2015 Annual Report

4142 Hylan Boulevard
Staten Island, New York 10308
(718) 979-1100

Forward Looking Statements

When used in this annual report, or in any written or oral statement made by us or our officers, directors or employees, the words and phrases "will result," "expect," "will continue," "anticipate," "estimate," "project," or similar terms are intended to identify "forward-looking statements." A variety of factors could cause our actual results and experiences to differ materially from the anticipated results or other expectations expressed in any forward-looking statements. Some of the risks and uncertainties that may affect our operations, performance, development and results, the interest rate sensitivity of our assets and liabilities, and the adequacy of our loan loss allowance, include, but are not limited to:

- deterioration in local, regional, national or global economic conditions which could result in, among other things, an increase in loan delinquencies, a decrease in property values, or a change in the real estate turnover rate;
- changes in market interest rates or changes in the speed at which market interest rates change;
- changes in laws and regulations affecting the financial service industry;
- changes in public policy initiatives and regulatory philosophy;
- adverse weather conditions or other severe climate occurrences;
- the acceptability of alternate quasi-currencies or other products that affect banks as financial intermediaries
- changes in the public's perception of financial institutions in general and banks in particular;
- changes in competition; and
- changes in consumer preferences by our customers or the customers of our business borrowers.

Please do not place undue reliance on any forward-looking statement, which speaks only as of the date made. There are many factors, including those described above, that could affect our future business activities or financial performance and could cause our actual future results or circumstances to differ materially from those we anticipate or project. We do not undertake any obligation to update any forward-looking statement after it is made.

Table of Contents

To Our Stockholders

Our strategic plan started to blossom in 2015. We were able to grow our loan portfolio by $36.6 million in 2015, a 55% jump over the previous year. We hired a second new business development officer and purchased loan participations from other financial institutions. The competition for loans continues to be strong and many institutions have lowered their credit standards to attract new loan opportunities. We have demonstrated that we can build our loan portfolio at reasonable loan rates and terms without compromising our current prudent underwriting standards. We will continue on our path to increasing our loan portfolio in 2016.

The economy stirred from its malaise and was improving in late 2015. The Federal Reserve has increased short term rates by 25 basis points, but the current economic turmoil in China and Europe is dampening our prospects for faster growth. We expect to stay in a low interest rate environment in 2016 and we will manage our balance sheet accordingly.

In February 2016, we were named to the 2016 OTCQX® Best 50, a ranking of top performing companies traded on the OTCQX Best Market for 2015. The ranking is calculated based on an equal weighting of one-year total return and average daily dollar volume growth in the previous calendar year. We are proud to be recognized as one of the 2016 OTCQX Best 50. The implementation of our strategic plan in 2015 drove the higher return on our common stock. We are committed to increasing shareholder value.

The increase in our loan portfolio translated into higher net income. We reported net income of $1.6 million, or basic net income of $0.93 per common share, in 2015, a rise of over 28% from 2014. This was despite a one-time increase in our New York City tax expense of approximately $155,000, due to recently enacted tax law changes. Our effective tax rate has subsequently decreased to 35% and we currently anticipate it remaining at this level for 2016. Net interest income grew by $643,000, and non-interest income grew by $149,000. This growth was partially offset by the increase in non-interest expenses due primarily to increased staff and the recognition of expenses related to the sale of a non-performing loan. Overall, we maintained a tight control over our expenses, which we continually monitor through our cost containment program.

We shifted $8.0 million in investment securities and $3.3 million in cash and other liquid assets into our higher yielding loan portfolio. Our non-performing loans decreased from $4.6 million at December 31, 2014 to $1.9 million at December 31, 2015. Total OREO stood at $570,000 at December 31, 2015. With these asset shifts, we are closely analyzing and managing our interest rate risk profile. Our level of charge-offs and write downs decreased significantly in 2015. We added four REO properties and sold one in 2015. We are actively marketing these properties for sale.

As with most financial institutions, there are additional expenses related to regulatory compliance. We are monitoring those expenses and looking for alternative methods, including enhanced monitoring software that will help reduce their impact on our net income

Total deposits, including escrow deposits, increased to $276.3 million, an increase of $24.9 million, or 10.0% during 2015. The increase was spread among our money market, demand and checking, NOW, and in time deposit accounts. We are focused on building our non-interest bearing checking accounts, as these accounts are the foundations for both existing and new relationships. We have been able to maintain a low cost of funds, and we do not routinely solicit deposits by paying above market rates. We are introducing an enhanced mobile banking solution in the first half of 2016 to provide our customers with the benefits and features that our competitors are offering. This will also make our bank more attractive to potential younger customers, such as millennials, as smart phones and tablets are now standard fare.

We began our fourth stock buyback program and we have repurchased 330,111 shares since we started buying back our shares, at a significant discount to book value. We just announced our thirty-fourth consecutive cash dividend, in which we have increased our cash dividend by 16.7%. Our book value per share stands at $16.00. Our regulatory capital base remains well in excess of what is needed to be considered well capitalized by current and new industry standards.

Our Return on Assets rose to 0.65% and our Return on Equity rose to 7.18%, which is a result of our enhanced financial performance. As we add new quality loans, we expect to see a continued rise in these metrics, as well as a higher interest rate margin and net income.

We look forward to building upon our successes in 2015. We will continue to explore ways to boost stockholder value while we serve our community and customers with the best in personal service.

March 29, 2016

Joseph J. LiBassi
Chairman of the Board

Raffaele (Ralph) M. Branca
President and Chief Executive Officer

Business Description

VSB Bancorp, Inc. (referred to using terms such as "we," "us," or the "Company") is the holding company for Victory State Bank (the "Bank"), a New York State chartered commercial bank. Our primary business is owning all of the issued and outstanding stock of the Bank. Victory State Bank is a New York State chartered commercial bank, founded in November 1997. The Bank is supervised by the New York State Department of Financial Services ("NYSDFS") and the Federal Deposit Insurance Corporation ("FDIC"). The Bank gathers deposits from individuals and businesses primarily in Staten Island and makes loans throughout that community. The Bank invests funds that are not used for lending primarily in government securities, mortgage backed securities and collateralized mortgage obligations. Customer deposits are insured, up to the applicable limit, by the FDIC. VSB Bancorp, Inc. common stock is quoted on the OTC Markets Group ("OTCQX") under the symbol "VSBN".

Our results of operations are dependent primarily on net interest income, which is the difference between the income we earn on our loan and investment portfolios and our costs of funds, consisting primarily of interest paid on our deposits. Our operating expenses principally consist of employee compensation and benefits, occupancy expenses, professional fees, advertising and marketing expenses and other general and administrative expenses. Our results of operations are significantly affected by general economic and competitive conditions, particularly the general strength of the local economy, changes in market interest rates, government policies and actions of regulatory authorities.

Since the Bank opened for business in 1997, the Board of Directors and management have pursued a strategy of growth and expansion in order to enhance the long term value of our banking franchise. The Board of Directors and management anticipate that an increase in customer deposits, and the resulting increase in funds we would have available to fund asset growth, will generate an increase in net interest income.

In order to support branch expansion and asset growth, we had not paid cash dividends prior to the fourth quarter of 2007. Our Board of Directors approved our first $0.06 cash dividend to stockholders of record on November 29, 2007, payable on January 2, 2008 and we paid quarterly dividends of $0.06 per share with respect to each calendar quarter thereafter through the end of 2015. We paid $416,411 of dividends out of net income of $1,630,703, for a dividend payout ratio of 26% in 2015 and we paid $426,712 of dividends out of net income of $1,272,494, for a dividend payout ratio of 34% in 2014. Thus, we retained the majority of our net income to increase our capital base to support our efforts to expand our franchise in the future.

During 2015, we significantly reduced our level of non-accrual loans. Low market interest rates have pushed down our yields on assets. Our non-accrual loans decreased from 2014 to 2015, and they totaled $1.9 million, or 1.2% of total loans, at December 31, 2015.

Our cost of funds declined due to the downward pressure of deposit rates, but not as fast as our yield on assets. The real estate market has firmed. We incurred smaller provisions for loan losses due to the reduced level of delinquencies.

Management intends to exert efforts to continue growing our company in the future. However, both internal and external factors could adversely affect our future growth. We have expanded outside of Staten Island to originate some new loans that meet our underwriting standards. This may lead to reduced level of available funds to invest in lower-yielding securities.

An increase in market rates may have a negative impact on our net interest income. Furthermore, regulatory capital requirements could have a negative effect on our ability to grow if growth outpaces our ability to support that growth with increased capital.

Management's Discussion and Analysis of Financial Condition and Results of Operations

Since Victory State Bank opened for business, management has worked to grow its franchise. From no deposits, no loans and less than $7.0 million of assets on the day it opened for business in 1997, the bank has grown to total assets of $306.4 million, total deposits of $276.3 million and capital of $28.8 million by December 31, 2015.

Economic Conditions

The economy in the United States, including the economy in Staten Island, has been in a moderate recovery. The recent turmoil overseas and overall lower global economic activity is affecting our domestic economy. The effects of low inflation, moderate job growth, and the Federal Reserve's expected increase in the fed funds rate has created uncertainty not only in the pace of economic growth but in its sustainability. Substantial stress remains on many financial institutions and financial products due to the artificially maintained low interest rate environment, which directly places negative pressure on interest rate margins. We draw a substantial portion of our customer base from local businesses, especially those in the building trades and related industries, and we believe that there continue to be significant weaknesses in the business economy in our market area. If adverse conditions in the local economy continue, it will become more difficult for us to conduct prudent and profitable business in our community.

Possible Adverse Effects on Our Net Income Due to Fluctuations in Market Rates

Our principal source of income is the difference between the interest income we earn on interest-earning assets, such as loans and securities, and our cost of funds, principally interest paid on deposits. These rates of interest change from time to time, depending upon a number of factors, including general market interest rates. However, the frequency of the changes varies among different types of assets and liabilities. For example, for a five-year loan with an interest rate based upon the prime rate, the interest rate may change every time the prime rate changes. In contrast, the rate of interest we pay on a five-year certificate of deposit adjusts only every five years, based upon changes in market interest rates.

In general, the interest rates we pay on deposits adjust more slowly than the interest rates we earn on loans because our loan portfolio consists primarily of loans with interest rates that fluctuate based upon the prime rate. In contrast, although many of our deposit categories have interest rates that could adjust immediately, such as interest checking accounts and savings accounts, changes in the interest rates on those accounts are at our discretion. Thus, the rates on those accounts, as well as the rates we pay on certificates of deposit, tend to adjust more slowly. In the past six years, the prime rate held steady at 3.25% and recently rose to 3.50%. Deposit rates have fluctuated within a relatively narrow band during this time frame but may rise as the Federal Reserve increase short term rates.

Many of our prime-based loans have minimum interest rates, or floors, below which the interest rate does not decline despite further decreases in the prime rate. This helped stabilize our loan yields in a period of declining interest rates.

Based upon the Federal Reserve current projections, we expect that market interest rates will continue to increase, albeit at a more modest pace than originally thought. We anticipate that this will have an initial adverse effect on our net income because our deposit rates should begin to rise, soon thereafter as we respond to market pressures. In contrast, loan yields will remain relatively steady until the prime rate increases sufficiently that our loans begin to reprice above their interest rate floors. For most of our prime-rate based loans, this will not occur until the prime rate increases above 6%. Once our loan rates exceed their interest rate floors, increases in market interest rates should increase our net interest income because our cost of deposits should probably increase more slowly than the yields on our loans. However, customer preferences and competitive pressures may negate this positive effect because customers may choose to move funds into higher-earning deposit types as higher interest rates make them more attractive, or competitors offer premium rates to attract deposits.

We have a substantial amount of investment securities with fixed rates of interest, most of which are mortgage-backed securities with an estimated average life of not more than 7 years. We receive regular cash flows from the repayment of our securities portfolios. These repayments were in excess of $33.1 million in 2014 and $42.3 million in 2015. We also have a high level of overnight and short term investments. The availability overnight funds and securities repayments should allow us to invest at higher yields as market rates increase, thus mitigating the effect of the delay in repricing our loans with interest rate floors.

Delays in Foreclosure Proceedings May Affect Collateral Value

The length of time it takes to prosecute a foreclosure action and be able to sell real estate collateral in New York has substantially lengthened. It is not unusual for it to take more than three years from the date a foreclosure action is commenced until the property is sold even in uncontested cases, and some uncontested cases can take longer. This problem, if it continues or gets worse, could have a substantial adverse effect on the value of our collateral, for our loans, that are in default. The inability to realize upon collateral promptly increases our loss in the event of a default due to the property value deterioration during a lengthy foreclosure.

Comparative Results for the Years Ended December 31, 2015 and December 31, 2014

Our results of operations depend primarily on net interest income, which is the difference between the income we earn on our loan and investment portfolios and our cost of funds, consisting primarily of interest we pay on customer deposits. Our operating expenses principally consist of employee compensation and benefits, occupancy expenses, professional fees, advertising and marketing expenses and other general and administrative expenses. Our results of operations are significantly affected by general economic and competitive conditions, particularly changes in market interest rates, government policies and actions of regulatory authorities.

General. We had net income of $1,630,703 for the year ended December 31, 2015, compared to net income of $1,272,494 for the comparable period in 2014. The principal categories which make up the 2015 net income are:

- Interest income of $9,663,309
- Reduced by interest expense of $757,196
- Reduced by a provision for loan losses of $230,000
- Increased by non-interest income of $2,827,949
- Reduced by non-interest expense of $8,720,448
- Reduced by income tax expense of $1,152,911

We discuss each of these categories individually and the reasons for the differences between the years ended December 31, 2015 and 2014 in the following paragraphs.

Interest Income. Interest income was $9,663,309 for the year ended December 31, 2015, compared to $8,969,450 for the year ended December 31, 2014, an increase of $693,859 or 7.7%. The main reason for the increase was a $23,090,494 or 32.9% increase in the average balance of loans. There was also a decrease in interest income of $39,092 in investment securities and $44,818 in other interest earning assets.

Interest income on loans increased by $777,769 as a result of an increase of $23.1 million in the average balance of loans from the year ended December 31, 2014 to the year ended December 31, 2015 due to management's efforts to increase our loan portfolio while maintain our underwriting standards. The positive effect of the increase in average balance was partially offset by a 103 basis point drop in our average loan yield due to the continued low market interest rate conditions and competitive pressure from other lenders. Our non-performing loans decreased from $4.6 million at December 31, 2014 to $1.9 million at December 31, 2015, due primarily to the sale of $1.2 million of non-performing loans, the payoff of $1.5 million of non-performing loans and the foreclosure of a $255,000 loan in the second quarter of 2015. Non-performing loans continue to be included in the calculation of average loan yield, but with an effective yield of zero. We estimate that if all non-performing loans were performing according to their contractual terms during the year ended December 31, 2015, our average loan yield would have been approximately 22 basis points higher. In contrast, we estimate that the comparable effect in 2014 would have been approximately a 39 basis point increase in average loan yield. Substantially all of the non-accrual loans are secured by mortgages on real estate.

