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Kinderhook Bank Corp.
and Subsidiaries

Consolidated Financial Statements

December 31, 2016 and 2015
With Independent Auditors' Report

Baker Newman & Noyes, LLC
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INDEPENDENT AUDITORS' REPORT

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

We have audited the accompanying consolidated financial statements of Kinderhook Bank Corp. and Subsidiaries, which comprise the consolidated balance sheets as of December 31, 2016 and 2015, and the related consolidated statements of income, comprehensive income, changes in stockholders' equity, and cash flows for the years then ended, and the related notes to the consolidated financial statements.

Management's Responsibility for the Financial Statements

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

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

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

Opinion

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Kinderhook Bank Corp. and Subsidiaries as of December 31, 2016 and 2015, 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.

Baker Newman & Noyes LLC

Peabody, Massachusetts
March 23, 2017

KINDERHOOK BANK CORP. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

December 31, 2016 and 2015

(In Thousands, Except Share Data)

ASSETS	2016	2015
Cash and due from banks	$ 4,566	$ 4,991
Interest-bearing deposits with Federal Home Loan Bank		
and Federal Reserve Bank	6,510	21,215
Total cash and cash equivalents	11,076	26,206
Investments in available-for-sale securities (at fair value)	97,529	55,229
Investments in held-to-maturity securities (fair values of $1,132 as of		
December 31, 2016 and $126 as of December 31, 2015)	1,130	125
Federal Home Loan Bank stock, at cost	836	355
Federal Reserve Bank stock, at cost	705	660
Loans, net	328,400	316,289
Premises and equipment, net	8,159	8,509
Cash surrender value of life insurance policies	8,444	8,239
Accrued interest receivable	1,299	1,010
Other assets	2,990	2,370
Total assets	$ 460,568	$ 418,992
LIABILITIES AND STOCKHOLDERS' EQUITY		
Deposits:		
Noninterest-bearing	$ 54,216	$ 50,105
Interest-bearing	344,371	317,437
Total deposits	398,587	367,542
Federal Home Loan Bank advances	10,000	-
Junior subordinated debentures and notes	11,876	11,856
Notes payable	230	298
Accrued interest payable	303	240
Other liabilities	3,223	3,703
Total liabilities	424,219	383,639

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

KINDERHOOK BANK CORP. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

December 31, 2016 and 2015

(In Thousands, Except Share Data)

(continued)

	2016	2015
Stockholders' equity:		
Preferred stock, par value $25; authorized, 100,000 shares:		
Series A, issued and outstanding, 12,087 shares 6% fixed rate non-cumulative convertible perpetual, liquidation value $350.00 per share as of December 31, 2016 and 2015	302	302
Series C, issued and outstanding, 20,687 shares 5.25% fixed rate non-cumulative convertible perpetual, liquidation value $357.15 per share as of December 31, 2016 and 2015	517	517
Common stock, par value $0.83; authorized, 2,000,000 shares; issued and outstanding 730,861.509 shares as of December 31, 2016 and 2015	607	607
Paid-in capital	16,121	16,121
Retained earnings	19,210	17,363
Accumulated other comprehensive (loss) income	(465)	386
Total Kinderhook Bank Corp. stockholders' equity	36,292	35,296
Noncontrolling interest	57	57
Total stockholders' equity	36,349	35,353
Total liabilities and stockholders' equity	$ 460,568	$ 418,992

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

KINDERHOOK BANK CORP. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF INCOME

Years Ended December 31, 2016 and 2015

(In Thousands, Except Share and Per Share Data)

	2016	2015
Interest and dividend income:		
Interest and fees on loans	$ 15,814	$ 14,050
Interest on debt securities:		
Taxable	796	449
Tax-exempt	727	690
Dividends	59	55
Other interest	25	25
Total interest and dividend income	17,421	15,269
Interest expense:		
Interest on deposits	2,061	1,671
Interest on advances from Federal Home Loan Bank	-	9
Interest on notes payable	16	21
Interest on junior subordinated debentures	731	144
Total interest expense	2,808	1,845
Net interest and dividend income	14,613	13,424
Provision for loan losses	520	844
Net interest and dividend income after provision for loan losses	14,093	12,580
Noninterest income:		
Customer service charges and fees	1,302	1,089
Gain on sales of loans	428	290
Gain on sales of available-for-sale securities	-	103
Gain on sale of The Kleeber Agency, Inc.	-	472
Insurance commissions and fees	-	802
Increase in cash surrender value life insurance	205	206
Other income	128	121
Total noninterest income	2,063	3,083
Noninterest expense:		
Salaries and employee benefits	6,710	7,029
Occupancy expense	1,107	1,132
Equipment expense	594	482
Professional and assessment fees	507	503
Director fees	241	237
Advertising	419	371
Data processing	596	525
Federal Deposit Insurance Corp. assessment	280	265
Loss on sale of other real estate owned	-	62
Other expense	1,298	1,424
Total noninterest expense	11,752	12,030
Income before income tax expense	4,404	3,633
Income tax expense	1,256	1,368
Net income attributable to noncontrolling interest and Kinderhook Bank Corp.	3,148	2,265
Less: Net income attributable to noncontrolling interest	6	6
Net income	$ 3,142	$ 2,259
Earnings per common share, basic	$ 3.42	$ 2.13
Earnings per common share, assuming dilution	$ 2.97	$ 2.08

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

KINDERHOOK BANK CORP. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

Years Ended December 31, 2016 and 2015

(In Thousands)

	2016	2015
Net income	$ 3,142	$ 2,259
Other comprehensive loss, net of tax:		
Net change in unrealized holding gain on available-for-sale securities, net of tax	(851)	(161)
Other comprehensive loss, net of tax	(851)	(161)
Comprehensive income	$ 2,291	$ 2,098

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

KINDERHOOK BANK CORP. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY

Years Ended December 31, 2016 and 2015

(In Thousands, Except Share and Per Share Data)

	Preferred Stock Series A	Preferred Stock Series B	Preferred Stock Series C	Common Stock	Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive (Loss) Income	Noncontrolling Interest	Total
Balance, December 31, 2014	$ 302	$ 175	$ 517	$ 607	$ 22,946	$ 16,429	$ 547	$ 57	41,580
Net income						2,259			2,259
Other comprehensive loss, net of tax							(161)		(161)
Redemption of Series B preferred stock		(175)			(6,825)				(7,000)
Dividends declared ($0.85 per common share)						(621)			(621)
Dividends declared preferred stock						(704)			(704)
Balance, December 31, 2015	302	-	517	607	16,121	17,363	386	57	35,353
Net income						3,142			3,142
Other comprehensive loss, net of tax							(851)		(851)
Dividends declared ($0.89 per common share)						(650)			(650)
Dividends declared preferred stock						(645)			(645)
Balance, December 31, 2016	$ 302	$ -	$ 517	$ 607	$ 16,121	$ 19,210	$ (465)	$ 57	$ 36,349

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

KINDERHOOK BANK CORP. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS

Years Ended December 31, 2016 and 2015

(In Thousands)

