

*Jeffersonville  
Bancorp*



 **JEFF BANK**

*2016 Annual Report*



## A letter from the President & Chairman of the Board

It is with great pleasure that we share with you this report for Jeffersonville Bancorp (the “Company”), which outlines continued improvement in financial performance in 2016. Our strategy to pursue controlled growth, which has been the vision of the board of directors and management, was well executed over the past year. For the year ended December 31, 2016, the Company earned net income of \$5,118,000 or \$1.21 per share compared with \$4,708,000 or \$1.11 per share for the year ended December 31, 2015. Total assets of the Company grew by \$24,105,000 or 5.2%. Loans, net of allowance for loan losses, grew by \$16,118,000 or 6.0%. Our return on average assets of 1.06x continues to compare favorably to our local and regional competition.

During 2016, we had two significant changes in the composition of the board of directors of the Company. In March 2016, we sadly lost Mr. John Gempler, who served as a director for almost 35 years. Mr. Gempler was only the third secretary of the bank, serving in the role since 1986. An outspoken advocate for the Company and our shareholders, Mr. Gempler helped to grow the bank into the sound financial institution it is today. He has been sorely missed by all those who knew him.

In October 2016, Mr. James “Mickey” Roche announced his retirement from the board of directors after 37 years of service. Mr. Roche served on every committee of the board during that time. Mickey was a steward of the bank providing his knowledge and business acumen for the benefit of our customers, employees and shareholders. We miss Mickey’s tireless work ethic and sense of humor at our frequent meetings and wish him the very best in retirement.

During 2016, we made several strategic decisions to grow the Jeff Bank brand which included opening a new branch in the City of Port Jervis in Orange County, New York. We also completed the construction/renovation of a branch located at 18 Anawana Lake Road in Monticello, New York. The former Wal-Mart branch location was relocated to the 18 Anawana Lake Road location after it was completed in June 2016. These changes highlight the commitment and vision shared by the board of directors and management to capitalize on the improving economy in both Sullivan and Orange Counties. The Port Jervis branch is performing well with organic growth of deposits and loans. It provides access to a new market in Orange County as well as neighboring counties in Pennsylvania and New Jersey. We continue to believe there is opportunity for additional economic growth in Sullivan County related to development of the Montreign Resort Casino and associated businesses. Other industries in Sullivan County, particularly those benefiting from increased tourism, are also experiencing improving economic trends.

The Company saw improvement in our stock price during 2016 with a 22.1% increase in per share value. The change in presidential administrations has spawned renewed optimism in regulatory relief for banks combined with the possibility of reductions in corporate tax rates. Both events will likely benefit Jeff Bank and community banks in general in the coming years. However, net interest margin in 2016 continued to decline for the Company as limited loan demand and increased competition for loans drove rates for new loans lower for most of the year. The Federal Open Markets Committee increased the Fed Funds rate by 25 basis points in December 2016. The bank’s variable rate loan portfolio immediately realizes the benefit from increased rates through higher interest income. The Federal Reserve Bank has signaled the likelihood it will continue to increase interest rates in 2017. Strategically, we made it a goal to shorten the duration of the loan portfolio in an effort to reduce the risk associated with rising interest rates. In the short-term, the Company is well positioned to benefit from the potential of rising rates, as our cost of funds will likely remain low, therefore increasing net interest margins.

As previously mentioned, the loan portfolio showed solid growth in 2016, albeit with lower rates. The growth occurred in the commercial loan portfolio, which generally has shorter interest rate terms and therefore less exposure to interest rate risk. While commercial loans generally have higher credit risk than most types of consumer loans, it remains a top priority of the board of directors and management to preserve a conservative credit culture at the bank. Our experienced lending professionals prudently and conservatively underwrite commercial loans to strict policy standards. We are not immune to credit losses and are vigilant in our portfolio monitoring and collection processes.

Jeff Bank proudly maintained its dominant position in Sullivan County with a 32.8% deposit market share at June 30, 2016. Deposit growth during the year occurred in core deposits, which continue to represent the bank’s primary source of funding. Another strategic initiative in 2016 was identification and optimization of individual branch financial performance. With alternative delivery channels available for bank transactions (i.e., on-line banking and mobile banking), the bank has experienced a declining trend in branch transactions which is consistent across the banking industry. Consistent with this strategic initiative, on January 4, 2017, we announced the difficult decision to close our Bloomingburg branch because of underperformance. We believe the branch’s closure on April 14, 2017, will provide for a reduction in operating expenses and will improve the return on earning assets for the bank and our shareholders. Customers who currently utilize the Bloomingburg branch will continue to have access to our full range of banking services at the nearby Wurtsboro location.

We will continue to build upon the successes of past years and believe that the strategic changes made in 2016 will better position the Company for further prosperity. Jeff Bank is uniquely positioned to benefit from improving trends in our local and national economy. We are very appreciative of the continued support of our shareholders, employees and customers. If you have any questions regarding this report please don’t hesitate to contact us. Thank you for your continued confidence.



A handwritten signature in orange ink that reads "George W. Kinne, Jr." in a cursive style.

**George W. Kinne, Jr.**  
President & Chief Executive Officer



A handwritten signature in orange ink that reads "K.C. Klein" in a cursive style.

**Kenneth C. Klein,**  
Chairman of the Board



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## **Independent Auditor's Report**

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

We have audited the accompanying consolidated financial statements of Jeffersonville Bancorp and its subsidiary, 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.

### ***Auditor's Responsibility***

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

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

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



*Opinion*

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Jeffersonville Bancorp and its subsidiary as of December 31, 2016 and 2015, and the results of their operations and their cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

*BDO USA, LLP*

Harrisburg, Pennsylvania  
March 22, 2017

**Jeffersonville Bancorp and Subsidiary**  
**Consolidated Balance Sheets**

(In thousands, except share and per share data)

As of December 31,	2016	2015
<b>ASSETS</b>		
Cash and cash equivalents	\$ 45,684	\$ 40,187
Securities available for sale, at fair value	90,073	95,064
Securities held to maturity, fair value of \$28,492 at December 31, 2016 and \$20,148 at December 31, 2015	28,730	19,666
Loans, net of allowance for loan losses of \$3,692 at December 31, 2016 and \$4,075 at December 31, 2015	286,165	270,047
Accrued interest receivable	1,800	1,894
Bank-owned life insurance	16,817	17,401
Foreclosed real estate	988	1,381
Premises and equipment, net	7,898	6,908
Restricted investments	559	566
Other assets	<u>5,057</u>	<u>6,552</u>
Total Assets	<u>\$ 483,771</u>	<u>\$ 459,666</u>
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
Liabilities		
Deposits:		
Demand deposits (non-interest bearing)	\$ 108,392	\$ 101,918
NOW and super NOW accounts	74,327	58,938
Savings and insured money market deposits	136,070	125,743
Time deposits	<u>98,638</u>	<u>106,724</u>
Total Deposits	417,427	393,323
Other liabilities	<u>5,795</u>	<u>7,484</u>
Total Liabilities	<u>423,222</u>	<u>400,807</u>
Stockholders' equity		
Series A preferred stock, no par value; 2,000,000 shares authorized, none issued	—	—
Common stock, \$0.50 par value; 11,250,000 shares authorized, 4,767,786 shares issued with 4,234,505 outstanding	2,384	2,384
Paid-in capital	6,483	6,483
Treasury stock, at cost; 533,281 shares	(4,965)	(4,965)
Retained earnings	59,275	56,528
Accumulated other comprehensive loss	<u>(2,628)</u>	<u>(1,571)</u>
Total Stockholders' Equity	<u>60,549</u>	<u>58,859</u>
Total Liabilities and Stockholders' Equity	<u>\$ 483,771</u>	<u>\$ 459,666</u>

See accompanying notes to consolidated financial statements.

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

For the Years Ended December 31,	2016	2015
<b>INTEREST AND DIVIDEND INCOME</b>		
Loan interest and fees	\$ 14,487	\$ 14,738
Securities:		
Taxable	971	876
Tax-exempt	2,431	2,377
Other interest and dividend income	<u>220</u>	<u>84</u>
Total Interest and Dividend Income	18,109	18,075
<b>INTEREST EXPENSE</b>		
Deposits	<u>922</u>	<u>992</u>
Net interest income	17,187	17,083
Provision for loan losses	<u>100</u>	<u>100</u>
Net Interest Income after Provision for Loan Losses	<u>17,087</u>	<u>16,983</u>
<b>NON-INTEREST INCOME</b>		
Service charges	1,216	1,309
Fee income	1,321	1,273
Earnings on bank-owned life insurance	389	405
Life insurance benefit	248	—
Net gain on sales of securities	—	23
Other non-interest income	<u>193</u>	<u>208</u>
Total Non-Interest Income	<u>3,367</u>	<u>3,218</u>
<b>NON-INTEREST EXPENSES</b>		
Salaries and employee benefits	8,368	8,727
Occupancy and equipment expenses	1,978	2,035
Advertising expense	141	126
Foreclosed real estate expense, net	189	321
Other non-interest expenses	<u>3,419</u>	<u>3,139</u>
Total Non-Interest Expenses	<u>14,095</u>	<u>14,348</u>
Income before income tax expense	6,359	5,853
Income tax expense	<u>1,241</u>	<u>1,145</u>
Net Income	<u>\$ 5,118</u>	<u>\$ 4,708</u>
Basic earnings per common share	<u>\$ 1.21</u>	<u>\$ 1.11</u>
Average common shares outstanding	<u>4,235</u>	<u>4,235</u>
Cash dividends declared per share	<u>\$ 0.56</u>	<u>\$ 0.56</u>

See accompanying notes to consolidated financial statements.

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

For the Years Ended December 31,	2016	2015
Net Income	\$ 5,118	\$ 4,708
Other comprehensive income (loss):		
Securities available for sale:		
Net unrealized holding losses	(1,254)	(264)
Income tax benefit	450	96
Net unrealized holding losses, net of tax	(804)	(168)
Reclassification adjustment for net realized gains included in income <sup>(1) (3)</sup>	—	(23)
Income tax expense	—	8
Reclassification adjustment for net realized gains included in income, net of tax	—	(15)
Change in pension and post retirement liabilities <sup>(2)</sup>	(395)	891
Income tax (expense) benefit <sup>(3)</sup>	142	(321)
Amortization of pension and post retirement liabilities' gains (losses), net of tax	(253)	570
Other comprehensive income (loss), net of tax	(1,057)	387
Comprehensive income	<u>\$ 4,061</u>	<u>\$ 5,095</u>

(1) Amounts are included in net gain on sales of securities on the Consolidated Statements of Income as a separate element in total non-interest income.

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

(3) Income tax amounts are included in income tax expense on the Consolidated Statements of Income.

See accompanying notes to consolidated financial statements.

