UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

[**X**] QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended June 30, 2018

OR

[ ] TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from _______ to _______

(Exact Name of Company as Specified in its Charter)

Maryland	001-36695	38-3941859
(State of Other Jurisdiction of Incorporation)	(Commission File No.)	(I.R.S. Employer Identification No.)

214 West First Street, Oswego, NY 13126
(Address of Principal Executive Office) (Zip Code)

(315) 343-0057
(Issuer's Telephone Number including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.
YES ☒ NO ☐

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (Section 232.405 of this Chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).
YES ☒ NO ☐

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a smaller reporting company or an emerging growth company. See definitions of “large accelerated filer,” “accelerated filer”, “smaller reporting company” and “emerging growth company” in Rule 12b-2 of the Exchange Act.

Large accelerated filer ☐ Accelerated filer ☐ Non-accelerated filer ☐ Smaller reporting company ☒ Emerging growth company ☐
(Do not check if a smaller reporting company)

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act. ☐

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). YES ☐ NO ☒

As of August 10, 2018, there were 4,347,413 shares outstanding of the registrant’s common stock.

PATHFINDER BANCORP, INC.
INDEX

Table of Contents

PART I - FINANCIAL INFORMATION
Item 1 – Consolidated Financial Statements

Pathfinder Bancorp, Inc.
Consolidated Statements of Condition
(Unaudited)

(In thousands, except share and per share data)		June 30, 2018		December 31, 2017
ASSETS:				
Cash and due from banks	$	8,787	$	9,708
Interest-earning deposits (including restricted balances of $4,365 and $6,342, respectively)		27,953		12,283
Total cash and cash equivalents		36,740		21,991
Available-for-sale securities, at fair value		184,030		171,138
Held-to-maturity securities, at amortized cost (fair value of $26,244 and $66,426, respectively)		26,647		66,196
Marketable equity securities, at fair value		541		-
Federal Home Loan Bank stock, at cost		4,388		3,855
Loans		607,185		580,831
Less: Allowance for loan losses		7,605		7,126
Loans receivable, net		599,580		573,705
Premises and equipment, net		16,692		16,117
Accrued interest receivable		2,725		3,047
Foreclosed real estate		97		468
Intangible assets, net		173		182
Goodwill		4,536		4,536
Bank owned life insurance		16,695		11,742
Other assets		10,638		8,280
Total assets	$	903,482	$	881,257
LIABILITIES AND SHAREHOLDERS' EQUITY:				
Deposits:				
Interest-bearing	$	624,718	$	633,820
Noninterest-bearing		108,451		89,783
Total deposits		733,169		723,603
Short-term borrowings		26,600		30,600
Long-term borrowings		57,503		43,288
Subordinated loans		15,076		15,059
Accrued interest payable		255		186
Other liabilities		8,010		6,377
Total liabilities		840,613		819,113
Shareholders' equity:				
Common stock, par value $0.01; 25,000,000 authorized shares; 4,332,076 and 4,280,227 shares outstanding, respectively		43		43
Additional paid in capital		28,629		28,170
Retained earnings		40,540		39,020
Accumulated other comprehensive loss		(5,471)		(4,208)
Unearned ESOP		(1,124)		(1,214)
Total Pathfinder Bancorp, Inc. shareholders' equity		62,617		61,811
Noncontrolling interest		252		333
Total equity		62,869		62,144
Total liabilities and shareholders' equity	$	903,482	$	881,257

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

Pathfinder Bancorp, Inc.
Consolidated Statements of Income
(Unaudited)

(In thousands, except per share data)	For the three months ended June 30, 2018	For the three months ended June 30, 2017	For the six months ended June 30, 2018	For the six months ended June 30, 2017
Interest and dividend income:				
Loans, including fees	$ 7,018	$ 5,869	$ 13,736	$ 11,610
Debt securities:				
Taxable	1,171	825	2,299	1,577
Tax-exempt	217	312	465	590
Dividends	61	50	129	104
Federal funds sold and interest earning deposits	49	28	96	73
Total interest and dividend income	8,516	7,084	16,725	13,954
Interest expense:				
Interest on deposits	1,566	895	2,911	1,660
Interest on short-term borrowings	70	283	163	578
Interest on long-term borrowings	203	128	378	248
Interest on subordinated loans	210	197	413	390
Total interest expense	2,049	1,503	3,865	2,876
Net interest income	6,467	5,581	12,860	11,078
Provision for loan losses	297	423	910	812
Net interest income after provision for loan losses	6,170	5,158	11,950	10,266
Noninterest income:				
Service charges on deposit accounts	273	274	547	537
Earnings and gain on bank owned life insurance	108	62	181	133
Loan servicing fees	42	32	83	68
Net (losses) gains on sales and redemptions of investment securities	(22)	135	(129)	206
Gains on equity securities	13	-	26	-
Net gains (losses) on sales of loans and foreclosed real estate	13	(21)	16	(45)
Debit card interchange fees	148	147	291	268
Other charges, commissions & fees	449	421	904	820
Total noninterest income	1,024	1,050	1,919	1,987
Noninterest expense:				
Salaries and employee benefits	3,429	2,819	6,513	5,669
Building occupancy	553	531	1,144	1,070
Data processing	476	416	955	843
Professional and other services	405	219	736	410
Advertising	285	172	476	348
FDIC assessments	135	81	255	137
Audits and exams	105	85	210	169
Other expenses	739	688	1,297	1,338
Total noninterest expense	6,127	5,011	11,586	9,984
Income before income taxes	1,067	1,197	2,283	2,269
Provision for income taxes	166	238	348	483
Net income attributable to noncontrolling interest and Pathfinder Bancorp, Inc.	901	959	1,935	1,786
Net income attributable to noncontrolling interest	(44)	39	(14)	66
Net income attributable to Pathfinder Bancorp Inc.	$ 945	$ 920	$ 1,949	$ 1,720
Earnings per common share - basic	$ 0.23	$ 0.23	$ 0.47	$ 0.42
Earnings per common share - diluted	$ 0.22	$ 0.22	$ 0.46	$ 0.41
Dividends per common share	$ 0.06	$ 0.0525	$ 0.12	$ 0.1025

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

Table of Contents

Pathfinder Bancorp, Inc.
Consolidated Statements of Comprehensive Income
(Unaudited)