	2016	2015
Cash flows from operating activities:		
Net income	$ 3,142	$ 2,259
Adjustments to reconcile net income to net cash provided by operating activities:		
Amortization on securities, net	460	346
Gain on sales of available-for-sale securities	-	(103)
Provision for loan losses	520	844
Change in net deferred loan origination costs	(8)	(98)
Net gain on loans sold	(428)	(290)
Depreciation and amortization	532	463
Deferred tax benefit	(296)	(324)
(Increase) decrease in accrued interest receivable	(289)	75
Increase in interest payable	63	128
(Decrease) increase in other liabilities	(480)	297
Gain on sale of The Kleeber Agency, Inc.	-	(472)
Amortization of intangible assets	-	90
Amortization of deferred gain on sale of customer lists	-	(81)
Loss on sale of other real estate owned	-	62
Decrease in other assets	55	36
Increase in cash surrender value of life insurance policies	(205)	(206)
Net cash provided by operating activities	3,066	3,026
Cash flows from investing activities:		
Purchases of available-for-sale securities	(49,595)	(30,582)
Proceeds from maturities, paydowns and calls of available-for-sale securities	5,441	5,913
Proceeds from sales of available-for-sale securities	-	33,176
Proceeds from maturities of held-to-maturity securities	125	1,139
Purchases of held-to-maturity securities	(1,130)	(125)
Purchases of Federal Home Loan Bank stock	(481)	(2,949)
Redemption of Federal Home Loan Bank stock	-	3,533
Purchases of Federal Reserve Bank stock	(45)	(90)
Payments received on notes receivable	164	140
Loan originations and principal collections, net	(21,215)	(32,215)
Proceeds from sales of loans	10,433	8,911
Loans purchased	(1,567)	(12,964)
Recoveries of loans previously charged off	154	39
Proceeds from sale of The Kleeber Agency, Inc.	-	1,773
Capital expenditures	(162)	(1,628)
Proceeds from sales of other real estate owned	-	377
Net cash used in investing activities	(57,878)	(25,552)

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

KINDERHOOK BANK CORP. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS

Years Ended December 31, 2016 and 2015

(In Thousands)

(continued)

	2016	2015
Cash flows from financing activities:		
Net increase in demand deposits, NOW and savings accounts	28,831	22,657
Net increase in time deposits	2,214	31,912
Net change in short-term advances	10,000	(14,000)
Proceeds from issuance of subordinated debt, net of issuance costs	-	9,812
Payments made on notes payable	(68)	(37)
Decrease in securities sold under agreements to repurchase	-	(178)
Redemption of Series B preferred stock	-	(7,000)
Dividends paid – preferred stock	(645)	(704)
Dividends paid – common stock	(650)	(621)
Net cash provided by financing activities	39,682	41,841
Net (decrease) increase in cash and cash equivalents	(15,130)	19,315
Cash and cash equivalents at beginning of year	26,206	6,891
Cash and cash equivalents at end of year	$ 11,076	$ 26,206
Supplemental disclosures:		
Interest paid	$ 2,745	$ 1,717
Income taxes paid	2,110	1,239
Transfer from other real estate owned to other liabilities	-	168
Sale of The Kleeber Agency, Inc.:		
Furniture, fixtures and equipment		$ (32)
Other assets		(47)
Goodwill		(931)
Intangible assets		(291)
		(1,301)
Proceeds from sale		1,773
Gain on sale		$ 472

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

NOTE 1 - NATURE OF OPERATIONS

Kinderhook Bank Corp. (Company) is a New York corporation that was organized in 1996 to become the holding company of The National Union Bank of Kinderhook (Bank). The Company's primary activity is to act as the holding company for the Bank. The Bank is a nationally chartered bank, headquartered in Kinderhook, New York. The Bank operates its business from eight banking offices located in New York. The Bank is engaged principally in the business of attracting deposits from the general public and investing those deposits in business and consumer loans, and in residential and commercial real estate loans.

NOTE 2 - ACCOUNTING POLICIES

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

USE OF ESTIMATES:

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. Material estimates that are particularly susceptible to significant change are the determination of the allowance for loan losses.

BASIS OF PRESENTATION:

The consolidated financial statements include the accounts of the Company and its wholly-owned subsidiaries, the Bank and The Kleeber Agency, Inc. through December 7, 2015 and Kinderhook Holdings, Inc., which was formed on December 8, 2015, and the Bank's wholly-owned subsidiary, Kinderhook Realty Holding Corp. The Kleeber Agency, Inc., an insurance agency, was sold on December 8, 2015. Kinderhook Holdings, Inc. was formed on December 8, 2015 upon the completion of the sale of the Kleeber Agency, Inc. Kinderhook Realty Holding Corp., a real estate investment trust, was formed to hold real estate mortgage loans. All significant intercompany accounts and transactions have been eliminated in the consolidation.

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

CASH AND CASH EQUIVALENTS:

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

The Bank is required to maintain average balances on hand with the Federal Reserve Bank of New York. As of December 31, 2016 and 2015, these reserve balances amounted to $5,715,000 and $2,239,000, respectively.

SECURITIES:

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

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

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

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

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

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

NON-MARKETABLE EQUITY SECURITIES:

The Bank is required to own shares of capital stock in the Federal Home Loan Bank of New York and the Federal Reserve Bank as a condition of membership. These securities do not have a readily determinable fair value, as their ownership is restricted. They are carried at cost and evaluated for impairment based on the ultimate recoverability of the cost basis.

LOANS:

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

Interest on loans is recognized on a simple interest basis.

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

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

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

ALLOWANCE FOR LOAN LOSSES:

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

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

General Component:

The general component of the allowance for loan losses is based on historical loss experience adjusted for qualitative factors stratified by the following loan segments: residential real estate, commercial real estate, home equity, commercial and consumer and other. Management uses a rolling average of historical losses based on a time frame appropriate to capture relevant loss data for each loan segment. These historical loss factors are adjusted for the following qualitative factors: levels/trends in delinquencies; trends in volume and terms of loans; effects of changes in risk selection and underwriting standards and other changes in lending policies, procedures and practices; concentrations identified within the portfolio; effects of legal and regulatory requirements; experience/ability/depth of lending management and staff; and national and local economic trends and conditions. Management follows a similar process to estimate its liability for off-balance sheet commitments to extend credit. There were no changes in the Company's policies or methodology pertaining to the general component of the allowance for loan losses during 2016.

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

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

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

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

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

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

Allocated Component:

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

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

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

Unallocated Component:

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

LOAN SERVICING:

The Company services loans for others. Loan servicing assets are recognized at fair value, as separate assets when rights are acquired through purchase or through sale of financial assets. Initial fair value is determined using prices for similar assets with similar characteristics. Capitalized servicing rights are reported in other assets and are amortized into loan servicing fee income in proportion to, and over the period of, the estimated future net servicing income of the underlying financial assets. Servicing assets are evaluated for impairment based upon the fair value of the rights as compared to amortized cost. Impairment is determined by stratifying rights by predominant risk characteristics, such as interest rates and terms. Fair value is based on a quarterly, third-party valuation model that calculates the present value of estimated future net servicing income. Impairment is recognized through a valuation allowance for an individual stratum, to the extent that fair value is less than the capitalized amount for the stratum. Changes in the valuation allowance are reported in loan servicing fee income.

PREMISES AND EQUIPMENT:

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

Premises and equipment are periodically evaluated for impairment when events or changes in circumstances indicate that the carrying amount may not be recoverable. Impairment exists when the expected undiscounted future cash flows of premises and equipment are less than their carrying amount. In that event, the Company records a loss equal to the difference between the carrying amount and the fair value of the asset based on quoted market prices, if applicable, or a discounted cash flow analysis.

OTHER REAL ESTATE OWNED AND IN-SUBSTANCE FORECLOSURES:

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

The Company classifies commercial loans as in-substance repossessed or foreclosed if the Company receives physical possession of the debtor's assets regardless of whether formal foreclosure proceedings take place. An in-substance repossession or foreclosure occurs, and the Company is considered to have received physical possession of residential real estate property collateralizing a consumer mortgage loan upon either: (1) obtaining legal title to the residential real estate property upon completion of a foreclosure; or (2) the borrower conveying all interest in the residential real estate property to the creditor to satisfy that loan through completion of a deed in lieu of foreclosure or through a similar legal agreement.

BANK-OWNED LIFE INSURANCE:

The Company has purchased insurance policies on the lives of certain directors, executive officers and employees. Bank-owned life insurance policies are reflected on the consolidated balance sheets at cash surrender value. Changes in net cash surrender value of the policies, as well as insurance proceeds received, are reflected in noninterest income on the consolidated statements of income and are not subject to income taxes.