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

For the Years Ended December 31, 2016 and 2015	Common stock	Paid-in capital	Treasury stock	Retained earnings	Accumulated other compre- hensive loss	Total stockholders' equity	Common shares issued and outstanding
Balance at January 1, 2015	\$ 2,384	\$ 6,483	\$ (4,965)	\$ 54,191	\$ (1,958)	\$ 56,135	4,235
Net income	—	—	—	4,708	—	4,708	—
Other comprehensive income	—	—	—	—	387	387	—
Cash dividends (\$0.56 per share)	—	—	—	(2,371)	—	(2,371)	—
Balance at December 31, 2015	2,384	6,483	(4,965)	56,528	(1,571)	58,859	4,235
Net income	—	—	—	5,118	—	5,118	—
Other comprehensive loss	—	—	—	—	(1,057)	(1,057)	—
Cash dividends (\$0.56 per share)	—	—	—	(2,371)	—	(2,371)	—
Balance at December 31, 2016	<u>\$ 2,384</u>	<u>\$ 6,483</u>	<u>\$ (4,965)</u>	<u>\$ 59,275</u>	<u>\$ (2,628)</u>	<u>\$ 60,549</u>	<u>4,235</u>

See accompanying notes to consolidated financial statements.



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

For the Years Ended December 31,	2016	2015
<b>OPERATING ACTIVITIES:</b>		
Net income	\$ 5,118	\$ 4,708
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for loan losses	100	100
Depreciation and amortization	604	541
Valuation allowance on premises and equipment	170	—
Amortization of bond premium, net	1,146	1,128
Net loss on sale of premise and equipment	4	28
Net gain on revaluation and sale of foreclosed real estate	(2)	(21)
Earnings on bank-owned life insurance and life insurance benefit	(389)	(405)
Life insurance benefit	(248)	—
Net gain on sales of securities	—	(23)
Deferred income tax expense	351	626
(Increase) decrease in accrued interest receivable	94	(17)
(Increase) decrease in other assets	1,738	(1,334)
Increase (decrease) in other liabilities	(2,084)	782
Net Cash Provided by Operating Activities	<u>6,602</u>	<u>6,113</u>
<b>INVESTING ACTIVITIES:</b>		
Proceeds from maturities and calls:		
Securities available for sale	14,121	12,951
Securities held to maturity	1,901	696
Proceeds from sales of securities available for sale	369	2,777
Purchases:		
Securities available for sale	(11,626)	(7,382)
Securities held to maturity	(11,240)	(13,154)
Net (increase) decrease in loans	(16,479)	2,571
Proceeds from cash surrender value of bank owned life insurance	1,221	—
Proceeds on foreclosed property insurance claim	15	—
Net redemption of restricted investments	7	2
Purchases of premises and equipment	(1,768)	(1,317)
Proceeds from sales of foreclosed real estate	641	978
Net Cash Used in Investing Activities	<u>(22,838)</u>	<u>(1,878)</u>
<b>FINANCING ACTIVITIES:</b>		
Net increase in deposits	24,104	16,832
Cash dividends paid	(2,371)	(2,371)
Net Cash Provided by Financing Activities	<u>21,733</u>	<u>14,461</u>
Net Increase in Cash and Cash Equivalents	5,497	18,696
Cash and Cash Equivalents at Beginning of Year	40,187	21,491
Cash and Cash Equivalents at End of Year	<u>\$ 45,684</u>	<u>\$ 40,187</u>
<b>SUPPLEMENTAL INFORMATION:</b>		
Cash paid for interest	\$ 925	\$ 997
Cash paid for income taxes	697	606
Transfer of loans to foreclosed real estate	261	620

See accompanying notes to consolidated financial statements.

## **(1) Summary of Significant Accounting Policies**

### ***Basis of Presentation***

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

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

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

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

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

The Company has evaluated subsequent events and transactions occurring through March 22, 2017; the date these consolidated financial statements were available for issuance.

### ***Investment Securities***

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

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

A security is considered impaired when its amortized cost basis exceeds its fair value at the consolidated balance sheet date. All securities are evaluated on at least a quarterly basis, and more frequently when market conditions warrant such an evaluation, to determine whether the impairment is other-than-temporary. To determine whether an impairment is other-than-temporary, management utilizes criteria such as the reasons underlying the impairment, and the magnitude and duration of the impairment. The Company follows accounting guidance related to recognition and presentation of other-than-temporary impairment. This guidance specifies that (a) if an entity does not have the intent to sell a debt security prior to recovery and (b) it is more likely than not that it will not have to sell the debt security prior to recovery, the security would not be considered other-than-temporarily impaired unless there is a credit loss. The term "other-than-temporary" is not intended to indicate that the decline is permanent, but indicates that the prospects for a near-term recovery of value are not necessarily favorable, or that there is a lack of evidence to support a realizable value equal to or greater than the carrying value of the security. In addition, the total impairment for debt securities is separated into the amount of the impairment related to (a) credit loss and (b) the amount of the impairment related to all other factors, such as interest rate changes. The amount of credit loss, if any, is calculated as the difference between the present value of the cash flows expected to be collected and the amortized cost basis of a security. Once an impairment is determined to be other-than-temporary, the impairment related to credit loss, if any, is charged to income and the amount of the impairment related to all other factors is recognized in other comprehensive income (loss). No impairment charge was recognized during the years ended December 31, 2016 or 2015. For further discussion see Note 3.

### ***Loans***

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

### ***Allowance for Loan Losses***

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

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

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

#### ***Bank-Owned Life Insurance***

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

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

#### ***Foreclosed Real Estate***

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

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

#### ***Premises and Equipment***

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

#### ***Restricted Investments***

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

#### ***Advertising Costs***

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

#### ***Income Taxes***

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

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

#### ***Earnings Per Common Share***

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

### **Recent Accounting Pronouncements**

In January 2016, the FASB issued ASU 2016-01, *Recognition and Measurement of Financial Assets and Liabilities Subtopic (825-10)*, which requires an entity to: (i) measure equity investments at fair value through net income, with certain exceptions; (ii) present in OCI the changes in instrument-specific credit risk for financial liabilities measured using the fair value option; (iii) present financial assets and financial liabilities by measurement category and form of financial asset; (iv) calculate the fair value of financial instruments for disclosure purposes based on an exit price and; (v) assess a valuation allowance on deferred tax assets related to unrealized losses of AFS debt securities in combination with other deferred tax assets. The Update provides an election to subsequently measure certain nonmarketable equity investments at cost less any impairment and adjusted for certain observable price changes. The Update also requires a qualitative impairment assessment of such equity investments and amends certain fair value disclosure requirements. The new standard is effective for nonpublic entities for fiscal years beginning after December 15, 2018 with early adoption permitted only for the provision related to instrument-specific credit risk and the fair value disclosure exemption provided to nonpublic entities. The Company is currently evaluating the impact of the adoption of this guidance on its consolidated financial statements.

In February 2016, the FASB ASU 2016-02, *Leases (Topic 842)*, for both lessees and lessors. Under its core principle, a lessee will recognize lease assets and liabilities on the balance sheet for all arrangements with terms longer than 12 months. Lessor accounting remains largely consistent with existing U.S. GAAP. The new standard takes effect for nonpublic entities with fiscal years beginning after December 15, 2019 with early adoption permitted. Specific transition requirements apply. The Company is currently evaluating the impact of the adoption of this guidance on its consolidated financial statements.

In May 2014, the FASB issued ASU 2014-09, *Revenue from Contracts with Customers (Topic 606)*. This standards update provides a framework that replaces most existing revenue recognition guidance. The guidance requires an entity to recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the company expects to be entitled in exchange for those goods or services. In August 2015, ASU 2015-14 deferred the effective date by two years. The revised effective date is for interim and annual reporting periods beginning after December 15, 2018 with early adoption permitted only for annual reporting periods beginning after December 15, 2016. The Company is currently evaluating the impact of the adoption of this guidance on its consolidated financial statements.

In June 2016, the FASB issued ASU 2016-13, *Financial Instruments—Credit Losses - Measurement of Credit Losses on Financial Instruments Subtopic (326)*, which requires credit losses on most financial assets measured at amortized cost and certain other instruments to be

measured using an expected credit loss model (referred to as the current expected credit loss (CECL) model). Under this model, entities will estimate credit losses over the entire contractual term of the instrument (considering estimated prepayments, but not expected extensions or modifications unless reasonable expectation of a troubled debt restructuring exists) from the date of initial recognition of that instrument.

The ASU also replaces the current accounting model for purchased credit impaired loans and debt securities. The allowance for credit losses for purchased financial assets with a more-than insignificant amount of credit deterioration since origination (“PCD assets”), should be determined in a similar manner to other financial assets measured on an amortized cost basis. However, upon initial recognition, the allowance for credit losses is added to the purchase price (“gross up approach”) to determine the initial amortized cost basis. The subsequent accounting for PCD financial assets is the same expected loss model described above.

Further, the ASU made certain targeted amendments to the existing impairment model for available-for-sale (AFS) debt securities. For an AFS debt security for which there is neither the intent nor a more-likely-than-not requirement to sell, an entity will record credit losses as an allowance rather than a write-down of the amortized cost basis. Certain incremental disclosures are required.

The new standard is effective for nonpublic entities for fiscal years beginning after December 15, 2020 with early adoption for fiscal years beginning after December 15, 2018 and interim periods within those periods. An entity will apply the amendments in this Update through a cumulative-effect adjustment to retained earnings as of the beginning of the first reporting period in which the guidance is effective. The Company is currently evaluating the impact of the adoption of this guidance on its consolidated financial statements.

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

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## **(2) Cash and Cash Equivalents**

The Bank is required to maintain certain reserves in the form of vault cash and/or deposits with the Federal Reserve Bank (FED). There was no reserve requirement by the FED at December 31, 2016 or 2015. Cash and due from banks includes interest earning deposits at the FED. The interest earning balance at the FED was \$28.4 million and \$28.8 million at December 31, 2016 and December 31, 2015, respectively. As of December 31, 2016 and 2015, the Bank has deposits with correspondent banks in excess of federally insured limits in the amount of \$7.8 million and \$4.4 million respectively.