Interest rate floors on most of our loans helped to maintain our level of interest income from the loan portfolio during periods of low interest rates, but these floors will have the effect of limiting increases in our income as market rates increase until the prime rate rises above 6%.

We experienced a 8 basis point decrease in the average yield on our investment securities portfolios, from 2.10% to 2.02%, due to the purchase of new investment securities at lower market rates than the rates we had been earning on the investment securities previously purchased that were gradually being repaid. The aggregate average balance of our investment portfolios increased by $7.8 million, or 4.6%, between the periods. The decrease in yield offset the increase in volume, resulting in an overall decline in interest on investment securities of $39,092, or 1.1%. The investment securities portfolios represented 61.45% of average interest earning assets in 2015 compared to 60.39% in 2014.

Interest income from other interest earning assets (principally overnight investments) decreased by $44,818 due principally to the $23.1 million decrease in average other interest earning assets between the periods, as we invested those lower yielding funds into our growing loan portfolio and higher yielding investment securities.

Interest Expense. Interest expense was $757,196 for the year ended December 31, 2015, compared to $706,234 for the year ended December 31, 2014, an increase of $50,962 or 7.2%. The increase in interest expense was principally due to an $83,421 increase in interest expense on money market accounts, due to the average cost increasing by 8 basis points and the average balance increasing by $7.6 million.

Average interest-bearing deposits increased by $5.9 million, and average demand deposits, an interest free source of funds for us to invest, increased $3.6 million, or 3.4%. This resulted in a combined $9.6 million increase in average total deposits from 2014 to 2015. Demand deposits represented approximately 40% of average total deposits in 2015.

Net Interest Income Before Provision for Loan Losses. Net interest income before the provision for loan losses was $8,906,113 for the year ended December 31, 2015, compared to $8,263,216 for the year ended December 31, 2014, an increase of $642,897, or 7.8%. The increase in our interest income, partially offset by the increase in our cost of funds, resulted in the overall increase in net interest income.

The average yield on interest earning assets increased by 16 basis points and the average cost of funds increased by 2 basis points. Overall, our interest rate spread increased 14 basis points, from 2.72% to 2.86% between the periods. Correspondingly, our net interest margin increased to 3.06% for the year ended December 31, 2015 from 2.91% in the same period of 2014. The margin is higher than the spread because it takes into account the effect of interest free demand deposits and capital.

The spread and margin both increased because of the effect of the shift in our asset mix towards higher-yielding loans and investment securities and away from lower-yielding other interest-earning assets. An increase in noninterest-bearing demand deposits as a percentage of total deposits also had a positive effect on our net interest margin.

Provision for Loan Losses. The provision for loan losses in any period depends upon the amount necessary to bring the allowance for loan losses to the level management believes is appropriate, after taking into account charge offs and recoveries. We took a provision for loan losses of $230,000 for the year ended December 31, 2015 compared to a provision for loan losses of $345,000 for the same period in 2014. The $115,000 decrease in the provision was a result of a lower level of non-performing loans and charged-offs when comparing year-end 2014 to year-end 2015, which effect was partially offset by the increase in the loan portfolio as a whole.

Our non-performing loans decreased from $4.6 million at December 31, 2014 to $1.9 million at December 31, 2015, due primarily to the sale of $1.2 million of non-performing loans, the payoff of $1.5 million of non-performing loans and the foreclosure of a $255,000 loan in the second quarter of 2015. Most of those loans are secured by real estate. We individually evaluated the non-performing mortgage loans based primarily upon updated appraisals as part of our analysis of the appropriate level of our allowance for loan and lease losses. We charged off $3,325 of loans for the year ended December 31, 2015 as compared to charge-offs of $623,816 for the same period in 2014. We also had recoveries (which are added back to the allowance for loan losses) of $104,922 for the year ended December 31, 2015 as compared to $143,994 in the same period of 2014.

After considering available information, we determined that the level of our allowance at December 31, 2015 was appropriate to address probable incurred losses. Overall, our allowance for loan losses increased from $958,966 or 1.4% of total loans, at December 31, 2014 to $1,290,563 or 1.2% of total loans, at December 31, 2015. There can be no assurance that a higher level, or a higher provision for loan losses, will not be necessary in the future.

Non-interest Income. Non-interest income was $2,827,949 for the year ended December 31, 2015, compared to $2,679,345 during the same period last year. The $148,604, or 5.6% increase in non-interest income was a direct result of an increase of $157,708 in other income partially offset by a $94,803 decrease in service charges on deposits. The increase in other income was attributed to $68,718 received due to the settlement of pending litigation and a $57,507 increase in income on bank owned life insurance. Service charges on deposits consist mainly of insufficient fund fees, which are inherently volatile, and are based upon the number of items being presented for payment against insufficient funds.

In July 2014, we purchased $5 million of Bank Owned Life Insurance ("BOLI") policies, which are life insurance policies held for the benefit of the Company on our key executives, subject to their voluntary consent. The proceeds of any life insurance payments are sent directly to the Company, and are partially paid to the executive's heirs under a split dollar arrangement if certain conditions are satisfied. BOLI policies generated tax exempt non-interest income as the cash surrender value of the policies increase.

Non-interest Expense. Non-interest expense was $8,720,448 for the year ended December 31, 2015, compared to $8,082,416 for the year ended December 31, 2014, an increase of $638,032 or 7.9%. The principal shifts in the individual categories were:

- a $347,668 increase in other expenses due to the recording of $153,256 in expenses related to a non-performing loan sale in the second quarter of 2015, a $66,000 increase in New York State and New York City franchise tax due to the recent tax law changes, a $49,335 increase in loan servicing fees paid on participation loans, a $27,622 increase in ATM expenses due to increased customer base, and a $14,900 loss on a fraud;
- a $317,391 increase in salaries and benefits due to new hires and the higher cost of some benefits partially offset by; and
- an $80,504 decrease in legal fees due to the recovery of legal fees previously expensed in both successfully collecting a past due loan and settling a litigation about a potential branch site.

In addition to these changes, we also experienced changes in the various other non-interest expense categories due to normal fluctuations in operations.

Income Tax Expense. Income tax expense was $1,152,911 for the year ended December 31, 2015, compared to income tax expense of 1,242,651 for the same period ended 2014. The decrease in income tax expense was due to the reduction of our effective tax rate to 33% partially offset by an increase in the valuation allowance recorded against the New York City portion of our net deferred tax asset, both of which were due to recently enacted tax law changes. The future effective tax rate has dropped to approximately 33% and we expect it to remain at that level in the future based upon our current income profile, assuming no further changes in tax laws. Our effective tax rate for 2015 was 41.4% and 2014 was 49.4%.

Changes in Financial Condition

Total assets were $306,407,129 at December 31, 2015, an increase of $25,368,208, or 9.0%, from December 31, 2014. The principal changes resulting in the increase in assets can be summarized as follows:

- a $36,577,298 increase in loans receivable, net, partially offset by
- a $8,007,423 decrease in investment securities and
- a $3,284,070 decrease in cash and cash equivalents.

In addition to these changes in major asset categories, we also experienced changes in other asset categories due to normal fluctuations in operations.

Our deposits (including escrow deposits) were $276,304,263 at December 31, 2015, an increase of $24,927,134 or 9.9%, from December 31, 2014. The components of the increase in deposits included increases of $15,667,681 in money market accounts, $5,489,537 in non-interest demand deposits, $4,188,662 in NOW accounts, and $3,202,179 in time deposits, partially offset by decreases of $3,468,722 in savings accounts and $152,203 in escrow deposits.

Total stockholders' equity was $28,799,291 at December 31, 2015, an increase of $284,801, or 1.0%, from December 31, 2014. The increase reflected: (i) a $1,214,292 increase in retained earnings due to net income of $1,630,703 for the year ended December 31, 2015, partially offset by $416,411 of dividends paid in 2015; (ii) a reduction of $100,125 in Unearned ESOP shares reflecting the gradual payment of the loan we made to fund the ESOP's purchase of our stock; (iii) a decrease in the net unrealized gain on securities of $342,256 and (iv) a $743,316 increase in treasury shares representing the cost of 59,947 shares of common stock we repurchased.

The unrealized gain or loss on the available for sale and held to maturity securities portfolios are excluded from the calculation of regulatory capital. Management does not anticipate selling securities in these portfolios, but changes in market interest rates or in the demand for funds may change management's plans with respect to the securities portfolios. If there is a material increase in interest rates, the market value of the securities portfolios may decline.

Liquidity and Capital Resources

Our primary sources of funds are increases in deposits, proceeds from the repayment of investment securities, and the repayment of loans. We use these funds to purchase new investment securities and to fund new and renewing loans in our loan portfolio. Remaining funds are invested in short-term liquid assets such as overnight federal funds loans and bank deposits.

During the year ended December 31, 2015, we had a net increase in total deposits of $24,927,134 due to increases of $15,667,681in money market accounts, $5,489,537 in non-interest demand deposits, $4,188,662 in NOW accounts, and $3,202,179 in time deposits, partially offset by decreases of $3,468,722 in savings accounts and $152,203 in escrow deposits. These are all what are commonly known as "retail" deposits that we obtain through the efforts of our branch network rather than "wholesale" deposits that some banks obtain from deposit brokers or deposit listing services. We also received proceeds from repayment of investment securities of $42,292,230. We used $35,491,630 of available funds to purchase new investment securities and we had a net loan increase of $37,304,795. These changes resulted in an overall decrease in cash and cash equivalents of $3,284,070. Total cash and cash equivalents at December 31, 2015 were $14,845,096.

In contrast, in 2014, we had a net decrease in total deposits of $17,177,449 due to decreases of $14,629,905 in time deposits, $5,749,685 in NOW accounts,$470,375 in non-interest demand deposits and $26,830 in escrow accounts partially offset by increases of $3,169,793 in money market accounts and $526,559 in savings accounts. These are also all "retail" deposits. We also received proceeds from repayment of investment securities of $33,102,796. We used $65,640,318 of available funds to purchase new investment securities and we had a net loan decrease of $4,856,673. We also used $5,000,000 of available funds to purchase bank owned life insurance. These changes resulted in an overall decrease in cash and cash equivalents of $47,433,469. Total cash and cash equivalents at December 31, 2014 were $18,129,166.

At December 31, 2015, cash and cash equivalents represented 4.8% of total assets. Our cash and cash equivalents decreased during the year as we deployed those funds into loans, which enabled us to generate higher interest income. We anticipate, based upon historical experience that cash and cash equivalents, combined with cash inflows we anticipate from payments on our loan and investment securities portfolios, will be sufficient to fund loan growth and unanticipated deposit outflows. Depending upon competitive pressures, we may need to implement interest-paying business checking in order to maintain demand deposits at historical levels or to increase such deposits.

As a secondary source of liquidity, at December 31, 2015 we had $58.1 million of investment securities classified available for sale. The disposition of these securities prior to maturity is an option available to us in the event, which we believe is unlikely, that our primary sources of liquidity and expected cash flows are insufficient to meet our need for funds. Additionally, we have the ability to borrow funds at the Federal Home Loan Bank of New York and the Federal Reserve Bank of New York using all the securities in our investment portfolios as collateral if the need arises. Based upon our asset size and the amount of our securities portfolios that qualifies as eligible collateral, we had more than $84 million of unused borrowing capability from the FHLBNY at December 31, 2015. Victory State Bank also has a $2 million unsecured credit facility with Atlantic Central Bankers Bank, which the Bank has not drawn upon. We do not anticipate a need for additional capital resources and do not expect to raise funds through a stock offering in the near future. We have sufficient resources to allow us to continue to make loans as appropriate opportunities arise without having to rely on government funds to support our lending activities.

Victory State Bank satisfied all capital ratio requirements of the Federal Deposit Insurance Corporation at December 31, 2015, with a Tier I Leverage Capital ratio of 8.86%, a Common Equity Tier I to Risk Weighted Assets ratio of 18.69%, a Tier I Capital to Risk-Weighted Assets ratio of 18.69%, and a Total Capital to Risk-Weighted Assets ratio of 19.55%.

VSB Bancorp, Inc. satisfied all capital ratio requirements of the Federal Reserve Bank of New York at December 31, 2015, with a Tier I Leverage Capital ratio of 9.05%, a Common Equity Tier I to Risk Weighted Assets ratio of 19.40%, a Tier I Capital to Risk-Weighted Assets ratio of 19.40%, and a Total Capital to Risk-Weighted Assets ratio of 20.27%.

Non-Performing Loans

The following is information about the four largest non-performing loans, totaling $1,254,445, or 67.6% of our non-performing loans, by outstanding book balance at December 31, 2015. Management believes it has taken appropriate steps with a view towards maximizing recovery and minimizing loss, if any, on these loans.

- $377,428 in a commercial real estate loan. The loan is secured by a first mortgage on property in Staten Island, NY and two second mortgages on other real estate collateral in Staten Island, NY. The loan is guaranteed personally by the principal of the borrower. The borrower signed a forbearance agreement in June

2015 and monthly payments due on the agreement are current.

- $364,431 in a commercial real estate loan. The loan is secured by a first mortgage on a property in Staten Island, NY and an assignment of a first mortgage loan receivable on an additional property Staten Island, NY. The loan is guaranteed by the principal of the borrower. The borrower sold the first property and we recovered our book balance in February 2016. We still maintain the assigned loan receivable first mortgage as collateral for the remaining monies due.
- $260,923 in a commercial real estate loan on property in Staten Island. The loan is secured by a first mortgage on the property. The loan is guaranteed personally by the borrower. The borrower sold the property and the loan was paid in full in March 2016.
- $251,663 in a commercial real estate loan. The loan is secured by a second mortgage on property in Staten Island, NY. The loan is guaranteed by the principal of the borrower. We are currently proceeding with a foreclosure action on the property.

From time to time, the Bank will enter into agreements with borrowers to modify the terms of their loans when we believe that a modification will maximize our recovery. In most cases, we do not agree to reduce the rate of interest or forgive the repayment of principal when we agree to the loan modification, and we did not do so in any of the modifications described above. Instead, we seek to modify terms on an interim basis to allow the borrower to reduce payments for a short duration and thus give the borrower an opportunity to get back on its feet. We prefer to develop repayment plans for our borrowers that provide them with cash flow relief while requiring that they ultimately pay all amounts that they owe. However, we are not averse to commencing legal action to foreclose on mortgages or obtain personal judgments against obligors when we perceive that as the appropriate strategy. Unfortunately, in recent years, many courts have taken a very pro-borrower stance in foreclosure actions, which has resulted in delays in our ability to realize upon real estate collateral.