STOCK-BASED COMPENSATION:

Stock-based compensation represents the cost related to stock-based awards to officers and employees. The Company measures stock-based compensation cost at the grant date based upon the estimated fair value of the award, and recognizes the cost as expense on a straight-line basis (net of estimated forfeitures) over the employee requisite service period.

ADVERTISING:

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

INCOME TAXES:

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

FAIR VALUES OF FINANCIAL INSTRUMENTS:

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

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

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

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

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

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

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

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

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

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

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

EARNINGS PER COMMON SHARE:

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

NONCONTROLLING INTEREST:

Noncontrolling interest represents the portion of ownership and interest expense that is attributable to the minority owners of Kinderhook Realty Holding Corp. The minority ownership is in the form of preferred stock. (see Note 10, “NONCONTROLLING INTEREST IN SUBSIDIARY”)

RECENT ACCOUNTING PRONOUNCEMENTS:

In May 2014 and August 2015, respectively, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2014-09 and 2015-14, “Revenue from Contracts with Customers (Topic 606).” The objective of ASU 2014-09 is to clarify principles for recognizing revenue and to develop a common revenue standard for GAAP and International Financial Reporting Standards. The guidance in ASU 2014-09 affects any entity that either enters into contracts with customers to transfer goods or services or enters into contracts for the transfer of nonfinancial assets, unless those contracts are within the scope of other standards. The core 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 amendments in ASU 2015-14 defer the effective date of ASU 2014-09 to annual reporting periods beginning after December 15, 2017, and interim periods within that period. Earlier application is permitted only as of an annual reporting period beginning after December 15, 2016, including interim reporting periods within that reporting period. The Company is currently reviewing ASUs 2014-09 and 2015-14 to determine if they will have an impact on its consolidated financial statements.

In January 2016, the FASB issued ASU 2016-01, “Financial Instruments - Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities.” The amendments in this ASU address certain aspects of recognition, measurement, presentation, and disclosure of financial instruments and makes targeted improvements to GAAP as follows:

1. Require equity investments (except those accounted for under the equity method of accounting or those that result in consolidation of the investee) to be measured at fair value with changes in fair value recognized in net income. However, an entity may choose to measure equity investments that do not have readily determinable fair values at cost minus impairment, if any, plus or minus changes resulting from observable price changes in orderly transactions for the identical or a similar investment of the same issuer.
2. Simplify the impairment assessment of equity investments without readily determinable fair values by requiring a qualitative assessment to identify impairment. When a qualitative assessment indicates that impairment exists, an entity is required to measure the investment at fair value.
3. Eliminate the requirement to disclose the fair value of financial instruments measured at amortized cost.
4. Require an entity to present separately in other comprehensive income the portion of the total change in the fair value of a liability resulting from a change in the instrument-specific credit risk when the entity has elected to measure the liability at fair value in accordance with the fair value option for financial instruments.
5. Require separate presentation of financial assets and financial liabilities by measurement category and form of financial asset (that is, securities or loans and receivables) on the balance sheet or the accompanying notes to the consolidated financial statements.
6. Clarify that an entity should evaluate the need for a valuation allowance on a deferred tax asset related to available-for-sale securities in combination with the entity’s other deferred tax assets.

The amendments in this Update are effective for fiscal years beginning after December 15, 2018, and interim periods within fiscal years beginning after December 15, 2019. Early adoption of the amendments in this ASU is permitted as of the fiscal years beginning after December 15, 2017, including interim periods within those fiscal years. In addition, the Bank, as permitted under the ASU, adopted item 3 during fiscal year 2015. The Company is currently reviewing the other amendments in this ASU to determine the impact on its consolidated financial statements.

In February 2016, the FASB issued ASU 2016-02, “Leases (Topic 842).” This ASU was issued to increase transparency and comparability among organizations by requiring reporting entities to recognize all leases, including operating, as lease assets and lease liabilities on the balance sheet and disclosing key information about leasing arrangements. The amendments in this ASU are effective for fiscal years beginning after December 15, 2019. Early application is permitted. The Company anticipates that the adoption of this ASU will not have a material impact on its consolidated financial statements.

In June 2016, the FASB issued ASU 2016-13, “Financial Instruments - Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments.” The amendments in this ASU affect entities holding financial assets and net investment in leases that are not accounted for at fair value through net income. The main objective of this ASU is to provide financial statement users with more decision-useful information about the expected credit losses on financial instruments and other commitments to extend credit held by a reporting entity at each reporting date. To achieve this objective, the amendments in this ASU replace the incurred loss impairment methodology in current GAAP with a methodology that reflects expected credit losses and requires consideration of a broader range of reasonable and supportable information to inform credit loss estimates. This ASU also requires enhanced disclosures to help investors and other financial statement users better understand significant estimates and judgments used in estimating credit losses, as well as the credit quality and underwriting standards of a reporting entity’s portfolio. Additionally, this ASU amends the accounting for credit losses on available-for-sale debt securities and purchased financial assets with credit deterioration. The amendments in this ASU are effective for fiscal years beginning after December 15, 2020, and interim periods within fiscal years beginning after December 15, 2021. All entities may adopt the amendments in this ASU earlier as of the fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. An entity will apply the amendments in this ASU through a cumulative-effect adjustment to retained earnings as of the beginning of the first reporting period in which the guidance is effective (that is, a modified-retrospective approach). The Company is currently reviewing the amendments in this ASU to determine the impact on its consolidated financial statements.

NOTE 3 - INVESTMENTS IN SECURITIES

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

	Amortized Cost Basis	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
		(In Thousands)		
Available-for-sale securities:				
December 31, 2016:				
Debt securities issued by U.S. government corporations and agencies	$ 37,274	$ 114	$ 212	$ 37,176
Debt securities issued by states of the United States and political subdivisions of the states	32,666	204	428	32,442
Mortgage-backed securities	12,344	53	19	12,378
Collateralized mortgage obligations	16,006	-	473	15,533
	$ 98,290	$ 371	$ 1,132	$ 97,529
December 31, 2015:				
Debt securities issued by U.S. government corporations and agencies	$ 22,676	$ 82	$ 48	$ 22,710
Debt securities issued by states of the United States and political subdivisions of the states	31,364	596	21	31,939
Mortgage-backed securities	556	24	-	580
	$ 54,596	$ 702	$ 69	$ 55,229
Held-to-maturity securities:				
December 31, 2016:				
Debt securities issued by states of the United States and political subdivisions of the states	$ 1,130	$ 3	$ 1	$ 1,132
December 31, 2015:				
Debt securities issued by states of the United States and political subdivisions of the states	$ 125	$ 1	$ -	$ 126

The scheduled maturities of debt securities were as follows as of December 31, 2016:

	Available-For-Sale	Held-To-Maturity	
	Fair Value	Amortized Cost Basis	Fair Value
		(In Thousands)	
Due within one year	$ 1,490	$ 1,028	$ 1,031
Due after one year through five years	47,104	102	101
Due after five years through ten years	20,257	-	-
Due after ten years	767	-	-
Mortgage-backed securities	12,378	-	-
Collateralized mortgage obligations	15,533	-	-
	$ 97,529	$ 1,130	$ 1,132

There were no securities of issuers whose aggregate carrying amount exceeded 10% of stockholders' equity as of December 31, 2016.

Debt securities with total carrying amounts of $65,032,000 and $52,189,000 were pledged to secure public funds on deposit, Federal Home Loan Bank advances and available Federal Reserve Bank borrowings as of December 31, 2016 and 2015, respectively.

There were no sales of available-for sale securities during the year ended December 31, 2016. During the year ended December 31, 2015, proceeds from sales of available-for-sale securities amounted to $33,176,000, with gross realized gains of $108,000 and gross realized losses of $5,000.