### (3) Investment Securities

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

Investment Securities	Amortized cost	Gross unrealized gains	Gross unrealized losses	Fair value
<b>December 31, 2016</b>				
Securities Available for Sale:				
Government Sponsored Enterprises (GSE)	\$ 4,326	\$ —	\$ (146)	\$ 4,180
Obligations of states and political subdivisions – New York State	53,722	923	(49)	54,596
Mortgage-backed securities and collateralized mortgage obligations – GSE residential	13,932	160	(142)	13,950
Corporate debt – financial services industry	<u>15,564</u>	<u>69</u>	<u>(91)</u>	<u>15,542</u>
	87,544	1,152	(428)	88,268
Equity securities – financial services industry	<u>1,604</u>	<u>214</u>	<u>(13)</u>	<u>1,805</u>
Total securities available for sale	<u>\$ 89,148</u>	<u>\$ 1,366</u>	<u>\$ (441)</u>	<u>\$ 90,073</u>
Securities Held to Maturity – Obligations of states and political subdivisions	<u>\$ 28,730</u>	<u>\$ 247</u>	<u>\$ (485)</u>	<u>\$ 28,492</u>
<b>December 31, 2015</b>				
Securities Available for Sale:				
Obligations of states and political subdivisions – New York State	\$ 60,781	\$ 1,868	\$ (24)	\$ 62,625
Mortgage-backed securities and collateralized mortgage obligations – GSE residential	17,223	203	(185)	17,241
Corporate debt – financial services industry	<u>12,832</u>	<u>83</u>	<u>(59)</u>	<u>12,856</u>
	90,836	2,154	(268)	92,722
Equity securities – financial services industry	<u>2,049</u>	<u>294</u>	<u>(1)</u>	<u>2,342</u>
Total securities available for sale	<u>\$ 92,885</u>	<u>\$ 2,448</u>	<u>\$ (269)</u>	<u>\$ 95,064</u>
Securities Held to Maturity – Obligations of states and political subdivisions	<u>\$ 19,666</u>	<u>\$ 489</u>	<u>\$ (7)</u>	<u>\$ 20,148</u>

Included in securities available for sale are Government Sponsored Enterprises (GSE) including securities of the Federal Home Loan Bank (FHLB), Federal Home Loan Mortgage Corporation (FHLMC or “Freddie Mac”), Government National Mortgage Association (GNMA or “Ginnie Mae”), and Federal National Mortgage Association (FNMA or “Fannie Mae”). FHLB, FHLMC, and FNMA securities are not backed by the full faith of the U.S. government. Also included are agency bonds issued by Federal Government agencies such as the Small Business Administration (SBA) which are backed by the full faith and credit of the U.S. government. Because of different structures, liquidity and possible call risk SBA’s may provide a slightly higher rate of interest than Treasury bonds. Substantially all mortgage-backed securities and collateralized mortgage obligations consist of residential mortgage securities and are securities guaranteed by Ginnie Mae, Freddie Mac, or Fannie Mae. Obligations of state and political subdivisions are general obligation and revenue bonds of New York State municipalities, agencies, and authorities. General obligation bonds must have a nationally recognized statistical rating organization (NRSRO) investment grade rating in the top four categories (S&P “BBB-” or higher). Revenue bonds must have an

NRSRO rating in the top three categories (S&P “A” or higher). Corporate debt securities are comprised of bonds with an NRSRO rating in the top four investment grades (S&P “BBB-” or higher).

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

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



There were no sales of securities held to maturity during the years ended December 31, 2016 or 2015. Proceeds from sale, gross gains and gross losses realized on sales of securities available for sale were as follows for the years ended December 31 (in thousands).

<b>Net Security Gains</b>	<b>2016</b>	<b>2015</b>
Gross proceeds	\$ 369	\$ 2,777
Gross realized gains	\$ 1	\$ 30
Gross realized losses	(1)	(7)
Net gain on sale of securities	<u>\$ —</u>	<u>\$ 23</u>

The amortized cost and estimated fair value of debt securities available for sale and held to maturity at December 31, 2016, by remaining period to contractual maturity, are shown in the following table (in thousands). Actual maturities will differ from contractual maturities because of security prepayments and the right of certain issuers to call or prepay their obligations.

<b>Available for Sale Securities</b>	<b>Amortized cost</b>	<b>Estimated fair value</b>
Within one year	\$ 24,137	\$ 24,262
One to five years	39,589	40,150
Five to ten years	9,376	9,419
Over ten years	<u>510</u>	<u>487</u>
	73,612	74,318
Mortgage-backed securities	<u>13,932</u>	<u>13,950</u>
	<u>\$ 87,544</u>	<u>\$ 88,268</u>

<b>Held to Maturity Securities</b>	<b>Amortized cost</b>	<b>Estimated fair value</b>
Within one year	\$ 2,560	\$ 2,596
One to five years	5,790	5,843
Five to ten years	19,449	19,121
Over ten years	<u>931</u>	<u>932</u>
	<u>\$ 28,730</u>	<u>\$ 28,492</u>

Securities available for sale with an estimated fair value of \$37,288,000, and \$41,280,000 at December 31, 2016 and 2015 respectively, were pledged to secure public funds on deposit and for other purposes.

Investment securities in a continuous unrealized loss position are reflected in the following table which groups individual securities by length of time that they have been in a continuous unrealized loss position and then details by investment category the number of instruments aggregated with their gross unrealized losses and fair values at December 31, 2016 and 2015 (dollars in thousands):

<b>Investment Securities</b>	<b>Less than 12 months</b>		<b>12 months or more</b>			<b>Total</b>			
	<b>No.</b>	<b>Estimated fair value</b>	<b>No.</b>	<b>Estimated fair value</b>	<b>Unrealized losses</b>	<b>No.</b>	<b>Estimated fair value</b>	<b>Unrealized losses</b>	
<b>December 31, 2016</b>									
Securities Available for Sale:									
Debt Securities:									
Government Sponsored Enterprises (GSE)	7	\$ 4,180	\$ 146	—	\$ —	\$ —	7	\$ 4,180	\$ 146
Obligations of states and political sub-divisions - New York State	48	7,372	49	—	—	—	48	7,372	49
Mortgage-backed securities and collateralized mortgage obligations – GSE residential	6	3,332	61	4	2,015	81	10	5,347	142
Corporate debt – financial services industry	11	3,375	18	1	928	73	12	4,303	91
Equity security – financial services industry	4	167	13	—	—	—	4	167	13
Total securities available for sale	<u>76</u>	<u>\$ 18,426</u>	<u>\$ 287</u>	<u>5</u>	<u>\$ 2,943</u>	<u>\$ 154</u>	<u>81</u>	<u>\$ 21,369</u>	<u>\$ 441</u>
Held to Maturity securities	<u>72</u>	<u>\$ 15,606</u>	<u>\$ 485</u>	<u>—</u>	<u>—</u>	<u>—</u>	<u>72</u>	<u>\$ 15,606</u>	<u>\$ 485</u>
<b>December 31, 2015</b>									
Securities Available for Sale:									
Debt Securities:									
Obligations of states and political sub-divisions - New York State	6	\$ 1,783	\$ 23	2	\$ 89	\$ 1	8	\$ 1,872	\$ 24
Mortgage-backed securities and collateralized mortgage obligations – GSE residential	7	5,042	39	6	4,033	146	13	9,075	185
Corporate debt – financial services industry	7	3,378	59	—	—	—	7	3,378	59
Equity security – financial services industry	1	126	1	—	—	—	1	126	1
Total securities available for sale	<u>21</u>	<u>\$ 10,329</u>	<u>\$ 122</u>	<u>8</u>	<u>\$ 4,122</u>	<u>\$ 147</u>	<u>29</u>	<u>\$ 14,451</u>	<u>\$ 269</u>
Held to Maturity securities	<u>8</u>	<u>\$ 2,222</u>	<u>\$ 7</u>	<u>—</u>	<u>—</u>	<u>—</u>	<u>8</u>	<u>\$ 2,222</u>	<u>\$ 7</u>

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

Management believes that none of the unrealized losses on debt or equity securities at December 31, 2016 are due to the underlying credit quality of the issuers of the securities, but instead are primarily related to market interest rates, and the full value of the securities will be realized. Additionally, the Company does not intend to sell the securities and it is more-likely-than-not that the Company will not be required to sell the securities before recovery of their amortized cost. Therefore, no other-than-temporary impairment charge was recognized for the years ended December 31, 2016 or, 2015. Management believes the unrealized losses related to the equity security held at December 31, 2016 does not represent other-than-temporary impairment as the loss is believed to be due to market fluctuations and management believes the share price will recover.

#### (4) Restricted Investments

Restricted investments include stock held in correspondent banks and the Federal Reserve Bank. As a member of the Federal Home Loan Bank of New York (FHLB), the Company is required to purchase and hold stock in the FHLB to satisfy membership and borrowing requirements. This stock is restricted in that it can only be sold to the FHLB or to another member institution and all sales of FHLB stock must be at par value. As a result of these restrictions, FHLB stock is unlike the Company’s other

investment securities insofar as there is no trading market for FHLB stock and the transfer price is determined by FHLB membership rules, not by market participants. As of December 31, 2016 and 2015, FHLB stock totaled \$349,000 and \$356,000, respectively, and is included as a part of restricted investments on the consolidated balance sheets.

#### (5) Loans

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

Loans, Net	2016	2015
Commercial		
Commercial real estate loans:		
Commercial mortgage	\$ 113,221	\$ 105,450
Farm land	4,936	5,817
Construction	15,870	7,144
Total commercial real estate loans	<u>134,027</u>	<u>118,411</u>
Other commercial loans:		
Commercial loans	32,310	31,642
Agricultural loans	922	837
Total other commercial loans	<u>33,232</u>	<u>32,479</u>
Total commercial loans	<u>167,259</u>	<u>150,890</u>
Consumer		
Consumer real estate loans:		
Residential mortgage	92,661	92,829
Home equity	22,342	24,645
Construction	3,501	1,404
Total residential real estate loans	<u>118,504</u>	<u>118,878</u>
Other consumer loans:		
Consumer installment loans	2,674	2,996
Other consumer loans	1,420	1,358
Total other loans	<u>4,094</u>	<u>4,354</u>
Total consumer loans	<u>122,598</u>	<u>123,232</u>
Total gross loans	289,857	274,122
Allowance for loan losses	<u>(3,692)</u>	<u>(4,075)</u>
Total loans, net	<u>\$ 286,165</u>	<u>\$ 270,047</u>

Included in the above loan amounts are deferred loan fees and origination costs of \$507,000 and \$482,000 as of December 31, 2016 and 2015, respectively.

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

### Nonperforming Loans

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

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

<b>Nonperforming Loans</b>	<b>Total Loans</b>	<b>Commercial Real Estate</b>	<b>Commercial Other</b>	<b>Residential Real Estate</b>
December 31, 2016				
Nonaccrual loans	\$ 6,695	\$ 5,060	\$ 100	\$ 1,535
Troubled debt restructures	<u>868</u>	<u>644</u>	<u>—</u>	<u>224</u>
Total nonaccrual loans	7,563	5,704	100	1,759
Loans past due 90 days or more and still accruing interest	<u>629</u>	<u>58</u>	<u>—</u>	<u>571</u>
Total nonperforming loans	<u>\$ 8,192</u>	<u>\$ 5,762</u>	<u>\$ 100</u>	<u>\$ 2,330</u>
December 31, 2015				
Nonaccrual loans	\$ 5,589	\$ 4,920	\$ —	\$ 669
Troubled debt restructures	<u>759</u>	<u>574</u>	<u>—</u>	<u>185</u>
Total nonaccrual loans	6,348	5,494	—	854
Loans past due 90 days or more and still accruing interest	<u>676</u>	<u>—</u>	<u>—</u>	<u>676</u>
Total nonperforming loans	<u>\$ 7,024</u>	<u>\$ 5,494</u>	<u>\$ —</u>	<u>\$ 1,530</u>

There were no nonperforming loans in the other consumer loans classes at December 31, 2016 or 2015.