Average Balance Sheet

The following table sets forth certain information relating to our consolidated statements of financial condition and the consolidated statements of earnings for the fiscal years ended December 31, 2015 and 2014 and reflects the average yield on assets and average cost of liabilities for the periods indicated. Such yields and costs are derived by dividing income or expense by the average balance of assets or liabilities, respectively, for the periods shown. Average balances are derived from average daily balances. The average balance of loans receivable include loans on which we have discontinued accruing interest. The yields and costs include net fees, which are considered adjustments to yields. No tax equivalent adjustments have been made.

	Year Ended December 31, 2015			Year Ended December 31, 2014		
	Average Balance	Interest[1]	Yield/ Cost	Average Balance	Interest[1]	Yield/ Cost
Assets:						
Interest-earning assets:						
Loans receivable	$ 93,318,086	$ 6,050,577	6.48 %	$ 70,227,592	$ 5,272,808	7.51 %
Other interest earning assets	19,029,119	49,715	0.26	42,148,338	94,533	0.22
Investment securities	179,098,490	3,563,017	2.02	171,299,542	3,602,109	2.10
Total interest-earning assets	291,445,695	9,663,309	3.32	283,675,472	8,969,450	3.16
Non-interest earning assets	12,375,469			9,821,257		
Total assets	$ 303,821,164			$ 293,496,729		
Liabilities and equity:						
Interest-bearing liabilities:						
Savings accounts	$ 24,542,209	90,172	0.37	$ 25,635,443	108,714	0.42
Time accounts	59,673,454	294,480	0.49	61,405,829	310,008	0.50
Money market accounts	49,461,680	321,200	0.65	41,839,822	237,779	0.57
Now accounts	31,777,724	50,574	0.16	30,713,318	49,733	0.16
Short term borrowings	230,137	770	0.33	-	-	-
Total interest-bearing liabilities	165,685,204	757,196	0.46	159,594,412	706,234	0.44
Checking accounts	107,986,717			104,406,480		
Escrow Deposits	250,112			91,792		
Total	273,922,033			264,092,684		
Other liabilities	1,166,559			1,180,728		
Total liabilities	275,088,592			265,273,412		
Equity	28,732,572			28,223,317		
Total liabilities and equity	$ 303,821,164			$ 293,496,729		
Net interest income/net interest rate spread		$ 8,906,113	2.86 %		$ 8,263,216	2.72 %
Net interest earning assets/net interest margin	$ 125,760,491		3.06 %	$ 124,081,060		2.91 %
Ratio of interest-earning assets to to interest-bearing liabilities	1.76 x			1.78 x		
Return On Average Equity:			5.68 %			4.51 %
Equity To Assets:			9.40 %			10.15 %
Dividend Payout Ratio			25.54 %			33.53 %

1 - Interest on loans includes $338,316 in 2015 and $625,774 in 2014 representing interest received during the year on non-accrual loans that is attributable to prior years. Those amounts were excluded in calculating the average loan yield for the year in which they were received but were not added to the prior period interest in calculating the yield in the prior period.

Market for Common Equity and Related Stockholder Matters.

Our common stock has been quoted on the OTC Marketplace under the symbol "VSBN" since December 23, 2013. Until February 6, 2015, it was quoted on the OTCQB tier of the OTC Marketplace. On February 9, 2015 our common stock began quoting on the OTCQX Banks, continuing under the symbol “VSBN”. Prior to December 23, 2013, we were listed on the NASDAQ Global Market under the same symbol.

The following table reflects the high and low sales prices for our common stock during each calendar quarter of the last two fiscal years.

	2015			
	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
High Price	$12.75	$12.75	$12.60	$14.25
Low Price	$11.65	$12.15	$12.15	$12.25

	2014			
	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
High Price	$11.00	$12.00	$11.68	$11.76
Low Price	$10.40	$10.92	$11.40	$11.41

We have approximately 131 stockholders of record. We paid our first cash dividend of $0.06 per common share on January 2, 2008 to stockholders of record on November 29, 2007, and we paid quarterly dividends of $0.06 per share with respect to each calendar quarter thereafter through the end of 2015.

INDEPENDENT AUDITOR'S REPORT

Board of Directors and Stockholders
VSB Bancorp, Inc.
Staten Island, New York

Report on the Financial Statements

We have audited the accompanying consolidated financial statements of VSB Bancorp, Inc. (the "Company"), which comprise the consolidated statements of financial condition as of December 31, 2015 and 2014, and the related consolidated statements of earnings, comprehensive income/(loss), 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 the Company as of December 31, 2015 and 2014, and the results of its operations and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

/s/Crowe Horwath LLP

Livingston, New Jersey
March 15, 2016

VSB BANCORP, INC.
CONSOLIDATED STATEMENTS OF FINANCIAL CONDITION
DECEMBER 31, 2015 AND 2014

ASSETS	**2015**	**2014**
Cash and cash equivalents	$ 14,845,096	$ 18,129,166
Investment securities, available for sale	58,096,583	64,759,836
Investment securities, held to maturity		
(fair value of $120,556,799 at 2015 and $122,358,472 at 2014)	120,585,784	121,929,954
Loans receivable (net of allowance for loan losses		
of $1,290,563 at 2015 and $958,966 at 2014, respectively)	103,051,107	66,473,809
Accrued interest receivable	743,375	668,631
Premises and equipment, net	1,528,914	1,839,292
Bank owned life insurance	5,194,945	5,068,719
Prepaid and other assets	2,361,325	2,169,514
Total assets	$ 306,407,129	$ 281,038,921
LIABILITIES AND STOCKHOLDERS' EQUITY		
LIABILITIES:		
Deposits		
Non-interest bearing	$ 101,716,331	$ 96,378,997
Interest bearing	174,587,932	154,998,132
Total deposits	276,304,263	251,377,129
Accounts payable, accrued expenses and other liabilities	1,303,575	1,147,302
Total liabilities	277,607,838	252,524,431
Commitments and contigent liabilities (Note 12)	-	-
STOCKHOLDERS' EQUITY		
Common stock ($.0001 par value, 10,000,000 shares authorized.		
2,078,509 issued, 1,799,398 outstanding at December 31, 2015		
and 1,856,845 outstanding at December 31, 2014)	208	208
Additional paid-in capital	10,512,041	10,487,210
Retained earnings	22,021,007	20,806,715
Treasury stock, at cost (279,111 shares at December 31, 2015		
and 221,664 shares at December 31, 2014)	(2,976,175)	(2,263,984)
Unearned Employee Stock Ownership Plan shares	(834,375)	(934,500)
Accumulated other comprehensive gains, net of taxes		
of $41,238 and $353,216, respectively	76,585	418,841
Total stockholders' equity	28,799,291	28,514,490
Total liabilities and stockholders' equity	$ 306,407,129	$ 281,038,921

See notes to consolidated financial statements.

VSB BANCORP, INC.
CONSOLIDATED STATEMENTS OF EARNINGS FOR THE YEARS ENDED DECEMBER 31, 2015 AND 2014

	2015	2014
INTEREST INCOME:		
Loans receivable	$ 6,050,577	$ 5,272,808
Investment securities	3,563,017	3,602,109
Other interest income	49,715	94,533
Total interest income	9,663,309	8,969,450
INTEREST EXPENSE:		
Deposits	757,196	706,234
Total interest expense	757,196	706,234
Net interest income	8,906,113	8,263,216
PROVISION FOR LOAN LOSSES	230,000	345,000
Net interest income after provision for loan losses	8,676,113	7,918,216
NON-INTEREST INCOME:		
Deposit service fees	2,224,935	2,319,738
Other income	603,014	359,607
Total non-interest income	2,827,949	2,679,345
NON-INTEREST EXPENSES:		
Salaries and employee benefits	4,210,949	3,893,558
Occupancy and equipment	1,383,643	1,370,506
Data processing service fees	376,973	354,806
Legal fees	225,933	330,028
Professional fees	403,486	389,622
Director fees	242,150	232,750
FDIC and NYSBD assessments	264,000	245,500
Supplies and service	297,861	290,270
Checkbook charges	180,298	173,658
Other	1,135,155	801,718
Total non-interest expenses	8,720,448	8,082,416
INCOME BEFORE INCOME TAXES	2,783,614	2,515,145
PROVISION/(BENEFIT) FOR INCOME TAXES:		
Current	863,000	1,043,017
Deferred	289,911	199,634
Total income taxes	1,152,911	1,242,651
NET INCOME	$ 1,630,703	$ 1,272,494
Earnings per share:		
Basic	$ 0.93	$ 0.72
Diluted	$ 0.93	$ 0.72
Comprehensive income	$ 1,288,447	$ 1,304,763

See notes to consolidated financial statements.

VSB BANCORP, INC.
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME/(LOSS)
DECEMBER 31, 2015 AND 2014

	2015	2014
Net Income	$ 1,630,703	$ 1,272,494
Other comprehensive income/(loss):		
Unrealized gains on securities, AFS:		
Change in unrealized gain (loss) on securties , AFS	(350,537)	294,626
Amortization on unrealized gains on HTM securities	(303,696)	(235,145)
Tax effects	(311,977)	27,212
Net of tax	(342,256)	32,269
Comprehensive income	$ 1,288,447	$ 1,304,763

See notes to consolidated financial statements.

VSB BANCORP, INC.
CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY FOR THE YEARS ENDED DECEMBER 31, 2015 AND 2014

	Number of Common Shares	Common Stock	Additional Paid-in Capital	Retained Earnings	Treasury Stock, at cost	Unearned ESOP Shares	Other Comprehensive Gain /(Loss)	Total Stockholders' Equity
Balance at January 1, 2014	1,780,109	$ 199	$ 9,364,950	$ 19,960,933	$ (2,123,546)	$ (56,360)	$ 386,572	$ 27,532,748
Purchase of newly issued common stock by ESOP	89,000	9	1,001,241			(1,001,250)		-
Stock-based compensation			130,194					130,194
Amortization of earned portion of ESOP common stock						123,110		123,110
Amortization of cost over fair value - ESOP			(9,175)					(9,175)
Cash dividends declared ($0.24 per share)				(426,712)				(426,712)
Purchase of treasury stock, at cost	(12,264)				(140,438)			(140,438)
Net income				1,272,494				1,272,494
Other comprehensive income	-	-	-	-	-	-	32,269	32,269
Balance at December 31, 2014	1,856,845	$ 208	$ 10,487,210	$ 20,806,715	$ (2,263,984)	$ (934,500)	$ 418,841	$ 28,514,490
Stock-based compensation			38,041					38,041
Amortization of earned portion of ESOP common stock						100,125		100,125
Amortization of cost over fair value - ESOP			17,915					17,915
Cash dividends declared ($0.24 per share)				(416,411)				(416,411)
Purchase of treasury stock, at cost	(59,947)				(743,316)			(743,316)
Contribution to RRP Trust from treasury shares	2,500		(31,125)		31,125			-
Net income				1,630,703				1,630,703
Other comprehensive loss	-	-	-	-	-	-	(342,256)	(342,256)
Balance at December 31, 2015	1,799,398	$ 208	$ 10,512,041	$ 22,021,007	$ (2,976,175)	$ (834,375)	$ 76,585	$ 28,799,291

See notes to consolidated financial statements.

VSB BANCORP, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS FOR THE YEARS ENDED DECEMBER 31, 2015 and 2014

	2015	2014
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income	$ 1,630,703	$ 1,272,494
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	503,253	488,153
Premium amortization, net of discount accretion	515,160	512,503
ESOP compensation expense	118,040	113,935
Stock-based compensation expense	38,041	130,194
Provision for loan losses	230,000	345,000
(Gain)/loss on sale of other real estate	(8,810)	-
Changes in operating assets and liabilities:		
Increase in cash surrender value of BOLI	(126,226)	(68,719)
(increase)/decrease in prepaid and other assets	(4,818)	131,749
Increase in accrued interest receivable	(74,744)	(129,539)
Decrease in deferred income taxes	289,911	432,607
Increase in accrued expenses, income tax payable and other liabilities	156,273	98,520
Net cash provided by operating activities	3,266,783	3,326,897
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchase of bank owned life insurance	-	(5,000,000)
Net change in loans receivable	(37,304,795)	4,856,673
Available-for-sale securities:		
Proceeds from repayments and calls of investment securities	17,542,180	8,860,480
Purchase of investment securities	(11,366,731)	(15,935,290)
Held-to-maturity securities:		
Proceeds from repayments and calls of investment securities	24,750,050	24,242,316
Purchase of investment securities	(24,124,899)	(49,705,028)
Proceeds from sale of other real estate	378,810	-
Purchases of premises and equipment, net	(192,875)	(334,918)
Net cash used in investing activities	(30,318,260)	(33,015,767)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Net increase/(decrease) in deposits	24,927,134	(17,177,449)
Cash dividends paid	(416,411)	(426,712)
Purchase of treasury stock, at cost	(743,316)	(140,438)
Net cash provided by/(used in) financing activities	23,767,407	(17,744,599)
NET DECREASE CASH AND CASH EQUIVALENTS	(3,284,070)	(47,433,469)
CASH AND CASH EQUIVALENTS, BEGINNING OF YEAR	18,129,166	65,562,635
CASH AND CASH EQUIVALENTS, END OF YEAR	$ 14,845,096	$ 18,129,166
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION:		
Cash paid during the period for:		
Interest	$ 742,054	$ 690,289
Income taxes	$ 767,809	$ 976,000
SUPPLEMENTAL NONCASH DISCLOSURE:		
Transfer from loans to real estate owned	$ 569,619	$ 370,000

See notes to consolidated financial statements.

VSB BANCORP, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEARS ENDED DECEMBER 31, 2015 and 2014

1. GENERAL

VSB Bancorp, Inc. (referred to using terms such as "we," "us," or the "Company") is the holding company for Victory State Bank (the "Bank"), a New York chartered commercial bank. Our primary business is owning all of the issued and outstanding stock of the Bank. Our common stock is listed on the OTCQX Best Market. We trade under the symbol "VSBN".

Through the Bank, the Company is primarily engaged in the business of commercial banking, and to a lesser extent retail banking. The Bank gathers deposits from individuals and businesses primarily in Staten Island, New York and makes loans throughout that community. Therefore, the Company's exposure to credit risk is significantly affected by changes in the local Staten Island economic and real estate markets. The Bank invests funds that are not used for lending primarily in government securities, mortgage backed securities and collateralized mortgage obligations. Customer deposits are insured, up to the applicable limit, by the Federal Deposit Insurance Corporation ("FDIC"). The Bank is supervised by the New York State Department of Financial Services ("NYDFS") and the FDIC.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The following is a description of the significant accounting and reporting policies followed in preparing and presenting the accompanying consolidated financial statements. These policies conform with accounting principles generally accepted in the United States of America ("GAAP").