The aggregate fair value and unrealized losses of securities that have been in a continuous unrealized loss position for less than twelve months and for twelve months or more, and are not other than temporarily impaired, are as follows as of December 31:

	Less than 12 Months		12 Months or Longer		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
	(In Thousands)					
December 31, 2016:						
Debt securities issued by U.S. Government corporations and agencies	$ 19,670	$ 212	$ -	$ -	$ 19,670	$ 212
Debt securities issued by states of the United States and political subdivisions of the states	25,397	428	355	1	25,752	429
Mortgage-backed securities	5,133	19	-	-	5,133	19
Collateralized mortgage obligations	15,532	473	-	-	15,532	473
Total temporarily impaired securities	$ 65,732	$ 1,132	$ 355	$ 1	$ 66,087	$ 1,133
December 31, 2015:						
Debt securities issued by U.S. Government corporations and agencies	$ 7,137	$ 48	$ -	$ -	$ 7,137	$ 48
Debt securities issued by states of the United States and political subdivisions of the states	3,677	10	1,190	11	4,867	21
Total temporarily impaired securities	$ 10,814	$ 58	$ 1,190	$ 11	$ 12,004	$ 69

The investments in the Company’s portfolio that are temporarily impaired as of December 31, 2016 consist of sixteen debt securities issued by U.S. Government corporations and agencies, eighty-five debt securities issued by states of the United States and political subdivisions of the states, and six debt securities collateralized by mortgage obligations. The aggregate unrealized loss from amortized cost basis is 1.69%. The unrealized losses in the above table related to debt securities are attributable primarily to changes in market interest rates and current market inefficiencies in the pricing of these types of securities. Company management has the ability and intent to hold these securities until cost recovery occurs and considers these declines to be temporary.

NOTE 4 - LOANS

Loans consisted of the following as of December 31:

	2016	2015
	(In Thousands)	
Real estate:		
Residential	$ 78,058	$ 72,684
Commercial	206,330	195,526
Home equity	11,554	12,529
Commercial	32,569	34,961
Consumer and other	3,424	3,496
	331,935	319,196
Net deferred loan origination costs	193	185
Allowance for loan losses	(3,728)	(3,092)
Net loans	$ 328,400	$ 316,289

Certain directors and executive officers of the Company and companies in which they have significant ownership interest were customers of the Bank during 2016 and 2015. Total loans to such persons and their companies amounted to $4,229,000 as of December 31, 2016 and $4,236,000 as of December 31, 2015.

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

	Real Estate:						
	Residential	Commercial	Home Equity	Commercial	Consumer and Other	Unallocated	Total
				(In Thousands)			
December 31, 2016:							
Allowance for loan losses:							
Beginning balance	$ 249	$ 2,184	$ 118	$ 515	$ 26	$ -	$ 3,092
Charge-offs	-	(4)	-	(10)	(24)	-	(38)
Recoveries	-	85	-	53	16	-	154
(Benefit) provision	(10)	478	(25)	(70)	19	128	520
Ending balance	$ 239	$ 2,743	$ 93	$ 488	$ 37	$ 128	$ 3,728
Ending balance: Individually evaluated for impairment	$ -	$ -	$ -	$ -	$ -	$ -	$ -
Ending balance: Collectively evaluated for impairment	239	2,743	93	488	37	128	3,728
Total allowance for loan losses ending balance	$ 239	$ 2,743	$ 93	$ 488	$ 37	$ 128	$ 3,728
Loans:							
Ending balance: Individually evaluated for impairment	$ 27	$ 3,469	$ -	$ 1,666	$ -	$ -	$ 5,162
Ending balance: Collectively evaluated for impairment	78,031	202,861	11,554	30,903	3,424	-	326,773
Total loans ending balance	$ 78,058	$ 206,330	$ 11,554	$ 32,569	$ 3,424	$ -	$ 331,935

	Real Estate: Residential	Real Estate: Commercial	Real Estate: Home Equity	Commercial (In Thousands)	Consumer and Other	Unallocated	Total
December 31, 2015:							
Allowance for loan losses:							
Beginning balance	$ 215	$ 1,855	$ 140	$ 490	$ 41	$ 54	$ 2,795
Charge-offs	-	(273)	-	(285)	(28)	-	(586)
Recoveries	-	1	-	20	18	-	39
Provision (benefit)	34	601	(22)	290	(5)	(54)	844
Ending balance	$ 249	$ 2,184	$ 118	$ 515	$ 26	$ -	$ 3,092
Ending balance: Individually evaluated for impairment	$ -	$ -	$ -	$ -	$ -	$ -	$ -
Ending balance: Collectively evaluated for impairment	249	2,184	118	515	26	-	3,092
Total allowance for loan losses ending balance	$ 249	$ 2,184	$ 118	$ 515	$ 26	$ -	$ 3,092
Loans:							
Ending balance: Individually evaluated for impairment	$ 24	$ 5,729	$ -	$ 1,699	$ -	$ -	$ 7,452
Ending balance: Collectively evaluated for impairment	72,660	189,797	12,529	33,262	3,496	-	311,744
Total loans ending balance	$ 72,684	$ 195,526	$ 12,529	$ 34,961	$ 3,496	$ -	$ 319,196

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

	30–59 Days Past Due	60–89 Days Past Due	90 Days or More Past Due	Total Past Due	Total Current (In Thousands)	Total Loans	90 Days or More Past Due and Accruing	Nonaccrual Loans
December 31, 2016:								
Real estate:								
Residential	$ 233	$ 95	$ -	$ 328	$ 77,730	$ 78,058	$ -	$ 219
Commercial	4,224	100	330	4,654	201,676	206,330	-	3,045
Home equity	4	-	-	4	11,550	11,554	-	15
Commercial	1,207	-	180	1,387	31,182	32,569	-	1,666
Consumer and other	-	-	-	-	3,424	3,424	-	
Total	$ 5,668	$ 195	$ 510	$ 6,373	$ 325,562	$ 331,935	$ -	$ 4,945
December 31, 2015:								
Real estate:								
Residential	$ 375	$ 100	$ 95	$ 570	$ 72,114	$ 72,684	$ -	$ 242
Commercial	3,301	210	3,055	6,566	188,960	195,526	-	4,969
Home equity	45	-	7	52	12,477	12,529	-	16
Commercial	463	36	57	556	34,405	34,961	-	1,395
Consumer and other	19	6	-	25	3,471	3,496	-	-
Total	$ 4,203	$ 352	$ 3,214	$ 7,769	$ 311,427	$ 319,196	$ -	$ 6,622

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

	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Interest Income Recognized
			(In Thousands)		
December 31, 2016:					
With no related allowance recorded:					
Real estate:					
Residential	$ 27	$ 27	$ -	$ 28	$ 1
Commercial	3,469	3,573	-	4,358	121
Commercial	1,666	1,666	-	1,746	9
Total impaired with no related allowance	$ 5,162	$ 5,266	$ -	$ 6,132	$ 131
With an allowance recorded:					
Real estate:					
Residential	$ -	$ -	$ -	$ -	$ -
Commercial	-	-	-	-	-
Commercial	-	-	-	-	-
Total impaired with an allowance recorded	$ -	$ -	$ -	$ -	$ -
Total					
Real estate:					
Residential	$ 27	$ 27	$ -	$ 28	$ 1
Commercial	3,469	3,573	-	4,358	121
Commercial	1,666	1,666	-	1,746	9
Total impaired loans	$ 5,162	$ 5,266	$ -	$ 6,132	$ 131
December 31, 2015:					
With no related allowance recorded:					
Real estate:					
Residential	$ 24	$ 24	$ -	$ 26	$ 1
Commercial	5,729	6,803	-	5,107	74
Commercial	1,699	2,239	-	1,028	37
Total impaired with no related allowance	$ 7,452	$ 9,066	$ -	$ 6,161	$ 112
With an allowance recorded:					
Real estate:					
Residential	$ -	$ -	$ -	$ -	$ -
Commercial	-	-	-	-	-
Commercial	-	-	-	-	-
Total impaired with an allowance recorded	$ -	$ -	$ -	$ -	$ -
Total					
Real estate:					
Residential	$ 24	$ 24	$ -	$ 26	$ 1
Commercial	5,729	6,803	-	5,107	74
Commercial	1,699	2,239	-	1,028	37
Total impaired loans	$ 7,452	$ 9,066	$ -	$ 6,161	$ 112

Credit Quality Information

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

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

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

Loans rated 6: Loans in this category are considered "special mention." These loans have potential weaknesses that deserve management's close attention. If left uncorrected, these potential weaknesses may result in deterioration of the repayment prospects for the loan or in the Company's credit position at some future date.

