | Held-To-Maturity | |
|---|---|---|---|
| | Fair Value | Amortized Cost Basis | Fair Value |
| | | (In Thousands) | |
| Due within one year | $ 11,365 | $ 1,139 | $ 1,145 |
| Due after one year through five years | 42,658 | - | - |
| Due after five years through ten years | 8,765 | - | - |
| Due after ten years | 778 | - | - |
| Mortgage-backed securities | 677 | - | - |
| | $ 64,243 | $ 1,139 | $ 1,145 |

There were no securities of issuers whose aggregate carrying amount exceeded 10% of stockholders' equity as of December 31, 2014.

Debt securities with total carrying amounts of $55,343,000 and $57,058,000 were pledged to secure public funds on deposit, securities sold under agreement to repurchase, Federal Home Loan Bank advances and available Federal Reserve Bank borrowings as of December 31, 2014 and 2013, respectively.

During the year ended December 31, 2014, proceeds from sales of available-for-sale securities amounted to $5,813,000, with gross realized gains of $10,000 and gross realized losses of $0. During the year ended December 31, 2013, proceeds from sales of available-for-sale securities amounted to $4,217,000, with gross realized gains of $6,000 and gross realized losses of $0.

The aggregate fair value and unrealized losses of securities that have been in a continuous unrealized loss position for less than twelve months and for twelve months or more, and are not other than temporarily impaired, are as follows:

| | Less than 12 Months | | 12 Months or Longer | | Total | |
|---|---|---|---|---|---|---|
| | Fair Value | Unrealized Losses | Fair Value | Unrealized Losses | Fair Value | Unrealized Losses |
| | | | (In Thousands) | | | |
| December 31, 2014: | | | | | | |
| Debt securities issued by U.S. Government corporations and agencies | $ 9,963 | $ 9 | $ 4,161 | $ 44 | $ 14,124 | $ 53 |
| Debt securities issued by states of the United States and political subdivisions of the states | 2,232 | 12 | 1,806 | 29 | 4,038 | 41 |
| Total temporarily impaired securities | $ 12,195 | $ 21 | $ 5,967 | $ 73 | $ 18,162 | $ 94 |
| December 31, 2013: | | | | | | |
| Debt securities issued by U.S. Government corporations and agencies | $ 9,140 | $ 60 | $ 1,140 | $ 80 | $ 10,280 | $ 140 |
| Debt securities issued by states of the United States and political subdivisions of the states | 1,733 | 44 | 1,375 | 51 | 3,108 | 95 |
| Total temporarily impaired securities | $ 10,873 | $ 104 | $ 2,515 | $ 131 | $ 13,388 | $ 235 |

The investments in the Company's portfolio that are temporarily impaired as of December 31, 2014 consist of debt securities issued by U.S. Government corporations and agencies and debt securities issued by states of the United States and political subdivisions of the states. The unrealized losses in the above table related to debt securities are attributable primarily to changes in market interest rates and current market inefficiencies in the pricing of these types of securities. Company management has the ability and intent to hold these securities until cost recovery occurs and considers these declines to be temporary.

NOTE 4 - LOANS

Loans consisted of the following as of December 31:

| | 2014 | 2013 |
|---|---|---|
| | (In Thousands) | |
| Real estate: | | |
| Residential | $ 64,690 | $ 58,278 |
| Commercial | 168,396 | 133,299 |
| Home equity | 13,170 | 14,626 |
| Commercial | 33,133 | 25,487 |
| Consumer and other | 3,835 | 3,270 |
| | 283,224 | 234,960 |
| Net deferred loan origination costs | 87 | 20 |
| Allowance for loan losses | (2,795) | (2,774) |
| Net loans | $ 280,516 | $ 232,206 |

Certain directors and executive officers of the Company and companies in which they have significant ownership interest were customers of the Bank during 2014. Total loans to such persons and their companies amounted to $5,224,000 as of December 31, 2014. During 2014, principal payments were $2,508,000 and principal advances amounted to $1,854,000.

The following tables set forth information regarding the allowance for loan losses by portfolio segment as of December 31:

| | Real Estate: | | | | | | |
|---|---|---|---|---|---|---|---|
| | Residential | Commercial | Home Equity | Commercial | Consumer and Other | Unallocated | Total |
| | | | | (In Thousands) | | | |
| December 31, 2014: | | | | | | | |
| Allowance for loan losses: | | | | | | | |
| Beginning balance | $ 210 | $ 1,886 | $ 163 | $ 472 | $ 38 | $ 5 | $ 2,774 |
| Charge-offs | (3) | (500) | - | (101) | (32) | - | (636) |
| Recoveries | - | 5 | - | 1 | 23 | - | 29 |
| Provision (benefit) | 8 | 464 | (23) | 118 | 12 | 49 | 628 |
| Ending balance | $ 215 | $ 1,855 | $ 140 | $ 490 | $ 41 | $ 54 | $ 2,795 |
| Ending balance: Individually evaluated for impairment | $ - | $ - | $ - | $ 1 | $ - | $ - | $ 1 |
| Ending balance: Collectively evaluated for impairment | 215 | 1,855 | 140 | 489 | 41 | 54 | 2,794 |
| Total allowance for loan losses ending balance | $ 215 | $ 1,855 | $ 140 | $ 490 | $ 41 | $ 54 | $ 2,795 |
| Loans: | | | | | | | |
| Ending balance: Individually evaluated for impairment | $ 27 | $ 3,902 | $ - | $ 343 | $ - | $ - | $ 4,272 |
| Ending balance: Collectively evaluated for impairment | 64,663 | 164,494 | 13,170 | 32,790 | 3,835 | - | 278,952 |
| Total loans ending balance | $ 64,690 | $ 168,396 | $ 13,170 | $ 33,133 | $ 3,835 | $ - | $ 283,224 |

| | Real Estate: | | | | | | |
|---|---|---|---|---|---|---|---|
| | Residential | Commercial | Home Equity | Commercial | Consumer and Other | Unallocated | Total |
| | | | | (In Thousands) | | | |
| December 31, 2013: | | | | | | | |
| Allowance for loan losses: | | | | | | | |
| Beginning balance | $ 208 | $ 1,391 | $ 177 | $ 380 | $ 39 | $ 99 | $ 2,294 |
| Charge-offs | - | (105) | - | (22) | (8) | - | (135) |
| Recoveries | - | - | | 8 | 13 | - | 21 |
| Provision (benefit) | 2 | 600 | (14) | 106 | (6) | (94) | 594 |
| Ending balance | $ 210 | $ 1,886 | $ 163 | $ 472 | $ 38 | $ 5 | $ 2,774 |
| Ending balance: Individually evaluated for impairment | $ - | $ 274 | $ - | $ 87 | $ - | $ - | $ 361 |
| Ending balance: Collectively evaluated for impairment | 210 | 1,612 | 163 | 385 | 38 | 5 | 2,413 |
| Total allowance for loan losses ending balance | $ 210 | $ 1,886 | $ 163 | $ 472 | $ 38 | $ 5 | $ 2,774 |
| Loans: | | | | | | | |
| Ending balance: Individually evaluated for impairment | $ - | $ 2,087 | $ - | $ 588 | $ - | $ - | $ 2,675 |
| Ending balance: Collectively evaluated for impairment | 58,278 | 131,212 | 14,626 | 24,899 | 3,270 | - | 232,285 |
| Total loans ending balance | $ 58,278 | $ 133,299 | $ 14,626 | $ 25,487 | $ 3,270 | $ - | $ 234,960 |