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

The recorded investment in consumer mortgage loans secured by residential real estate properties where formal foreclosure procedures are in process at December 31, 2016 was \$899,000. The recorded investment in consumer mortgage loans secured by residential real estate properties included in foreclosed real estate at December 31, 2016 was \$186,000.

Impaired loans are also included in nonperforming loans in the table above. The table below presents impaired loans, including troubled debt restructurings, as of December 31, 2016 and December 31, 2015 and their effect on interest income for the periods then ended (in thousands).

<b>Impaired Loans</b>	<b>Total Loans</b>	<b>Commercial Real Estate</b>	<b>Commercial Other</b>	<b>Residential Real Estate</b>
<b>December 31, 2016</b>				
Unpaid principal balance	\$ 8,893	\$ 7,615	\$ 378	\$ 900
Recorded investment	\$ 6,755	\$ 5,988	\$ 100	\$ 667
Average balance	\$ 7,153	\$ 6,409	\$ 75	\$ 669
Interest income:				
Interest contractually due at original rates	\$ 516	\$ 472	\$ 6	\$ 38
Interest income recognized	\$ 396	\$ 332	\$ 13	\$ 51
Impaired loans:				
With no allowance	\$ 6,148	\$ 5,425	\$ 100	\$ 623
With an allowance recorded	\$ 563	\$ 563	\$ —	\$ —
Related specific allowance	\$ 175	\$ 175	\$ —	\$ —
<b>December 31, 2015</b>				
Unpaid principal balance	\$ 8,078	\$ 7,132	\$ —	\$ 946
Recorded investment	\$ 6,507	\$ 5,794	\$ —	\$ 713
Average balance	\$ 7,046	\$ 6,091	\$ —	\$ 955
Interest income:				
Interest contractually due at original rates	\$ 508	\$ 453	\$ —	\$ 55
Interest income recognized	\$ 347	\$ 295	\$ —	\$ 52
Impaired loans:				
With no allowance	\$ 5,397	\$ 4,684	\$ —	\$ 713
With an allowance recorded	\$ 1,110	\$ 1,110	\$ —	\$ —
Related specific allowance	\$ 389	\$ 389	\$ —	\$ —

Loans restructured under the guidelines of ASC 310-40 *Receivables Troubled Debt Restructures by Creditors* are disclosed below as of and for the years ended December 31, 2016 and 2015 (in thousands):

<b>Troubled Debt Restructuring</b>	<b>No.</b>	<b>Pre-Mod-ification Recorded investment</b>	<b>Post-Mod-ification recorded investment</b>	<b>Current recorded investment</b>
<b>December 31, 2016</b>				
Commercial:				
Real estate	4	\$ 785	\$ 792	\$ 644
Consumer:				
Real estate	7	901	967	667
<b>December 31, 2015</b>				
Commercial:				
Real estate	4	\$ 785	\$ 792	\$ 665
Consumer:				
Real estate	6	862	923	713
For the year ended December 31, 2016				
Consumer:				
Real estate	1	\$ 41	\$ 44	\$ 44

A loan is classified as a troubled debt restructuring ("TDR") when a concession that the Bank would not otherwise have considered is granted to a borrower experiencing financial difficulty. Most of the Bank's TDRs involve the restructuring of loan terms to reduce the total payment amount in order to assist those borrowers who are experiencing temporary financial difficulty. In a TDR, the Bank may also increase loan balances for unpaid interest and fees or acquire additional collateral to secure its position.

During the year ending December 31, 2016 the Bank had one new consumer loan that qualified as a TDR. During the year ended December 31, 2015 the Bank had no new TDRs. As of December 31, 2016 and 2015 the Bank had total charge offs of \$336,000 for borrowers whose loan terms have been modified as TDRs. There were no additional charge offs during 2016 or 2015. At December 31, 2016 and 2015, the Bank had a total of \$1,312,000 and \$1,378,000, respectively, in TDRs which did not require a specific reserve. The Bank has not committed to lend any additional funds to customers whose loans are classified as a TDR as of December 31, 2016. The Bank evaluates TDRs that are over 60 days past due to determine whether or not they are in default. However, all TDRs over 90 days past due are reported as "in default". For the year ended December 31, 2015 there were no TDRs considered to be in default for loans restructured in the preceding twelve months, however during the year ended December 31, 2016 one consumer mortgage was in default.

### **Loan Credit Quality Information**

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

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

At underwriting, all unsecured commercial loans in excess of \$10,000 and secured commercial loans in excess of \$25,000 are assigned a risk rating in conformity with the loan review and risk identification policy. All commercial loans with aggregate relationship exposure of \$100,000 or more are required to be reviewed annually. The analysis is compared to any financial covenants to ensure conformity. If the analysis reveals non-conformity, the applicable lending officer or loan committee may recommend corrective action including a revised loan risk rating, non-renewal of lines of credit, reduction in lines of credit, or collection action.

Once a loan is underwritten, the risk rating is updated if the lending officer notes either positive or negative characteristics in the loan.

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



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

Loans by Risk Ratings	Total	Commercial		Consumer		
		Real Estate	Other	Real Estate	Installment	Other
December 31, 2016						
Pass	\$ 72,329	\$ 56,394	\$ 15,935			
Pass watch	82,333	66,492	15,841			
Special mention	532	459	73			
Substandard	10,051	9,325	726			
Doubtful	175	175	—			
Non-reviewed	124,437	1,182	657	\$ 118,504	\$ 2,674	\$ 1,420
Total	<u>\$ 289,857</u>	<u>\$ 134,027</u>	<u>\$ 33,232</u>	<u>\$ 118,504</u>	<u>\$ 2,674</u>	<u>\$ 1,420</u>
December 31, 2015						
Pass	\$ 65,499	\$ 49,156	\$ 16,343			
Pass watch	69,492	55,419	14,073			
Special mention	3,865	3,062	803			
Substandard	9,815	9,319	496			
Doubtful	424	424	—			
Non-reviewed	125,027	1,031	764	\$ 118,878	\$ 2,996	\$ 1,358
Total	<u>\$ 274,122</u>	<u>\$ 118,411</u>	<u>\$ 32,479</u>	<u>\$ 118,878</u>	<u>\$ 2,996</u>	<u>\$ 1,358</u>

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

Category of loans	30-59 Days past due	60-89 Days past due	Greater than 90 Days	Total past due	Current	Total loans	Over 90 and accruing
2016							
Commercial real estate	\$ 2,215	\$ 366	\$ 3,045	\$ 5,626	\$ 128,401	\$ 134,027	\$ 58
Residential real estate	1,725	2,005	1,579	5,309	113,195	118,504	571
Commercial other	205	193	—	398	32,834	33,232	—
Consumer installment	39	—	—	39	2,635	2,674	—
Other consumer	—	—	—	—	1,420	1,420	—
Total	<u>\$ 4,184</u>	<u>\$ 2,564</u>	<u>\$ 4,624</u>	<u>\$ 11,372</u>	<u>\$ 278,485</u>	<u>\$ 289,857</u>	<u>\$ 629</u>
2015							
Commercial real estate	\$ 984	\$ 2,078	\$ 3,699	\$ 6,761	\$ 111,650	\$ 118,411	\$ —
Residential real estate	1,881	1,482	1,045	4,408	114,470	118,878	676
Commercial other	194	6	—	200	32,279	32,479	—
Consumer installment	33	4	—	37	2,959	2,996	—
Other consumer	—	—	—	—	1,358	1,358	—
Total	<u>\$ 3,092</u>	<u>\$ 3,570</u>	<u>\$ 4,744</u>	<u>\$ 11,406</u>	<u>\$ 262,716</u>	<u>\$ 274,122</u>	<u>\$ 676</u>

As of December 31, 2016 and 2015, nonaccrual loans included \$3.6 million and \$2.3 million of loans, respectively, which are paying currently but have not met the specific criteria to be placed on accrual status.

#### Allowance for Loan Losses

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

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

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

These allowance pool rates are then adjusted based on management's current assessment of eight risk factors. These risk factors are:

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

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

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

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

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

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

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

Allowance for Loan Losses	Total	Commercial		Consumer			Unallocated
		Real Estate	Other	Real Estate	Installment	Other	
December 31, 2016:							
Beginning balance January 1	\$ 4,075	\$ 2,146	\$ 376	\$ 1,359	\$ —	\$ 38	\$ 156
Charge-offs	(536)	(402)	(34)	(48)	(14)	(38)	—
Recoveries	53	—	7	2	23	21	—
Provision	100	302	16	(170)	(9)	4	(43)
Ending balance December 31	<u>\$ 3,692</u>	<u>\$ 2,046</u>	<u>\$ 365</u>	<u>\$ 1,143</u>	<u>\$ —</u>	<u>\$ 25</u>	<u>\$ 113</u>
Ending balance as related to allowance:							
Evaluated collectively							
[general reserve]	\$ 3,517	\$ 1,871	\$ 365	\$ 1,143	\$ —	\$ 25	\$ 113
Evaluated individually							
[specific reserve]	175	175	—	—	—	—	—
Total Allowance for Loan Losses	<u>\$ 3,692</u>	<u>\$ 2,046</u>	<u>\$ 365</u>	<u>\$ 1,143</u>	<u>\$ —</u>	<u>\$ 25</u>	<u>\$ 113</u>
Ending balance as related to loans:							
Loans evaluated collectively	\$ 283,146	\$ 128,039	\$ 33,132	\$ 117,881	\$ 2,674	\$ 1,420	
Loans evaluated individually	6,711	5,988	100	623	—	—	
Total Loans	<u>\$ 289,857</u>	<u>\$ 134,027</u>	<u>\$ 33,232</u>	<u>\$ 118,504</u>	<u>\$ 2,674</u>	<u>\$ 1,420</u>	
December 31, 2015:							
Beginning balance January 1	\$ 4,353	\$ 1,848	\$ 652	\$ 1,472	\$ 25	\$ 41	\$ 315
Charge-offs	(824)	(225)	(118)	(420)	(11)	(50)	—
Recoveries	446	276	71	20	49	30	—
Provision	100	247	(229)	287	(63)	17	(159)
Ending balance December 31	<u>\$ 4,075</u>	<u>\$ 2,146</u>	<u>\$ 376</u>	<u>\$ 1,359</u>	<u>\$ —</u>	<u>\$ 38</u>	<u>\$ 156</u>
Ending balance as related to allowance:							
Evaluated collectively							
[general reserve]	\$ 3,686	\$ 1,757	\$ 376	\$ 1,359	\$ —	\$ 38	\$ 156
Evaluated individually							
[specific reserve]	389	389	—	—	—	—	—
Total Allowance for Loan Losses	<u>\$ 4,075</u>	<u>\$ 2,146</u>	<u>\$ 376</u>	<u>\$ 1,359</u>	<u>\$ —</u>	<u>\$ 38</u>	<u>\$ 156</u>
Ending balance as related to loans:							
Loans evaluated collectively	\$ 267,615	\$ 112,617	\$ 32,479	\$ 118,165	\$ 2,996	\$ 1,358	
Loans evaluated individually	6,507	5,794	—	713	—	—	
Total Loans	<u>\$ 274,122</u>	<u>\$ 118,411</u>	<u>\$ 32,479</u>	<u>\$ 118,878</u>	<u>\$ 2,996</u>	<u>\$ 1,358</u>	