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

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

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

It is the policy of the Company to review the ratings on all commercial and commercial real estate loan relationships annually. The Company also engages an independent third-party to review a significant portion of loans within these segments. Management uses the results of these reviews as part of its annual review process.

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

	Real Estate					
	Residential	Commercial	Home Equity	Commercial	Consumer and Other	Total
			(In Thousands)			
December 31, 2016:						
Loans rated 1-5	$ -	$ 194,203	$ -	$ 30,575	$ -	$ 224,778
Loans rated 6	-	6,729	-	311	-	7,040
Loans rated 7	219	1,929	15	17	-	2,180
Performing loans not rated (A)	77,812	-	11,539	-	3,424	92,775
Impaired loans not rated (A)	27	3,469	-	1,666	-	5,162
Total	$ 78,058	$ 206,330	$ 11,554	$ 32,569	$ 3,424	$ 331,935
December 31, 2015:						
Loans rated 1-5	$ -	$ 187,239	$ -	$ 32,974	$ -	$ 220,213
Loans rated 6	275	2,206	-	87	-	2,568
Loans rated 7	276	352	181	201	-	1,010
Performing loans not rated (A)	72,109	-	12,348	-	3,496	87,953
Impaired loans not rated (A)	24	5,729	-	1,699	-	7,452
Total	$ 72,684	$ 195,526	$ 12,529	$ 34,961	$ 3,496	$ 319,196

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

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

	Number of Contracts	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment
		(Dollars In Thousands)	
December 31, 2016:			
Troubled Debt Restructurings:			
Real estate:			
Residential	1	$ 7	$ 7
Commercial	2	903	903
Commercial	1	302	302
	4	$ 1,212	$ 1,212
December 31, 2015:			
Troubled Debt Restructurings:			
Real estate:			
Commercial	3	$ 1,669	$ 1,669
Commercial	2	1,153	1,153
	5	$ 2,822	$ 2,822

There were four loans modified in 2016 as troubled debt restructurings. Two loans, with a recorded investment of $903,000, were secured by commercial real estate. One modification extended the maturity date and one modification recast the loan's amortization from 13 years to 20 years. One loan, with a recorded investment of $302,000, was secured by non-real estate assets and was modified to extend the maturity date of the loan. One loan, with a recorded investment of $7,000, was secured by residential real estate and was modified to reduce the interest rate and extend the maturity date.

The loans were individually evaluated for impairment and it was determined that no specific allocation was necessary. The loans were reported as impaired and all of the loans were on non-accrual status as of December 31, 2016.

There were five loans modified in 2015 as troubled debt restructurings. Two loans, with a recorded investment of $1,153,000, were secured by non-real estate assets. The modifications allow the borrower to defer the principal portion of payments for a period of six months. Three loans, with a recorded investment of $1,669,000, were secured by commercial real estate. Two modifications allow the borrower to defer the principal portion of payments for a period of six months, and one loan was modified to reduce the interest rate and extend the maturity date.

The loans were individually evaluated for impairment and it was determined that no specific allocation was necessary. The loans were reported as impaired and all of the loans were on non-accrual status as of December 31, 2015.

As of December 31, 2016 and 2015, there were no commitments to lend additional funds to borrowers whose loans were modified in troubled debt restructurings.

There were no loans modified as troubled debt restructurings during the years ended December 31, 2016 and 2015, for which a payment default occurred within twelve months of the restructuring.

As of December 31, 2016 and 2015, there were no consumer mortgage loans collateralized by residential real estate in the process of foreclosure.

Loans serviced for others are not included in the accompanying consolidated balance sheets. The unpaid principal balances of loans serviced for others were $41,539,000 and $48,068,000 at December 31, 2016 and 2015, respectively.

The balance of capitalized net loan servicing rights included in other assets at December 31, 2016 and 2015 was $286,000 and $337,000, respectively. Mortgage servicing rights of $164,000 and $122,000 were capitalized in 2016 and 2015, respectively. Amortization of capitalized mortgage servicing rights was $215,000 and $131,000 in 2016 and 2015, respectively. At December 31, 2016 and 2015, the fair value of the mortgage servicing rights exceeded their carrying value.

NOTE 5 - PREMISES AND EQUIPMENT

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

	2016	2015
	(In Thousands)	
Land	$ 98	$ 98
Buildings and leasehold improvements	9,331	9,270
Furniture and equipment	3,601	3,500
	13,030	12,868
Accumulated depreciation and amortization	(4,871)	(4,359)
	$ 8,159	$ 8,509

Depreciation and amortization expense was $512,000 and $459,000 for the years ended December 31, 2016 and 2015, respectively.

NOTE 6 - DEPOSITS

The aggregate amount of time deposit accounts in denominations that meet or exceed the Federal Deposit Insurance Corporation (FDIC) insurance limit of $250,000 at December 31, 2016 and 2015 was $13,656,000 and $13,393,000, respectively.

As of December 31, 2016, the scheduled maturities of time deposits are as follows:

	(In Thousands)
2017	$ 57,492
2018	22,709
2019	1,908
2020	800
2021	8
Total	$ 82,917

Deposits from related parties held by the Company as of December 31, 2016 and 2015 amounted to $13,671,000 and $11,701,000, respectively.

NOTE 7 - FEDERAL HOME LOAN BANK ADVANCES

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

At December 31, 2016, there was one FHLB advance outstanding in the amount of $10,000,000 with an interest rate of 0.74% and a maturity date of January 6, 2017. At December 31, 2015, there were no FHLB advances outstanding.

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

NOTE 8 - JUNIOR SUBORDINATED DEBENTURES AND NOTES

On September 27, 2004, Kinderhook Capital Trust ("Trust"), a Delaware statutory trust formed by the Company, completed the sale of $2,000,000 of Trust Preferred Securities due December 15, 2034, adjustable every three months at three month LIBOR plus 2.70% ("Capital Securities"). At December 31, 2016 and 2015, the three month LIBOR was 1.00% and 0.61%, respectively. The Trust also issued common securities to the Company and used the net proceeds from the offering to purchase $2,062,000 of Junior Subordinated Deferrable Interest Debentures ("Debentures") of the Company. The Debentures are the sole assets of the Trust. Total expenses associated with the offering of $33,000 were netted against the carrying value of the Debentures and are being amortized on a straight-line basis over the life of the Debentures.

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

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

In November 2016, the Bank borrowed $10,000,000 from other financial institutions in the form of subordinated notes. The subordinated notes are subordinate and junior in right of payment to the Bank's obligations to its depositors, and its other obligations to its general and secured creditors, except such other creditors holding obligations of the Bank ranking on a parity with or junior to these subordinated notes. The subordinated notes carry an interest rate of 6.375%. Interest is paid quarterly with principle due on the maturity date of November 18, 2025. Total expenses associated with the offering of $188,000 were netted against the carrying value of the subordinated notes and are being amortized on a straight-line basis over the contractual term of the notes. The subordinated notes qualify as Tier 2 capital for regulatory purposes.