The following is a summary of past due and non-accrual loans as of December 31:

| | 30–59 Days | 60–89 Days | 90 Days or More Past Due | Total Past Due | Total Current | Total Loans | 90 Days or More Past Due and Accruing | Nonaccrual Loans |
|---|---|---|---|---|---|---|---|---|
| | | | | (In Thousands) | | | | |
| December 31, 2014: | | | | | | | | |
| Real estate: | | | | | | | | |
| Residential | $ 284 | $ - | $ 121 | $ 405 | $ 64,285 | $ 64,690 | $ - | $ 121 |
| Commercial | 564 | 523 | 3,954 | 5,041 | 163,355 | 168,396 | 277 | 3,716 |
| Home equity | - | 23 | - | 23 | 13,147 | 13,170 | - | 197 |
| Commercial | 161 | 1,000 | 444 | 1,605 | 31,528 | 33,133 | 100 | 343 |
| Consumer and other | 20 | 1 | - | 21 | 3,814 | 3,835 | - | - |
| Total | $ 1,029 | $ 1,547 | $ 4,519 | $ 7,095 | $ 276,129 | $ 283,224 | $ 377 | $ 4,377 |
| December 31, 2013: | | | | | | | | |
| Real estate: | | | | | | | | |
| Residential | $ 270 | $ - | $ 339 | $ 609 | $ 57,669 | $ 58,278 | $ - | $ 339 |
| Commercial (1) | 1,471 | 441 | 596 | 2,508 | 130,791 | 133,299 | - | 3,496 |
| Home equity | 49 | 28 | - | 77 | 14,549 | 14,626 | - | 220 |
| Commercial | 49 | 517 | - | 566 | 24,921 | 25,487 | - | 348 |
| Consumer and other | 2 | - | - | 2 | 3,268 | 3,270 | - | - |
| Total | $ 1,841 | $ 986 | $ 935 | $ 3,762 | $ 231,198 | $ 234,960 | $ - | $ 4,403 |

(1) The $1,471,000 amount of commercial real estate loans past due 30-59 days is net of the USDA government guaranty amount of $2,656,000 since the guarantee amount is included within loans held-for-sale on the December 31, 2013 balance sheet.

Information about loans that meet the definition of an impaired loan in ASC 310-10-35 is as follows as of and for the years ended December 31:

| | Recorded Investment | Unpaid Principal Balance | Related Allowance | Average Recorded Investment | Interest Income Recognized |
|---|---|---|---|---|---|
| | | | (In Thousands) | | |
| December 31, 2014: | | | | | |
| With no related allowance recorded: | | | | | |
| Real estate: | | | | | |
| Residential | $ 27 | $ 60 | $ - | $ 22 | $ 1 |
| Commercial | 3,902 | 4,638 | - | 2,211 | 28 |
| Commercial | 273 | 374 | - | 228 | 1 |
| Total impaired with no related allowance | $ 4,202 | $ 5,072 | $ - | $ 2,461 | $ 30 |
| With an allowance recorded: | | | | | |
| Real estate: | | | | | |
| Residential | $ - | $ - | $ - | $ - | $ - |
| Commercial | - | - | - | - | - |
| Commercial | 70 | 87 | 1 | 79 | - |
| Total impaired with an allowance recorded | $ 70 | $ 87 | $ 1 | $ 79 | $ - |
| Total | | | | | |
| Real estate: | | | | | |
| Residential | $ 27 | $ 60 | $ - | $ 22 | $ 1 |
| Commercial | 3,902 | 4,638 | - | 2,211 | 28 |
| Commercial | 343 | 461 | 1 | 307 | 1 |
| Total impaired loans | $ 4,272 | $ 5,159 | $ 1 | $ 2,540 | $ 30 |
| December 31, 2013: | | | | | |
| With no related allowance recorded: | | | | | |
| Real estate: | | | | | |
| Commercial (1) | $ 1,299 | $ 1,325 | $ - | $ 611 | $ 9 |
| Commercial (1) | 348 | 348 | - | 70 | 2 |
| Total impaired with no related allowance | $ 1,647 | $ 1,673 | $ - | $ 681 | $ 11 |
| With an allowance recorded: | | | | | |
| Real estate: | | | | | |
| Commercial (1) | $ 788 | $ 788 | $ 274 | $ 315 | $ 30 |
| Commercial (1) | 240 | 240 | 87 | 96 | 5 |
| Total impaired with an allowance recorded | $ 1,028 | $ 1,028 | $ 361 | $ 411 | $ 35 |
| Total | | | | | |
| Real estate: | | | | | |
| Commercial (1) | $ 2,087 | $ 2,113 | $ 274 | $ 926 | $ 39 |
| Commercial (1) | 588 | 588 | 87 | 166 | 7 |
| Total impaired loans | $ 2,675 | $ 2,701 | $ 361 | $ 1,092 | $ 46 |

(1) Impaired commercial real estate loans in the amount of $2,087,000 and impaired commercial loans in the amount of $588,000 exclude the balance of the USDA government guaranty. The balance of $2,087,000 in commercial real estate loans excludes the balance of the government guaranty of two USDA government guaranteed loans in the amount of $2,656,000, and the balance of $588,000 in commercial loans excludes the balance of the government guaranty of one USDA government guaranteed loan in the amount of $129,000. The balance of the loans guaranteed by the USDA is included in loans held-for-sale on the December 31, 2013 balance sheet.

Credit Quality Information

The Company utilizes a nine grade internal loan rating system for commercial real estate and commercial loans. This risk rating system has been established to provide a consistent measure of the credit quality for all commercial credit exposures in the loan portfolio, and allows management to monitor the portfolio's quality. A risk rating system is designed to provide an early warning signal of a deteriorating credit, is integral to pricing decisions and acts as a vital link in the process by which the Company determines the size of its allowance for loan losses. All commercial loan relationships must have a risk rating grade and be updated at least annually. Impaired loans are not formally risk rated since they are individually evaluated and assigned a specific allocation. Certain consumer loans, residential 1-4 family and home equity loans or any other open end credit must be risk rated if they become delinquent 90 days or more. The risk rating shall be substandard, doubtful or loss depending on the weakness as defined in the classification below.

Loans rated 1 - 4: Loans in these categories are considered "pass" rated loans with low to average risk.

Loans rated 5: Loans in this category are considered "watch list" with marginal risk. These loans are to borrowers with strained liquidity and fully-leveraged balance sheets and are closely monitored by management.

Loans rated 6: Loans in this category are considered "special mention." These loans are starting to show signs of potential weaknesses jeopardizing repayment and are being closely monitored by management.

Loans rated 7: Loans in this category are considered "substandard." Generally, a loan is considered substandard if it is inadequately protected by the current net worth and paying capacity of the obligors and/or the collateral pledged. There is a distinct possibility that the Company will sustain some loss if the weakness is not corrected.

Loans rated 8: Loans in this category are considered "doubtful." Loans classified as doubtful have all the weaknesses inherent in those classified substandard with the added characteristic that the weaknesses make collection or liquidation in full, on the basis of currently existing facts, conditions and values highly questionable and improbable.

Loans rated 9: Loans in this category are considered uncollectible ("loss") and of such little value that their continuance as loans is not warranted.

At least annually, the Company formally reviews the ratings on commercial and commercial real estate loan relationships which exceed $150,000. The Company also engages an independent third-party to review a significant portion of loans within these segments. Management uses the results of these reviews as part of its annual review process.

The following tables present the Company's loans by risk rating at December 31:

| | Real Estate | | | | | |
|---|---|---|---|---|---|---|
| | Residential | Commercial | Home Equity | Commercial | Consumer and Other | Total |
| | | | (In Thousands) | | | |
| December 31, 2014: | | | | | | |
| Loans rated 1-5 | $ - | $ 161,166 | $ - | $ 32,079 | $ - | $ 193,245 |
| Loans rated 6 | - | 2,742 | - | 254 | - | 2,996 |
| Loans rated 7 | 176 | 586 | 181 | 457 | - | 1,400 |
| Performing loans not rated (A) | 64,487 | - | 12,989 | - | 3,835 | 81,311 |
| Impaired loans not rated (A) | 27 | 3,902 | - | 343 | - | 4,272 |
| Total | $ 64,690 | $ 168,396 | $ 13,170 | $ 33,133 | $ 3,835 | $ 283,224 |
| December 31, 2013: | | | | | | |
| Loans rated 1-5 | $ - | $ 128,745 | $ - | $ 24,259 | $ - | $ 153,004 |
| Loans rated 6 | - | 1,273 | - | 74 | - | 1,347 |
| Loans rated 7 | 569 | 1,194 | 308 | 566 | - | 2,637 |
| Performing loans not rated (A) | 57,709 | - | 14,318 | - | 3,270 | 75,297 |
| Impaired loans not rated (A) (1) | - | 2,087 | - | 588 | - | 2,675 |
| Total | $ 58,278 | $ 133,299 | $ 14,626 | $ 25,487 | $ 3,270 | $ 234,960 |

(A) Residential, home equity, consumer and other and impaired loans are not formally risk rated.