There are no commitments to lend additional funds on the above noted non-performing loans. Management has determined that the majority of these non-performing loans remain well collateralized. Based on its comprehensive analysis of the loan portfolio, and since the Company has no exposure to subprime loans, management believes the current level of the allowance for loan losses is adequate. However, regulatory agencies, as an integral part of their examination process, periodically review the Company's allowance for loan losses and may require the Company to recognize additions to the allowance based on their judgments about information available to them at the time of their examination, which may not be currently available to management.

## (6) Premises and Equipment

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

Premise and Equipment, Net	2016	2015
Land	\$ 2,157	\$ 2,157
Buildings and improvements	9,801	8,886
Furniture and fixtures	502	435
Equipment	<u>4,169</u>	<u>3,782</u>
Total premises and equipment	16,629	15,260
Valuation allowance	(170)	—
Less accumulated depreciation and amortization	<u>(8,561)</u>	<u>(8,352)</u>
Premises and equipment, net	<u>\$ 7,898</u>	<u>\$ 6,908</u>

Depreciation and amortization expense was \$604,000 and \$541,000 in 2016 and 2015, respectively. Included in "Occupancy and equipment expenses", the Company recognized a \$170,000 valuation allowance on the contracted sale of the Bloomingburg branch.

The Company has three leases for branches located in Callicoon, Wurtsboro and Port Jervis which expire in 2017, 2020 and 2021, respectively. The Monticello lease which expired in 2016 was not renewed. A renewal option exists for Callicoon for an additional 10 years. Total rent expense for the years ended December 31, 2016 and 2015 was \$92,000 and \$91,000, respectively. The Company's contractual obligation on future minimum non-cancellable lease payments as of December 31, 2015, is as follows (in thousands):

### Future Minimum Lease Payments, for the years ending:

2017	\$ 75
2018	65
2019	62
2020	43
2021	18
2022 and thereafter	—
	<u>\$ 263</u>

## (7) Time Deposits

The following is a summary of time deposits at December 31, 2016 by remaining period to contractual maturity (in thousands):

Within one year	\$ 64,011
One to two years	23,125
Two to three years	4,770
Three to four years	3,416
Four to five years	3,316
Over five years	—
Total time deposits	<u>\$ 98,638</u>

Time deposits of \$250,000 or more totaled \$9,344,000 and \$11,117,000 at December 31, 2016 and 2015, respectively.

## (8) Short-Term Borrowings

There were no short-term borrowings as of December 31, 2016 or 2015. At December 31, 2016, the Bank maintained unsecured lines of credit with Atlantic Community Bank for \$7.0 million and First Tennessee Bank for \$5.0 million. The Bank has access to a primary credit line with the Federal Reserve Discount Window (Discount Window) which would be available upon collateralization by securities held in trust. Currently there is no available credit. The Bank, as a member of the FHLB, has access to a line of credit program with a maximum borrowing capacity of \$48.9 million as of December 31, 2016 which is collateralized by mortgage loans and FHLB stock. During 2016 and 2015, there were no borrowings at any month-end. During the year ended 2016, the Bank borrowed an average balance of \$1,000 with an average interest rate of .02%. During 2015, the Bank borrowed an average balance of \$1,000 with an average interest rate of .67%.

## (9) Federal Home Loan Bank Borrowings

As of December 31, 2016 and December 31, 2015, the Bank had no Federal Home Loan Bank Borrowings.

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

## (10) Income Taxes

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

Income Tax Expense	2016	2015
Current:		
Federal	\$ 772	\$ 466
State	118	52
Deferred	<u>351</u>	<u>626</u>
	<u>\$ 1,241</u>	<u>\$ 1,145</u>

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

Income Tax Expense (Benefit)	2016		2015	
	Amount	% <sup>(1)</sup>	Amount	% <sup>(1)</sup>
Tax at statutory rate	\$ 2,167	34%	\$ 1,990	34%
State taxes, net of Federal				
Tax benefit	81	1	114	2
Tax-exempt interest and dividends	(822)	(13)	(801)	(14)
Interest expense allocated to tax-exempt securities	11	—	12	—
Bank-owned life insurance	(217)	(3)	(138)	(2)
Other adjustments	<u>21</u>	<u>—</u>	<u>(32)</u>	<u>—</u>
Income tax expense	<u>\$ 1,241</u>	<u>19%</u>	<u>\$ 1,145</u>	<u>20%</u>

<sup>(1)</sup> Percentage is of pre-tax income

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

<b>Deferred Tax Asset, Net</b>	<b>2016</b>	<b>2015</b>
Deferred tax assets:		
Allowance for loan losses in excess of tax bad debt reserve	\$ 1,157	\$ 1,251
Retirement benefits	12	173
Alternative minimum tax credit carryforward	362	208
Depreciation	415	529
Foreclosed real estate	87	137
Other comprehensive income (retirement benefits)	1,810	1,668
Other	141	63
Total deferred tax assets	<u>3,984</u>	<u>4,029</u>
Deferred tax liabilities:		
Prepaid expenses	(100)	(93)
Other comprehensive income:		
Unrealized gain on securities available for sale	(333)	(785)
Total deferred tax liabilities	<u>(433)</u>	<u>(878)</u>
Net deferred tax asset		
(included in other assets)	<u>\$ 3,551</u>	<u>\$ 3,151</u>

In assessing the ability to realize the Company's total deferred tax assets, management considers whether it is more likely than not that some portion or all of those assets will not be realized. Based upon management's consideration of historical and anticipated future pre-tax income, as well as the reversal period for the items giving rise to the deferred tax assets and liabilities, a valuation allowance for deferred tax assets was not considered necessary at December 31, 2016 and 2015.

No unrecognized tax benefits are expected to arise within the next twelve months. The Company files income tax returns in both the US Federal and New York State tax jurisdictions. The Company is no longer subject to examination by the US Federal for years before 2013 and NYS taxing authorities for years before 2013.

### (11) Regulatory Capital Requirements

State-chartered, nonmember banks are required to maintain minimum levels of regulatory capital in accordance with regulations of the Federal Deposit Insurance Corporation ("FDIC") as amended January 1, 2015. FDIC regulations require a minimum leverage ratio of Tier I capital to total adjusted assets of 4.0%, and minimum ratios of Common equity Tier I (CET1) capital, Tier 1 capital and Total capital to risk-weighted assets of 4.5%, 6.0% and 8.0%, respectively.

Under its prompt corrective action regulations, the FDIC is required to take certain supervisory actions (and may take additional discretionary actions) with respect to an undercapitalized bank. Such actions could have a direct material effect on banks' financial statements. The regulations establish a framework for the classification of banks into four categories: well capitalized, adequately capitalized, undercapitalized, and significantly undercapitalized. Generally, a bank is considered well capitalized if it has a CET1 capital ratio of at least 6.5%, a Tier I risk-based capital ratio of at least 8.0%, and a total risk-based capital ratio of at least 10.0%.

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

Management believes that, as of December 31, 2016 and 2015, the Bank met all capital adequacy requirements to which it is subject. Further, the most recent FDIC notification categorized the Bank as a well-capitalized bank under the prompt corrective action regulations. There have been no conditions or events since that notification that management believes have changed the Bank's capital classification.

The following is a summary of the actual capital amounts and ratios as of December 31, 2016 and 2015 for the Bank compared to the required ratios for minimum capital adequacy and for classification as well-capitalized (dollars in thousands):

<b>Regulatory Capital</b>	<b>Actual</b>		<b>Required Ratios</b>		
	<b>Amount</b>	<b>Ratio</b>	<b>Minimum Buffer</b>	<b>Well capital adequacy</b>	<b>capital-ized</b>
December 31, 2016:					
Leverage (Tier I) capital	\$52,854	11.0%		4.0%	N/A
Risk-based capital:					
CET1	52,854	16.8	6.5	4.5	6.5
Tier I	52,854	16.8	8.0	6.0	8.0
Total	56,554	17.9	10.0	8.0	10.0
December 31, 2015:					
Leverage (Tier I) capital	\$53,059	11.6%		4.0%	N/A
Risk-based capital:					
CET1	53,059	17.4		4.5	6.5
Tier I	53,059	17.4		6.0	8.0
Total	56,876	18.6		8.0	10.0

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



## (12) Stockholders' Equity

### **Dividend Restrictions**

Dividends paid by the Bank are the primary source of funds available to the Parent Company for payment of dividends to its stockholders and for working capital needs. Applicable Federal and state statutes, regulations and guidelines impose restrictions on the amount of dividends that may be declared by the Bank. Under these restrictions, the dividends declared and paid by the Bank to the Parent Company may not exceed the total amount of the Bank's net profit retained in the current year plus its retained net profits, as defined, from the two preceding years. The Bank's retained net profits available for dividends at December 31, 2016 totaled \$4,509,000.

## (13) Comprehensive Income

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

At December 31, 2016 and 2015, the components of accumulated other comprehensive income (loss) reflected on the consolidated balance sheets are as follows (in thousands):

<b>Accumulated Other Comprehensive Loss, Net of Tax</b>	<b>2016</b>	<b>2015</b>
Supplemental executive retirement plan	\$ (433)	\$ (450)
Defined benefit pension liability	(4,596)	(4,184)
Net unrealized holding gains on securities available for sale	<u>925</u>	<u>2,179</u>
Accumulated other comprehensive loss, before income tax	(4,104)	(2,455)
Income tax related to accumulated other comprehensive loss	<u>1,476</u>	<u>884</u>
Accumulated other comprehensive loss, net of tax	<u>\$ (2,628)</u>	<u>\$ (1,571)</u>

## (14) Related Party Transactions

Certain directors and executive officers of the Company, as well as certain affiliates of these directors and officers, have engaged in loan transactions with the Company.