	For the three months ended		For the six months ended	
(In thousands)	June 30, 2018	June 30, 2017	June 30, 2018	June 30, 2017
Net Income	$ 901	$ 959	$ 1,935	$ 1,786
Other Comprehensive (Loss) Income				
Retirement Plans:				
Retirement plan net losses recognized in plan expenses	43	37	86	73
Unrealized holding (losses) gains on available-for-sale securities				
Unrealized holding (losses) gains arising during the period	(1,156)	1,387	(2,502)	2,408
Reclassification adjustment for net (losses) gains included in net income	22	(135)	129	(206)
Net unrealized (losses) gains on available-for-sale securities	(1,134)	1,252	(2,373)	2,202
Accretion of net unrealized loss on securities transferred to held-to-maturity(1)	470	22	163	58
Other comprehensive (loss) income, before tax	(621)	1,311	(2,124)	2,333
Tax effect	162	(524)	555	(931)
Other comprehensive (loss) income, net of tax	(459)	787	(1,569)	1,402
Comprehensive income	$ 442	$ 1,746	$ 366	$ 3,188
Comprehensive (loss) income, attributable to noncontrolling interest	$ (44)	$ 39	$ (14)	$ 66
Comprehensive income attributable to Pathfinder Bancorp, Inc.	$ 486	$ 1,707	$ 380	$ 3,122
Tax Effect Allocated to Each Component of Other Comprehensive (Loss) Income				
Retirement plan net losses recognized in plan expenses	$ (11)	$ (15)	$ (22)	$ (28)
Unrealized holding (losses) gains arising during the period	302	(555)	654	(963)
Reclassification adjustment for net (losses) gains included in net income	(6)	55	(34)	83
Accretion of net unrealized loss on securities transferred to held-to-maturity(1)	(123)	(9)	(43)	(23)
Income tax effect related to other comprehensive (loss) income	$ 162	$ (524)	$ 555	$ (931)

(1) The accretion of the unrealized holding losses in accumulated other comprehensive loss at the date of transfer at September 30, 2013 partially offsets the amortization of the difference between the par value and the fair value of the investment securities at the date of transfer, and is an adjustment of yield.

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

Pathfinder Bancorp, Inc.
Consolidated Statements of Changes in Shareholders' Equity
Six months ended June 30, 2018 and June 30, 2017
(Unaudited)

(In thousands, except share and per share data)	Common Stock	Additional Paid in Capital	Retained Earnings	Accumulated Other Comprehensive Loss	Unearned ESOP	Non-controlling Interest	Total
Balance, January 1, 2018	$ 43	$ 28,170	$ 39,020	$ (4,208)	$ (1,214)	$ 333	$ 62,144
Net income	-	-	1,949	-	-	(14)	1,935
Other comprehensive loss, net of tax	-	-	-	(1,569)	-	-	(1,569)
ESOP shares earned (12,221 shares)	-	101	-	-	90	-	191
Restricted stock units (14,490 shares)	-	-	-	-	-	-	-
Stock based compensation	-	162	-	-	-	-	162
Stock options exercised	-	204	-	-	-	-	204
Cumulative effect of change in measurement of equity securities (1)	-	-	53	(53)	-	-	-
Cumulative effect of change in investment securities transfer (2)	-	-	-	359	-	-	359
Common stock dividends declared ($0.12 per share)	-	-	(497)	-	-	-	(497)
Cumulative effect of affiliate capital allocation	-	(8)	15	-	-	(7)	-
Distributions from affiliates	-	-	-	-	-	(60)	(60)
Balance, June 30, 2018	$ 43	$ 28,629	$ 40,540	$ (5,471)	$ (1,124)	$ 252	$ 62,869
Balance, January 1, 2017	$ 43	$ 27,483	$ 35,619	$ (3,822)	$ (1,394)	$ 432	$ 58,361
Net income	-	-	1,720	-	-	66	1,786
Other comprehensive income, net of tax	-	-	-	1,402	-	-	1,402
ESOP shares earned (12,221 shares)	-	90	-	-	90	-	180
Restricted stock units (15,720 shares)	-	-	-	-	-	-	-
Stock based compensation	-	189	-	-	-	-	189
Stock options exercised	-	61	-	-	-	-	61
Common stock dividends declared ($0.1025 per share)	-	-	(417)	-	-	-	(417)
Distributions from affiliates	-	-	-	-	-	(31)	(31)
Balance, June 30, 2017	$ 43	$ 27,823	$ 36,922	$ (2,420)	$ (1,304)	$ 467	$ 61,531

(1) Cumulative effect of unrealized gain on marketable equity securities based on the adoption of ASU 2016-01 - Financial Instruments - Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Liabilities.

(2) Cumulative effect of unrealized gains on the transfer of 52 investment securities from held-to-maturity classification to available-for-sale classification based on the adoption of ASU 2017-12: Derivatives and Hedging (Topic 815): Targeted Improvements to Accounting for Hedging Activities.

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

Pathfinder Bancorp, Inc.
Consolidated Statements of Cash Flows
(Unaudited)

	For the six months ended June 30,	
(In thousands)	2018	2017
OPERATING ACTIVITIES		
Net income attributable to Pathfinder Bancorp, Inc.	$ 1,949	$ 1,720
Adjustments to reconcile net income to net cash flows from operating activities:		
Provision for loan losses	910	812
Realized (gains) losses on sales, redemptions and calls of:		
Real estate acquired through foreclosure	(16)	49
Loans	-	(4)
Available-for-sale investment securities	131	59
Held-to-maturity investment securities	(2)	(15)
Premises and equipment	(8)	-
Depreciation	578	503
Amortization of mortgage servicing rights	22	6
Amortization of deferred loan costs	150	100
Amortization of deferred financing from subordinated debt	17	17
Earnings and gain on bank owned life insurance	(181)	(133)
Net amortization of premiums and discounts on investment securities	994	825
Amortization of intangible assets	9	8
Stock based compensation and ESOP expense	353	369
Net change in accrued interest receivable	322	(147)
Pension plan contribution	(825)	-
Net change in other assets and liabilities	648	(786)
Net cash flows from operating activities	5,051	3,383
INVESTING ACTIVITIES		
Purchase of investment securities available-for-sale	(34,427)	(53,077)
Purchase of investment securities held-to-maturity	-	(18,636)
Purchase of Federal Home Loan Bank stock	(4,660)	(1,200)
Proceeds from redemption of Federal Home Loan Bank stock	4,127	-
Proceeds from maturities and principal reductions of investment securities available-for-sale	24,941	18,746
Proceeds from maturities and principal reductions of investment securities held-to-maturity	4,688	3,906
Proceeds from sales, redemptions and calls of:		
Available-for-sale investment securities	27,125	40,357
Held-to-maturity investment securities	967	213
Real estate acquired through foreclosure	496	556
Premise and equipment	14	-
Purchase of bank owned life insurance	(5,000)	-
Proceeds from bank owned life insurance	228	-
Realized gains on hedging activity	-	(250)
Net change in loans	(27,044)	(58,265)
Purchase of premises and equipment	(1,159)	(1,108)
Net cash flows from investing activities	(9,704)	(68,758)
FINANCING ACTIVITIES		
Net change in demand deposits, NOW accounts, savings accounts, money management deposit accounts, MMDA accounts and escrow deposits	(2,634)	38,884
Net change in time deposits	1,842	8,737
Net change in brokered deposits	10,358	(14,761)
Net change in short-term borrowings	(4,000)	(411)
Payments on long-term borrowings	-	(3,000)
Proceeds from long-term borrowings	14,215	29,160
Proceeds from exercise of stock options	204	61
Cash dividends paid to common shareholders	(502)	(425)
Change in noncontrolling interest, net	(81)	35
Net cash flows from financing activities	19,402	58,280
Change in cash and cash equivalents	14,749	(7,095)
Cash and cash equivalents at beginning of period	21,991	22,419
Cash and cash equivalents at end of period	$ 36,740	$ 15,324
CASH PAID DURING THE PERIOD FOR:		
Interest	$ 3,793	$ 2,845
Income taxes	645	210
NON-CASH INVESTING ACTIVITY		
Real estate acquired in exchange for loans	109	686
RESTRICTED CASH		
Federal Reserve Bank Reserve Requirements included in interest earning deposits	4,365	4,255