NOTE 9 - NOTES PAYABLE

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

	2016	2015
	(In Thousands)	
Note payable to a third party maturing August 2022, payable in 180 equal monthly installments of $1,075, bearing interest at a rate of 7.00% as of December 31, 2016 and 2015	$ 60	$ 68
Note payable to a third party maturing November 2019, payable in 48 equal monthly installments of $5,391, bearing interest at a rate of 5.00% as of December 31, 2016 and 2015	170	230
	$ 230	$ 298

At December 31, 2016, scheduled repayments of notes payable obligations are as follows:

	(In Thousands)
2017	$ 66
2018	67
2019	66
2020	11
2021	12
Thereafter	8
Total	$ 230

NOTE 10 - NONCONTROLLING INTEREST IN SUBSIDIARY

The Bank owns 100% of the common stock of its subsidiary, Kinderhook Realty Holding Corp (KRHC). The Bank also owns 94.6% of the KRHC preferred stock. Minority interest in KRHC consists of 114 shares of the preferred stock as of December 31, 2016 and 2015. All voting rights of KRHC vest exclusively with its common stockholder, the Bank. The preferred stock has a liquidation value of $500 per share. The holders of the preferred stock are entitled to receive dividends, when, and if declared by the Board of Directors of KRHC. Such dividends declared are paid on such date as determined by the Board of Directors of KRHC.

NOTE 11 - INCOME TAXES

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

	2016	2015
	(In Thousands)	
Current:		
Federal	$ 1,393	$ 1,515
State	159	177
	1,552	1,692
Deferred:		
Federal	(263)	(298)
State	(33)	(26)
	(296)	(324)
Total income tax expense	$ 1,256	$ 1,368

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

	2016 % of Income	2015 % of Income
Federal income tax at statutory rate	34.0 %	34.0 %
Increase (decrease) in tax resulting from:		
Tax-exempt income	(7.2)	(8.4)
Unallowable expenses	0.6	1.8
Goodwill write-off	-	7.4
Other	(0.7)	0.2
State tax expense, net of federal tax benefit	1.9	2.7
Effective tax rates	28.6 %	37.7 %

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

	2016	2015
	(In Thousands)	
Deferred tax assets:		
Allowance for loan losses	$ 1,520	$ 1,293
Phantom stock appreciation rights	436	423
Interest on nonperforming loans	167	94
Deferred gain	72	103
Lease step-up	13	2
Net unrealized holding loss on available-for-sale securities	296	-
Gross deferred tax assets	2,504	1,915
Deferred tax liabilities:		
Depreciation	(336)	(319)
Servicing asset	(109)	(129)
Net unrealized holding gain on available-for-sale securities	-	(247)
Gross deferred tax liabilities	(445)	(695)
Net deferred tax asset	$ 2,059	$ 1,220

Deferred tax assets as of December 31, 2016 and 2015 have not been reduced by a valuation allowance because management believes that it is more likely than not that the full amount of deferred tax assets will be realized.

It is the Company's policy to provide for uncertain tax positions and the related interest and penalties based upon management's assessment of whether a tax benefit is more likely than not to be sustained upon examination by tax authorities. As of December 31, 2016 and 2015, there were no material uncertain tax positions related to federal and state income tax matters. Interest and penalties, if any, are recorded as income tax expense.

NOTE 12 - EMPLOYEE BENEFITS

Defined Contribution Pension Plan

The Company has a 401(k) plan whereby substantially all employees participate in the plan. The Company matches employee contributions at a rate of 50% of up to 6% of employee salaries for employees enrolled in the plan. In addition, the Company may, in its sole and absolute discretion, make discretionary employer contributions to the plan. For the years ended December 31, 2016 and 2015 the Company made 401(k) contributions of $257,000 and $268,000, respectively.

Phantom Stock Appreciation Rights Plan

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

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

During the years ended December 31, 2016 and 2015, 16,830 and 18,830 PSARs were granted under the Plan, respectively. The total liability for PSARs included in other liabilities was $1,139,000 at December 31, 2016 and $1,104,000 at December 31, 2015. The related expense recognized in 2016 and 2015 was $232,000 and $210,000, respectively.

Employment and Change in Control Agreements

Effective January 1, 2006 and subsequently amended January 27, 2014, the Company entered into Change in Control Agreements ("Agreements") with certain officers of the Company. In accordance with the Agreements, in the event of a change in control, as defined in the Agreements, the officers shall be entitled to a termination payment equal to a multiple, ranging from 1 to 2.99, of their average annual base compensation from the Company over the preceding five years.

Other Postretirement Benefits

In 2008, the Company adopted ASC 715 - 60, "Compensation - Retirement Benefits - Defined Benefit Plans," and recognized a liability for the Company's future postretirement benefit obligations under the Officer Supplemental Life Insurance Plan. The total liability for the arrangements included in other liabilities was $599,000 at December 31, 2016 and $550,000 at December 31, 2015. Expense under this arrangement was $49,000 for 2016 and $147,000 for 2015.

2016 Restricted Stock Plan

The Company adopted the Kinderhook Bank Corp. 2016 Restricted Stock Plan (the "Plan"), to provide officers and employees of the Company with additional incentives to further the success of the Company. In addition, the Plan is intended to further align the interest of officers and employees with the interests of the Company's shareholders. Subject to permitted adjustments for certain corporate transactions, the Plan authorizes the issuance or delivery to participants of up to 30,000 shares of Kinderhook Bank Corp. common stock. The Plan shall be administered and interpreted by a committee (the "Committee"), which shall consist of either the board of directors (the "Board") of the Company or two or more directors appointed by the Board, all of whom (unless the Board determines otherwise) shall be "non-employee directors" of the Board as defined in the plan. The Committee may determine the type and terms and conditions of the awards under the Plan, which shall be set forth in an award agreement delivered to each participant. The Plan was effective upon approval at the June 23, 2016 annual meeting. The plan will terminate on the day immediately preceding the tenth anniversary of its effective date unless terminated earlier by the Board or unless extended by the Board with the approval of the shareholders. However, any termination of the Plan will not affect outstanding awards. On January 2, 2017, 1,900 shares of restricted stock awards were issued or granted. (See Note 22)

NOTE 13 - PERPETUAL PREFERRED STOCK

Preferred stock has certain preferential rights with respect to cash dividends and upon liquidation of the Company. The 12,087 shares of preferred stock issued during 2009 are designated as Series A. All of the shares are non-voting except for certain matters that affect their rights. Holders of the stock are eligible to receive non-cumulative cash dividends in an amount per share equal, on an annual basis, to 6% applied to the Series A issue price of $350, payable on a quarterly basis to holders of record of shares on the dividend record date. In the event of liquidation the holders of these shares are entitled to a preference in liquidation equal to the Series A issue price of $350 per share plus an amount equal to all accrued but unpaid dividends on such shares. If elected by a holder (an Initial Offering Holder) of the Series A preferred stock who acquired his/her interest on or prior to September 30, 2009, or a holder (a Successor Holder) who acquired his/her shares from an Initial Holder, each share of Series A preferred stock can be converted to common shares at a conversion price of $35 per share of common stock for each share of preferred, subject to adjustment in certain circumstances. If a Series A preferred stock holder who is not an Initial Offering Holder or Successor Holder elects to convert Series A preferred stock to common shares after August 15, 2013, the term "Conversion Price" shall mean, with respect to assigned per share value of the common stock, the greater of A) an amount equal to one hundred twenty five percent (125.0%) of the tangible common book value of the Company as determined by the Company's total equity at the most recent quarter-end less any goodwill assets less any accumulated other comprehensive income adjustment (other than for investments marked-to-market) less any non-common equity components (such as preferred stock) divided by the number of common shares outstanding, or B) $35.00 per share of common stock, subject to adjustment. The Company has the right to redeem all or any lesser portion of the outstanding shares after five years of issue at 108% of the liquidation preference of $350 plus accrued but unpaid dividends, but is under no obligation to redeem the preferred shares. At December 31, 2016 and 2015, there are 67,226 of shares authorized as preferred stock that are undesignated as to series and not included in the balance sheet within stockholders' equity.