(1) Impaired commercial real estate loans in the amount of $2,087,000 and impaired commercial loans in the amount of $588,000 exclude the balance of the USDA government guaranty. The balance of $2,087,000 in commercial real estate loans excludes the balance of the government guaranty of two USDA government guaranteed loans in the amount of $2,656,000, and the balance of $588,000 in commercial loans excludes the balance of the government guaranty of one USDA government guaranteed loan in the amount of $129,000. The balance of the loans guaranteed by the USDA is included in loans held-for-sale on the December 31, 2013 balance sheet.

The following tables set forth information regarding troubled debt restructurings that were restructured during the years ended December 31:

| | Number of Contracts | Pre-Modification Outstanding Recorded Investment | Post-Modification Outstanding Recorded Investment |
|---|---|---|---|
| | | (Dollars In Thousands) | |
| December 31, 2014: | | | |
| Troubled Debt Restructurings: | | | |
| Real estate: | | | |
| Residential | 1 | $ 19 | $ 28 |
| Commercial | 2 | 318 | 318 |
| | 3 | $ 337 | $ 346 |
| December 31, 2013: | | | |
| Troubled Debt Restructurings: | | | |
| Real estate: | | | |
| Commercial | 2 | $ 3,444 | $ 3,444 |
| Commercial | 3 | 370 | 370 |
| | 5 | $ 3,814 | $ 3,814 |

There were three loans modified in 2014 as troubled debt restructurings. One loan was secured by one-to-four family real estate. The loan, with a post-modification recorded investment of $19,000, was modified to reduce the interest rate and capitalize past-due and other fees. Two loans, with a recorded investment of $318,000, were secured by commercial real estate. The modifications allow the borrower to defer the principal portion of payments for a period of six months in each of the next three years, reduce the interest rate, and extend the maturity date.

The loans were individually evaluated for impairment and it was determined that no specific allocation was necessary. The loans were reported as impaired and two of the loans, totaling $317,000, were on non-accrual status as of December 31, 2014.

There were five loans modified in 2013 as troubled debt restructures. Two loans were secured by commercial real estate and three were secured by business assets. The troubled debt restructures involved an interest only period of three months. These loans were individually evaluated for impairment as of December 31, 2013, and it was determined that the loans required a specific allocation in the aggregate amount of $361,000. None of the loans were on nonaccrual status as of December 31, 2013.

As of December 31, 2014 and 2013, there were no commitments to lend additional funds to borrowers whose loans were modified in troubled debt restructurings.

Mortgage loans serviced for others are not included in the accompanying consolidated balance sheets. The unpaid principal balances of mortgage loans serviced for others were $29,839,000 and $21,254,000 at December 31, 2014 and 2013, respectively.

The balance of capitalized net mortgage servicing rights included in other assets at December 31, 2014 and 2013 was $346,000 and $309,000, respectively. Mortgage servicing rights of $171,000 and $147,000 were capitalized in 2014 and 2013, respectively. Amortization of capitalized mortgage servicing rights was $134,000 and $65,000 in 2014 and 2013, respectively. At December 31, 2014, the carrying value of the mortgage servicing rights approximated fair value.

NOTE 5 - PREMISES AND EQUIPMENT

The following is a summary of premises and equipment as of December 31:

| | 2014 | 2013 |
|---|---|---|
| | (In Thousands) | |
| Land | $ 98 | $ 98 |
| Buildings and leasehold improvements | 8,061 | 6,496 |
| Furniture and equipment | 3,195 | 2,537 |
| | 11,354 | 9,131 |
| Accumulated depreciation and amortization | (3,982) | (3,635) |
| | $ 7,372 | $ 5,496 |

NOTE 6 - DEPOSITS

The aggregate amount of time deposit accounts in denominations that meet or exceed the Federal Deposit Insurance Corporation (FDIC) insurance limit (currently $250,000) at December 31, 2014 was $6,177,000.

The aggregate amount of time deposit accounts in denominations of $100,000 or more as of December 31, 2014 and 2013 was $24,334,000 and $30,750,000, respectively.

As of December 31, 2014, the scheduled maturities of time deposits are as follows:

| | (In Thousands) |
|---|---|
| 2015 | $ 23,694 |
| 2016 | 21,773 |
| 2017 | 2,979 |
| 2018 | 345 |
| Total | $ 48,791 |

Deposits from related parties held by the Company as of December 31, 2014 and 2013 amounted to $10,220,000 and $11,360,000, respectively.

The Bank has one customer with deposits in the Bank amounting to $16,664,000, or 5.3% of total deposits, as of December 31, 2014.

NOTE 7 - FEDERAL HOME LOAN BANK ADVANCES

Advances consist of funds borrowed from the Federal Home Loan Bank of New York (FHLB).

At December 31, 2014, there was one FHLB advance outstanding amounting to $14,000,000, maturing in 2015.

At December 31, 2014, the interest rate on the FHLB advance was 0.36%.

Borrowings from the FHLB are secured by a blanket lien on qualified collateral, consisting primarily of loans with first mortgages secured by one to four family properties and other qualified assets.

NOTE 8 - JUNIOR SUBORDINATED DEBENTURES

On September 27, 2004, Kinderhook Capital Trust ("Trust"), a Delaware statutory trust formed by the Company, completed the sale of $2,000,000 of Trust Preferred Securities due December 15, 2034, adjustable every three months at three month LIBOR plus 2.70% ("Capital Securities"). At December 31, 2014, the three month LIBOR was 0.26%. The Trust also issued common securities to the Company and used the net proceeds from the offering to purchase $2,062,000 of Junior Subordinated Deferrable Interest Debentures ("Debentures") of the Company. The Debentures are the sole assets of the Trust. Total expenses associated with the offering of $33,000 are included in other assets and are being amortized on a straight-line basis over the life of the Debentures.

The Capital Securities accrue and pay distributions quarterly based on the stated liquidation amount of $1,000 per Capital Security. The Company has fully and unconditionally guaranteed all of the obligations of the Trust. The guaranty covers the quarterly distributions and payments on liquidation or redemption of the Capital Securities, but only to the extent that the Trust has funds necessary to make these payments.

The Capital Securities are mandatorily redeemable upon the maturity of the Debentures on December 15, 2034 or upon earlier redemption as provided in the Indenture. The Company has the right to redeem the Debentures, in whole or in part, at the liquidation amount plus any accrued but unpaid interest to the redemption date.

On June 12, 2009, the Company entered into an interest rate swap master agreement, notional amount $2,000,000, with Vining Sparks Interest Rate Products, LLC to convert the floating rate payments on the Capital Securities to fixed rate payments (see Note 17). The terms of the interest rate swap agreement are as follows:

| | |
|---|---|
| Trade date | July 1, 2009 |
| Effective date | July 16, 2009 |
| Termination date | June 15, 2014 |
| Fixed rate payer | Kinderhook Bank Corp. |
| Payment dates | Quarterly |
| Fixed rate | 5.75% |
| Floating rate payer | Vining Sparks Interest Rate Products, LLC |
| Payment dates | Quarterly |
| Index | Three Month LIBOR plus 2.70% |

NOTE 9 - NOTES PAYABLE

The Company had the following notes payable as of December 31:

| | 2014 | 2013 |
|---|---|---|
| | (In Thousands) | |
| Note payable to a third party maturing August 2022, payable in 180 equal monthly installments of $1,075, bearing interest at a rate of 7.00% as of December 31, 2014 and 2013. | $ 76 | $ 83 |
| Note payable to a third party maturing May 2022, payable in 180 equal monthly installments of $4,303, bearing interest at a rate of 7.00% as of December 31, 2014 and 2013. | 259 | 285 |
| | $ 335 | $ 368 |

At December 31, 2014, scheduled repayments of notes payable obligations are as follows:

| | (In Thousands) |
|---|---|
| 2015 | $ 35 |
| 2016 | 37 |
| 2017 | 41 |
| 2018 | 44 |
| 2019 | 47 |
| Thereafter | 131 |
| Total | $ 335 |

As of December 31, 2014 and 2013, the Company guaranteed an unsecured line of credit to the Kleeber Agency, Inc. with the National Bank of Coxsackie in the amount of $100,000. This line of credit has an interest rate that is based on the Wall Street Journal Prime Rate. This line of credit had a zero balance as of December 31, 2014 and 2013.