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

Note 1: Basis of Presentation

The accompanying unaudited consolidated financial statements of Pathfinder Bancorp, Inc., (the "Company"), Pathfinder Bank (the "Bank") and its other wholly owned subsidiaries have been prepared in accordance with accounting principles generally accepted in the United States of America for interim financial information, the instructions for Form 10-Q and Article 8 of Regulation S-X. Accordingly, they do not include all of the information and footnotes necessary for a complete presentation of consolidated financial condition, results of operations and cash flows in conformity with generally accepted accounting principles. In the opinion of management, all adjustments, consisting of normal recurring accruals considered necessary for a fair presentation, have been included. Certain amounts in the 2017 consolidated financial statements may have been reclassified to conform to the current period presentation. These reclassifications had no effect on net income or comprehensive income as previously reported. Operating results for the three and six months ended June 30, 2018 are not necessarily indicative of the results that may be expected for the full year ending December 31, 2018 or any other interim period.

The Company's consolidated financial statements are prepared in accordance with accounting principles generally accepted in the United States and follow practices within the banking industry. Application of these principles requires management to make estimates, assumptions, and judgments that affect the amounts reported in the consolidated financial statements and accompanying notes. These estimates, assumptions, and judgments are based on information available as of the date of the financial statements; accordingly, as this information changes, the financial statements could reflect different estimates, assumptions, and judgments. Certain accounting policies inherently have a greater reliance on the use of estimates, assumptions, and judgments and as such have a greater possibility of producing results that could be materially different than originally reported. Estimates, assumptions, and judgments are necessary when assets and liabilities are required to be recorded at fair value or when an asset or liability needs to be recorded contingent upon a future event. Carrying assets and liabilities at fair value inherently results in more financial statement volatility. The fair values and information used to record valuation adjustments for certain assets and liabilities are based on quoted market prices or are provided by unaffiliated third-party sources, when available. When third party information is not available, valuation adjustments are estimated in good faith by management.

Although the Company owns, through its subsidiary Pathfinder Risk Management Company, Inc., 51% of the membership interest in FitzGibbons Agency, LLC ("Agency"), the Company is required to consolidate 100% of the Agency within the consolidated financial statements. The 49% of which the Company does not own is accounted for separately as noncontrolling interests within the consolidated financial statements.

Note 2: New Accounting Pronouncements

The Financial Accounting Standards Board ("FASB") and, to a lesser extent, other authoritative rulemaking bodies promulgate generally accepted accounting principles ("GAAP") to regulate the standards of accounting in the United States. From time to time, the FASB issues new GAAP standards, known as Accounting Standards Updates ("ASUs") some of which, upon adoption, may have the potential to change the way in which the Company recognizes or reports within its consolidated financial statements. The following presentation provides a description of an accounting standard that was adopted in the second quarter of 2018 as well as standards that are not currently effective but could have an impact on the Company's consolidated financial statements upon adoption.

Standards Adopted in the Quarter Ended June 30, 2018

Standard: Improvements to Accounting for Hedging Activities (*ASU 2017-12: Derivatives and Hedging [Topic 815]: Targeted Improvements to Accounting for Hedging Activities*)

Description: The amended guidance expands and clarifies hedge accounting for nonfinancial and financial risk components, aligns the recognition and presentation of the effects of the hedging instrument and hedged item in the financial statements, and simplifies the requirements for assessing effectiveness in a hedging relationship.

Required Date of Implementation: January 1, 2019 (early adoption permitted)

Effect on Consolidated Financial Statements: The Company adopted this guidance, effective January 1, 2018, in the second quarter of 2018. As a result of the adoption of this Update, the Company transferred 52 securities with an aggregate amortized cost before transfer of $35.2 million from the held-to-maturity classification to the available-for-sale classification on that date. The transfer of these securities resulted in a decrease in accumulated other comprehensive loss of $359,000 on the adoption date. The Company had no derivative or hedging positions at June 30, 2018 and, as a result, the adoption of this Update had no other material impact on the consolidated financial statements of the Company at the date of adoption or at June 30, 2018.

Standards Not Yet Adopted as of June 30, 2018

Standard: Leases (*ASU 2016-02: Leases [Topic 842]*)

Description: The new guidance requires lessees to record a right-of-use asset and a lease liability for all leases with a term greater than 12 months. While the guidance requires all leases to be recognized in the balance sheet, there continues to be a differentiation between finance leases and operating leases for purposes of income statement recognition and cash flow statement presentation. For finance leases, interest on the lease liability and amortization of the right-of-use asset will be recognized separately in the statement of income. Repayments of principal on those lease liabilities will be classified within financing activities and payments of interest on the lease liability will be classified within operating activities in the statement of cash flows. For operating leases, a single lease cost is recognized in the statement of income and allocated over the lease term, generally on a straight-line basis. All cash payments are presented within operating activities in the statement of cash flows. The accounting applied by lessors is largely unchanged from existing GAAP, however, the guidance eliminates the accounting model for leveraged leases for leases that commence after the effective date of the guidance.

Required Date of Implementation: January 1, 2019 (early adoption permitted)

Effect on Consolidated Financial Statements: The Company occupies certain banking offices and uses certain equipment under noncancelable operating lease agreements which currently are not reflected in its consolidated balance sheet. Upon adoption of the guidance, the Company expects to report increased assets and increased liabilities as a result of recognizing right-of-use assets and lease liabilities on its consolidated balance sheet. The Company was committed to $1.1 million of minimum lease payments under noncancelable operating lease agreements at June 30, 2018. In addition, the Company leases office and similar use space, also under noncancelable operating lease agreements to unrelated entities within a limited number of its real estate locations. At June 30, 2018, the Company expects to receive approximately $1.0 million of minimum lease payments under those agreements. The Company does not expect the new guidance will have a material impact to its consolidated statement of income.