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

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

The SBLF Preferred Stock qualified as Tier 1 capital and received non-cumulative dividends quarterly on each January 1, April 1, July 1 and October 1, beginning October 1, 2012. The dividend rate fluctuated on a quarterly basis during the first 10 quarters during which the SBLF Preferred Stock was outstanding, based upon changes in the level of "Qualified Small Business Lending" or "QSBL" (as defined in the Purchase Agreement). Based upon the increase in the Bank's level of QSBL over the baseline level calculated under the terms of the Purchase Agreement, at December 31, 2014 and through the redemption date of November 19, 2015 (see below), the dividend rate payable by the Company on the Series B Preferred Stock was 1%.

The SBLF Preferred Stock was non-voting, except in limited circumstances.

On November 19, 2015, the Company redeemed all of the 7,000 outstanding shares of the Company's SBLF Preferred Stock for the liquidation amount of $1,000 per share. The aggregate redemption price of the SBLF Preferred Stock was $7,009,000, including dividends accrued but unpaid through, but not including, the redemption date.

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

NOTE 14 - EARNINGS PER COMMON SHARE

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

	2016	2015
	(In Thousands, Except Share Data)	
Basic earnings per common share computation:		
Net income	$ 3,142	$ 2,259
Preferred stock dividends	(645)	(704)
Net income available to common stockholders	$ 2,497	$ 1,555
Weighted average common shares outstanding, basic	730,861.509	730,861.509
Basic earnings per common share	$ 3.42	$ 2.13
Diluted earnings per common share computation:		
Net income available to common stockholders	$ 2,497	$ 1,555
Effect on income of assumed conversion of preferred stock	645	642
Net income available to common stockholders and assumed conversions	$ 3,142	$ 2,197
Weighted average common shares outstanding, basic	730,861.509	730,861.509
Assumed conversion of preferred stock	327,740.000	327,740.000
Weighted average common shares outstanding, assuming dilution	1,058,601.509	1,058,601.509
Diluted earnings per common share	$ 2.97	$ 2.08

NOTE 15 - OFF-BALANCE SHEET ACTIVITIES

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

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

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

Standby letters of credit are conditional commitments issued by the Company to guarantee the performance by a customer to a third party. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loan facilities to customers. As of December 31, 2016 and 2015, the maximum potential amount of the Company's obligation was $1,658,000 and $1,496,000, respectively, for financial and standby letters of credit. The Company's outstanding letters of credit generally have a term of less than one year. If a letter of credit is drawn upon, the Company may seek recourse through the customer's underlying line of credit. If the customer's line of credit is also in default, the Company may take possession of the collateral, if any, securing the line of credit.

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

	2016	2015
	(In Thousands)	
Commitments to originate loans	$ 10,737	$ 22,664
Unused commitments on commercial loans	28,877	28,699
Standby letters of credit	1,658	1,496
Credit cards, unused credit lines	2,675	2,670
Home equity lines	9,919	8,763
	$ 53,866	$ 64,292

Allowances for possible losses of $241,000 and $284,000 on the above commitments are included in other liabilities at December 31, 2016 and 2015, respectively.

NOTE 16 - FAIR VALUE MEASUREMENTS

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

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

Level 1 - Valuations for assets and liabilities traded in active exchange markets, such as the New York Stock Exchange. Valuations are obtained from readily available pricing sources for market transactions involving identical assets or liabilities.

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

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

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

A description of the valuation methodologies used for instruments measured at fair value, as well as the general classification of such instruments pursuant to the valuation hierarchy, is set forth below. These valuation methodologies were applied to all of the Company's financial assets and financial liabilities carried at fair value for December 31, 2016 and 2015. There were no significant transfers of assets between levels 1 and 2 of the fair value hierarchy during the year ended December 31, 2016.

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

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

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

ASSETS MEASURED AT FAIR VALUE ON A RECURRING BASIS

		Fair Value Measurements at Reporting Date Using:		
	Total	Quoted Prices in Active Markets for Identical Assets Level 1	Significant Other Observable Inputs Level 2	Significant Unobservable Inputs Level 3
		(In Thousands)		
December 31, 2016:				
Debt securities issued by U.S. government corporations and agencies	$ 37,176	$ -	$ 37,176	$ -
Debt securities issued by states of the United States and political subdivisions of the states	32,442	-	32,442	-
Mortgage-backed securities	12,378	-	12,378	-
Collateralized mortgage obligations	15,533	-	15,533	-
Totals	$ 97,529	$ -	$ 97,529	$ -
December 31, 2015:				
Debt securities issued by U.S. government corporations and agencies	$ 22,710	$ -	$ 22,710	$ -
Debt securities issued by states of the United States and political subdivisions of the states	31,939	-	31,939	-
Mortgage-backed securities	580	-	580	-
Totals	$ 55,229	$ -	$ 55,229	$ -

There were no gains or losses for the periods ending December 31, 2016 and 2015 included in earnings attributable to the change in unrealized gains or losses relating to assets still held at the reporting dates.

There were no assets or liabilities carried on the consolidated balance sheets at December 31, 2016 and 2015 for which a nonrecurring change in fair value has been recorded.

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

	December 31, 2016				
	Carrying Amount	Fair Value			
		Level 1	Level 2	Level 3	Total
			(In Thousands)		
Financial assets:					
Cash and cash equivalents	$ 11,076	$ 11,076	$ -	$ -	$ 11,076
Available-for-sale securities	97,529	-	97,529	-	97,529
Held-to-maturity securities	1,130	-	1,132	-	1,132
Federal Home Loan Bank stock	836	836	-	-	836
Federal Reserve Bank stock	705	705	-	-	705
Investment in unconsolidated affiliate	62	-	62	-	62
Loans, net	328,400	-	-	332,319	332,319
Notes receivable	283	-	308	-	308
Accrued interest receivable	1,299	1,299	-	-	1,299
Financial liabilities:					
Deposits	398,587	-	398,882	-	398,882
Federal Home Loan Bank advances	10,000	-	10,000	-	10,000
Junior subordinated debentures and notes	11,876	-	11,623	-	11,623
Notes payable	230	-	239	-	239
Accrued interest payable	303	303	-	-	303

	December 31, 2015				
	Carrying Amount	Fair Value			
		Level 1	Level 2	Level 3	Total
			(In Thousands)		
Financial assets:					
Cash and cash equivalents	$ 26,206	$ 26,206	$ -	$ -	$ 26,206
Available-for-sale securities	55,229	-	55,229	-	55,229
Held-to-maturity securities	125	-	126	-	126
Federal Home Loan Bank stock	355	355	-	-	355
Federal Reserve Bank stock	660	660	-	-	660
Investment in unconsolidated affiliate	62	-	44	-	44
Loans, net	316,289	-	-	325,000	325,000
Notes receivable	447	-	456	-	456
Accrued interest receivable	1,010	1,010	-	-	1,010
Financial liabilities:					
Deposits	367,542	-	367,625	-	367,625
Junior subordinated debentures and notes	11,856	-	11,711	-	11,711
Notes payable	298	-	306	-	306
Accrued interest payable	240	240	-	-	240

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

NOTE 17 - COMMITMENTS

As of December 31, 2016, the Company was obligated under non-cancelable operating leases for premises and equipment expiring between September 2017 and October 2025. The total minimum rental due in future periods under these existing agreements is as follows as of December 31, 2016:

	(In Thousands)
2017	$ 328
2018	209
2019	128
2020	64
2021	69
Thereafter	265
Total	$ 1,063

Certain leases contain provisions for escalation of minimum lease payments contingent upon increases in real estate taxes and percentage increases in the consumer price index. Certain leases contain options to extend for periods from five to thirty-eight years. One of the land leases contains a provision for additional rent based upon the balance of deposit accounts attributable to that branch. The cost of such rentals is not included above. The total rental expense amounted to $504,000 and $473,000 for the years ended December 31, 2016 and 2015, respectively.