Principles of Consolidation - The consolidated financial statements of the Company include the accounts of the Company, including its subsidiary Victory State Bank. All significant inter-company accounts and transactions between the Company and Bank have been eliminated in consolidation.

Subsequent Events - The Company has evaluated subsequent events for recognition and disclosure through March 15, 2016, which is the day the financial statements were available to be issued.

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 the disclosure of contingent assets and liabilities at the date of the financial statements and the amounts of revenues and expenses during the reporting period. Actual results can differ from those estimates.

***Reclassifications* –** Some items in the prior year financial statements were reclassified to conform to the current presentation.

Cash and Cash Equivalents – Cash and cash equivalents consist of cash on hand, due from banks and interest-bearing deposits. Interest-bearing deposits with original maturities of 90 days or less are included in this category. Customer loan and deposit transactions are reported on a net cash basis. Regulation D of the Board of Governors of the Federal Reserve System requires that Victory State Bank maintain interest-bearing deposits or cash on hand as reserves against its demand deposits. The amount of reserves which Victory State Bank is required to maintain depends upon its level of transaction accounts. During the fourteen day period from December 24, 2015 through January 6, 2016, Victory State Bank was required to maintain reserves, after deducting vault cash, of $4,908,000. Reserves are required to be maintained on a fourteen day basis, so, from time to time, Victory State Bank may use available cash reserves on a day to day basis, so long as the fourteen day average reserves satisfy Regulation D requirements. Victory State Bank is required to report transaction account levels to the Federal Reserve on a weekly basis.

Interest-bearing bank balances – Interest-bearing bank balances mature overnight and are carried at cost.

Investment Securities - Investment securities, available for sale, are to be held for an unspecified period of time and include securities that management intends to use as part of its asset/liability strategy. These securities may be sold in response to changes in interest rates, prepayments or other factors and are carried at estimated fair value. Gains or losses on the sale of such securities are determined by the specific identification method. Interest income includes amortization of purchase premium and accretion of purchase discount. Premiums and discounts are recognized in interest income using a method that approximates the level yield method without anticipating prepayments, except for mortgage-backed securities where prepayments are estimated. Unrealized holding gains or losses, net of deferred income taxes, are excluded from earnings and reported as other comprehensive income in a separate component of stockholders' equity until realized.

Investment securities, held to maturity are carried at amortized cost when management has the positive intent and ability to hold them to maturity. The Company invests in agency Collateralized Mortgage-Backed Obligations ("CMOs") with average lives primarily under 7 years and balloon Mortgage-Backed Securities with a final maturity of ten years or less. These securities are primarily issued by the Federal National Mortgage Association ("FNMA"), the Government National Mortgage Association ("GNMA") or the Federal Home Loan Mortgage Corporation ("FHLMC") and are primarily comprised of mortgage pools guaranteed by FNMA, GNMA or FHLMC.

For debt securities with other than temporary impairment (OTTI) that management does not intend to sell or expect to be required to sell, the amount of impairment is split into two components as follows: 1) OTTI related to credit loss, which must be recognized in the income statement and 2) OTTI related to other factors, which is recognized in other comprehensive income. The credit loss is defined as the difference between the present value of the cash flows expected to be collected and the amortized cost basis.

The Company invests primarily in agency collateralized mortgage-Backed obligations ("CMOs") with estimated average lives primarily under 7 Years and mortgage-backed securities. These securities are primarily issued by the Federal National Mortgage Association ("FNMA"), the Government National Mortgage Association ("GNMA") or the Federal Home Loan Mortgage Corporation ("FHLMC") and are primarily comprised of mortgage pools guaranteed by FNMA, GNMA or FHLMC. The Company also invests in whole loan CMOs, collateralized loan obligations ("CLO") and asset backed securities, all of which are AAA rated at the time of purchase, as well as corporate bonds, which are typically rated A or better at the time of purchase . These securities expose the Company to risks such as interest rate, prepayment and credit risk and thus pay a higher rate of return than comparable treasury issues.

Loans Receivable - Loans receivable, that management has the intent and ability to hold for the foreseeable future or until maturity or payoff, are stated at unpaid principal balances, adjusted for deferred net origination and commitment fees and the allowance for loan losses. Interest income on loans is credited as earned.

It is the policy of the Company to provide a valuation allowance for probable incurred losses on loans based on the Company's past loan loss experience, known and inherent risks in the portfolio, adverse situations which may affect the borrower's ability to repay, estimated value of underlying collateral and current economic conditions in the Company's lending area. The allowance is increased by provisions for loan losses charged to earnings and is reduced by charge-offs, net of recoveries. While management uses available information to estimate losses on loans, future additions to the allowance may be necessary based upon the expected growth of the loan portfolio and any changes in economic conditions beyond management's control. In addition, various regulatory agencies, as an integral part of their examination process, periodically review the Bank's allowance for loan losses. Such agencies may require the Bank to recognize additions to the allowance based on judgments different from those of management. Management believes, based upon all relevant and available information, that the allowance for loan losses is appropriate.

The allowance consists of specific and general components. The specific component relates to loans that are individually classified as impaired. The general component covers non-impaired loans and is based for all portfolio segments on historical loss experience adjusted for current factors. The historical loss experience is determined by portfolio segment and is based on the actual loss history experienced by the Company. This actual loss experience is supplemented with other economic factors based on the risks present for each portfolio segment. These economic factors include consideration of the following: levels of and trends in delinquencies and impaired loans; levels of and trends in charge-offs and recoveries; trends in volume and terms of loans; effects of any changes in risk selection and underwriting standards; other changes in lending policies, procedures, and practices; experience, ability, and depth of lending management and other relevant staff; national and local economic trends and conditions; industry conditions; and effects of changes in credit concentrations.

The Company has a policy that all loans 90 days past due are placed on non-accrual status. It is the Company's policy to cease the accrual of interest on loans to borrowers past due less than 90 days where a probable loss is estimated and to reverse out of income all interest that is due but has not been paid. Past due status is based on the contractual terms of the loan. The Company applies payments received on non-accrual loans to the outstanding principal balance due before applying any amount to interest, until the loan is restored to an accruing status. On a limited basis, the Company may apply a payment to interest on a non-accrual loan if there is no impairment or no estimated loss on these assets. The Company continues to accrue interest on construction loans that are 90 days past contractual maturity date if the loan is expected to be paid in full in the next 60 days and all interest is paid up to date.

Loans are returned to accrual status when all the principal and interest amounts contractually due are brought current, there has been a history of prompt payments and future payments are reasonably assured.

Loan origination fees and certain direct loan origination costs are deferred and the net amount recognized over the contractual loan terms using the level-yield method, adjusted for periodic prepayments in certain circumstances.

The Company considers a loan to be impaired when, when full payment under the loan terms is not expected. Commercial and commercial real estate loans are individually evaluated for impairment. Loans that experience insignificant payment delays and payment shortfalls generally are not classified as impaired. Impairment is measured on a loan by loan basis for commercial and construction loans. Impaired loans are measured based on the present value of expected future cash flows discounted at the loan's effective interest rate or, as a practical expedient, at the loan's observable market price or the fair value of the collateral. The fair value of the collateral, as reduced by costs to sell, is utilized if a loan is collateral dependent. The fair value of the collateral is estimated by obtaining a new appraisal, if the loan amount exceeds $100,000, or by adjusting the most recent appraisal to reflect the current market if the loan is less than $100,000 or a more recent appraisal has yet to be received. Loans with modified terms that the Company would not normally consider, and for which the borrower is experiencing financial difficulties, are considered troubled debt restructurings and classified as impaired. Large groups of homogeneous loans are collectively evaluated for impairment.

Long-Lived Assets - The Company periodically evaluates the recoverability of long-lived assets, such as premises and equipment, to ensure the carrying value has not been impaired. In performing the review for recoverability, the Company would estimate the future cash flows expected to result from the use of the asset. If the sum of the expected future cash flows is less than the carrying amount, an impairment will be recognized. The Company reports these assets at the lower of the carrying value or fair value.

Premises and Equipment - Premises, leasehold improvements, and furniture and equipment are stated at cost less accumulated depreciation and amortization. Depreciation and amortization are accumulated by the straight-line method over the estimated useful lives of the respective assets, which range from three to fifteen years. Leasehold improvements are amortized at the lesser of their useful life or the term of the lease.

Federal Home Loan Bank (FHLB) Stock - The Bank is a member of the FHLB system. Members are required to own a certain amount of stock based on the level of borrowings and other factors, and may invest in additional amounts. FHLB stock is carried at cost, classified as a restricted security, and periodically evaluated for impairment. Because this stock is viewed as a long term investment, impairment is based on ultimate recovery of par value, which is the price the Bank pays for the FHLB Stock. Both cash and stock dividends are reported as income.

Bank-Owned Life Insurance - The Company has purchased life insurance policies on certain employees. These bank-owned life insurance policies ("BOLI") policies are recorded in the Consolidated Statements of Condition at their cash surrender value. Income from these policies and changes in the cash surrender value are recorded in "Non-interest income" in the Consolidated Statements of Earnings. The Company's investment in BOLI was $5,194,945 at December 31, 2015 and $5,068,719 at December 31, 2014. The company's initial purchase of BOLI was recorded on July 1, 2014. The Company's investment in BOLI generated income of $126,226 and $68,719 during the years ended December 31, 2015 and 2014.

Income Taxes - The Company utilizes the liability method to account for income taxes. Under this method, deferred tax assets and liabilities are determined on differences between financial reporting and the tax bases of assets and liabilities and are measured using the enacted tax rates and laws expected to be in effect when the differences are expected to reverse. As changes in tax laws or rates are enacted, deferred tax assets and liabilities are adjusted through the provision for income taxes. As such, a tax position is recognized as a benefit only if it is "more likely than not" that the tax position would be sustained in a tax examination, with a tax examination being presumed to occur. The amount recognized is the largest amount of tax benefit that is greater than 50% likely of being realized on examination. For tax positions not meeting the "more likely than not" test, no tax benefit is recorded.

The Company recognizes interest and/or penalties related to income tax matters in income tax expense.

Financial Instruments - In the ordinary course of business, the Company has entered into off-balance sheet financial instruments, primarily consisting of commitments to extend credit. The face amount for these items represents the exposure to loss, before considering customer collateral or ability to repay. Such financial instruments are recorded when they are funded.

Basic and Diluted Net Income Per Common Share - The Company has stock compensation awards with non-forfeitable dividend rights which are considered participating securities. As such, earnings per share is computed using the two-class method. Basic earnings per common share is computed by dividing net income allocated to common stock by the weighted average number of common shares outstanding during the period which excludes the participating securities. Diluted earnings per common share includes the dilutive effect of additional potential common shares from stock-based compensation plans, but excludes awards considered participating securities. Earnings and dividends per share are restated for all stock splits and stock dividends through the date of issuance of the financial statements.

Basic net income per share of common stock is based on 1,742,271 shares and 1,763,574 shares, the weighted average number of common shares outstanding for the years ended December 31, 2015 and 2014, respectively. Diluted net income per share of common stock is based on 1,747,339 and 1,763,805, the weighted average number of common shares outstanding plus potentially dilutive common shares for the years ended December 31, 2015 and 2014, respectively. The weighted average number of potentially dilutive common shares excluded in calculating diluted net income per common share due to the anti-dilutive effect is 0 and 1,293 shares for the years ended December 31, 2015 and 2014, respectively. Common stock equivalents were calculated using the treasury stock method.

The reconciliation of the numerators and the denominators of the basic and diluted per share computations for the years ended December 31, are as follows:

Reconciliation of EPS	Year ended December 31, 2015	Year ended December 31, 2014
Basic		
Distributed earnings allocated to common stock	$ 418,145	$ 423,258
Undistributed earnings allocated to common sock	1,209,988	840,364
Net earnings allocated to common stock	$ 1,628,133	$ 1,263,622
Weighted common shares outstanding including participating securities	1,745,021	1,775,957
Less: Participating securities	(2,750)	(12,383)
Weighted average shares	1,742,271	1,763,574
Basic EPS	$ 0.93	$ 0.72
Diluted		
Net earnings allocated to common stock	$ 1,628,133	$ 1,263,622
Weighted average shares for basic	1,742,271	1,763,574
Dilutive effects of:		
Stock Options	5,068	231
Unvested shares not considered particpating securtities	-	-
	1,747,339	1,763,805
Diluted EPS	$ 0.93	$ 0.72

Net earnings allocated to common stock for the period are distributed earnings during the period, such as dividends on common shares outstanding, plus a proportional amount of retained income for the period based on restricted shares granted but unvested compared to the total common shares outstanding.

Stock Based Compensation - The Company records compensation expense for stock options provided to employees in return for employment service. The cost is measured at the fair value of the options when granted, and this cost is expensed over the employment service period, which is normally the vesting period of the options.

Employee Stock Ownership Plan ("ESOP") - The cost of shares issued to the ESOP, but not yet allocated to participants, is shown as a reduction of stockholders' equity. Compensation expense is based on the market price of shares as they are committed to be released to participant accounts. Cash dividends on allocated ESOP shares reduce retained earnings; cash dividends on unearned ESOP shares reduce debt and accrued interest.

Stock Repurchase Programs – On September 8, 2008, the Company announced that its Board of Directors had authorized a Rule 10b5-1 stock repurchase program for the repurchase of up to 100,000 shares of the Company's common stock. On April 21, 2009, the Company announced that its Board of Directors had authorized a second Rule 10b5-1 stock repurchase program for the repurchase of up to an additional 100,000 shares of the Company's common stock. On September 14, 2011, the Company announced that its Board of Directors had authorized a third Rule 10b5-1 stock repurchase program for the repurchase of up to an additional 100,000 shares of the Company's common stock. On June 11, 2015, the Company announced that its Board of Directors had authorized a fourth Rule 10b5-1 stock repurchase program for the repurchase of up to an additional 100,000 shares of the Company's common stock. At December 31, 2015, the Company had repurchased a total of 330,111 shares of its common stock under the stock repurchase programs. Stock repurchases under the programs have been accounted for using the cost method, in which the Company will reflect the entire cost of repurchased shares as a separate reduction of stockholders' equity on its balance sheet.

***Retention and Recognition Plan* –**The stockholders of VSB Bancorp, Inc. approved the adoption of the 2010 Retention and Recognition Plan (the "RRP"). The RRP authorizes the award of up to 50,000 shares of its common stock to directors, officers and employees. In conjunction with the approval the RRP, stockholders approved the award of 4,000 shares of stock to each of its eight directors who had at least five years of service. The director awards will vest over five years, with 20% vesting annually for each of the first five years after the award is made, subject to acceleration and forfeiture. The recipient of an award will not be required to make any payment to receive the award or the stock covered by the award. The Company recognizes compensation expense for the shares awarded under the RRP gradually as the shares vest, based upon the market price of the shares on the date of the award.