NOTE 10 - SECURITIES SOLD UNDER AGREEMENTS TO REPURCHASE

The securities sold under agreements to repurchase as of December 31, 2014 and 2013 are securities sold on a short term basis by the Company that have been accounted for not as sales but as borrowings. The securities consisted of municipal bonds and U.S. government agency debt. The securities are pledged to the purchasers of the securities. The purchasers have agreed to sell to the Bank substantially identical securities at the maturity of the agreements.

NOTE 11 - NONCONTROLLING INTEREST IN SUBSIDIARY

The Bank owns 100% of the common stock of its subsidiary, Kinderhook Realty Holding Corp (KRHC). The Bank also owns 94.6% of the KRHC preferred stock. Minority interest in KRHC consists of 114 shares of the preferred stock as of December 31, 2014 and 2013. All voting rights of KRHC vest exclusively with its common stockholder, the Bank. The preferred stock has a liquidation value of $500 per share. The holders of the preferred stock are entitled to receive dividends, when, and if declared by the Board of Directors of KRHC. Such dividends declared are paid on such date as determined by the Board of Directors of KRHC.

NOTE 12 - INCOME TAXES

The components of the income tax expense are as follows for the years ended December 31:

| | 2014 | 2013 |
|---|---|---|
| | (In Thousands) | |
| Current: | | |
| Federal | $ 933 | $ 1,206 |
| State | 136 | 213 |
| | 1,069 | 1,419 |
| Deferred: | | |
| Federal | (104) | (266) |
| State | (23) | (60) |
| | (127) | (326) |
| Total income tax expense | $ 942 | $ 1,093 |

The reasons for the differences between the statutory federal income tax rate and the effective tax rates are summarized as follows for the years ended December 31:

| | 2014 % of Income | 2013 % of Income |
|---|---|---|
| Federal income tax at statutory rate | 34.0 % | 34.0 % |
| Increase (decrease) in tax resulting from: | | |
| Tax-exempt income | (8.6) | (7.4) |
| Unallowable expenses | 0.5 | 0.5 |
| Other | 0.7 | 0.2 |
| State tax expense, net of federal tax benefit | 2.3 | 2.8 |
| Effective tax rates | 28.9 % | 30.1 % |

The Company had gross deferred tax assets and gross deferred tax liabilities as follows as of December 31:

| | 2014 | 2013 |
|---|---|---|
| | (In Thousands) | |
| Deferred tax assets: | | |
| Allowance for loan losses | $ 1,179 | $ 1,145 |
| Phantom stock appreciation rights | 346 | 286 |
| Interest on nonperforming loans | 51 | 17 |
| Deferred gain | 135 | 35 |
| Lease step-up | 2 | - |
| Net unrealized loss on derivative | - | 10 |
| Gross deferred tax assets | 1,713 | 1,493 |
| Deferred tax liabilities: | | |
| Depreciation | (330) | (202) |
| Intangible assets | (106) | (146) |
| Servicing asset | (134) | (119) |
| Net unrealized holding gain on available-for-sale securities | (350) | (332) |
| Gross deferred tax liabilities | (920) | (799) |
| Net deferred tax asset | $ 793 | $ 694 |

Deferred tax assets as of December 31, 2014 and 2013 have not been reduced by a valuation allowance because management believes that it is more likely than not that the full amount of deferred tax assets will be realized.

It is the Company's policy to provide for uncertain tax positions and the related interest and penalties based upon management's assessment of whether a tax benefit is more likely than not to be sustained upon examination by tax authorities. As of December 31, 2014 and 2013, there were no material uncertain tax positions related to federal and state income tax matters. The Company is currently open to audit under the statute of limitations by the Internal Revenue Service and state taxing authorities for the years ended December 31, 2011 through December 31, 2014.

## NOTE 13 - EMPLOYEE BENEFITS

### Defined Contribution Pension Plan

The Company has a 401(k) plan whereby substantially all employees participate in the plan. The Company matches employee contributions at a rate of 50% of up to 6% of employee salaries for employees enrolled in the plan. In addition, the Company may, in its sole and absolute discretion, make discretionary employer contributions to the plan. For the years ended December 31, 2014 and 2013 the Company made 401(k) contributions of $274,000 and $241,000, respectively.

### Phantom Stock Appreciation Rights Plan

In July 2006, the Company established the National Union Bank of Kinderhook Phantom Stock Appreciation Rights Plan (the "Plan"). Under the Plan, the Company may award Phantom Stock Appreciation rights ("PSARs"), as defined in the Plan, to certain officers and directors. The purpose of the Plan is to provide deferred compensation to officers and directors of the Company and to provide performance incentives for such persons. Such deferred compensation is based upon the award of PSARs, the value of which is related to the appreciation in the book value of the Bank.

Upon reaching the Normal Retirement Age, as defined in the Plan, the Company shall distribute to each participant the PSARs account value determined as of the end of the plan year immediately preceding the Normal Retirement Age. If a participant's separation from service occurs prior to attaining Normal Retirement Age, he/she will receive a benefit equal to 100% of the PSARs account value determined as of the end of the plan year immediately preceding separation from service.

During the years ended December 31, 2014 and 2013, 13,770 and 31,950 PSARs were granted under the Plan, respectively. The total liability for PSARs included in other liabilities was $894,000 at December 31, 2014 and $739,000 at December 31, 2013. The related expense recognized in 2014 and 2013 was $208,000 and $243,000, respectively.

Employee Stock Ownership Plan

Effective January 1, 2009, the Company adopted the National Union Bank of Kinderhook Employee Stock Ownership Plan ("Plan"). From January 1, 2009 through October 17, 2013, the Company made contributions to the Plan in amounts determined by the Board of Directors. On October 18, 2013, the Board of Directors voted to terminate the Employee Stock Ownership plan as of December 31, 2013. In February of 2014, using an effective date of December 31, 2013, the value of the Company shares held by the ESOP plan was distributed to each participating employee's 401(k) plan account provided by the Company. In December 2013, the Bank sent a letter to the Internal Revenue Service requesting an updated favorable determination letter relating to the termination of the ESOP. The Internal Revenue Service provided the Bank with a favorable determination letter dated May 2, 2014.

In order to be eligible to participate in the Plan, employees were required to complete one year of qualifying service and attain 21 years of age. Participants became 20% vested per year starting at two full years of service and were 100% vested after six years of service.

Contributions were allocated among active participants' ESOP accounts in the same proportion that each active participant's compensation for the Plan year bears to total compensation of all active participants for the Plan year. Dividends on allocated shares were credited to participants' accounts.

Employment and Change in Control Agreements

Effective January 1, 2006 and subsequently amended January, 2014, the Company entered into Change in Control Agreements ("Agreements") with certain officers of the Company. In accordance with the Agreements, in the event of a change in control, as defined in the Agreements, the officers shall be entitled to a termination payment equal to a multiple, ranging from 1 to 2.99, of their average annual base compensation from the Company over the preceding five years.

Effective February 3, 2009, the Company entered into an employment agreement with an employee of The Kleeber Agency, Inc. In accordance with the agreement, in the event of a change in control, as defined in the agreement, the employee is entitled to receive compensation equal to the annualized rate on the date of termination for a period of 2.99 years.

Other Postretirement Benefits

In 2008, the Company adopted ASC 715 - 60, "Compensation - Retirement Benefits - Defined Benefit Plans," and recognized a liability for the Company's future postretirement benefit obligations under the Officer Supplemental Life Insurance Plan. The Company recognized this change in accounting principle as a cumulative effect adjustment to retained earnings of $249,000. The total liability for the arrangements included in other liabilities was $403,000 at December 31, 2014 and $378,000 at December 31, 2013. Expense under this arrangement was $25,000 for 2014 and $61,000 for 2013.