Outstanding loans to these related parties are summarized as follows at December 31 (in thousands):

<b>Related Party Transactions</b>	<b>2016</b>	<b>2015</b>
Directors	\$ 1,671	\$ 3,205
Executive officers (non-directors)	<u>379</u>	<u>462</u>
	<u>\$ 2,050</u>	<u>\$ 3,667</u>

During 2016, total advances to these directors and officers were \$27,000, and total loan payments and reclassifications due to retirements was \$1,644,000. Directors and officers had unused lines of credit with the Company of \$413,000 and \$580,000 at December 31, 2016 and 2015, respectively. As of December 31, 2016 and 2015, the amount of deposits of related parties was \$1,306,000 and \$1,830,000 respectively.

## (15) Employee Benefit Plans

### **Pension Benefits**

The Company has a noncontributory defined benefit pension plan. The plan was amended on September 30, 2011 to be closed to new participants hired after September 30, 2010. The Company's funding policy is to contribute annually an amount sufficient to satisfy the minimum funding requirements of the Employee Retirement Income Security Act, but not greater than the maximum amount that can be deducted for Federal income tax purposes. Contributions are intended to provide not only for benefits attributed to service to date, but also for benefits expected to be earned in the future.

The Company has no minimum required pension contribution for 2017, however the Company expects to contribute \$500,000 to its pension plan in 2017. Benefits, which reflect estimated future employee service, are expected to be paid as follows (in thousands):

### **Estimated Future Benefits**

2017	\$ 767
2018	760
2019	757
2020	759
2021	763
Years 2022-2026	4,056

The following is a summary of changes in the benefit obligations and plan assets for the pension plan for the December 31, 2016 and 2015 measurement dates, together with a reconciliation of the plan's funded status to the amounts recognized in the consolidated balance sheets (in thousands).

**Changes in Benefit Obligations, Plan Assets and Funded Status**

<b>As of the Measurement Date, December 31,</b>	<b>2016</b>	<b>2015</b>
Change in benefit obligation:		
Beginning of year	\$ 14,081	\$ 14,773
Service cost	375	410
Interest cost	621	578
Actuarial (gain) loss	544	(936)
Benefits paid and expected expenses	<u>(815)</u>	<u>(744)</u>
End of year	<u>14,806</u>	<u>14,081</u>
Changes in fair value of plan assets:		
Beginning of year	12,184	12,115
Actual return on plan assets	794	324
Employer contributions	1,700	500
Benefits paid and actual expenses	<u>(821)</u>	<u>(755)</u>
End of year	<u>13,857</u>	<u>12,184</u>
Funded status at end of year, recognized		
In other liabilities on the balance sheet	\$ <u>(949)</u>	\$ <u>(1,897)</u>
Amounts recognized in accumulated other comprehensive loss consists of:		
Unrecognized actuarial loss	\$ <u>(4,596)</u>	\$ <u>(4,184)</u>
Net amount recognized	\$ <u>(4,596)</u>	\$ <u>(4,184)</u>

The projected benefit obligation for the pension plan was \$14,806,000 and \$14,081,000 at December 31, 2016 and 2015, respectively. The accumulated benefit obligation for the pension plan was \$14,300,000 and \$13,600,000 at December 31, 2016 and 2015, respectively.

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

**Net Periodic Benefit Cost**

<b>For the year ended December 31,</b>	<b>2016</b>	<b>2015</b>
Net periodic benefit cost:		
Service cost	\$ 375	\$ 410
Interest cost	621	578
Expected return on plan assets	(886)	(789)
Recognized net actuarial loss	<u>230</u>	<u>261</u>
Net Periodic Benefit Cost	<u>\$ 340</u>	<u>\$ 460</u>
Net (gain) loss	\$ 642	\$ (461)
Amortization of net loss	<u>(230)</u>	<u>(261)</u>
Total recognized in other comprehensive income (loss)	\$ <u>412</u>	\$ <u>(722)</u>

**Net Periodic Benefit Cost**

<b>For the year ended December 31,</b>	<b>2016</b>	<b>2015</b>
Continued:		
Total recognized in net periodic benefit cost (income) and other comprehensive (loss)	\$ <u>752</u>	\$ <u>(262)</u>

The estimated net loss for the defined benefit pension plan that will be amortized from accumulated other comprehensive loss into net periodic benefit cost during 2017 is \$262,000.

The Company measures its pension obligation using the RP-2000 with generational projection Scale BB mortality table for its pension plan. Assumptions used to determine benefit obligations for the pension plan and for the other postretirement benefits plan as of the December 31 measurement date were as follows:

<b>Benefit Obligation Assumptions</b>	<b>2016</b>	<b>2015</b>
Discount rate	4.41%	4.55%
Rate of compensation increase	3.00	3.00

As of December 31, 2016 the pension plan discount rate decreased to 4.41% compared to 4.55% as of December 31, 2015 due to observations of estimates inherent in market data.

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

<b>Net Periodic Benefit</b>	<b>2016</b>	<b>2015</b>
Discount rate	4.55%	4.03%
Expected long-term rate of return on plan assets	6.75	6.75
Rate of compensation increase	3.00	3.00

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

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

<b>Pension Plan Asset Allocation</b>	<b>2016</b>	<b>2015</b>
Asset category:		
Equity securities	45%	45%
U.S. Government securities	5	4
Debt securities	12	12
Mutual funds	38	37
Other	—	2

The following table presents pension plan assets measured at fair value on a recurring basis by their level within the fair value hierarchy as of December 31, 2016 and 2015, dollars in thousands. Financial assets are classified based on the lowest level of input that is significant to their fair value measurement.

Fair Value Hierarchy For Pension Plan Assets	Total	(Level 1) Quoted Prices in Active Markets for Identical Assets	(Level 2) Significant Other Observable Inputs	(Level 3) Significant Unobservable Inputs
Asset category as of December 31, 2016:				
Cash and cash equivalents	\$ 46	\$ 46	\$ —	\$ —
Bonds:				
U.S. government agency	698	—	698	—
Municipal	626	—	626	—
U.S. corporate	811	—	811	—
Foreign corporate	207	—	207	—
Equity securities:				
U.S. companies	5,997	5,997	—	—
International companies	270	270	—	—
Mutual funds:				
U.S. companies	781	781	—	—
International companies	763	763	—	—
U.S. companies – fixed income	3,479	3,479	—	—
International companies - fixed income	179	179	—	—
	<u>\$ 13,857</u>	<u>\$ 11,515</u>	<u>\$ 2,342</u>	<u>\$ —</u>
Asset category as of December 31, 2015:				
Cash and cash equivalents	\$ 230	\$ 230	\$ —	\$ —
Bonds:				
U.S. government agency	501	—	501	—
Municipal	636	—	636	—
U.S. corporate	611	—	611	—
Foreign corporate	209	—	209	—
Equity securities:				
U.S. companies	5,207	5,207	—	—
International companies	273	273	—	—
Mutual funds:				
U.S. companies	745	745	—	—
International companies	674	674	—	—
U.S. companies – fixed income	2,855	2,855	—	—
International companies - fixed income	243	243	—	—
	<u>\$ 12,184</u>	<u>\$ 10,227</u>	<u>\$ 1,957</u>	<u>\$ —</u>

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

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

### **Directors Survival Insurance**

The Company maintains a separate insurance program for Directors. The benefits accrued under this plan totaled \$150,000 at December 31, 2016 and 2015 and is unfunded. The Company recorded an expense of \$11,000 relating to this plan during the year ended December 31, 2015. There was no expense in 2016 as the plan had reached its maximum accrual limit.

### **Profit Incentive Program**

The Company maintains a profit incentive program for all employees. There were no accrued benefits at December 31, 2016 or 2015 as benefits are paid in the year earned. The Company recorded an expense of \$608,000, and \$449,000 relating to this plan during the years ended December 31, 2016 and 2015, respectively.

### **Tax-Deferred Savings Plan**

The Company maintains a qualified 401(k) plan for all employees, which permits tax-deferred employee contributions up to the greater of 75% of salary or the maximum allowed by law and provides for matching contributions by the Company. The Company matches 100% of employee contributions up to 4% of the employee's salary and 25% of the next 2% of the employee's salary. The Company incurred annual expenses of \$227,000 and \$215,000 in 2016 and 2015, respectively.

### **Supplemental Executive Retirement Plan**

The Company maintains a Supplemental Executive Retirement Plan for certain executive officers primarily to restore benefit reductions in certain employee benefit plans due to Internal Revenue Service regulations. The benefits accrued under this plan totaled \$3,108,000 at December 31, 2016 and \$3,189,000 at December 31, 2015 and are unfunded. The Company recorded an expense of \$354,000 and \$421,000 relating to this plan during the years ended December 31, 2016 and 2015, respectively.

### **Director Retirement Plan**

The Company maintains a Director Retirement Plan in order to provide certain retirement benefits to participating directors. Generally, each participating director receives an annual retirement benefit of eighty percent of their average annual cash compensation during the three highest calendar years, as defined in the plan. This annual retirement benefit is payable until death and may not exceed \$40,000 per year. The benefits accrued under this plan totaled \$566,000 and \$746,000 at December 31, 2016 and 2015, respectively, and are unfunded. Due to a withdrawal of a participant of the plan, the Company recorded a benefit of \$126,000 during the year ended December 31, 2016. The Company recorded an expense of \$88,000, relating to this plan during the years ended December 31, 2015.

## **(16) Commitments and Contingent Liabilities**

### **Legal Proceedings**

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

### **Off-Balance-Sheet Financial Instruments**

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

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

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

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

<b>Off-Balance Sheet Financial Instruments</b>	<b>2016</b>	<b>2015</b>
Loan origination commitments and unused lines of credit:		
Commercial and residential mortgages	\$ 4,039	\$ 4,031
Commercial loans	34,500	29,761
Home equity lines	<u>7,126</u>	<u>7,075</u>
	45,665	40,867
Capital expenditures	—	1,307
Standby letters of credit	<u>329</u>	<u>201</u>
	<u>\$ 45,994</u>	<u>\$ 42,375</u>

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

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

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

The Company does not issue any guarantees that would require liability-recognition or disclosure, other than its standby letters of credit. The Company has issued unconditional commitments in the form of standby letters of credit to guarantee payment on behalf of a customer and guarantee the performance of a customer to a third party. Standby letters of credit generally arise in connection with lending relationships. The credit risk involved in issuing these instruments is essentially the same as that involved in extending loans to customers. Contingent obligations under standby letters of credit totaled \$329,000 and \$201,000 at December 31, 2016 and 2015, respectively, and represent the maximum potential future payments the Company could be required to make. Typically, these instruments have terms of twelve months or less and expire unused; therefore, the total amounts do not necessarily represent

future cash requirements. Each customer is evaluated individually for creditworthiness under the same underwriting standards used for commitments to extend credit and on-balance-sheet instruments. Company policies governing loan collateral apply to standby letters of credit at the time of credit extension. Loan-to-value ratios are generally consistent with loan-to-value requirements for other commercial loans secured by similar types of collateral. The fair value of the Company's standby letters of credit at December 31, 2016 and 2015 was not significant.