Comprehensive Income - Comprehensive income consists of net income and other comprehensive income. Other comprehensive income includes unrealized gains and losses, net of taxes, on our securities' portfolios which are also recognized as separate components of equity.

Recently-Adopted Accounting Standards – In May 2014, the FASB issued an update (ASU No. 2014-09, Revenue from Contracts with Customers) creating FASB Topic 606, Revenue from Contracts with Customers. The guidance in this update 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 (for example, insurance contracts or lease contracts). The core principle 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 guidance provides steps to follow to achieve the core principle. An entity should disclose sufficient information to enable users of financial statements to understand the nature, amount, timing and uncertainty of revenue and cash flows arising from contracts with customers. Qualitative and quantitative information is required about contracts with customers, significant judgments and changes in judgments, and assets recognized from the costs to obtain or fulfill a contract. The amendments in this update become effective for annual periods and interim periods within those annual periods beginning after December 15, 2017. We are currently evaluating the impact of adopting the new guidance on the consolidated financial statements.

3. INVESTMENT SECURITIES

The following table summarizes the amortized cost and fair value of securities available-for-sale and securities held-to-maturity at December 31, 2015 and December 31, 2014 and the corresponding amounts of unrealized and unrecognized gains and losses herein:

	December 31, 2015			
	Amortized Cost	Unrealized Gains	Unrealized Losses	Fair Value
Available-for-Sale				
FNMA MBS - Residential	$ 495,976	$ 23,921	$ -	$ 519,897
Whole Loan MBS - Residential	6,965	57	-	7,022
Collateralized mortgage obligations	38,098,802	174,676	(296,851)	37,976,627
Collateralized loan obligations	7,750,000	-	-	7,750,000
Corporate bonds	9,540,729	-	(136,133)	9,404,596
Other debt securities	2,468,443	-	(30,002)	2,438,441
Total Available-for-Sale	$ 58,360,915	$ 198,654	$ (462,986)	$ 58,096,583

	December 31, 2015			
	Amortized Cost	Gross Unrecognized Gains	Gross Unrecognized Losses	Fair Value
Held-to-Maturity				
FNMA MBS - Residential	$ 62,248,104	$ 417,691	$ (201,594)	$ 62,464,201
GNMA MBS - Residential	2,153,420	23,274	(5,262)	2,171,432
FHLMC MBS - Residential	2,898,355	-	(32,863)	2,865,492
Collateralized mortgage obligations	36,751,713	143,130	(355,741)	36,539,102
Corporate Notes	16,534,192	15,556	(33,176)	16,516,572
Total Held-to-Maturity	$ 120,585,784	$ 599,651	$ (628,636)	$ 120,556,799

	December 31, 2014			
	Amortized Cost	Unrealized Gains	Unrealized Losses	Fair Value
Available-for-Sale				
FNMA MBS - Residential	$ 715,935	$ 43,661	$ -	$ 759,596
Whole Loan MBS - Residential	13,819	157	-	13,976
Collateralized mortgage obligations	40,460,707	242,000	(198,818)	40,503,889
Collateralized loan obligations	9,000,000	31,250	-	9,031,250
Corporate bonds	11,552,618	42,865	(104,408)	11,491,075
Other debt securities	2,930,552	29,498	-	2,960,050
Total Available-for-Sale	$ 64,673,631	$ 389,431	$ (303,226)	$ 64,759,836

	December 31, 2014			
	Amortized Cost	Gross Unrecognized Gains	Gross Unrecognized Losses	Fair Value
Held-to-Maturity				
Government Agencies	$ 2,958,883	$ 24,029	$ -	$ 2,982,912
FNMA MBS - Residential	62,417,857	601,697	(128,341)	62,891,213
GNMA MBS - Residential	2,854,052	46,149	-	2,900,201
FHLMC MBS - Residential	3,649,785	-	(6,670)	3,643,115
Collateralized mortgage obligations	36,006,291	239,847	(327,451)	35,918,687
Corporate Notes	14,043,086	16,219	(36,961)	14,022,344
Total Held-to-Maturity	$ 121,929,954	$ 927,941	$ (499,423)	$ 122,358,472

There were no sales of investment securities for the years ended December 31, 2015 and 2014.

The amortized cost and fair value of the investment securities portfolio are shown by expected maturity. Expected maturities may differ from contractual maturities, especially for collateralized mortgage obligations, if borrowers have the right to call or prepay obligations with or without call or prepayment penalties.

	December 31, 2015	
Available-for-Sale	Amortized Cost	Fair Value
Less than one year	$ -	$ -
Due after one year through five years	5,608,506	5,548,530
Due after five years through ten years	14,808,352	14,717,598
Due after ten years	37,944,057	37,830,455
Available-for-Sale	$ 58,360,915	$ 58,096,583

	December 31, 2015	
Held-to-maturity	Amortized Cost	Fair Value
Less than one year	$ -	$ -
Due after one year through five years	48,999,114	49,211,396
Due after five years through ten years	19,792,770	19,786,188
Due after ten years	51,793,900	51,559,215
Held-to-maturity	$ 120,585,784	$ 120,556,799

The following table summarizes the investment securities with unrealized losses at December 31, 2015 and December 31, 2014 by aggregated major security type and length of time in a continuous unrealized loss position:

December 31, 2015	Less than 12 months		More than 12 months		Total	
Available-for-Sale	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss
Collateralized mortgage obligations	$ 19,364,091	$ (228,601)	$ 4,354,916	$ (68,250)	$ 23,719,007	$ (296,851)
Corporate bonds	4,427,391	(72,609)	4,977,205	(63,524)	9,404,596	(136,133)
Other debt securities	2,438,441	(30,002)	-	-	2,438,441	(30,002)
Available-for-Sale	$ 26,229,923	$ (331,212)	$ 9,332,121	$ (131,774)	$ 35,562,044	$ (462,986)

December 31, 2015	Less than 12 months		More than 12 months		Total	
Held-to-Maturity	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss
FNMA MBS	$ 20,372,629	$ (162,944)	$ 9,431,101	$ (38,650)	$ 29,803,730	$ (201,594)
GNMA MBS	1,071,225	(5,262)	-	-	1,071,225	(5,262)
FHLMC MBS	2,865,492	(32,863)	-	-	2,865,492	(32,863)
Collateralized mortgage obligations	22,872,369	(267,437)	5,800,558	(88,304)	28,672,927	(355,741)
Corporate notes	8,991,382	(33,176)	-	-	8,991,382	(33,176)
Held-to-Maturity	$ 56,173,097	$ (501,682)	$ 15,231,659	$ (126,954)	$ 71,404,756	$ (628,636)

December 31, 2014	Less than 12 months		More than 12 months		Total	
Available-for-Sale	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss
Collateralized mortgage obligations	$ 14,857,570	$ (79,141)	$ 8,320,877	$ (119,677)	$ 23,178,447	$ (198,818)
Corporate bonds	1,980,610	(19,390)	4,963,848	(85,018)	6,944,458	(104,408)
Available-for-Sale	$ 16,838,180	$ (98,531)	$ 13,284,725	$ (204,695)	$ 30,122,905	$ (303,226)

December 31, 2014	Less than 12 months		More than 12 months		Total	
Held-to-Maturity	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss
FNMA MBS	$ 7,891,607	$ (13,957)	$ 13,234,214	$ (114,384)	$ 21,125,821	$ (128,341)
FHLMC MBS	3,643,115	(6,670)	-	-	3,643,115	(6,670)
Collateralized mortgage obligations	8,782,017	(31,892)	12,998,703	(295,559)	21,780,720	(327,451)
Corporate notes	5,982,892	(36,961)	-	-	5,982,892	(36,961)
Held-to-Maturity	$ 26,299,631	$ (89,480)	$ 26,232,917	$ (409,943)	$ 52,532,548	$ (499,423)

The Company evaluates securities for other-than-temporary impairment at least on a quarterly basis, and more frequently when economic or market concerns warrant such evaluation. Consideration is given to the length of time and the extent to which the fair value has been less than cost, the financial condition and near-term prospects of the issuer, and the intent and ability of the Company to retain its investment in the issuer for a period of time sufficient to allow for any anticipated recovery in fair value. In analyzing an issuer's financial condition, the Company may consider whether the securities are issued by the federal government or its agencies, whether downgrades by bond rating agencies have occurred, and the results of reviews of the issuer's financial condition.

At December 31, 2015, the unrealized loss on investment securities was caused by a rise in intermediate and long term market interest rates generally. We expect that these securities, at maturity, will be settled for at least the amortized cost of the investment. Because the decline in fair value is attributable to changes in interest rates and not credit quality, and because the Company does not intend to sell the securities and it is not more likely than not that the Company will be required to sell the securities before recovery of the amortized cost basis less any current-period loss, these investments are not considered other-than-temporarily impaired. At December 31, 2015, there were no debt securities with unrealized losses with aggregate depreciation of 5% or more from the Company's amortized cost basis.

Securities pledged had a fair value of $58,333,161 and $55,606,346 at December 31, 2015 and 2014, respectively and were pledged to secure public deposits and balances in excess of the deposit insurance limit on certain customer accounts.

During the second quarter of 2013, $74,540,643 of securities was transferred from the available for sale portfolio to the held to maturity portfolio. These securities were transferred at fair value with the unrealized gain/loss remaining in accumulated other comprehensive income to be accreted or amortized through other comprehensive income over the remaining life of the securities. As of December 31, 2015 and 2014, the unrealized gain on the transferred securities were $ 382,155 and $685,851, respectively.

4. LOANS RECEIVABLE, NET

Loans receivable, net at December 31, 2015 and 2014 are summarized as follows:

	2015	2014
Commercial loans (principally variable rate):		
Secured	$ 2,634,087	$ 2,208,293
Unsecured	15,880,900	15,913,165
Total commercial loans	18,514,987	18,121,458
Real estate loans:		
Commercial	71,431,876	42,797,249
Residential	2,333,807	2,606,346
Total real estate loans	73,765,683	45,403,595
Construction loans (net of undisbursed funds of $6,981,500 and $2,602,500, respectively)	11,007,000	2,047,500
Consumer loans	814,701	870,937
Other loans	455,902	1,168,366
	1,270,603	2,039,303
Total loans receivable	104,558,273	67,611,856
Less:		
Unearned loans fees, net	(216,603)	(179,081)
Allowance for loan losses	(1,290,563)	(958,966)
Total	$ 103,051,107	$ 66,473,809

Lending Risk

The principal business of the Bank is lending, primarily in commercial real estate mortgage loans and commercial and industrial loans. The Bank considers its primary lending area to be Staten Island, New York, and a substantial portion of the Bank's loans are secured by real estate in this area. Accordingly, the ultimate collectability of such a loan portfolio is susceptible to changes in market and economic conditions in this region.

Commercial Real Estate

Loans in this classification include income producing investment properties and owner occupied real estate used for business purposes. The underlying properties are generally located largely in our primary market area. The cash flows of the income producing investment properties are adversely impacted by a downturn in the economy as evidenced by increased vacancy rates, which in turn, will have an effect on credit quality. Generally, management seeks to obtain annual financial information for borrowers in this category. In the case of owner-occupied real estate used for business purposes, a weakened economy and resultant decreased consumer and/or business spending will have an adverse effect on credit quality.

Construction

Loans in this classification include investment properties and owner occupied real estate that are being developed for business and residential purposes. The underlying properties are generally located largely in Bank's primary market area. Repayment on construction loans is expected to come from the sale of the underlying collateral, or from permanent financing once the property is stabilized. The sales of the underlying properties, and the ability to rent the completed buildings, could be adversely impacted by a downturn in the economy as evidenced by lack of qualified borrowers, tightening of credit terms and increased vacancy rates, which in turn, will have an effect on credit quality. Generally, management seeks to obtain annual financial information for borrowers in this category. In the case of owner-occupied real estate used for business purposes, a weakened economy and resultant decreased consumer and/or business spending could have an adverse effect on credit quality.

Commercial & Industrial

Loans in this classification are made to businesses. Generally these loans are unsecured and repayment is expected from the cash flows of the business. A weakened economy, and resultant decreased consumer and/or business spending will have an effect on the credit quality in this loan class.

Nonaccrual loans outstanding at December 31, 2015 and 2014 are summarized as follows:

	2015	2014
Nonaccrual loans:		
Commercial real estate	$ 1,815,236	$ 4,600,516
Commercial unsecured	20,044	30,436
Consumer	12,438	-
Other Loans	9,241	513
Total nonaccrual loans	$ 1,856,959	$ 4,631,465

	2015	2014
Interest income that would have been recorded during the period on nonaccrual loans outstanding in accordance with original terms	$133,928	$276,249

At December 31, 2015 and 2014, there were no loans 90 days past due and still accruing interest.

The following table presents the aging of the past due loan balances as of December 31, 2015 and 2014 by class of loans:

December 31, 2015	Total	30-59 Days Past Due	60-89 Days Past Due	Greater than 90 Days Past Due	Total Past Due	Loans Not Past Due
Commercial loans:						
Unsecured	$15,880,900	$ 44,992	$ -	$ 20,044	$ 65,036	$15,815,864
Secured	2,634,087	-	-	-	-	2,634,087
Real Estate loans						
Commercial	71,431,876	63,238	878,742	1,815,236	2,757,216	68,674,660
Residential	2,333,807	308,945	-	-	308,945	2,024,862
Construction loans	11,007,000	-	-	-	-	11,007,000
Consumer loans	814,701	-	-	12,438	12,438	802,263
Other loans	455,902	-	-	9,241	9,241	446,661
Total loans	$104,558,273	$417,175	$878,742	$1,856,959	$3,152,876	$101,405,397

December 31, 2014	Total	30-59 Days Past Due	60-89 Days Past Due	Greater than 90 Days Past Due	Total Past Due	Loans Not Past Due
Commercial loans:						
Unsecured	$15,913,165	$ 199,470	$ -	$ 30,436	$ 229,906	$15,683,259
Secured	2,208,293	-	-	-	-	2,208,293
Real Estate loans						
Commercial	42,797,249	401,932	430,247	4,600,516	5,432,695	37,364,554
Residential	2,606,346	91,758	285,000	-	376,758	2,229,588
Construction loans	2,047,500	-	-	-	-	2,047,500
Consumer loans	870,937	-	-	-	-	870,937
Other loans	1,168,366	-	-	513	513	1,167,853
Total loans	$67,611,856	$693,160	$715,247	$4,631,465	$6,039,872	$61,571,984

Nonaccrual loans include smaller balance homogeneous loans that are collectively evaluated for impairment and individually classified impaired loans.