At December 31, 2016 and 2015, the Company had $6,250,000 of letters of credit issued by the FHLB of New York to secure municipal deposits. As of December 31, 2016, the letters of credit have terms of less than one year and expire between February 7, 2017 and March 22, 2017. As of December 31, 2015, the letters of credit had terms of less than one year and expired between March 17, 2016 and May 2, 2016.

The Company entered into an agreement with a third party to provide the Company with account processing, item processing and other services. The term of the agreement commenced in August 2016 and expires in March 2021. The Company is obligated to pay minimum monthly charges per the agreement. The Company has the option to terminate the agreement subject to a penalty equal to eighty percent (80%) of the Company's largest monthly invoice for each service received by the Company during the term multiplied by the remaining unused term of the agreement, not to exceed $500,000. As of December 31, 2016, the Company had no intent on terminating the agreement.

NOTE 18 - SIGNIFICANT GROUP CONCENTRATIONS OF CREDIT RISK

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

NOTE 19 - OTHER COMPREHENSIVE LOSS

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

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

	2016	2015
	(In Thousands)	
Unrealized losses on securities:		
Net unrealized holding losses on available-for-sale securities	$ (1,394)	$ (161)
Reclassification adjustment for realized gains in net income (1)	-	(103)
Other comprehensive loss before income tax effect	(1,394)	(264)
Income tax benefit	543	103
Other comprehensive loss, net of tax	$ (851)	$ (161)

(1) Reclassification adjustments are comprised of realized securities gains. The gains during the year ended December 31, 2015 have been reclassified out of accumulated other comprehensive income and have affected certain lines in the consolidated statements of income as follows; the pre-tax amount is included in gain on sales of available-for-sale securities, the tax expense in the amount of $40,000 is included in income tax expense and the after tax amount is included in net income.

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

	2016	2015
	(In Thousands)	
Net unrealized holding (loss) gains on available-for-sale securities, net of tax	$ (465)	$ 386
Accumulated other comprehensive (loss) income	$ (465)	$ 386

NOTE 20 - REGULATORY MATTERS

The Bank, as a National Bank, is subject to the dividend restrictions set forth by the Comptroller of the Currency. Under such restrictions, the Bank may not, without the prior approval of the Comptroller of the Currency, declare dividends in excess of the sum of the current year's earnings (as defined) plus the retained earnings (as defined) from the prior two years. The dividends, as of December 31, 2016 and 2015, that the Bank could declare amounted to $4,231,000 and $3,695,000, respectively.

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

Effective January 1, 2015 (with a phase-in period of two to four years for certain components), the Bank became subject to capital regulations adopted by the Board of Governors of the Federal Reserve System (FRB) and the FDIC, which implement the Basel III regulatory capital reforms and the changes required by the Dodd-Frank Act. The regulations require a common equity Tier 1 (CET1) capital ratio of 4.5%, a minimum Tier 1 capital to risk-weighted assets ratio of 6.0%, a minimum total capital to risk-weighted assets ratio of 8.0%, and a minimum Tier 1 leverage ratio of 4.0%. CET1 generally consists of common stock and retained earnings, subject to applicable adjustments and deductions. Under prompt corrective action regulations, in order to be considered "well capitalized," the Bank must maintain a CET1 capital ratio of 6.5%, a Tier 1 risk based capital ratio of 8.0%, a total risk based capital ratio of 10.0% and a Tier 1 leverage ratio of 5.0%. In addition, the regulations establish a capital conservation buffer above the required capital ratios that phases in beginning January 1, 2016 at 0.625% of risk-weighted assets and increases each year by 0.625% until it is fully phased in at 2.5% effective January 1, 2019. Failure to maintain the capital conservation buffer will limit the ability of the Bank to pay dividends, repurchase shares or pay discretionary bonuses. At December 31, 2016, the Bank exceeded the fully phased in regulatory requirement for the capital conservation buffer.

Management believes, as of December 31, 2016, that the Bank meets all capital adequacy requirements to which it is subject.

As of December 31, 2016, the most recent notification from the Office of the Comptroller of the Currency categorized the Bank as well capitalized under the regulatory framework for prompt corrective action. To be categorized as well capitalized, an institution must maintain minimum total risk-based, Tier 1 risk-based, Common Equity risk-based and Tier 1 leverage ratios as set forth in the following tables. There are no conditions or events since that notification that management believes have changed the Bank's category.

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

	Actual		For Capital Adequacy Purposes		To Be Well Capitalized Under Prompt Corrective Action Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
			(Dollars In Thousands)			
As of December 31, 2016:						
Total Capital (to risk-weighted assets)	$ 47,914	13.59 %	$ 28,202	8.0 %	$ 35,253	10.0 %
Tier 1 Capital (to risk-weighted assets)	43,945	12.47	21,152	6.0	28,202	8.0
Common Equity Tier 1 Capital (to risk-weighted assets)	43,945	12.47	15,864	4.5	22,914	6.5
Tier 1 Capital (to average assets)	43,945	9.61	18,291	4.0	22,863	5.0
As of December 31, 2015:						
Total Capital (to risk-weighted assets)	$ 43,719	12.92 %	$ 27,070	8.0 %	$ 33,838	10.0
Tier 1 Capital (to risk-weighted assets)	40,343	11.92	20,303	6.0	27,070	8.0
Common Equity Tier 1 Capital (to risk-weighted assets)	40,343	11.92	15,227	4.5	21,995	6.5
Tier 1 Capital (to average assets)	40,343	9.82	16,441	4.0	20,551	5.0

NOTE 21 - GOODWILL AND INTANGIBLE ASSETS

On December 8, 2015, the Company sold The Kleeber Agency, Inc., a wholly-owned subsidiary, for a total sales price of $1,869,000, less commissions and working capital totaling $96,000. The Company received $1,773,000 in cash proceeds at closing. The assets sold consisted primarily of intangible assets. The Company recognized a gain on sale of $472,000 as follows:

	(In Thousands)
Net sales price	$ 1,773
Tangible assets sold	(79)
Intangible assets sold (including goodwill)	(1,222)
Gain on sale	$ 472

Amortization of covenants not to compete was being calculated on a straight-line basis and amortization of customer lists was being calculated using the sum-of-the-years' digits method. During the year ended December 31, 2015, aggregate amortization expense was $90,000.

NOTE 22 - AGREEMENT AND PLAN OF MERGER

On March 14, 2017, the Company signed an Agreement and Plan of Merger (Agreement) with Patriot Federal Bank (Patriot). The proposed merger is an all-stock transaction. Pursuant to the terms of the Agreement, Patriot would merge into the Bank and Patriot shareholders would receive 0.3 shares of Company common stock for each share of Patriot common stock. Upon closing, Patriot shareholders will own approximately 29% of the stock of the combined company, on a fully-diluted basis. The transaction is subject to receipt of state and federal regulatory approvals and approval by the requisite votes of the shareholders of Patriot, and is expected to close in the fourth quarter of 2017. The Agreement contains certain provisions which state that in the event the Agreement is terminated, Patriot shall pay the Company a termination fee of $525,000.

NOTE 23 - SUBSEQUENT EVENTS

Management has evaluated subsequent events through March 23, 2017, which is the date the consolidated financial statements were available to be issued. Management has not evaluated subsequent events after that date for inclusion in the consolidated financial statements.

On January 2, 2017, the Company issued 1,900 shares of restricted stock awards to certain officers and employees under the Restricted Stock Plan at $33.78 per share. (See Note 12).

On January 6, 2017, the Company entered into an agreement to purchase real estate in the amount of $2,500,000. This transaction is expected to close in the first quarter of 2017.

NOTE 24 - RECLASSIFICATIONS

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