NOTE 14 - PERPETUAL PREFERRED STOCK

Preferred stock has certain preferential rights with respect to cash dividends and upon liquidation of the Company. The 12,087 shares of preferred stock issued during 2009 are designated as Series A. All of the shares are non-voting except for certain matters that affect their rights. Prior to October 1, 2013, holders of the stock were eligible to receive cumulative cash dividends in an amount per share equal, on an annual basis, to 6% applied to the Series A issue price of $350, payable on a quarterly basis to holders of record of shares on the dividend record date. From and after October 1, 2013, dividend payments on the stock are not cumulative. In the event of liquidation the holders of these shares are entitled to a preference in liquidation equal to the Series A issue price of $350 per share plus an amount equal to all accrued but unpaid dividends on such shares. If elected by a holder (an "Initial Offering Holder") of the Series A preferred stock who acquired his/her interest on or prior to September 30, 2009, or a holder (a "Successor Holder") who acquired his/her shares from an Initial Holder, each share of Series A preferred stock can be converted to common shares at a conversion price of $35 per share of common stock for each share of preferred, subject to adjustment in certain circumstances. If a Series A preferred stock holder who is not an Initial Offering Holder or Successor Holder elects to convert Series A preferred stock to common shares after August 15, 2013, the term "Conversion Price" shall mean, with respect to assigned per share value of the commons stock, the greater of A) an amount equal to one hundred twenty five percent (125.0%) of the tangible common book value of the Company as determined by the Company's total equity at the most recent quarter-end less any goodwill assets less any accumulated other comprehensive income adjustment (other than for investments marked-to-market) less any non-common equity components (such as preferred stock) divided by the number of common shares outstanding, or B) $35.00 per share of common stock, subject to adjustment. The Company has the right to redeem all or any lesser portion of the outstanding shares after five years of issue at 108% of the liquidation preference of $350 plus accrued but unpaid dividends, but is under no obligation to redeem the preferred shares. At December 31, 2014 and 2013, there are 67,000 and 88,000, respectively, of shares authorized as preferred stock that are undesignated as to series and not included in the balance sheet within stockholders' equity.

On August 9, 2012, as part of the United States Department of the Treasury (the "Treasury") Small Business Lending Fund program (the "SBLF"), the Company entered into a Small Business Lending Fund – Securities Purchase Agreement (the "Purchase Agreement") with the Secretary of the Treasury (the "Secretary"), pursuant to which the Company agreed to issue and sell, and the Secretary agreed to purchase 7,000 shares of the Company's Senior Non-cumulative Perpetual Preferred Stock, Series B, having a liquidation preference of $1,000 per share (the "SBLF Preferred Stock"), for a purchase price of $7,000,000. The SBLF Preferred Stock was issued pursuant to the SBLF program, a $30 billion fund established under the Small Business Jobs Act of 2010 that was created to encourage lending to small business by providing capital to qualified community banks with assets of less than $10 billion.

The transaction described above closed on August 9, 2012. The SBLF Preferred Stock has no maturity date and ranks senior to the Company's common stock and Series A and Series C preferred stock with respect to the payment of dividends and distributions and amounts payable upon liquidation, dissolution or winding up of the Company.

The SBLF Preferred Stock qualifies as Tier 1 capital and will pay non-cumulative dividends quarterly on each January 1, April 1, July 1 and October 1, beginning October 1, 2012. The dividend rate can fluctuate on a quarterly basis during the first 10 quarters during which the SBLF Preferred Stock is outstanding, based upon changes in the level of "Qualified Small Business Lending" or "QSBL" (as defined in the Purchase Agreement). Based upon the increase in the Bank's level of QSBL over the baseline level calculated under the terms of the Purchase Agreement, at December 31, 2014, the dividend rate payable by the Company on the Series B Preferred Stock is 1%. For the second through ninth calendar quarters, the dividend rate may be adjusted between one percent (1%) and five percent (5%) per annum to reflect the amount of change in the Bank's level of QSBL. If the level of the Bank's qualified small business loans declines so that the percentage increase in QSBL as compared to the baseline level is less than 10%, then the dividend rate payable on the SBLF Preferred Stock would increase. For the tenth calendar quarter through four and one half years after issuance, the dividend rate will be fixed at between one percent (1%) and seven percent (7%) based upon the increase in QSBL as compared to the baseline. After four and one half years from issuance, the dividend rate will increase to 9%.

The SBLF Preferred Stock is non-voting, except in limited circumstances. In the event that the Company misses five dividend payments, whether or not consecutive, the holder of the SBLF Preferred Stock will have the right, but not the obligation, to appoint a representative as on observer on the Company's Board of Directors.

The SBLF Preferred Stock may be redeemed in increments of not less than 25%, at any time at the Company's option, at a redemption price of 100% of the liquidation amount plus accrued but unpaid dividends to the date of redemption for the current period, subject to the approval of the Federal Deposit Insurance Corporation.

Under the terms of the SBLF Preferred Stock, the Company may only declare and pay a dividend on the common stock or other stock junior to the SBLF Preferred Stock, or repurchase shares of any such class or series of stock, if, after payment of such dividend, the dollar amount of the Company's Tier 1 Capital would be at least 90% of the Signing Date Tier 1 Capital, as set forth in the Certificate of Amendment to the Certificate of Incorporation of the Company fixing the designations, preferences, limitations and relative rights of the SBLF Preferred Stock, excluding any subsequent net charge-offs and any redemption of the SBLF Preferred Stock (the "Tier 1 Dividend Threshold"). The Tier 1 Dividend Threshold is subject to reduction, beginning on the second anniversary of issuance and ending on the tenth anniversary, by 10% for each one percent increase in QSBL over the baseline level.

In April 2014, the Company offered 22,400 shares of preferred stock designated as Series C for private placement. As a result of the offering, 20,687 shares were issued, raising $7,311,000 in capital, net of offering costs. All of the shares are non-voting except for certain matters that affect their rights. Holders of the stock are eligible to receive non-cumulative cash dividends in an amount per share equal, on an annual basis, to 5.25% applied to the Series C issue price of $357.15, payable on a quarterly basis to holders of record of shares on the dividend record date. The Company may not declare or pay dividends on the Series C preferred stock unless all accrued and unpaid dividends on Series A and Series B preferred stock have been paid. In the event of liquidation the holders of these shares are entitled to a preference in liquidation equal to the Series C issue price of $357.15 per share plus an amount equal to all accrued but unpaid dividends on such shares. The shares of Series C preferred stock are convertible at any time into shares of common stock at a rate of 10 shares of common stock for each share of preferred stock, subject to certain anti-dilution provisions. The Company has the right to redeem all or any lesser portion of the outstanding shares after five years of issue at 108% of the liquidation preference of $357.15 plus accrued but unpaid dividends, but is under no obligation to redeem the preferred shares.

NOTE 15 - EARNINGS PER COMMON SHARE

Reconciliation of the numerators and the denominators of the basic and diluted per share computations for net income available to common stockholders are as follows:

| | 2014 | 2013 |
|---|---|---|
| | (In Thousands, Except Share Data) | |
| Basic earnings per common share computation: | | |
| Net income | $ 2,307 | $ 2,537 |
| Preferred stock dividends | (609) | (578) |
| Preferred stock amortization | (2) | (2) |
| Net income available to common stockholders | $ 1,696 | $ 1,957 |
| Weighted average common shares outstanding, basic | 731,123.870 | 732,856.507 |
| Basic earnings per common share | $ 2.32 | $ 2.67 |
| Diluted earnings per common share computation: | | |
| Net income available to common stockholders | $ 1,696 | $ 1,957 |
| Effect on income of assumed conversion of preferred stock | 539 | - |
| Net income available to common stockholders and assumed conversions | $ 2,235 | $ 1,957 |
| Weighted average common shares outstanding, basic | 731,123.870 | 732,856.507 |
| Assumed conversion of preferred stock | 273,330.000 | - |
| Weighted average common shares outstanding, assuming dilution | 1,004,453.870 | 732,856.507 |
| Diluted earnings per common share | $ 2.23 | $ 2.67 |

NOTE 16 - OFF-BALANCE SHEET ACTIVITIES

The Company is party to financial instruments with off-balance sheet risk in the normal course of business to meet the financing needs of its customers. These financial instruments include commitments to originate loans, standby letters of credit and unadvanced funds on loans. The instruments involve, to varying degrees, elements of credit risk in excess of the amount recognized in the balance sheets. The contract amounts of those instruments reflect the extent of involvement the Company has in particular classes of financial instruments.