Loans individually evaluated for impairment were as follows:

	December 31, 2015	**December 31, 2014**
Loans with no allocated allowance for loan losses:		
Commercial real estate	$ 1,815,236	$ 4,330,838
Loans with allocated allowance for loan losses:		
Commercial real estate	-	85,771
Commercial unsecured	20,044	30,435
Consumer	12,438	-
Other loans	9,241	513
	$ 1,856,959	$ 4,447,557

Amount of the allowance for loan losses allocated:		
Commercial real estate	$ -	$ 42,371
Commercial unsecured	4,009	6,087
Consumer	2,488	-
Other loans	1,848	103
	$ 8,345	$ 48,561

The following table sets forth certain information about impaired loans with a measured impairment:

	Year Ended December 31, 2015	Year Ended December 31, 2014
Average of individually impaired loans during period:		
Commercial real estate	$ 2,922,492	$ 3,543,111
Residential real estate	166,250	-
Construction	-	100,000
Commercial secured	-	35,105
Commercial unsecured	68,298	171,143
Consumer	1,453	-
Other loans	1,324	2,844
	$ 3,159,817	$ 3,852,203
Interest income recognized during time period that loans were impaired, either using accrual or cash-basis method of accounting	$ 12,038	$ -

Troubled Debt Restructurings:

The Company has allocated $0 and $42,371 of specific reserves to customers whose loan terms have been modified in troubled debt restructurings ("TDRs") as of December 31, 2015 and 2014, respectively. The Company has not committed to lend any additional amounts to customers with outstanding loans that are classified as TDRs.

The outstanding principal balance of trouble debt restructurings at December 31, 2015 was $2,927,401 and at December 31, 2014 was $4,310,374. None of the loans currently classified as TDRs have defaulted during this period. These TDRs are all current and are paying under the modified arrangements.

There were no loans that were modified during the year ended December 31, 2015 that did not meet the definition of a TDR and there was one loan that was modified during the year ended December 31, 2014 that did not meet the definition of a TDR. Modification of loans that do not meet the definition of a TDR involve either a modification of the terms of a loan to borrowers who were not experiencing financial difficulties or a delay in a payment that was considered to be insignificant.

In order to determine whether a borrower is experiencing financial difficulty, an evaluation is performed of the probability that the borrower will be in payment default on any of its debt in the foreseeable future without the modification.

There were no loans modified as trouble debt restructurings that occurred during the years ended December 31, 2015 and 2014.

Credit Quality Indicators:

The Company categorizes loans into risk categories based on relevant information about the ability of borrowers to service their debts such as: current financial information, historical payment experience, credit documentation, public information, and current economic trends, among other factors. The Company analyzes loans individually by classifying the loans as to credit risk. This analysis is performed on a quarterly basis. The Company uses the following definitions for risk ratings:

Special Mention. Loans categorized as special mention have a potential weakness that deserves management's close attention. If left uncorrected, these potential weaknesses may result in deterioration of the repayment prospects for the loan or of the institution's credit position as some future date.

Substandard. Loans classified as substandard are inadequately protected by the current net worth and paying capacity of the obligor or of the collateral pledged, if any. Loans so classified have a well-defined weakness or weaknesses that jeopardize the liquidation of the debt. They are characterized by the distinct possibility that the institution will sustain some loss if the deficiencies are not corrected.

Doubtful. Loans classified as doubtful have all the weaknesses inherent in those classified as substandard, with the added characteristics that the weaknesses make collection or liquidation in full, on the basis of currently existing facts, conditions and values, highly questionable and improbable.

The following table sets forth at December 31, 2015 and 2014, the aggregate carrying value of our assets categorized as Special Mention, Substandard and Doubtful according to asset type:

	At December 31, 2015				
	Special Mention	Substandard	Doubtful	Not Classified	Total
Commercial Loans:					
Secured	$ -	$ 90,505	$ -	$ 2,543,582	$ 2,634,087
Unsecured	398,987	98,044	-	15,383,869	15,880,900
Commercial Real Estate	2,277,037	5,470,445	-	63,684,394	71,431,876
Residential Real Estate	-	2,024,861	-	308,946	2,333,807
Construction	2,275,000	-	-	8,732,000	11,007,000
Consumer	2,842	12,438	-	799,421	814,701
Other	-	9,241	-	446,661	455,902
Total loans	$ 4,953,866	$ 7,705,534	$ -	$ 91,898,873	$ 104,558,273
Real estate owned	-	569,619	-	-	569,619
Total assets	$ 4,953,866	$ 8,275,153	$ -	$ 91,898,873	$ 105,127,892

	At December 31, 2014				
	Special Mention	Substandard	Doubtful	Not Classified	Total
Commercial Loans:					
Secured	$ -	$ 90,505	$ -	$ 2,117,788	$ 2,208,293
Unsecured	117,703	562,521	-	15,232,941	15,913,165
Commercial Real Estate	3,944,122	6,384,385	-	32,468,742	42,797,249
Residential Real Estate	285,000	2,079,588	-	241,758	2,606,346
Construction	400,000	-	-	1,647,500	2,047,500
Consumer	5,944	-	-	864,993	870,937
Other	-	513	-	1,167,853	1,168,366
Total loans	$ 4,752,769	$ 9,117,512	$ -	$ 53,741,575	$ 67,611,856
Real estate owned	-	370,000	-	-	370,000
Total assets	$ 4,752,769	$ 9,487,512	$ -	$ 53,741,575	$ 67,981,856

The following table presents the balance in the allowance for loan losses and the recorded balance in loans, by portfolio segment, and based on impairment method as of December 31, 2015 and 2014:

December 31, 2015

	Commercial Unsecured	Commercial Secured	Construction	Commerical Real Estate	Residential Real Estate	Other Loans	Total
Allowance for loan losses:							
Ending allowance balance attributable to loans							
Individually evaluated for impairment	$ 4,009	$ -	$ -	$ -	$ -	$ 4,336	$ 8,345
Collectively evaluated for impairment	393,610	26,779	114,359	679,172	41,415	26,883	1,282,218
Total ending allowance balance	$ 397,619	$ 26,779	$ 114,359	$ 679,172	$ 41,415	$ 31,219	$ 1,290,563
Loans:							
Individually evaluated for impairment	$ 20,044	$ -	$ -	$ 1,815,236	$ -	$ 21,679	$ 1,856,959
Collectively evaluated for impairment	15,860,856	2,634,087	11,007,000	69,616,640	2,333,807	1,248,924	102,701,314
Total ending loans balance	$ 15,880,900	$ 2,634,087	$ 11,007,000	$ 71,431,876	$ 2,333,807	$ 1,270,603	$ 104,558,273

December 31, 2014

	Commercial Unsecured	Commercial Secured	Construction	Commerical Real Estate	Residential Real Estate	Other Loans	Total
Allowance for loan losses:							
Ending allowance balance attributable to loans							
Individually evaluated for impairment	$ 6,087	$ -	$ -	$ 42,371	$ -	$ 103	$ 48,561
Collectively evaluated for impairment	412,421	21,821	20,789	366,672	44,551	44,151	910,405
Total ending allowance balance	$ 418,508	$ 21,821	$ 20,789	$ 409,043	$ 44,551	$ 44,254	$ 958,966
Loans:							
Individually evaluated for impairment	$ 30,435	$ -	$ -	$ 4,416,609	$ -	$ 513	$ 4,447,557
Collectively evaluated for impairment	15,882,730	2,208,293	2,047,500	38,380,640	2,606,346	2,038,790	63,164,299
Total ending loans balance	$ 15,913,165	$ 2,208,293	$ 2,047,500	$ 42,797,249	$ 2,606,346	$ 2,039,303	$ 67,611,856

The following table presents the activity in the allowance for loan losses by portfolio segment for the years ended December 31, 2015 and 2014.

Year ended December 31, 2015

	Commercial Unsecured	Commercial Secured	Construction	Commerical Real Estate	Residential Real Estate	Other Loans	Total
Allowance for loan losses:							
Beginning balance	$ 418,508	$ 21,821	$ 20,789	$ 409,043	$ 44,551	$ 44,254	$ 958,966
Provision for loan losses	(49,936)	4,958	93,570	259,329	(3,136)	(74,785)	230,000
Loans charged-off	-	-	-	-	-	(3,325)	(3,325)
Recoveries	29,047	-	-	10,800	-	65,075	104,922
Total ending allowance balance	$ 397,619	$ 26,779	$ 114,359	$ 679,172	$ 41,415	$ 31,219	$ 1,290,563

Year ended December 31, 2014

	Commercial Unsecured	Commercial Secured	Construction	Commerical Real Estate	Residential Real Estate	Other Loans	Total
Allowance for loan losses:							
Beginning balance	$ 445,716	$ 12,985	$ 22,804	$ 567,834	$ 2,088	$ 42,361	$ 1,093,788
Provision for loan losses	300,908	8,836	(2,015)	(2,935)	39,732	474	345,000
Loans charged-off	(457,160)	-	-	(166,656)	-	-	(623,816)
Recoveries	129,044	-	-	10,800	2,731	1,419	143,994
Total ending allowance balance	$ 418,508	$ 21,821	$ 20,789	$ 409,043	$ 44,551	$ 44,254	$ 958,966

5. ACCRUED INTEREST RECEIVABLE

Accrued interest receivable at December 31, 2015 and 2014 are summarized as follows:

	2015	2014
Due from banks	$ 1,614	$ 915
Loans receivable	329,187	226,653
Investment securities	412,574	441,063
Total	$ 743,375	$ 668,631

6. PREMISES AND EQUIPMENT

Premises and equipment at December 31, 2015 and 2014 are summarized as follows:

	2015	2014
Leasehold improvements	$ 2,816,450	$ 2,772,339
Computer equipment and software	379,170	428,672
Furniture, fixtures and equipment	462,955	598,216
Other	59,130	59,130
	3,717,705	3,858,357
Less accumulated depreciation and amortization	(2,188,791)	(2,019,065)
Total	$ 1,528,914	$ 1,839,292

Depreciation and amortization expense amounted to $503,253 and $488,153 for the years ended December 31, 2015 and 2014, respectively.

At December 31, 2015 and 2014, the Company was obligated under five non-cancelable operating leases on property used for banking purposes. Rental expense under these leases was $419,918 for the year ended December 31, 2015 and $414,451 for the year ended December 31, 2014.

The projected minimum rental payments under the terms of the leases at December 31, 2015 are summarized as follows:

Year Ending December 31,	Amount
2016	$ 456,281
2017	466,098
2018	470,550
2019	425,540
2020	295,360
Thereafter	131,500
Total	$ 2,245,329

7. PREPAID AND OTHER ASSETS

Prepaid and other assets at December 31, 2015 and 2014 are summarized as follows:

	2015	2014
Accounts receivable and other assets	$ 16,728	$ 14,877
Security deposit receivable	11,200	11,200
Prepaid assets	435,359	348,911
Equity securities, primarily FHLB stock	309,300	303,800
Income tax receivable	183,766	278,957
Deferred income taxes, net	761,465	761,309
Late charges receivable	73,888	80,460
Other real estate owned	569,619	370,000
	$ 2,361,325	$ 2,169,514

8. DEPOSITS

Deposits are summarized, according to their original terms, at December 31, 2015 and 2014 as follows:

	2015			2014		
	Amount	Percent	Weighted Average Stated Rate	Amount	Percent	Weighted Average Stated Rate
Checking	$101,659,731	36.79 %	- %	$ 96,170,194	38.25 %	- %
Variable-rate money market	60,912,775	22.05	0.32	45,245,094	18.00	0.29
Statement savings	21,136,015	7.65	0.20	24,604,737	9.79	0.20
Interest-bearing checking	31,428,768	11.37	0.16	27,240,106	10.84	0.05
	215,137,289	77.86	0.13	193,260,131	76.88	0.10
Time deposits:						
Less than six months	7,338,277	2.66	0.35	8,296,464	3.30	0.38
Six months to one year	40,920,606	14.81	0.78	37,795,606	15.04	0.70
More than one year	12,851,491	4.65	1.09	11,816,125	4.70	1.02
	61,110,374	22.12	0.79	57,908,195	23.04	0.72
Other deposits	56,600	0.02	-	208,803	0.08	-
Total	$276,304,263	100.00 %	0.28 %	$251,377,129	100.00 %	0.25 %

The aggregate amount of jumbo time deposits with a minimum denomination of $100,000 was approximately $45,818,000 and $42,581,000 at December 31, 2015 and 2014 respectively.

Scheduled maturities of time deposits at December 31, 2015 are as follows:

	Amount	Percent
Within six months	$ 45,749,277	74.86 %
Six months to one year	4,679,384	7.66
Over one year to two years	9,119,835	14.92
Over two years to three years	563,449	0.92
Over three years to four years	420,275	0.69
Over four years to five years	578,154	0.95
Total	$ 61,110,374	100.00 %

Time deposits that meet or exceed the FDIC Insurance limit of $250,000 at year end 2015 and 2014 were $43,339,231 and $39,241,664, respectively.

9. INCOME TAXES

The Company files consolidated federal, state and local income tax returns on a calendar-year basis. For federal, state and local income tax purposes, the Company uses the Internal Revenue Code Section 585 reserve method in computing its federal, state and local tax bad debt deduction.

The basis for the determination of state and local tax is the greater of a calculated income tax liability, a tax liability based upon average equity capital or a minimum filing fee. Federal, state and city income tax provisions were determined based on the tax computed on book taxable income for the years ended December 31, 2015 and 2014.

The components of the income tax expense/(benefit) for the years ended December 31, 2015 and 2014 are summarized as follows:

	2015	2014
Current:		
Federal	$ 897,536	$ 679,108
State and local	0	363,909
	897,536	1,043,017
Deferred:		
Federal	65,605	6,651
State and local	110,521	58,995
	176,126	65,646
Valuation Allowance	79,249	133,988
	$ 1,152,911	$ 1,242,651

The components of the deferred income tax asset/(liability), net as of December 31, 2015 and 2014 are summarized as follows:

	2015	2014
Deferred tax assets:		
Excess book depreciation	$ 436,409	$ 513,060
Deferred loan fees	120,687	78,895
Excess book allowance for loan losses	324,128	235,645
Nonaccrual loan interest income	123,140	328,825
Other	68,023	92,088
	1,072,387	1,248,513
Deferred tax liabilities:		
Unrealized gain on investment securities	(41,238)	(353,216)
Valuation allowance	(213,237)	(133,988)
Net deferred tax asset:	$ 817,912	$ 761,309

Effective January 1, 2015, New York State and New York City enacted comprehensive tax reform provisions with significant impact on financial institutions. As a result of this legislation, beginning in 2015, the Bank calculates its tax obligation to New York State and New York City based upon the largest of a calculated income tax liability, a tax liability based upon average equity capital or a minimum filing fee. Also, effective January 1, 2015, banks under $8 billion in total assets are permitted to claim a subtraction from New York State and New York City taxable income equal to 50% of the net interest income on loans secured by residential real estate located within these respective jurisdictions. Based upon the forecasted impact of this subtraction on the Bank’s state and city taxable income, it is more likely than not that the Bank will generate income tax losses in future years and therefore calculate its New York State and New York City tax liability on the basis of average equity capital or a fixed minimum fee. Consequently, the Bank recorded a valuation allowance against its New York State and New York City deferred tax assets as of January 1, 2015 as it is unlikely these deferred tax assets will impact the Bank’s tax liability in future years.