Standard: Leases (*ASU 2018-10: Codification Improvements to Topic 842, Leases)*

Description: The Board has an ongoing project on its agenda about improvements to clarify the Codification or to correct unintended application of guidance related to ASU 2016-02. Those items generally are not expected to have a significant effect on current accounting practice or create a significant administrative cost for most entities. The amendments in this Update are of a similar nature to the items typically addressed in the Codification improvements project. However, the Board decided to issue a separate Update for the improvements related to Update 2016-02 to increase stakeholders' awareness of the amendments and to expedite the improvements.

Required Date of Implementation: January 1, 2019 (early adoption permitted)

Effect on Consolidated Financial Statements: See comments, above, related to the adoption of ASU 2016-02

Standard: Premium Amortization on Purchased Callable Debt Securities (*ASU 2017-08: Receivables—Nonrefundable Fees and Other Costs [Subtopic 310-20]: Premium Amortization on Purchased Callable Debt Securities*)

Description: The amended guidance requires the premium on callable debt securities to be amortized to the earliest call date. The amendments do not require an accounting change for securities held at a discount; the discount continues to be amortized to maturity.

Required Date of Implementation: January 1, 2019 (early adoption permitted)

Effect on Consolidated Financial Statements: The amendments should be applied on a modified retrospective basis through a cumulative-effect adjustment directly to retained earnings as of the beginning of the period of adoption. The Company does not expect the guidance to have a material impact on its consolidated financial statements.

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Standard: Improvements to Nonemployee Share-Based Payment Accounting (*ASU 2018-07: Compensation - Stock Compensation [Topic 718]*)

Description: Consistent with the accounting requirement for employee share-based payment awards, under the new guidance, nonemployee share-based payment awards within the scope of Topic 718 are measured on the grant date at the grant-date fair value of the equity instruments that an entity is obligated to issue when the good has been delivered or the service has been rendered and any other conditions necessary to earn the right to benefit from the instruments have been satisfied. The amendments in this Update affect all entities that enter into share-based payment transactions for acquiring goods and services from nonemployees.

Required Date of Implementation: January 1, 2019 (early adoption permitted)

Effect on Consolidated Financial Statements: The amendments should be applied using a prospective transition method. The Company does not expect the guidance will have a material impact on its consolidated financial statements.

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Standard: Measurement of Credit Losses on Financial Instruments (*ASU 2016-13: Financial Instruments—Credit Losses [Topic 326]: Measurement of Credit Losses on Financial Instruments*)

Description: The amended guidance replaces the current incurred loss model for determining the allowance for credit losses. The guidance requires financial assets measured at amortized cost to be presented at the net amount expected to be collected. The allowance for credit losses will represent a valuation account that is deducted from the amortized cost basis of the financial assets to present their net carrying value at the amount expected to be collected. The income statement will reflect the measurement of credit losses for newly recognized financial assets as well as expected increases or decreases of expected credit losses that have taken place during the period. When determining the allowance, expected credit losses over the contractual term of the financial asset(s) (taking into account prepayments) will be estimated considering relevant information about past events, current conditions, and reasonable and supportable forecasts that affect the collectability of the reported amount. The amended guidance also requires recording an allowance for credit losses for purchased financial assets with a more-than-insignificant amount of credit deterioration since origination. The initial allowance for these assets will be added to the purchase price at acquisition rather than being reported as an expense. Subsequent changes in the allowance will be recorded through the income statement as an expense adjustment. In addition, the amended guidance requires credit losses relating to available-for-sale debt securities to be recorded through an allowance for credit losses. The calculation of credit losses for available-for-sale securities will be similar to how it is determined under existing guidance.

Required Date of Implementation: January 1, 2020 (early adoption permitted as of January 1, 2019)

Effect on Consolidated Financial Statements: The Company is assessing the new guidance to determine what modifications to existing credit estimation processes may be required. The Company expects that the new guidance will result in an increase in its allowance for credit losses as a result of considering credit losses over the expected life of its loan and debt securities portfolios. Increases in the level of allowances will also reflect new requirements to include estimated credit losses on investment securities classified as held-to-maturity, if any. The Company has formed an Implementation Committee, whose membership includes representatives of senior management, to develop plans that will encompass: (1) internal methodology changes (2) data collection and management activities, (3) internal communication requirements, and (4) estimation of the projected impact of this guidance. The amount of any change in the allowance for credit losses resulting from the new guidance will ultimately be impacted by the provisions of this guidance as well as by the loan and debt security portfolios composition and asset quality at the adoption date, and economic conditions and forecasts at the time of adoption.

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Standard: Simplifying the Test for Goodwill Impairment (*ASU 2017-04: Intangibles—Goodwill and Other [Topic 350]: Simplifying the Test for Goodwill Impairment*)

Description: Current guidance requires a two-step approach to determining if recorded goodwill is impaired. In Step 1, reporting entities must first evaluate whether or not the carrying value of a reporting unit is greater than its fair value . In Step 2, if a reporting unit's carrying value is greater than its fair value, then the entity should calculate the implied fair value of goodwill. If the carrying value of goodwill is more than the implied fair value, an impairment charge for the difference must be recorded. The amended guidance eliminates Step 2 from the goodwill impairment test. Therefore, under the new guidance, if the carrying value of a reporting unit is greater than its fair value, a goodwill impairment charge will be recorded for the difference (up to the carrying value of the recorded goodwill).

Required Date of Implementation: January 1, 2020 (early adoption permitted)

Effect on Consolidated Financial Statements: The amendments should be applied using a prospective transition method. The Company does not expect the guidance will have a material impact on its consolidated financial statements, unless at some point in the future one of its reporting units were to fail Step 1 of the goodwill impairment test.

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Standard: Leases (*ASU 2018-11: Codification Improvements to Topic 842, Leases)*

Description: The amendments in this Update provide entities with an additional (and optional) transition method to adopt the new leases standard. Under this new transition method, an entity initially applies the new leases standard at the adoption date and recognizes a cumulative-effect adjustment to the opening balance of retained earnings in the period of adoption consistent with preparers' requests. Consequently, an entity's reporting for the comparative periods presented in the financial statements in which it adopts the new leases standard will continue to be in accordance with current GAAP (Topic 840, Leases). An entity that elects this additional (and optional) transition method must provide the required Topic 840 disclosures for all periods that continue to be in accordance with Topic 840. The amendments do not change the existing disclosure requirements in Topic 840 (for example, they do not create interim disclosure requirements that entities previously were not required to provide).

The amendments in this Update provide lessors with a practical expedient, by class of underlying asset, to not separate nonlease components from the associated lease component and, instead, to account for those components as a single component if the nonlease components otherwise would be accounted for under the new revenue guidance (Topic 606) and both of the following are met:

1. The timing and pattern of transfer of the nonlease component(s) and associated lease component are the same.
2. The lease component, if accounted for separately, would be classified as an operating lease.