The Company's exposure to credit loss in the event of nonperformance by the other party to the financial instrument for loan commitments and standby letters of credit is represented by the contractual amounts of those instruments. The Company uses the same credit policies in making commitments and conditional obligations as it does for on-balance sheet instruments.

Commitments to extend credit are agreements to lend to a customer provided there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. Since many of the commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. The Company evaluates each customer's creditworthiness on a case-by-case basis. The amount of collateral obtained, if deemed necessary by the Company upon extension of credit, is based on management's credit evaluation of the borrower. Collateral held varies, but may include secured interests in mortgages, accounts receivable, inventory, property, plant and equipment and income-producing properties.

Standby letters of credit are conditional commitments issued by the Company to guarantee the performance by a customer to a third party. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loan facilities to customers. As of December 31, 2014 and 2013, the maximum potential amount of the Company’s obligation was $1,548,000 and $1,294,000, respectively, for financial and standby letters of credit. The Company’s outstanding letters of credit generally have a term of less than one year. If a letter of credit is drawn upon, the Company may seek recourse through the customer’s underlying line of credit. If the customer’s line of credit is also in default, the Company may take possession of the collateral, if any, securing the line of credit.

Notional amounts of financial instrument liabilities with off-balance sheet credit risk are as follows as of December 31:

| | 2014 | 2013 |
|---|---|---|
| | (In Thousands) | |
| Commitments to originate loans | $ 20,528 | $ 9,386 |
| Unused commitments on commercial loans | 26,410 | 18,765 |
| Standby letters of credit | 1,548 | 1,294 |
| Credit cards, unused credit lines | 2,673 | 2,439 |
| Home equity lines | 8,928 | 9,019 |
| | $ 60,087 | $ 40,903 |

There is no material difference between the notional amounts and the estimated fair values of the off-balance sheet liabilities.

NOTE 17 - ON-BALANCE SHEET DERIVATIVE INSTRUMENTS AND HEDGING ACTIVTIES

Derivative Financial Instruments

The Company has stand alone derivative financial instruments in the form of interest rate swap agreements, which derive their value from underlying interest rates. These transactions involve both credit and market risk. The notional amounts are amounts on which calculations, payments and the value of the derivative are based. Notional amounts do not represent direct credit exposures. Direct credit exposure is limited to the net difference between the calculated amounts to be received and paid, if any. Such differences, which represent the fair value of the derivative instruments, are reflected on the Company's balance sheet as derivative assets and derivative liabilities.

The Company is exposed to credit-related losses in the event of nonperformance by the counterparties to these agreements. The Company controls the credit risk of its financial contracts through credit approvals, limits and monitoring procedures, and does not expect any counterparties to fail their obligations. The Company deals only with primary dealers.

Derivative instruments are generally either negotiated Over the Counter (OTC) contracts or standardized contracts executed on a recognized exchange. Negotiated OTC derivative contracts are generally entered into between two counterparties that negotiate specific agreement terms, including the underlying instrument, amount, exercise prices and maturity.

Risk Management Policies - Hedging Instruments

The primary focus of the Company's asset/liability management program is to monitor the sensitivity of the Company's net portfolio value and net income under varying interest rate scenarios to take steps to control its risks. On a quarterly basis, the Company simulates the net portfolio value and net income expected to be earned over a twelve-month period following the date of simulation. The simulation is based on projection of market interest rates at varying levels and estimates the impact of such market rates on the level of interest-earning assets and interest-bearing liabilities during the measurement period. Based on the outcome of the simulation analysis, the Company considers the use of derivatives as a means of reducing the volatility of net portfolio value and projected net income within certain ranges of projected changes in interest rates. The Company evaluates the effectiveness of entering into any derivative instrument agreement by measuring the cost of such an agreement in relation to the reduction in net portfolio value and net income volatility within an assumed range of interest rates.

Interest Rate Risk Management - Cash Flow Hedging Instruments

The Company uses long-term fixed and variable rate debt as a source of funds for use in the Company's lending and investment activities and other general business purposes. These debt obligations expose the Company to variability in interest payments due to changes in interest rates. If interest rates increase, interest expense increases. Conversely, if interest rates decrease, interest expense decreases. Management believes it is prudent to limit the variability of a portion of its interest payments and, therefore, generally hedges a portion of its variable-rate interest payments. To meet this objective, management enters into interest rate swap agreements whereby the Company receives variable interest rate payments and makes fixed interest rate payments during the contract period.

During 2014 and 2013, no interest rate swap agreements were terminated prior to maturity. During 2014, the Company's swap agreement matured, and at December 31, 2014 the Company had no outstanding interest rate swap agreements. At December 31, 2013, the unrealized loss relating to the interest rate swap was recorded in derivative liabilities in accordance with ASC 815. Changes in the fair value of interest rate swaps designated as hedging instruments of the variability of cash flows associated with long-term debt are reported in other comprehensive income. These amounts subsequently are reclassified into interest expense as a yield adjustment in the same period in which the related interest on the long-term debt affects earnings. None of the other comprehensive income was reclassified into interest expense during the years ended December 31, 2014 and 2013.

Risk management results for the year ended December 31, 2014 and 2013 related to the balance sheet hedging of long-term debt indicates that the hedges were 100% effective and that there was no component of the derivative instruments' gain or loss which was excluded from the assessment of hedge effectiveness.

NOTE 18 - FAIR VALUE MEASUREMENTS

ASC 820-10, "Fair Value Measurement- Overall," provides a framework for measuring fair value under generally accepted accounting principles. This guidance also allows an entity the irrevocable option to elect fair value for the initial and subsequent measurement for certain financial assets and liabilities on a contract-by-contract basis.

In accordance with ASC 820-10, the Company groups its financial assets and financial liabilities measured at fair value in three levels, based on the markets in which the assets and liabilities are traded and the reliability of the assumptions used to determine fair value.

Level 1 - Valuations for assets and liabilities traded in active exchange markets, such as the New York Stock Exchange. Level 1 also includes U.S. Treasury, other U.S. Government and agency mortgage-backed securities that are traded by dealers or brokers in active markets. Valuations are obtained from readily available pricing sources for market transactions involving identical assets or liabilities.

Level 2 - Valuations for assets and liabilities traded in less active dealer or broker markets. Valuations are obtained from third party pricing services for identical or comparable assets or liabilities.

Level 3 - Valuations for assets and liabilities that are derived from other methodologies, including option pricing models, discounted cash flow models and similar techniques, are not based on market exchange, dealer, or broker traded transactions. Level 3 valuations incorporate certain assumptions and projections in determining the fair value assigned to such assets and liabilities.

A financial instrument's level within the fair value hierarchy is based on the lowest level of input that is significant to the fair value measurement.

A description of the valuation methodologies used for instruments measured at fair value, as well as the general classification of such instruments pursuant to the valuation hierarchy, is set forth below. These valuation methodologies were applied to all of the Company's financial assets and financial liabilities carried at fair value for December 31, 2014 and 2013. There were no significant transfers of assets between levels 1 and 2 of the fair value hierarchy during the year ended December 31, 2014.

The Company's investment in securities available-for-sale is generally classified within level 2 of the fair value hierarchy. For these securities, we obtain fair value measurements from independent pricing services. The fair value measurements consider observable data that may include dealer quotes, market spreads, cash flows, the U.S. treasury yield curve, trading levels, market consensus prepayment speeds, credit information and the instrument's terms and conditions.

Level 3 is for positions that are not traded in active markets or are subject to transfer restrictions, valuations are adjusted to reflect illiquidity and/or non-transferability, and such adjustments are generally based on available market evidence. In the absence of such evidence, management's best estimate is used. Subsequent to inception, management only changes level 3 inputs and assumptions when corroborated by evidence such as transactions in similar instruments, completed or pending third-party transactions in the underlying investment or comparable entities, subsequent rounds of financing, recapitalization and other transactions across the capital structure, offerings in the equity or debt markets, and changes in financial ratios or cash flows.