At December 31, 2015 and December 31, 2014, the Company had no unrecognized tax benefits recorded. The Company does not expect the total amount of unrecognized tax benefits to significantly increase in the next twelve months. The Company recognizes interest and penalties on unrecognized tax benefits as a component of income tax expense.

The Company is subject to United States Federal income tax, New York State income tax and New York City income tax. The Company is no longer subject to examination by taxing authorities for years before 2012.

The Company's effective tax rates differ from the statutory Federal tax rate for the years ended December 31, 2015 and 2014 are as follows:

	2015		2014	
Federal income tax provision at statutory rates	$ 946,429	34.0 %	$ 855,149	34.0 %
State and local taxes, net of Federal income tax benefit	100,710	3.6	261,487	10.4
Valuation allowance	79,249	2.9	133,988	5.3
Other	26,523	0.9	(7,973)	(0.3)
	$ 1,152,911	41.4 %	$ 1,242,651	49.4 %

10. REGULATORY MATTERS

The Bank is a New York State chartered stock form commercial bank. The Bank's deposits are insured by the Federal Deposit Insurance Corporation ("FDIC"). The Bank is subject to certain FDIC capital requirements. Failure to meet minimum capital requirements can initiate certain mandatory and possibly discretionary actions by the 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 certain specific capital guidelines that involve quantitative measures of the Bank's assets, liabilities and certain off-balance sheet items calculated under regulatory accounting practices. The Bank's capital amounts and classification are also subject to qualitative judgments by the regulators about components, risk weightings and other factors.The final rules implementing the Basel Committee on Banking Supervision's capital guidelines for U.S. banks (Basel III rules) became effective for the Company on January 1, 2015 with full compliance with requirements being phased in over a multi-year schedule, and fully phased in by January 1, 2019. The net unrealized gain or loss on available for sale securities is not included in computing regulatory capital. Capital amounts and ratios for December 31, 2014 are calculated using rules in effect at that time (Basel I rules).

As of the latest notification from the FDIC, the Bank was classified as "well capitalized" under the regulatory framework for prompt corrective action. To be categorized as "well capitalized," the Bank must maintain Tier 1 Leverage, Common Equity Tier 1, Risk-Based, Tier 1 Risk-Based and minimum Total Risk-based ratios as set forth in the table below. There are no conditions or events since that notification that management believes have changed the Bank's category. Management believes, as of December 31, 2015, that the Bank meets all capital adequacy requirements to which it is subject.

The Bank is subject to certain restrictions on the availability of its undistributed earnings for payment of dividends to stockholders, including prior regulatory approval.

In accordance with the New York State Banking Law and the New York State Superintendent of Financial Services Regulations, the Bank credits 10% of quarterly net income to regulatory surplus and is required to do so until such time as shareholders' equity is equal to 10% of amounts due to depositors. As of December 31, 2015, regulatory surplus equals 10% of deposits.

The following table is the Bank's actual capital amounts and ratios, as well as the minimum required levels for both "capital adequacy purposes" and to be considered "well capitalized". No deductions were made for qualitative judgments by regulators:

	Actual		For capital adequacy purposes		To be well-capitalized under prompt corrective action provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
As of December 31, 2015:						
Tier 1 Capital (to Average Assets)	$ 28,302,000	8.86 %	$ 12,692,799	4.00 %	$ 15,865,999	5.00 %
Common Equity Tier 1 (to Risk Weighted Assets)	28,302,000	18.69	6,658,152	4.50	9,617,331	6.50
Tier 1 Capital (to Risk Weighted Assets)	28,302,000	18.69	8,877,536	6.00	11,836,714	8.00
Total Capital (to Risk Weighted Assets)	29,593,000	19.55	11,836,714	8.00	14,795,893	10.00

	Actual		For capital adequacy purposes		To be well-capitalized under prompt corrective action provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
As of December 31, 2014:						
Tier 1 Capital (to Average Assets)	$ 27,595,000	9.18 %	$ 12,024,144	4.00 %	$ 15,030,180	5.00 %
Tier 1 Capital (to Risk Weighted Assets)	27,595,000	25.41	4,343,400	4.00	6,515,100	6.00
Total Capital (to Risk Weighted Assets)	28,554,000	26.30	8,686,800	8.00	10,858,500	10.00

The Company's consolidated capital ratios as of December 31, 2015 were as follows: Tier 1 Capital to Average Assets of 9.05%; Common Equity Tier 1 to Risk Weighted Assets of 19.40%, Tier 1 Capital to Risk Weighted Assets of 19.40%; and Total Capital to Risk Weighted Assets of 20.27%, which are not substantially different than the Bank's capital ratios at December 31, 2014 and therefore are not presented separately.

11. EMPLOYEE BENEFITS

The Company sponsors an incentive savings plan (401(k) plan) which started March 1, 1999. All eligible employees, who have reached the age of 21, have at least one year of service and work a minimum of

1,000 hours per year are permitted to make tax deferred contributions up to certain limits. The Bank may reduce or cease matching contributions if it determines that the current or accumulated net earnings or undivided profits of the Bank are insufficient to pay the full contributions in a plan year. The Bank contributed $133,822 to the 401(k) plan in 2015 and $117,198 in 2014.

Stock Options

The Company has granted options pursuant to six different stock option plans. Options to buy stock are granted to directors, officers and employees under the VSB Bancorp, Inc. 2010 Incentive Plan, the 2000 Incentive Plan, the 1998 Incentive Plan, the 2004 Directors' Plan, the 2000 Directors' Plan and the 1998 Directors' Plan which, in the aggregate, provide for issue up to 293,750 options. Exercise price is the market price at the date of grant, and compensation expense will be recognized in the income statement over the vesting period. The maximum option term is ten years, and the options vesting period is up to five years.

In May 2014, 42,500 options were granted from the 2004 Director Stock Option Plan, as amended at an exercise price of $11.25. The Company granted no stock options in 2015. Total compensation expense for the stock option plans charged against income for 2015 and 2014 was $14,097 and $20,441, respectively.

The fair value of each option award is estimated on the date of grant using a closed form option valuation (Black-Scholes) model. Expected volatilities are based on historical volatilities of the Company's common stock. The Company uses historical data to estimate option exercise and post-vesting termination behavior. Employee and management options are tracked separately. The expected term of options granted is based on historical data and represents the period of time that options granted are expected to be outstanding, which takes into account that the options are not transferable. The risk-free interest rate for the expected term of the option is based on the U.S. Treasury yield curve in effect at the time of the grant.

The fair value of the options granted is estimated using the Black-Scholes option pricing model with the following weighted average assumptions used for 2014:

	2014		**Exercise Rate**
Dividend yield	**2.18**	**%**	
Expected volatility	**13.63**		
Risk-free interest rate	**0.88**		
Expected life	**3.0 Years**		**100%**

The fair value of the options granted in 2014 was $34,425. The unrecognized compensation expense at December 31, 2015 was $15,300.

The stock option components of the 2000 Incentive Plan, the 1998 Incentive Plan, the 2010 Incentive Plan and the 2004 Directors' Plan, the 2000 Directors' Plan and the 1998 Directors' Plan, as of December 31, 2015, and changes during the year ended, consist of the following:

	Shares	Weighted Average Exercise Price	Aggregate Intrinsic Value
Options outstanding at the beginning of the year	92,550	$11.43	
Granted	-	-	
Forfeited	-	-	
Expired	-	-	
Options outstanding at the end of the year	92,550	$11.43	$ -
Options exercisable at the end of the year	50,800	$11.59	$ -
Weighted average remaining contractual life of options outstanding at the end of the year		6.1 Years	

All non-vested options are expected to vest.

During the year ended December 31, 2015, no stock options were exercised.

Described below is the range of exercise prices for options granted and outstanding under the following option plans at December 31, 2015:

Plan Description	Number of Exercisable Shares	Weighted Average Exercise Price	Weighted Average Contractual Life
1998 Incentive Stock Option Plan	3,250	$ 11.75	1.92
2000 Incentive Stock Option Plan	4,727	11.10	4.08
2004 Director Stock Option Plan	54,500	11.43	7.46
2010 Incentive Stock Option Plan	30,073	11.45	4.50
All Plans	92,550	$ 11.43	6.12

Post-Retirement Benefits

The Company offers post-retirement benefits related to its Bank-owned life insurance plan to certain employees. The costs of such benefits are accrued during the years that an employee renders the service.

12. COMMITMENTS, CONTINGENCIES AND FINANCIAL INSTRUMENTS WITH OFF-BALANCE SHEET RISK

The Company is a party to financial instruments with off-balance sheet risk in the normal course of business in order to meet the financing needs of its customers. Such financial instruments primarily include commitments to extend credit.

A summary of these commitments and contingent liabilities, all of which are variable rate commitments tied to prime, at December 31:

	2015 Amount	2014 Amount
Commitments to fund secured construction loans	$ 6,981,500	$ 2,602,500
Commitments to fund all other commercial loans	42,981,218	25,327,003
	$ 49,962,718	$ 27,929,503

Commitments to extend credit are legally binding agreements to lend to a customer. Commitments are issued following the Company's evaluation of each applicant's creditworthiness on a case-by-case basis. The Company's exposure to credit loss in the event of nonperformance by the other party to the financial instrument is represented by the contractual notional amount of those instruments.

Victory State Bank currently has a $2 million unsecured credit facility with Atlantic Central Bankers Bank which the Bank has not drawn upon.

VSB Bancorp, Inc. is not involved in any pending legal proceedings. The Bank, from time to time, is involved in routine collection proceedings in the ordinary course of business on loans in default. Management believes that such other routine legal proceedings in the aggregate are immaterial to our financial condition or results of operations.

13. FAIR VALUE

The following disclosure of the estimated fair value of financial instruments is made in accordance with the requirements of FASB ASC 820, “Financial Instruments”. The estimated fair value amounts have been determined by the Company using available market information and appropriate valuation methodologies. However, considerable judgment is necessarily required to interpret market data to develop the estimates of fair value. Accordingly, the estimates presented herein are not necessarily indicative of the amounts the Company could realize in a current market exchange. The use of different market assumptions and/or estimation methodologies may have a material effect on the estimated fair value amounts.

The following methods and assumptions were used by the Company in estimating fair values of financial instruments:

Interest-bearing Bank Balances – Interest-bearing bank balances mature within one year and are carried at cost, which are estimated to be reasonably close to fair value.

Money Market Investments – The fair value of these securities approximates their carrying value due to the relatively short time to maturity.

Investment Securities, Available For Sale and Held To Maturity – The estimated fair value of these securities is determined by using available market information and appropriate valuation methodologies. The estimates presented herein are not necessarily indicative of the amounts that the Company could realize in a current market exchange.

Federal Home Loan Bank Stock - It is not practical to determine the fair value of FHLB stock due to restrictions placed on its transferability.

Loans Receivable - The fair value of commercial and construction loans is approximated by the carrying value as the loans are tied directly to the Prime Rate and are subject to change on a daily basis, subject to the applicable interest rate floors. The fair value of the remainder of the portfolio is determined by discounting the future cash flows of the loans using the appropriate discount rate.

Other Financial Assets - The fair value of these assets, principally accrued interest receivable, approximates their carrying value due to their short maturity.

Non-Interest Bearing and Interest Bearing Deposits - The fair value disclosed for non-interest bearing deposits is equal to the amount payable on demand at the reporting date. The fair value of interest bearing deposits is based upon the current rates for instruments of the same remaining maturity. Interest bearing deposits with a maturity of greater than one year are estimated using a discounted cash flow approach that applies interest rates currently being offered.

Other Liabilities - The estimated fair value of other liabilities, which primarily include accrued interest payable, approximates their carrying amount.

The carrying amounts and estimated fair values of financial instruments, at December 31, 2015 and December 31, 2014 are:

	Fair Value Measurements at December 31, 2015 Using				
	Carrying Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total
Financial Assets:					
Cash and cash equivalents	$ 14,845,096	$ 3,188,067	$ 11,657,029	$ -	$ 14,845,096
Investment securities, available for sale	58,096,583	-	58,096,583	-	58,096,583
Investment securities, held to maturity	120,585,784	-	120,556,799	-	120,556,799
Loans receivable	103,051,107	-	-	103,417,757	103,417,757
Accrued interest receivable	743,375	-	395,471	347,904	743,375
Total Financial Assets	$ 297,321,945	$ 3,188,067	$ 190,705,882	$ 103,765,661	$ 297,659,610
Financial Liabilities:					
Deposits	$ 276,304,263	$ 101,716,331	$ 174,370,714	$ -	$ 276,087,045
Accrued interest payable	53,120	-	53,120	-	53,120
Total Financial Liabilities	$ 276,357,383	$ 101,716,331	$ 174,423,834	$ -	$ 276,140,165

:

	Fair Value Measurements at December 31, 2014 Using				
	Carrying Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total
Financial Assets:					
Cash and cash equivalents	$ 18,129,166	$ 2,103,043	$ 16,026,123	$ -	$ 18,129,166
Investment securities, available for sale	64,759,836	-	64,759,836	-	64,759,836
Investment securities, held to maturity	121,929,954	-	122,358,472	-	122,358,472
Loans receivable	66,473,809	-	-	66,790,848	66,790,848
Accrued interest receivable	668,631	-	441,978	226,653	668,631
Total Financial Assets	$ 271,961,396	$ 2,103,043	$ 203,586,409	$ 67,017,501	$ 272,706,953
Financial Liabilities:					
Deposits	$ 251,377,129	$ 96,378,997	$ 154,851,518	$ -	$ 251,230,515
Accrued interest payable	34,495	-	34,495	-	34,495
Total Financial Liabilities	$ 251,411,624	$ 96,378,997	$ 154,886,013	$ -	$ 251,265,010

ASC 820 establishes a fair value hierarchy which requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. The standard describes three levels of inputs that may be used to measure fair value:

Level 1: Quoted prices (unadjusted) for identical assets or liabilities in active markets that the entity has the ability to access as of the measurement date.