If the nonlease component or components associated with the lease component are the predominant component of the combined component, an entity is required to account for the combined component in accordance with Topic 606. Otherwise, the entity must account for the combined component as an operating lease in accordance with Topic 842.

An entity electing this practical expedient (including an entity that accounts for the combined component entirely in Topic 606) is required to disclose the following by class of underlying asset:

1. The fact that it elected the expedient
2. Which class(es) of underlying asset the lessor made the election to
3. The nature of (a) the lease component and nonlease component(s) that were combined as a result of applying the practical expedient and (b) any nonlease components that were not eligible for the practical expedient and, thus, not combined
4. The Topic the entity applies to the combined component (Topic 606 or Topic 842).

Required Date of Implementation: January 1, 2019 (early adoption permitted)

Effect on Consolidated Financial Statements: See comments, above, related to the adoption of ASU 2016-02

Note 3: Earnings per Common Share

Basic earnings per share are calculated by dividing net income available to common shareholders by the weighted average number of common shares outstanding during the period. Net income available to common shareholders is net income to Pathfinder Bancorp, Inc. less the total of preferred dividends declared, if any. Diluted earnings per share include the potential dilutive effect that could occur upon the assumed exercise of issued stock options using the Treasury Stock method. Anti-dilutive stock options, not included in the computation below, were -0- for the three and six months ended June 30, 2018 and were -0- for the three months ended June 30, 2017 and 46,131 for the six months ended June 30, 2017. Unallocated common shares held by the ESOP are not included in the weighted-average number of common shares outstanding for purposes of calculating earnings per common share until they are committed to be released to plan participants.

The following table sets forth the calculation of basic and diluted earnings per share.

	Three months ended June 30,		Six months ended June 30,	
(In thousands, except per share data)	2018	2017	2018	2017
Basic Earnings Per Common Share				
Net income available to common shareholders	$ 945	$ 920	$ 1,949	$ 1,720
Weighted average common shares outstanding	4,157	4,074	4,138	4,063
Basic earnings per common share	$ 0.23	$ 0.23	$ 0.47	$ 0.42
Diluted Earnings Per Common Share				
Net income available to common shareholders	$ 945	$ 920	$ 1,949	$ 1,720
Weighted average common shares outstanding	4,157	4,074	4,138	4,063
Effect of assumed exercise of stock options	99	109	108	105
Diluted weighted average common shares outstanding	4,256	4,183	4,246	4,168
Diluted earnings per common share	$ 0.22	$ 0.22	$ 0.46	$ 0.41

Table of Contents

Note 4: Investment Securities

The amortized cost and estimated fair value of investment securities are summarized as follows:

	June 30, 2018			
(In thousands)	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Available-for-Sale Portfolio				
Debt investment securities:				
US Treasury, agencies and GSEs	$ 21,256	$ -	$ (221)	$ 21,035
State and political subdivisions	28,659	67	(738)	27,988
Corporate	13,148	158	(301)	13,005
Asset backed securities	10,845	3	(63)	10,785
Residential mortgage-backed - US agency	34,000	21	(988)	33,033
Collateralized mortgage obligations - US agency	60,087	8	(1,975)	58,120
Collateralized mortgage obligations - Private label	20,227	18	(386)	19,859
Total	188,222	275	(4,672)	183,825
Equity investment securities:				
Common stock - financial services industry	205	-	-	205
Total	205	-	-	205
Total available-for-sale	$ 188,427	$ 275	$ (4,672)	$ 184,030
Held-to-Maturity Portfolio				
Debt investment securities:				
US Treasury, agencies and GSEs	$ 3,982	$ -	$ (44)	$ 3,938
State and political subdivisions	5,309	27	(83)	5,253
Corporate	6,306	2	(217)	6,091
Residential mortgage-backed - US agency	3,813	-	(78)	3,735
Collateralized mortgage obligations - US agency	4,341	9	(24)	4,326
Collateralized mortgage obligations - Private label	2,896	16	(11)	2,901
Total held-to-maturity	$ 26,647	$ 54	$ (457)	$ 26,244

Table of Contents

(In thousands)	December 31, 2017 Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Available-for-Sale Portfolio				
Debt investment securities:				
US Treasury, agencies and GSEs	$ 41,489	$ 1	$ (154)	$ 41,336
State and political subdivisions	13,960	12	(291)	13,681
Corporate	8,584	108	(92)	8,600
Asset backed securities	6,662	12	(30)	6,644
Residential mortgage-backed - US agency	36,214	23	(495)	35,742
Collateralized mortgage obligations - US agency	54,481	-	(1,133)	53,348
Collateralized mortgage obligations - Private label	11,193	62	(203)	11,052
Total	172,583	218	(2,398)	170,403
Equity investment securities:				
Common stock - financial services industry	663	72	-	735
Total	663	72	-	735
Total available-for-sale	$ 173,246	$ 290	$ (2,398)	$ 171,138
Held-to-Maturity Portfolio				
Debt investment securities:				
US Treasury, agencies and GSEs	$ 4,948	$ 14	$ (14)	$ 4,948
State and political subdivisions	35,130	641	(311)	35,460
Corporate	8,311	151	(159)	8,303
Residential mortgage-backed - US agency	6,853	53	(10)	6,896
Collateralized mortgage obligations - US agency	7,574	83	(215)	7,442
Collateralized mortgage obligations - Private label	3,380	7	(10)	3,377
Total held-to-maturity	$ 66,196	$ 949	$ (719)	$ 66,426

The amortized cost and estimated fair value of debt investments at June 30, 2018 by contractual maturity are shown below. Expected maturities may differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without penalties.