The Company entered into a construction/renovation agreement for a new branch to be located in Monticello.

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### **(17) Fair Values of Financial Instruments**

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

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

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

*Level 1:* Unadjusted quoted prices in active markets that are accessible at the measurement date for identical, unrestricted assets or liabilities. Since valuations are based on quoted prices that are readily and regularly available in an active market, valuation of these products does not entail a significant degree of judgment.

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

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

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

For assets measured at fair value on a recurring and non-recurring basis, the fair value measurements by level within the fair value hierarchy used at December 31, 2016 and 2015, respectively are as follows (in thousands):

Fair Value Hierarchy For Assets Valued on a Recurring and Non-recurring Basis	Total	(Level 1) Quoted Prices in Active Markets for Identical Assets	(Level 2) Significant Other Observable Inputs	(Level 3) Significant Unobservable Inputs
December 31, 2016:				
Recurring:				
Available for sale securities				
Government sponsored enterprises (GSE)	\$ 4,180	\$ —	\$ 4,180	\$ —
Obligations of state and political subdivisions – New York state <sup>(a)</sup>	54,596	—	54,596	—
Mortgage backed securities and collateralized mortgage obligations – GSE residential <sup>(a)</sup>	13,950	—	13,950	—
Corporate debt – financial services industry	15,542	—	15,542	—
Equity securities – financial services industry	1,805	1,805	—	—
	<u>\$ 90,073</u>	<u>\$ 1,805</u>	<u>\$ 88,268</u>	<u>\$ —</u>
Non-recurring:				
Foreclosed real estate	\$ 619	\$ —	\$ —	\$ 619
Impaired loans	2,614	—	—	2,614
	<u>\$ 3,233</u>	<u>\$ —</u>	<u>\$ —</u>	<u>\$ 3,233</u>
December 31, 2015:				
Recurring:				
Available for sale securities				
Obligations of state and political subdivisions – New York state <sup>(a)</sup>	\$ 62,625	\$ —	\$ 62,625	\$ —
Mortgage backed securities and collateralized mortgage obligations – GSE residential <sup>(a)</sup>	17,241	—	17,241	—
Corporate debt – financial services industry	12,856	—	12,856	—
Equity securities – financial services industry	2,342	2,342	—	—
	<u>\$ 95,064</u>	<u>\$ 2,342</u>	<u>\$ 92,722</u>	<u>\$ —</u>
Non-recurring:				
Foreclosed real estate	\$ 887	\$ —	\$ —	\$ 887
Impaired loans	2,565	—	—	2,565
	<u>\$ 3,452</u>	<u>\$ —</u>	<u>\$ —</u>	<u>\$ 3,452</u>

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

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

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

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

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

Under ASC 825, fair value estimates are based on existing financial instruments without attempting to estimate the value of anticipated future business and the value of the assets and liabilities that are not financial instruments. Accordingly, the aggregate fair value amounts of existing financing instruments do not represent the underlying value of those instruments on the books of the Company.

The following information should not be interpreted as an estimate of the fair value of the entire Company since a fair value calculation is only provided for a limited portion of the Company's assets and liabilities. Due to a wide range of valuation techniques and the degree of subjectivity used in making the estimates, comparisons between the Company's disclosures and those of other companies may not be meaningful. The following methods and assumptions were used to estimate the fair values of the Company's financial instruments at December 31, 2016 and December 31, 2015:

#### **Cash and Cash Equivalents**

The carrying amounts reported in the consolidated balance sheet for cash and short-term instruments approximate those assets' fair values.

#### **Securities**

The fair value of securities available for sale (carried at fair value) and held to maturity (carried at amortized cost) are determined by obtaining quoted market prices on nationally recognized securities exchanges (Level 1), or matrix pricing (Level 2), which is a mathematical technique used widely in the industry to value debt securities without relying exclusively on quoted market prices for the specific securities but rather by relying on the securities' relationship to other benchmark quoted prices. The carrying values for securities maturing within 90 days approximate fair values because there is little interest rate or credit risk associated with these instruments.

#### **Loans**

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

#### **Impaired Loans**

Impaired loans, which are predominately commercial real estate loans where it is probable that the Bank will be unable to collect all amounts due per the contractual terms of the loan agreement, are those in which the Bank has measured impairment generally based on the fair value of the loan's collateral. Fair value is generally determined based upon independent third-party appraisals of the properties, liquidation value or discounted cash flows based upon the expected proceeds. These assets are included as Level 3 fair values, based upon the lowest level of input that is significant to the fair value measurements. Impaired loans are

transferred out of the Level 3 fair value hierarchy when payments reduce the outstanding loan balance below the fair value of the loan's collateral or the loan is foreclosed upon. If the financial condition of the borrower improves such that collectability of all contractual amounts due is probable, and payments are current for six months, the loan is transferred out of impaired status. As of December 31, 2016 the fair values of collateral-dependent impaired loans were calculated using an outstanding balance of \$2,789,000 net of charge-offs and a specific valuation allowance of \$175,000. At December 31, 2015, the fair values of collateral-dependent impaired loans were calculated using an outstanding balance of \$2,954,000, net of charge-offs and a specific valuation allowance of \$389,000. Impaired loans not requiring an allowance represent loans for which the fair value of the expected repayments or collateral exceed the recorded investments in such loans.

#### **Accrued Interest Receivable and Payable**

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

#### **Restricted Investments**

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

#### **Deposit Liabilities**

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

#### **Short-Term Debt**

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

#### **Federal Home Loan Bank Borrowings**

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

#### **Off-Balance-Sheet Financial Instruments**

Fair values for the Bank's off-balance-sheet financial instruments (lending commitments and letters of credit) are based on fees currently charged in the market to enter into similar agreements, taking into account the remaining terms of the agreements and the counterparties' credit standing. For fixed rate loan commitments, fair value estimates also consider the difference between current market interest rates and the committed rates. At December 31, 2016 and December 31, 2015, the fair values of these financial instruments approximated the related carrying values which were not significant.

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

Nonrecurring Assets	Fair value estimate As of December 31,		Valuation techniques	Unobservable input	Range
	2016	2015			
Foreclosed real estate	\$ 619	\$ 887	Appraisal of collateral (a)	Appraisal adjustments (b) Liquidation expenses (b)	0% to -10% 0% to -20%
Impaired loans	\$ 2,614	\$ 2,565	Appraisal of collateral (a)	Appraisal adjustments (b) Liquidation expenses (b)	0% to -10% 0% to -20%

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

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

The following table presents financial assets and financial liabilities that were measured or disclosed at carrying and fair value on a recurring and nonrecurring basis by level within the fair value hierarchy as of December 31, 2016 and 2015.

Financial Assets and Liabilities (in thousands)	Carrying Value	Fair Value	(Level 1) Quoted Prices in Active Markets for Identical Assets	(Level 2) Significant Other Observable Inputs	(Level 3) Significant Unobservable Inputs
<b>December 31, 2016</b>					
<b>Financial assets:</b>					
Cash and cash equivalents	\$ 45,684	\$ 45,684	\$ 45,684	\$ —	\$ —
Securities available for sale	90,073	90,073	1,805	88,268	—
Securities held to maturity	28,730	28,492	—	28,492	—
Loans, net	286,165	287,541	—	—	287,541
Accrued interest receivable	1,800	1,800	—	1,800	—
Restricted investments	559	559	—	559	—
<b>Financial liabilities:</b>					
Savings, money market and checking accounts	318,789	318,789	—	318,789	—
Time deposits	98,638	98,753	—	98,753	—
Accrued interest payable	66	66	—	66	—
<b>December 31, 2015</b>					
<b>Financial assets:</b>					
Cash and cash equivalents	\$ 40,187	\$ 40,187	\$ 40,187	\$ —	\$ —
Securities available for sale	95,064	95,064	2,342	92,722	—
Securities held to maturity	19,666	20,148	—	20,148	—
Loans, net	270,047	271,467	—	—	271,467
Accrued interest receivable	1,894	1,894	—	1,894	—
Restricted investments	566	566	—	566	—
<b>Financial liabilities:</b>					
Savings, money market and checking accounts	286,599	286,599	—	286,599	—
Time deposits	106,724	106,774	—	106,774	—
Accrued interest payable	69	69	—	69	—



## Directors

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David W. Bodenstein  
President  
Mike Preis, Inc.

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

John W. Galligan, Surveyor  
John W. Galligan Company

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

George W. Kinne, Jr.  
President  
Chief Executive Officer  
Jeffersonville Bancorp

Donald L. Knack, CPA  
Retired

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

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

Raymond L. Walter  
Retired

Wayne V. Zanetti  
Retired

## Officers

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George W. Kinne, Jr.  
President  
Chief Executive Officer

John A. Russell  
Executive Vice President  
Chief Financial Officer

Tatiana C. Hahn  
Executive Vice President  
Chief Lending Officer

Rhonda L. Decker  
Senior Vice President  
Retail Banking Administrator  
Security Officer

Jaclene Austin  
Marketing Coordinator

Amber Benson  
Assistant Vice President  
Compliance/Audit Officer

Jillian Bertot  
Branch Manager  
Eldred/Narrowsburg

Margaret Blaut  
Assistant Vice President  
Loan Support Officer

Michelle Brockner  
Training Officer

Krista Brink  
Branch Manager  
Loch Sheldrake

Linda Browne  
Branch Manager  
White Lake

Melanie Karkos  
Deposit Operations  
Supervisor

Bertha Donohue  
Assistant Vice President  
Branch Manager  
Liberty

Linda Fisk  
Vice President  
Regional Manager  
Livingston Manor

Bryan Flynn  
Assistant Vice President  
Commercial Loan Officer  
Portfolio Manager

DeWayne Haygood  
Vice President  
Commercial Loan Officer

Marisa Heisler  
Vice President  
Information Systems Manager

Florence Horecky  
Vice President  
Operations Officer

Stephanie Hoefling  
Branch Manager  
Anawana Lake

Dawn Kaplan  
Assistant Branch Manager  
Bloomingburg

Patricia Korth  
Branch Manager  
Port Jervis

Stacey Kuhn  
Assistant Vice President  
Sales Coordinator  
Branch Manager  
Jeffersonville

Diane McGrath  
Assistant Vice President  
Loan Servicing Manager

Tanja McKerrell  
Vice President  
Senior Loan Officer

Sherry McNutt  
Assistant Branch Manager  
Monticello

Anna Milucky  
Vice President  
Business Banker

Deborah Muzuruk  
Assistant Vice President  
Executive Assistant  
Facility Manager