Level 2: Significant other observable inputs other than Level 1 prices such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data.

Level 3: Significant unobservable inputs that reflect a reporting entity's own assumptions about the assumptions that market participants would use in pricing and asset or liability.

The fair value of securities available for sale and held to maturity is determined by obtaining quoted prices on nationally recognized securities exchanges (Level 1 inputs) or using matrix pricing, which is a mathematical technique widely used in the industry to value debt securities without relying exclusively on quoted prices for the specific securities but rather by relying on the securities' relationship to other benchmark quoted securities (Level 2 inputs). For securities where quoted prices or market prices of similar securities are not available, fair values are calculated using discounted cash flows or other market indicators (Level 3).

The tables below presents a reconciliation of all assets measured at fair value on a recurring basis using significant observable inputs (Level 2) for the years ended December 31, 2015 and 2014:

	Fair Value Measurements at December 31, 2015 Using			
	Total	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets:				
Available for sale:				
FNMA MBS - Residential	$ 519,897	$ -	$ 519,897	$ -
Whole Loan MBS-Residential	7,022	-	7,022	-
Collateralized mortgage obligations	37,976,627	-	37,976,627	-
Collateralized loan obligations	7,750,000	-	7,750,000	-
Corporate bonds	9,404,596	-	9,404,596	-
Other debt securities	2,438,441	-	2,438,441	-
Total Available for sale Securities	$ 58,096,583	$ -	$ 58,096,583	$ -

	Fair Value Measurements at December 31, 2014 Using			
	Total	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets:				
Available for sale:				
FNMA MBS - Residential	$ 759,596	$ -	$ 759,596	$ -
Whole Loan MBS-Residential	13,976	-	13,976	-
Collateralized mortgage obligations	40,503,889	-	40,503,889	-
Collateralized loan obligations	9,031,250	-	9,031,250	-
Corporate bonds	11,491,075	-	11,491,075	-
Other debt securities	2,960,050	-	2,960,050	-
Total Available for sale Securities	$ 64,759,836	$ -	$ 64,759,836	$ -

During the years-ended December 31, 2015 and 2014, there were no transfers between levels.

Assets Measured on a Non-Recurring Basis

Certain financial assets are measured at fair value on a nonrecurring basis, that is, the instruments are not measured at fair value on an ongoing basis but are subject to fair value adjustments in certain circumstances (for example, when there is evidence of impairment).

Assets measured at a fair value on a non-recurring basis are summarized below:

Impaired Loans: The fair value of impaired loans with specific allocations of the allowance for loan losses is generally based on recent real estate appraisals. These appraisals may utilize a single valuation approach or a combination of approaches including comparable sales and the income approach. Adjustments are routinely made in the appraisal process by the independent appraisers to adjust for differences between the comparable sales and income data available. Such adjustments are usually significant and typically result in a Level 3 classification of the inputs for determining fair value.

Real Estate Owned: Assets acquired through or instead of loan foreclosure are initially recorded at fair value less costs to sell when acquired, establishing a new cost basis. These assets are subsequently accounted for at lower of cost or fair value less estimated costs to sell. Fair value is commonly based on recent real estate appraisals which are updated no less frequently than annually or signed offers through auction if lower (which would be level 2). These appraisals may utilize a single valuation approach or a combination of approaches including comparable sales and the income approach. Adjustments are routinely made in the appraisal process by the independent appraisers to adjust for differences between the comparable sales and income data available. Such adjustments are usually significant and typically result in a Level 3 classification of the inputs for determining fair value.

	Fair Value Measurements at December 31, 2015 Using			
	Total	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets:				
Other real estate owned	$ 569,619	-	$ 569,619	-

	Fair Value Measurements at December 31, 2014 Using			
	Total	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets:				
Impaired loans				
Commercial Real Estate	$ 43,400	-	-	$ 43,400
Other real estate owned	370,000	-	370,000	-

As of December 31, 2015, we had no impaired loans with specific reserves that were collateral dependent.

As of December 31, 2014, we had one impaired loan with specific reserves that was collateral dependent. The collateral dependent impaired loan, which is measured for impairment using the fair value of the collateral, had a carrying amount of $85,771, with a valuation allowance of $42,371 at that date. The unpaid principal balance on impaired loans at December 31, 2014 was $99,921.

The following table presents quantitative information about Level 3 fair value measurements for financial instruments measured at fair value on a non-recurring basis at December 31, 2014.

	Fair Value	Valuation Techniques	Unobservable Inputs	Range
Impaired loans- Commercial real estate	$ 43,400	Third Party Appraisal	Adjustment for differences between comparable sales.	1% - 7%

14. RELATED PARTIES

The Bank at times has had loans, and other financial transactions, with its executive officers and directors. At December 31, 2015, the aggregate amount of loans outstanding to directors and director affiliated companies was $1,430,000. There were no loans granted to executive officers.

The change in aggregate amount of loans outstanding to directors as of December 31, 2015 and 2014 are as follows:

	2015	**2014**
Beginning balance	$ 300,000	$ -
Originations	1,145,604	300,296
Payments	(15,604)	(296)
Ending balance	$ 1,430,000	$ 300,000

The interest income that was paid on these loans was $36,113 and $- for 2015 and 2014, respectively.

Executive officers and directors own, in the aggregate, 29.1% and 26.9% of the common shares outstanding at December 31, 2015 and 2014, respectively.

15. CONDENSED FINANCIAL STATEMENTS OF THE PARENT COMPANY ONLY

VSB BANCORP, INC.

STATEMENTS OF FINANCIAL CONDITION
DECEMBER 31, 2015 and 2014

	2015	2014
ASSETS		
Cash and cash equivalents	$ 1,100	$ 1,100
Money market	427,492	458,476
Investment in subsidiaries	28,378,303	28,013,568
Deferred taxes	8,115	31,782
Other assets	17,340	40,907
Total assets	$ 28,832,350	$ 28,545,833
LIABILITIES AND STOCKHOLDERS' EQUITY		
LIABILITIES:		
Accounts payable, accrued expenses and other liabilities	$ 33,059	$ 31,343
Total liabilities	33,059	31,343
COMMITMENTS AND CONTINGENT LIABILITIES		
STOCKHOLDERS' EQUITY		
Common stock ($.0001 par value, 10,000,000 shares authorized 2,078,509 issued, 1,799,398 outstanding at December 31, 2015 and 1,856,845 outstanding at December 31, 2014)	208	208
Additional paid-in capital	10,512,041	10,487,210
Retained earnings	22,021,007	20,806,715
Treasury stock, at cost (279,111 shares at December 31, 2015 and 221,664 shares at December 31, 2014)	(2,976,175)	(2,263,984)
Unearned Employee Stock Ownership Plan shares	(834,375)	(934,500)
Accumulated other comprehensive gain, net of taxes of $41,238 and $353,216, respectively	76,585	418,841
Total stockholders' equity	28,799,291	28,514,490
Total liabilities and stockholders' equity	$ 28,832,350	$ 28,545,833

VSB BANCORP, INC.

STATEMENTS OF OPERATIONS
FOR THE YEARS ENDED DECEMBER 31, 2015 AND 2014

	2015	2014
INTEREST INCOME:		
Loans receivable	$ 30,362	$ 22,578
Other interest income	3,229	2,050
Total interest income	33,591	24,628
INTEREST EXPENSE:		
Total interest expense	-	-
Net interest income	33,591	24,628
NON-INTEREST INCOME:		
Dividend income	1,000,000	500,000
Other	-	-
	1,000,000	500,000
NON-INTEREST EXPENSES:		
Salaries and benefits	38,041	130,195
Legal fees	30,000	36,000
Other	52,467	47,175
Total non-interest expenses	120,508	213,370
INCOME BEFORE INCOME TAXES	913,083	311,258
PROVISION/(BENEFIT) FROM INCOME TAXES:		
Current	(57,712)	(111,358)
Deferred	16,721	21,676
Total income taxes	(40,991)	(89,682)
EQUITY IN UNDISTRIBUTED EARNINGS, NET OF TAXES	676,629	871,554
NET INCOME	$ 1,630,703	$ 1,272,494

VSB BANCORP, INC.

STATEMENTS OF CASH FLOWS FOR THE YEARS ENDED DECEMBER 31, 2015 AND 2014

	2015	2014
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income	$ 1,630,703	$ 1,272,494
Adjustments to reconcile net income to net cash used in operating activities:		
Changes in operating assets and liabilities:		
ESOP compensation expense	17,915	(16,543)
Stock-based compensation expense	38,041	130,194
Undistributed income of subsidiaries	(676,629)	(871,554)
Decrease in other assets	23,567	7,089
Decrease in deferred income taxes	16,721	21,676
Decrease in accounts payable, accrued expenses, and other liabilities	(21,700)	(32,890)
Net cash provided by operating activities	1,028,618	510,466
CASH FLOWS FROM INVESTING ACTIVITIES:		
Net decrease in loan receivable	100,125	123,110
Net decrease/(increase) in money market deposit	30,984	(67,367)
Net cash provided by investing activities	131,109	55,743
CASH FLOWS FROM FINANCING ACTIVITIES:		
Purchase of treasury stock, at cost	(743,316)	(140,438)
Payment of dividends	(416,411)	(426,712)
Net cash used in financing activities	(1,159,727)	(567,150)
NET DECREASE IN CASH AND CASH EQUIVALENTS	-	(941)
CASH AND CASH EQUIVALENTS, BEGINNING OF YEAR	1,100	2,041
CASH AND CASH EQUIVALENTS, END OF YEAR	$ 1,100	$ 1,100
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION:		
Cash paid during the period for:		
Interest	$ -	$ -
Income taxes	$ -	$ -

16. EMPLOYEE STOCK OWNERSHIP PLAN

Employees participate in an Employee Stock Ownership Plan (“ESOP”). VSB Bancorp, Inc. ESOP Trust was formed on May 1, 2004. The ESOP borrowed from the Company to purchase 92,900 shares of stock at $18.20 per share. The ESOP completed the repayment of this loan on April 30, 2014. On May 5, 2014, the ESOP borrowed from the Company to purchase 89,000 shares of stock at $11.25 per share. The Company makes discretionary contributions to the ESOP and pays dividends on unallocated shares to the ESOP. The ESOP uses these funds to repay the loan. When loan payments are made, ESOP shares are allocated to participants based on their relative compensation and the Company records compensation expense. Dividends on allocated shares increase participant accounts.

Shares allocated to each participant, to the extent vested, are distributed to the participant upon termination of employment. As required by federal law, a participant may require the Company to repurchase shares so distributed unless the stock is traded on an established market. Since the Company shares are traded on the OTCQX, which is considered an established market, the Company does not now have such a repurchase obligation.

The contribution to the ESOP was $100,125 for the year ended December 31, 2015 and $123,110 for the year ended December 31, 2014. ESOP expense was $121,787 and $105,212 for the years ended December 31, 2015 and 2014, respectively.

Shares held by the ESOP at December 31, 2015 and 2014 were as follows:

	2015	2014
Shares allocated to participants	109,430	99,584
Shares released to participants	(29,474)	(22,688)
Unearned shares	72,470	82,316
Total ESOP Shares	152,426	159,212
Fair value of unearned shares	$ 947,908	$ 962,274

17. RETENTION AND RECOGNITION PLAN

The stockholders of VSB Bancorp, Inc. approved the adoption of the 2010 Retention and Recognition Plan (the "RRP"). The RRP authorizes the award of up to 50,000 shares of its common stock to directors, officers and employees. No shares were awarded in 2014. On November 10, 2015, 500 shares were awarded to each of five key Vice Presidents of the Bank who each have tenure over 10 years. The awards will vest over three years.

The recipient of an award will not be required to make any payment to receive the award or the stock covered by the award. As of December 31, 2015, 47,500 shares of the RRP have been awarded. The Company recognizes compensation expense for the shares awarded under the RRP gradually as the shares vest, based upon the market price of the shares on the date of the award. For the years ended December 31, 2015 and 2014, the Company recognized $23,944 and $109,754 of compensation expense related to the shares awarded. The income tax benefit resulting from this expense was $8,380 and $50,212 for the years ended December 31, 2015 and 2014. As of December 31, 2015, there was approximately $29,490 of unrecognized compensation costs related to the shares awarded. These costs are expected to be recognized over the next year.

A summary of the status of the Company's non-vested plan shares as of December 31, 2015 is as follows:

For the Year Ended December 31, 2015:

	Shares	Weighted Average Grant Date Share Value
Non vested at beginning of period	6,300	$ 11.46
Granted	2,500	12.49
Vested	6,300	-
Non vested at end of period	2,500	$ 12.49

****

BOARD OF DIRECTORS

Joseph J. LiBassi
Chairman of the Board
Private Investor

Raffaele M. Branca
President & CEO
VSB Bancorp, Inc. and
Victory State Bank

Joan Nerlino Caddell
Attorney, Owner
Joan Nerlino Caddell &
Associates, PLLC

Chaim Farkas
President
Computer Software
Dataware Systems Lease,
Inc.

Alfred C. Johnsen, CPA
Private Practice
Alfred C. Johnsen, CPA

Robert P. Moore
Retired Vice President
KeySpan

Dr. Carlos M. Perez
Medical Doctor

Bruno Savo
Builder/Developer
Savo Brothers, Inc.

DIRECTOR EMERITUS

Savino Savo
Builder/Developer

Robert S. Cutrona, Sr.
President
Maintenance Company
Project One Services, Inc.

VICTORY STATE BANK SENIOR OFFICERS

Raffaele M. Branca
President &
Chief Executive Officer

Richard P. Boyle
Senior Vice President
Chief Lending Officer

Elizabeth Scarano
Senior Vice President
Chief Operations Officer

Jonathan Lipschitz
1st Vice President
Controller

Philip Stropoli
1st Vice President
Branch Administrator

Anna Williams
1st Vice President
Compliance

Steven Landau
Vice President
Business Development

Johnny Reyes
Vice President
Business Development

Isaac Zahavi
Vice President
IT Manager

INDEPENDENT AUDITOR
Crowe Horwath LLP

TRANSFER AGENT AND REGISTRAR
Computershare Trust Company, N.A.
250 Royall Street
Canton, MA 02021

STOCKHOLDER INFORMATION
Raffaele M. Branca
(718) 979-1100

STOCK QUOTATION
OTC Market Place OTCQX
Symbol: VSBN

BRANCHES
4142 Hylan Boulevard
Great Kills
(718) 979-1100

755 Forest Avenue
West Brighton
(718) 815-1100

One Hyatt Street
St. George
(718) 876-5400

1762 Hylan Boulevard
Dongan Hills
(718) 979-2300

1065 Bay Street
Rosebank
(718) 981-1200

Loan Department
Dongan Hills
1762 Hylan Boulevard
(718) 979-2000