	Available-for-Sale		**Held-to-Maturity**	
(In thousands)	Amortized Cost	Estimated Fair Value	Amortized Cost	Estimated Fair Value
Due in one year or less	$ 8,236	$ 8,215	$ 1,211	$ 1,207
Due after one year through five years	25,042	24,758	6,503	6,474
Due after five years through ten years	18,331	18,081	4,940	4,864
Due after ten years	22,299	21,759	2,943	2,737
Sub-total	73,908	72,813	15,597	15,282
Residential mortgage-backed - US agency	34,000	33,033	3,813	3,735
Collateralized mortgage obligations - US agency	60,087	58,120	4,341	4,326
Collateralized mortgage obligations - Private label	20,227	19,859	2,896	2,901
Totals	$ 188,222	$ 183,825	$ 26,647	$ 26,244

The Company’s investment securities’ gross unrealized losses and fair value, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position, are as follows:

	June 30, 2018								
	Less than Twelve Months			Twelve Months or More			Total		
(Dollars in thousands)	Number of Individual Securities	Unrealized Losses	Fair Value	Number of Individual Securities	Unrealized Losses	Fair Value	Number of Individual Securities	Unrealized Losses	Fair Value
Available-for-Sale Portfolio									
US Treasury, agencies and GSE's	4	$ (206)	$ 15,031	2	$ (15)	$ 5,984	6	$ (221)	$ 21,015
State and political subdivisions	18	(186)	9,113	15	(552)	10,486	33	(738)	19,599
Corporate	7	(134)	5,062	2	(167)	1,640	9	(301)	6,702
Asset backed securities	5	(63)	5,939	-	-	-	5	(63)	5,939
Residential mortgage-backed - US agency	19	(452)	20,238	9	(536)	10,054	28	(988)	30,292
Collateralized mortgage obligations - US agency	15	(365)	22,610	23	(1,610)	27,986	38	(1,975)	50,596
Collateralized mortgage obligations - Private label	7	(278)	13,833	3	(108)	3,229	10	(386)	17,062
Totals	75	$ (1,684)	$ 91,826	54	$ (2,988)	$ 59,379	129	$ (4,672)	$ 151,205
Held-to-Maturity Portfolio									
US Treasury, agencies and GSE's	3	$ (20)	$ 2,963	1	$ (24)	$ 976	4	$ (44)	$ 3,939
State and political subdivisions	5	(8)	1,071	3	(75)	1,986	8	(83)	3,057
Corporate	2	(37)	1,278	1	(180)	2,048	3	(217)	3,326
Residential mortgage-backed - US agency	6	(78)	3,735	-	-	-	6	(78)	3,735
Collateralized mortgage obligations - US agency	2	(24)	2,379	-	-	-	2	(24)	2,379
Collateralized mortgage obligations - Private label	-	-	-	1	(11)	949	1	(11)	949
Totals	18	$ (167)	$ 11,426	6	$ (290)	$ 5,959	24	$ (457)	$ 17,385

	December 31, 2017								
	Less than Twelve Months			Twelve Months or More			Total		
(Dollars in thousands)	Number of Individual Securities	Unrealized Losses	Fair Value	Number of Individual Securities	Unrealized Losses	Fair Value	Number of Individual Securities	Unrealized Losses	Fair Value
Available-for-Sale Portfolio									
US Treasury, agencies and GSE's	5	$ (105)	$ 27,359	4	$ (49)	$ 13,957	9	$ (154)	$ 41,316
State and political subdivisions	18	(24)	2,480	12	(267)	5,041	30	(291)	7,521
Corporate	2	(19)	1,791	1	(73)	1,727	3	(92)	3,518
Asset backed securities	2	(17)	3,123	1	(13)	742	3	(30)	3,865
Residential mortgage-backed - US agency	15	(159)	21,551	9	(336)	10,463	24	(495)	32,014
Collateralized mortgage obligations - US agency	14	(195)	23,790	21	(938)	25,395	35	(1,133)	49,185
Collateralized mortgage obligations - Private label	4	(203)	7,439	-	-	-	4	(203)	7,439
Totals	60	$ (722)	$ 87,533	48	$ (1,676)	$ 57,325	108	$ (2,398)	$ 144,858
Held-to-Maturity Portfolio									
US Treasury, agencies and GSE's	2	$ (2)	$ 1,990	1	$ (12)	$ 988	3	$ (14)	$ 2,978
State and political subdivisions	8	(55)	5,668	11	(256)	8,644	19	(311)	14,312
Corporate	3	(10)	1,412	1	(149)	2,087	4	(159)	3,499
Residential mortgage-backed - US agency	2	(10)	1,909	-	-	-	2	(10)	1,909
Collateralized mortgage obligations - US agency	2	(215)	4,418	-	-	-	2	(215)	4,418
Collateralized mortgage obligations - Private label	1	(10)	1,119	-	-	-	1	(10)	1,119
Totals	18	$ (302)	$ 16,516	13	$ (417)	$ 11,719	31	$ (719)	$ 28,235

Excluding the effects of changes in the characteristics of individual debt securities that potentially give rise to other-than-temporary impairment (“OTTI”), as described below, the fair market value of a debt security as of a particular measurement date is highly dependent upon prevailing market and economic environmental factors at the measurement date relative to the prevailing market and economic environmental factors present at the time the debt security was acquired. The most significant market and environmental factors include, but are not limited to (1) the general level of interest rates, (2) the relationship between shorter-term interest rates and longer-term interest rates (referred to as the “slope” of the interest rate yield curve), (3) general bond market liquidity, (4) the recent and expected near-term volume of new issuances of similar debt securities, and (5) changes in the market values of individual loan collateral underlying mortgage-backed debt securities. Changes in interest rates affect the fair market values of debt securities by influencing the discount rate applied to the securities’ future expected cash flows. The higher the discount rate, the lower the resultant security price. Conversely, the lower the discount rate, the higher the resultant security price. In addition, the cumulative amount and timing of undiscounted cash flows of debt securities may be also affected by changes in interest rates. For any given level of movement in the general market and economic environmental factors described above, the magnitude of any particular debt security’s price changes will also depend heavily upon security-specific factors such as (1) the duration of the security, (2) imbedded optionality contractually granted to the issuer of the security with respect to principal prepayments, and (3) changes in the level of market premiums demanded by investors for securities with imbedded credit risk (where applicable).

The Company conducts a formal review of investment securities on a quarterly basis for the presence of OTTI. The Company assesses whether OTTI is present when the fair value of a debt security is less than its amortized cost basis at the statement of condition date. Under these circumstances, OTTI is considered to have occurred (1) if we intend to sell the security; (2) if it is "more likely than not" we will be required to sell the security before recovery of its amortized cost basis; or (3) the present value of expected cash flows is not anticipated to be sufficient to recover the entire amortized cost basis. The guidance requires that credit-related OTTI is recognized in earnings while non-credit-related OTTI on securities not expected to be sold is recognized in other comprehensive income ("OCI"). Non-credit-related OTTI is based on other factors, including illiquidity and changes in the general interest rate environment. Presentation of OTTI is made in the consolidated statement of income on a gross basis, including both the portion recognized in earnings as well as the portion recorded in OCI. The gross OTTI would then be offset by the amount of non-credit-related OTTI, showing the net as the impact on earnings.

Management does not believe any individual unrealized loss in securities within the portfolio as of June 30, 2018 represents OTTI. At June 30, 2018, the Bank had the following securities, in a loss position for 12 months or more relative to their amortized historical cost, which were deemed to have no credit impairment, thus, the disclosed unrealized losses relate directly to changes in interest rates subsequent to the acquisition of the individual securities. The Company does not intend to sell these securities, nor is it more likely than not that the Company will be required to sell these securities prior to the recovery of the amortized cost.