Patricia Olsen  
Loan Origination Processor

Abigail Opper  
Assistant Controller

Valerie Panich  
Assistant Vice President  
Loan Origination Manager

LeighAnne Pfriendler  
Assistant Vice President  
Credit Administrator

Sherri Rhyne  
Assistant Branch Manager  
Livingston Manor

Sandra Ross  
Branch Manager  
Callicoon

Virginia Sanborn  
Vice President  
Controller  
Assistant Cashier

Stacey Stephenson  
Assistant Branch Manager  
Liberty

Melinda Stratton  
Branch Manager  
Monticello

Heinrich Strauch  
Assistant Vice President  
Commercial Loan Officer

Leanne Stuhlmiller  
Assistant Vice President  
BSA Officer

Claire Taggart  
Vice President  
Human Resources

Kimberly White  
Branch Manager  
Bloomingburg/Wurtsboro

## Staff

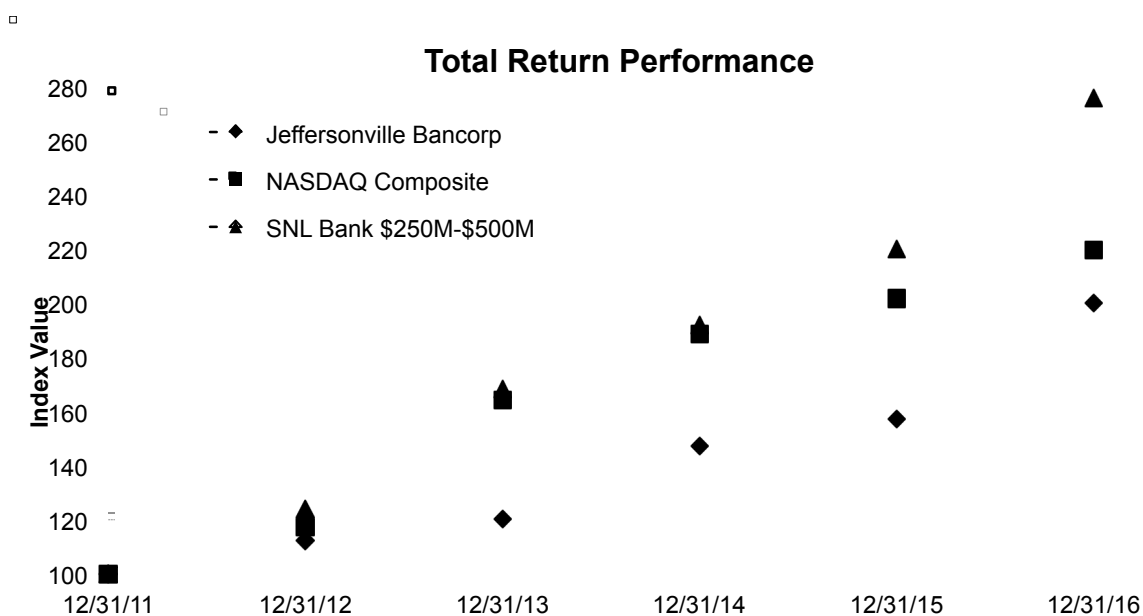
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Chelsea Abplanalp	Rebecca Gagnon	Kerry Madison	Margaret Porter
Donna Abplanalp	Linda Giese	Daniel Martell	Brooke Procak
Jennifer Alleman	Terriesa Giglio	Caitlyn Martin	Cassandra Rhodes
Rosa Arballes	Jill Goodall	Ashley McManus	Kelsey Ritz
Jill Atkins	Gary Grund	Carla Meigel	John Rudy
Tim Bernhardt	Marissa Halstead	Cathy Mickelson	Alicia Ryder
Victoria Berson	Emily Hoffman	Debra Murphy	Therese Schanil
Paul Brockner	Susan Hoffman	Edwin Neumann	Leonid Sharshukov
Jason Brooks	Cathy Horan	Amber Novikov	Angelica Shencavitz
Tiffany Caruso	Audra Hubert	Gloryvet Olivo	Denise Smestad
Dina Conklin	Jenna Keesler	Christine Olsen	Brandy Smith
Jennifer Court	Jean Kelly	Kayla Olsen	William Smith
Delores Cunningham	Jessica Kenyon	Rosemarie Paty	Kristina Snedeker
Ursula Curry	Pamela Knapp	Bruce Pecs, Jr.	McKenzie Stoddard
Nancie Davis	Amy Lebron	Tara Pecs	Matthew Sush
Cassandra Duffy	Brandy Leonardo	Lale Perez	Carlos Vega
Kelsey Dutton	Kristin Lockwood	Donna Peters	Debbie Wasyluk
Lisa Dymond	Robert Lohr	Barbara Pietrucha	Everett Williams
Dawn Feinman	Valerie Ludemann	Taylor Pilny	Jenna Yearwood
Ashley Freestone	Michele Lupardo	Sheryl Pinder	

## Shareholder Information

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

<b>For the Quarter Ended:</b>	<b>Sales Low</b>	<b>Sales High</b>	<b>Cash Dividends Paid</b>
December 31, 2016	\$ 14.10	\$ 16.50	\$ 0.14
September 30, 2016	\$ 13.15	\$ 15.15	\$ 0.14
June 30, 2016	\$ 13.10	\$ 13.60	\$ 0.14
March 31, 2016	\$ 12.94	\$ 14.00	\$ 0.14
December 31, 2015	\$ 13.01	\$ 14.15	\$ 0.14
September 30, 2015	\$ 13.06	\$ 14.00	\$ 0.14
June 30, 2015	\$ 13.12	\$ 15.75	\$ 0.14
March 31, 2015	\$ 12.90	\$ 13.74	\$ 0.14



<b>Index</b>	<b>Period Ending</b>					
	<b>12/31/11</b>	<b>12/31/12</b>	<b>12/31/13</b>	<b>12/31/14</b>	<b>12/31/15</b>	<b>12/31/16</b>
Jeffersonville Bancorp	100.00	112.56	120.56	147.26	157.51	200.29
NASDAQ Composite	100.00	117.45	164.57	188.84	201.98	219.89
SNL Bank \$250M-\$500M	100.00	124.13	168.55	192.33	220.05	276.11



## JEFF BANK BRANCHES

### **Bloomingsburg Office**

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

### **Callicoon Office**

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

### **Eldred Office**

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

### **Jeffersonville Office**

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

### **Liberty Office**

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

### **Livingston Manor Office**

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

### **Loch Sheldrake Office**

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

### **Monticello - Anawana Lake Office**

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

### **Monticello - Forestburgh Office**

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

### **Narrowsburg Office**

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

### **Port Jervis Office**

20-22 Fowler Street, Port Jervis, New York 12771 (845) 858-5333

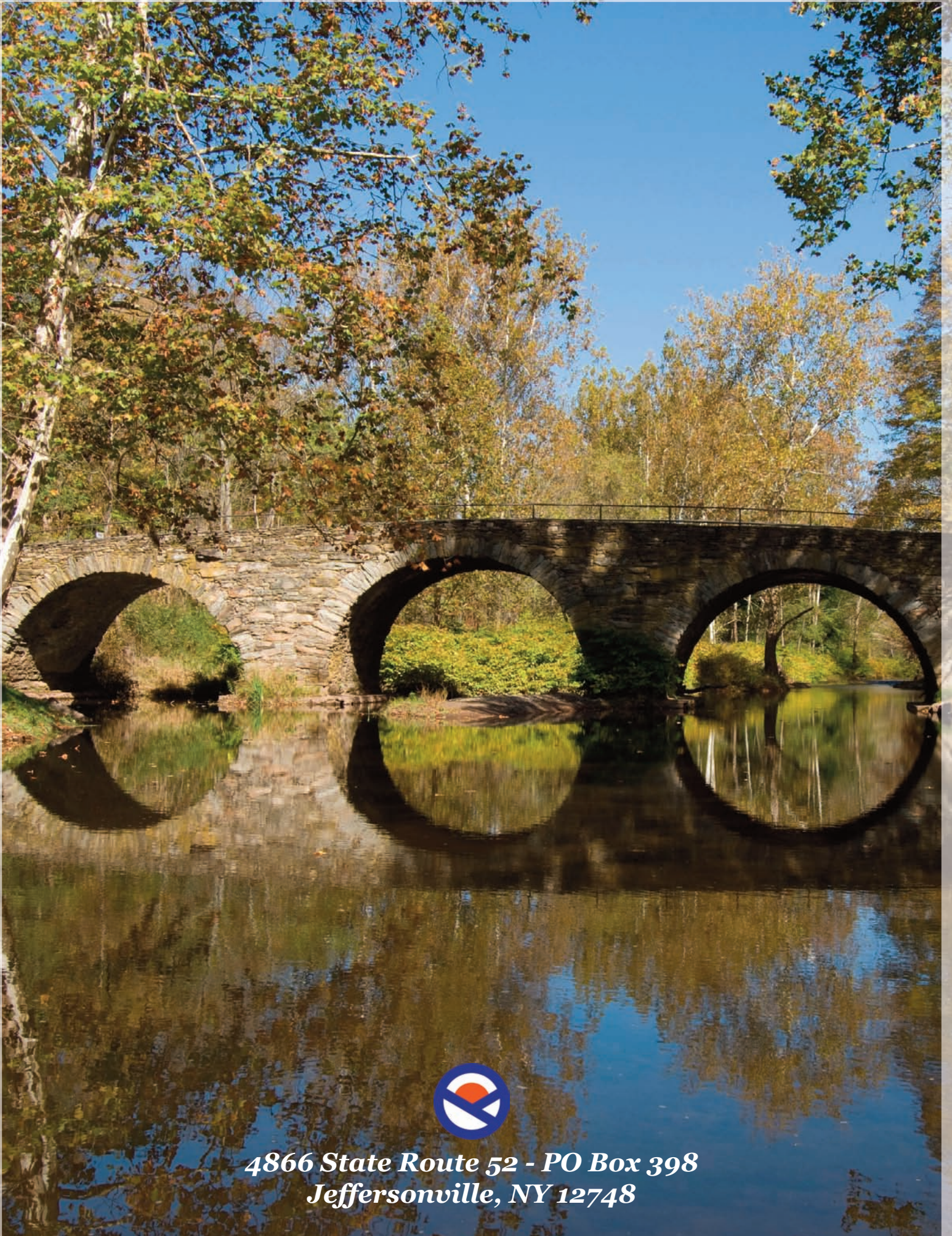
### **White Lake Office**

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

### **Wurtsboro Office**

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





*4866 State Route 52 - PO Box 398  
Jeffersonville, NY 12748*