The Company's impaired loans are reported at the fair value of the underlying collateral if repayment is expected solely from the collateral. Collateral values are estimated using level 2 inputs based upon appraisals of similar properties obtained from a third party. For level 3 inputs fair values are based on management estimates of the value of the underlying collateral or the present value of the expected cash flows.

The Company's derivative financial instruments are generally classified within level 2 of the fair value hierarchy. For these financial instruments, the Company obtains fair value measurements from independent pricing services. The fair value measurements utilize a discounted cash flow model that incorporates and considers observable data, that may include publicly available third party market quotes, in developing the curve utilized for discounting future cash flows.

The following summarizes assets and liabilities measured at fair value as of December 31.

**ASSETS MEASURED AT FAIR VALUE ON A RECURRING BASIS**

| | Fair Value Measurements at Reporting Date Using: | | | |
|---|---|---|---|---|
| | Total | Quoted Prices in Active Markets for Identical Assets Level 1 | Significant Other Observable Inputs Level 2 | Significant Unobservable Inputs Level 3 |
| | (In Thousands) | | | |
| December 31, 2014: | | | | |
| Debt securities issued by U.S. government corporations and agencies | $ 43,394 | $ - | $ 43,394 | $ - |
| Debt securities issued by states of the United States and political subdivisions of the states | 20,172 | - | 20,172 | - |
| Mortgage-backed securities | 677 | - | 677 | - |
| Totals | $ 64,243 | $ - | $ 64,243 | $ - |
| December 31, 2013: | | | | |
| Debt securities issued by U.S. government corporations and agencies | $ 44,671 | $ - | $ 44,671 | $ - |
| Debt securities issued by states of the United States and political subdivisions of the states | 16,196 | - | 16,196 | - |
| Mortgage-backed securities | 862 | - | 862 | - |
| Totals | $ 61,729 | $ - | $ 61,729 | $ - |

There were no gains or losses for the periods ending December 31, 2014 and 2013 included in earnings attributable to the change in unrealized gains or losses relating to assets still held at the reporting dates.

**LIABILITIES MEASURED AT FAIR VALUE ON A RECURRING BASIS**

| | Fair Value Measurements at Reporting Date Using: | | | |
|---|---|---|---|---|
| | Total | Quoted Prices in Active Markets for Identical Assets Level 1 | Significant Other Observable Inputs Level 2 | Significant Unobservable Inputs Level 3 |
| | (In Thousands) | | | |
| December 31, 2013: | | | | |
| Derivative financial instruments | $ 26 | $ - | $ 26 | $ - |
| Totals | $ 26 | $ - | $ 26 | $ - |

**ASSETS MEASURED AT FAIR VALUE ON A NONRECURRING BASIS**

Under certain circumstances the Company makes adjustments to its assets and liabilities although they are not measured at fair value on an ongoing basis. The following table presents those assets carried on the consolidated balance sheet by caption and by level in the fair value hierarchy at December 31, 2014 and 2013 for which a nonrecurring change in fair value has been recorded:

| | Fair Value Measurements at Reporting Date Using: | | | |
|---|---|---|---|---|
| | Total | Quoted Prices in Active Markets for Identical Assets Level 1 | Significant Other Observable Inputs Level 2 | Significant Unobservable Inputs Level 3 |
| | (In Thousands) | | | |
| December 31, 2014: | | | | |
| Impaired loans | $ 69 | $ - | $ - | $ 69 |
| Other real estate owned | 607 | - | - | 607 |
| Totals | $ 676 | $ - | $ - | $ 676 |
| December 31, 2013: | | | | |
| Impaired loans | $ 3,453 | $ - | $ - | $ 3,453 |
| Totals | $ 3,453 | $ - | $ - | $ 3,453 |

The estimated fair values of the Company's financial instruments, all of which are held or issued for purposes other than trading, are as follows as of December 31:

| | December 31, 2014 | | December 31, 2013 | |
|---|---|---|---|---|
| | Carrying Amount | Fair Value | Carrying Amount | Fair Value |
| | (In Thousands) | | | |
| Financial assets: | | | | |
| Cash and cash equivalents | $ 6,891 | $ 6,891 | $ 5,361 | $ 5,361 |
| Interest-bearing time deposits with other banks | - | - | 1,125 | 1,256 |
| Available-for-sale securities | 64,243 | 64,243 | 61,729 | 61,729 |
| Held-to-maturity securities | 1,139 | 1,145 | 2,128 | 2,150 |
| Federal Home Loan Bank stock | 939 | 939 | 355 | 355 |
| Federal Reserve Bank stock | 570 | 570 | 450 | 450 |
| Investment in unconsolidated affiliate | 62 | 48 | 62 | 51 |
| Loans held-for-sale | - | - | 10,496 | 11,186 |
| Loans, net | 280,516 | 286,750 | 232,206 | 233,160 |
| Notes receivable | 587 | 592 | 247 | 247 |
| Accrued interest receivable | 1,085 | 1,085 | 1,091 | 1,091 |
| Financial liabilities: | | | | |
| Deposits | 312,973 | 313,044 | 293,803 | 293,939 |
| Federal Home Loan Bank advances | 14,000 | 14,000 | - | - |
| Junior subordinated debentures | 2,062 | 1,581 | 2,062 | 1,687 |
| Notes payable | 335 | 370 | 368 | 411 |
| Securities sold under agreements to repurchase | 178 | 178 | 181 | 181 |
| Accrued interest payable | 112 | 112 | 56 | 56 |
| Derivative-interest rate swap | - | - | 26 | 26 |

The carrying amounts of financial instruments shown in the above tables are included in the consolidated balance sheets under the indicated captions, except for investment in unconsolidated affiliate and notes receivable which are included in other assets. Accounting policies related to financial instruments are described in Note 2.

NOTE 19 - COMMITMENTS

As of December 31, 2014, the Company was obligated under non-cancelable operating leases for land and equipment expiring between September 2017 and October 2025. The total minimum rental due in future periods under these existing agreements is as follows as of December 31, 2014:

| | (In Thousands) |
|---|---|
| 2015 | $ 331 |
| 2016 | 339 |
| 2017 | 313 |
| 2018 | 208 |
| 2019 | 81 |
| Thereafter | 462 |
| Total | $ 1,734 |

Certain leases contain provisions for escalation of minimum lease payments contingent upon increases in real estate taxes and percentage increases in the consumer price index. The land leases contain options to extend for periods from twenty to thirty-eight years. One of the land leases also contains a provision for additional rent based upon the balance of deposit accounts attributable to that branch. The cost of such rentals is not included above. The total rental expense amounted to $342,000 and $324,000 for the years ended December 31, 2014 and 2013, respectively.

The Company entered into an agreement with a third party to provide the Company with account processing, item processing and other services. The original term commenced in February 2006 and expired in February 2013. The Company has extended the term of this agreement five years, to March 1, 2018. The Company is obligated to pay minimum monthly charges per the agreement. The Company has the option to terminate the agreement subject to a penalty equal to eighty percent (80%) of the Company's largest monthly invoice for each service received by the Company during the term multiplied by the remaining unused term of the agreement, not to exceed $500,000. As of December 31, 2014, the Company had no intent on terminating the agreement.

NOTE 20 - SIGNIFICANT GROUP CONCENTRATIONS OF CREDIT RISK

Most of the Company's business activity is with customers located within the state of New York. The majority of the Company's loan portfolio is comprised of loans collateralized by real estate located in the state of New York.

NOTE 21 - OTHER COMPREHENSIVE INCOME (LOSS)

Accounting principles generally require that recognized revenue, expenses, gains and losses be included in net income. Although certain changes in assets and liabilities are reported as a separate component of the equity section of the consolidated balance sheets, such items, along with net income, are components of comprehensive income.

The components of other comprehensive income (loss), included in stockholders' equity are as follows during the years ended December 31:

| | 2014 | 2013 |
|---|---|---|
| | (In Thousands) | |
| Unrealized gains on securities: | | |
| Net unrealized holding gains (losses) on available-for-sale securities | $ 55 | $ (970) |
| Reclassification adjustment for realized gains in net income (1) | (10) | (6) |
| Other comprehensive income (loss) before income tax effect | 45 | (976) |
| Income tax (expense) benefit | (18) | 381 |
| | 27 | (595) |
| Other comprehensive income - derivative | 26 | 54 |
| Income tax expense | (10) | (21) |
| | 16 | 33 |
| Other comprehensive income (loss) , net of tax | $ 43 | $ (562) |

(1) Reclassification adjustments are comprised of realized securities gains. The gains have been reclassified out of accumulated other comprehensive income and have affected certain lines in the consolidated statements of income as follows; the pre-tax amount is included in gain on sales of available-for-sale securities, the tax expense amount is included in income tax expense and the after tax amount is included in net income.