- Fifteen state and political subdivision securities, categorized as available-for-sale, with an aggregate amortized historical cost of $11.0 million and an aggregate market value of $10.5 million (unrealized aggregate loss of $552,000, or 5.27%). Each of the securities maintains a credit rating established by one or more nationally-recognized statistical rating organization ("NRSRO") that is well above the minimum investment grade and, therefore, no credit-related OTTI is deemed to be present.

- Two corporate securities, categorized as available-for-sale, with an aggregate amortized historical cost of $1.8 million and an aggregate market value of $1.6 million (unrealized loss of $167,000, or 10.14%). The securities maintain credit ratings established by one or more NRSRO that are above the minimum investment grade and, therefore, no credit-related OTTI is deemed to be present.

- Three privately-issued mortgage-backed securities, categorized as available-for-sale, with an aggregate amortized historical cost of $3.3 million and an aggregate market value of $3.3 million (unrealized loss of $108,000, or 3.35%). Two of the securities, with aggregate book values of $2.8 million were unrated at the time of their issuance but remain significantly collateralized through subordination. Therefore, no credit-related OTTI is deemed to be present. The third security, with a book value of $521,000 is rated at the highest investment grade rating by one or more NRSRO and therefore, no credit-related OTTI is deemed to be present.

- One privately-issued mortgaged-backed security, categorized as held-to-maturity, with an amortized historical cost of $960,000 and a market value of $949,000 (unrealized loss of $11,000, or 1.13%). This security was unrated at the time of its issuance but remains significantly collateralized through subordination and, therefore, no credit-related OTTI is deemed to be present.

- Three state and political subdivision securities, categorized as held-to-maturity, with an aggregate amortized historical cost of $2.0 million and an aggregate market value of $2.0 million (unrealized aggregate loss of $75,000, or 3.78%). Each of the securities maintains a credit rating established by one or more NRSRO that is above the minimum investment grade and, therefore, no credit-related OTTI is deemed to be present.

- One corporate security, categorized as held-to-maturity, with an amortized historical cost of $2.2 million and a market value of $2.0 million (unrealized aggregate loss of $180,000, or 8.79%). This security maintains a credit rating established by one or more NRSRO well above the minimum investment grade and, therefore, no credit-related OTTI is deemed to be present.

All other securities with market values less than their amortized historical costs for twelve or more months are issued by United States agencies or government sponsored enterprises and consist of mortgage-backed securities, collateralized mortgage obligations and direct agency financings. These positions in US government agency and government-sponsored enterprises are deemed to have no credit impairment, thus, the disclosed unrealized losses relate directly to changes in interest rates subsequent to the acquisition of the individual securities. The Company does not intend to sell these securities, nor is it more likely than not that the Company will be required to sell these securities prior to the recovery of the amortized cost.

In determining whether OTTI has occurred for equity securities, the Company considers the applicable factors described above and the length of time the equity security's fair value has been below the carrying amount. The Company had no equity securities that were impaired at June 30, 2018 or December 31, 2017.

Gross realized gains (losses) on sales of securities for the indicated periods are detailed below:

	For the three months ended June 30,		For the six months ended June 30,	
(In thousands)	2018	2017	2018	2017
Realized gains on investments	$ 133	$ 70	$ 160	$ 148
Realized gains on hedging activity	-	156	-	250
Realized losses on investments	(155)	(91)	(289)	(192)
	$ (22)	$ 135	$ (129)	$ 206
Gains on equity securities	13	-	26	-
	$ 13	$ -	$ 26	$ -

The Company adopted *ASU 2017-12: Derivatives and Hedging [Topic 815]: Targeted Improvements to Accounting for Hedging Activities*, effective January 1, 2018, in the second quarter of 2018. The amended guidance within this Update expands and clarifies hedge accounting for nonfinancial and financial risk components, aligns the recognition and presentation of the effects of the hedging instrument and hedged item in the financial statements, and simplifies the requirements for assessing effectiveness in a hedging relationship. The Company did not have any hedging activities in the first half of 2018 but expects to utilize hedging in the future to improve the management of its risk profiles. In order to facilitate potential future hedging activities, the Company transferred 52 investment securities with an aggregate amortized cost before transfer of $35.2 million from the held-to-maturity classification to the available-for-sale classification at the date of adoption.

As of June 30, 2018 and December 31, 2017, securities with a fair value of $108.5 million and $113.0 million, respectively, were pledged to collateralize certain municipal deposit relationships. As of the same dates, securities with a fair value of $25.4 million and $19.9 million were pledged against the Company's established borrowing arrangements.

Management has reviewed its loan and mortgage-backed securities portfolios and determined that, to the best of its knowledge, only minimal exposure exists to sub-prime or other high-risk residential mortgages. With limited exceptions in the Company's investment portfolio involving the most senior tranches of securitized bonds, the Company is not in the practice of investing in, or originating, these types of investments or loans.

Note 5: Pension and Postretirement Benefits

The Company has a noncontributory defined benefit pension plan covering most employees. The plan provides defined benefits based on years of service and final average salary. On May 14, 2012, the Company informed its employees of its decision to freeze participation and benefit accruals under the plan, primarily to reduce some of the volatility in earnings that can accompany the maintenance of a defined benefit plan. The plan was frozen on June 30, 2012. Compensation earned by employees up to June 30, 2012 is used for purposes of calculating benefits under the plan but there are no future benefit accruals after this date. Participants as of June 30, 2012 will continue to earn vesting credit with respect to their frozen accrued benefits as they continue to work. In addition, the Company provides certain health and life insurance benefits for a limited number of eligible retired employees. The healthcare plan is contributory with participants' contributions adjusted annually; the life insurance plan is noncontributory. Employees with less than 14 years of service as of January 1, 1995, are not eligible for the health and life insurance retirement benefits.

The composition of net periodic pension plan and postretirement plan costs for the indicated periods is as follows:

	Pension Benefits		Postretirement Benefits		Pension Benefits		Postretirement Benefits	
	For the three months ended June 30,				For the six months ended June 30,			
(In thousands)	2018	2017	2018	2017	2018	2017	2018	2017
Service cost	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -
Interest cost	118	118	6	2	236	237	11	4
Expected return on plan assets	(259)	(236)	-	-	(518)	(473)	-	-
Amortization of prior service credits	-	-	(1)	-	-	-	(2)	-
Amortization of net losses/(gains)	41	39	3	(2)	82	77	6	(4)
Net periodic benefit plan (benefit) cost	$ (100)	$ (79)	$ 8	$ -	$ (200)	$ (159)	$ 15	$ -

The Company has made a contribution in the amount of $825,000 to the defined benefit pension plan during the second quarter of 2018. The Company will evaluate the need for further contributions to the defined benefit pension plan during 2018. The prepaid pension asset is recorded in other assets on the statement of condition as of June 30, 2018 and December 31, 2017.