Accumulated other comprehensive income consists of the following as of December 31:

| | 2014 | 2013 |
|---|---|---|
| | (In Thousands) | |
| Net unrealized holding gains on available-for-sale securities, net of tax | $ 547 | $ 520 |
| Net unrealized loss – derivative, net of tax | - | (16) |
| Accumulated other comprehensive income | $ 547 | $ 504 |

NOTE 22 - REGULATORY MATTERS

The Bank, as a National Bank, is subject to the dividend restrictions set forth by the Comptroller of the Currency. Under such restrictions, the Bank may not, without the prior approval of the Comptroller of the Currency, declare dividends in excess of the sum of the current year's earnings (as defined) plus the retained earnings (as defined) from the prior two years. The dividends, as of December 31, 2014, that the Bank could declare amounted to $4,232,000.

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

Quantitative measures established by regulation to ensure capital adequacy require the Bank to maintain minimum amounts and ratios (set forth in the table below) of total and Tier 1 capital (as defined in the regulations) to risk-weighted assets (as defined), and of Tier 1 capital (as defined) to average assets (as defined.) Management believes, as of December 31, 2014 and 2013, that the Bank meets all capital adequacy requirements to which it is subject.

As of December 31, 2014, the most recent notification from the Office of the Comptroller of the Currency categorized the Bank as well capitalized under the regulatory framework for prompt corrective action. To be categorized as well capitalized, an institution must maintain minimum total risk-based, Tier 1 risk-based and Tier 1 leverage ratios as set forth in the following tables. There are no conditions or events since that notification that management believes have changed the Bank's category.

The Bank's actual capital amounts and ratios are also presented in the table.

| | Actual | | For Capital Adequacy Purposes | | To Be Well Capitalized Under Prompt Corrective Action Provisions | |
|---|---|---|---|---|---|---|
| | Amount | Ratio | Amount | Ratio | Amount | Ratio |
| | (Dollars In Thousands) | | | | | |
| As of December 31, 2014: | | | | | | |
| Total Capital (to Risk-Weighted Assets) | $ 39,416 | 15.54 % | $ 20,286 | 8.0 % | $ 25,358 | 10.0 % |
| Tier 1 Capital (to Risk-Weighted Assets) | 36,374 | 14.34 | 10,143 | 4.0 | 15,215 | 6.0 |
| Tier 1 Capital (to Average Assets) | 36,374 | 9.96 | 14,601 | 4.0 | 18,251 | 5.0 |
| As of December 31, 2013: | | | | | | |
| Total Capital (to Risk-Weighted Assets) | 33,989 | 15.15 | 17,948 | 8.0 | 22,435 | 10.0 |
| Tier 1 Capital (to Risk-Weighted Assets) | 31,195 | 13.90 | 8,974 | 4.0 | 13,464 | 6.0 |
| Tier 1 Capital (to Average Assets) | 31,195 | 9.27 | 13,466 | 4.0 | 16,832 | 5.0 |

*Basel III:*

On July 2, 2013, the Federal Reserve Bank (FRB) approved the final rules implementing the Basel Committee on Banking Supervision's capital guidelines for U.S. banks. On July 9, 2013, the Federal Deposit Insurance Corporation (FDIC) also approved, as an interim final rule, the regulatory capital requirements for U.S. banks, following the actions of the FRB. On April 8, 2014, the FDIC adopted as final its interim final rule, which is identical in substance to the final rules issued by the FRB in July 2013. Under the final rules, minimum requirements will increase for both the quantity and quality of capital held by the Bank. The rules include a new common equity Tier 1 capital to risk-weighted assets minimum ratio of 4.5%, raise the minimum ratio of Tier 1 capital to risk-weighted assets from 4.0% to 6.0%, require a minimum ratio of Total capital to risk-weighted assets of 8.0%, and require a minimum Tier 1 leverage ratio of 4.0%. A new capital conservation buffer, comprised of common equity Tier 1 capital, is also established above the regulatory minimum capital requirements. This capital conservation buffer will be phased in beginning January 1, 2016 at 0.625% of risk-weighted assets and increases each subsequent year by an additional 0.625% until reaching its final level of 2.5% on January 1, 2019. Strict eligibility criteria for regulatory capital instruments were also implemented under the final rules.

The phase-in period for the final rules will begin for the Bank on January 1, 2015, with full compliance with all of the final rule's requirements phased in over a multi-year schedule and should be fully phased-in by January 1, 2019. Management believes that the Bank's capital levels will remain characterized as "well-capitalized" under the new rules.

NOTE 23 - GOODWILL AND INTANGIBLE ASSETS

The Company's assets as of December 31, 2014 and 2013 include goodwill of $931,000 recognized in the acquisition of The Kleeber Agency, Inc., an insurance agency. The Company acquired The Kleeber Agency, Inc. in order to increase non-interest income of the Company and to be able to offer a full menu of financial products that will diversify the Company's reliance on interest income.

On September 30, 2013, The Kleeber Agency, Inc. entered into an Asset Purchase Agreement ("Agreement") with a third party whereby The Kleeber Agency, Inc. sold client accounts to the third party. Under the terms of the Agreement, the third party agreed to pay The Kleeber Agency, Inc. $300,000 over forty-eight months at approximately $6,000 per month. The Kleeber Agency, Inc. discounted the amount due from the third party by $38,000 so as to incorporate an imputed interest rate of 7.00%. The Kleeber Agency, Inc. recorded a deferred gain of $98,000, which is being recognized into income ratably over the term of the note. As of December 31, 2014, the amount due under this note was $187,000.

On December 31, 2014, The Kleeber Agency, Inc. entered into an Asset Purchase Agreement ("Agreement II") with a third party whereby The Kleeber Agency sold certain client accounts to the third party. Under the terms of the agreement, the third party agreed to pay The Kleeber Agency $400,000 in equal quarterly installments over five years at an interest rate of 5%, $42,000 of which was to settle commissions receivable to the Kleeber Agency. The Agency recorded a deferred gain amounting to $282,000 which will be recognized into income ratably over the term of the note.

A summary of acquired amortized intangible assets, related to the Kleeber Agency, Inc. acquisition and the purchase of customer lists from other insurance agencies, is as follows:

| | Carrying Amount | Accumulated Amortization | Net Carrying Amount |
|---|---|---|---|
| | | (In Thousands) | |
| December 31, 2014: | | | |
| Covenants not to compete | $ 172 | $ 75 | $ 97 |
| Customer lists | 1,100 | 816 | 284 |
| Total | $ 1,272 | $ 891 | $ 381 |
| December 31, 2013: | | | |
| Covenants not to compete | $ 172 | $ 62 | $ 110 |
| Customer lists | 1,282 | 810 | 472 |
| Total | $ 1,454 | $ 872 | $ 582 |

Aggregate amortization expense was $125,000 in 2014 and $188,000 in 2013. Amortization of covenants not to compete is being calculated on a straight-line basis and amortization of customer lists is being calculated using the sum-of-the-years' digits method.

Estimated aggregate amortization expense for each of the five years succeeding 2014, and thereafter, is as follows:

| | (In Thousands) |
|---|---|
| 2015 | $ 98 |
| 2016 | 83 |
| 2017 | 68 |
| 2018 | 53 |
| 2019 | 38 |
| Thereafter | 41 |
| | $ 381 |

The Company determined that its goodwill and other intangible assets were not impaired as of December 31, 2014.

NOTE 24 - SUBSEQUENT EVENTS

Management has evaluated subsequent events through April 22, 2015, which is the date the consolidated financial statements were available to be issued. There were no subsequent events that require adjustment to or disclosure in the consolidated financial statements.

NOTE 25 - RECLASSIFICATION

Certain amounts in the prior years have been reclassified to be consistent with the current year's statement presentation.