Note 6: Loans

Major classifications of loans at the indicated dates are as follows:

(In thousands)	June 30, 2018	December 31, 2017
Residential mortgage loans:		
1-4 family first-lien residential mortgages	$ 225,864	$ 216,793
Construction	3,288	5,558
Total residential mortgage loans	229,152	222,351
Commercial loans:		
Real estate	206,960	192,525
Lines of credit	49,314	51,285
Other commercial and industrial	58,742	50,097
Tax exempt loans	9,860	10,405
Total commercial loans	324,876	304,312
Consumer loans:		
Home equity and junior liens	26,262	25,935
Other consumer	27,037	28,646
Total consumer loans	53,299	54,581
Total loans	607,327	581,244
Net deferred loan fees	(142)	(413)
Less allowance for loan losses	(7,605)	(7,126)
Loans receivable, net	$ 599,580	$ 573,705

Although the Bank may occasionally purchase or fund loan participation interests outside of its primary market areas, the Bank generally originates residential mortgage, commercial, and consumer loans largely to customers throughout Oswego and Onondaga counties. Although the Bank has a diversified loan portfolio, a substantial portion of its borrowers' abilities to honor their loan contracts is dependent upon the counties' employment and economic conditions.

The Bank acquired $15.6 million and $10.2 million of loans originated by an unrelated financial institution, located outside of the Bank's market area, in January 2017 and April 2017, respectively. The acquired loan pools represented a

Table of Contents

90% participating interest in a total of 1,231 loans secured by liens on automobiles with maturities ranging primarily from two to six years. These loans are serviced through their respective maturities by the originating financial institution. As of June 30, 2018 and December 31, 2017 there were 1,000 loans outstanding with a remaining outstanding carrying value of $16.3 million and 1,082 loans outstanding with a remaining outstanding carrying value of $19.6 million, respectively. Since the acquisition of these loan pools, a total of nine loans had cumulative net charge-offs totaling $79,000 with $34,000 in net charge-offs for the six months ended June 30, 2018.

As of June 30, 2018 and December 31, 2017, residential mortgage loans with a carrying value of $154.1 million and $148.1 million, respectively, have been pledged by the Company to the Federal Home Loan Bank of New York ("FHLBNY") under a blanket collateral agreement to secure the Company's line of credit and term borrowings.

Loan Origination / Risk Management

The Company's lending policies and procedures are presented in Note 5 to the audited consolidated financial statements included in the 2017 Annual Report on Form 10-K filed with the Securities and Exchange Commission on March 30, 2018 and have not changed. As part of the execution of the Company's overall balance sheet management strategies, the Bank will acquire participating interests in loans originated by unrelated third parties on a sporadic basis. The purchase of participations in loans that are originated by third parties only occurs after the completion of thorough pre-acquisition due diligence. Loans in which the Company acquires a participating interest are determined to meet, in all material respects, the Company's internal underwriting policies, including credit and collateral suitability thresholds, prior to acquisition. In addition, the financial condition of the originating financial institutions, which are generally retained as the ongoing loan servicing provider for participations acquired by the Bank, are analyzed prior to the acquisition of the participating interests and monitored on a regular basis thereafter for the life of those interests.

To develop and document a systematic methodology for determining the allowance for loan losses, the Company has divided the loan portfolio into three portfolio segments, each with different risk characteristics but with similar methodologies for assessing risk. Each portfolio segment is broken down into loan classes where appropriate. Loan classes contain unique measurement attributes, risk characteristics, and methods for monitoring and assessing risk that are necessary to develop the allowance for loan losses. Unique characteristics such as borrower type, loan type, collateral type, and risk characteristics define each class.

The following table illustrates the portfolio segments and classes for the Company's loan portfolio:

Portfolio Segment	**Class**
Residential Mortgage Loans	1-4 family first-lien residential mortgages
	Construction
Commercial Loans	Real estate
	Lines of credit
	Other commercial and industrial
	Tax exempt loans
Consumer Loans	Home equity and junior liens
	Other consumer

The following tables present the classes of the loan portfolio, not including net deferred loan costs, summarized by the aggregate pass rating and the classified ratings of special mention, substandard and doubtful within the Company's internal risk rating system as of the dates indicated:

	As of June 30, 2018				
(In thousands)	Pass	Special Mention	Substandard	Doubtful	Total
Residential mortgage loans:					
1-4 family first-lien residential mortgages	$ 221,719	$ 485	$ 1,284	$ 2,376	$ 225,864
Construction	3,288	-	-	-	3,288
Total residential mortgage loans	225,007	485	1,284	2,376	229,152
Commercial loans:					
Real estate	201,733	1,533	1,913	1,781	206,960
Lines of credit	48,941	164	169	40	49,314
Other commercial and industrial	57,411	407	628	296	58,742
Tax exempt loans	9,860	-	-	-	9,860
Total commercial loans	317,945	2,104	2,710	2,117	324,876
Consumer loans:					
Home equity and junior liens	25,906	127	140	89	26,262
Other consumer	26,864	161	12	-	27,037
Total consumer loans	52,770	288	152	89	53,299
Total loans	$ 595,722	$ 2,877	$ 4,146	$ 4,582	$ 607,327

	As of December 31, 2017				
(In thousands)	Pass	Special Mention	Substandard	Doubtful	Total
Residential mortgage loans:					
1-4 family first-lien residential mortgages	$ 211,825	$ 891	$ 1,869	$ 2,208	$ 216,793
Construction	5,558	-	-	-	5,558
Total residential mortgage loans	217,383	891	1,869	2,208	222,351
Commercial loans:					
Real estate	187,073	1,372	2,024	2,056	192,525
Lines of credit	50,507	195	523	60	51,285
Other commercial and industrial	48,738	407	532	420	50,097
Tax exempt loans	10,405	-	-	-	10,405
Total commercial loans	296,723	1,974	3,079	2,536	304,312
Consumer loans:					
Home equity and junior liens	25,396	61	304	174	25,935
Other consumer	28,584	55	7	-	28,646
Total consumer loans	53,980	116	311	174	54,581
Total loans	$ 568,086	$ 2,981	$ 5,259	$ 4,918	$ 581,244

Management has reviewed its loan portfolio and determined that, to the best of its knowledge, no material exposure exists to sub-prime or other high-risk residential mortgages. The Company is not in the practice of originating these types of loans.

Nonaccrual and Past Due Loans

Loans are placed on nonaccrual when the contractual payment of principal and interest has become 90 days past due or management has serious doubts about further collectability of principal or interest, even though the loan may be currently performing.

Loans are considered past due if the required principal and interest payments have not been received within thirty days of the payment due date.

An age analysis of past due loans, not including net deferred loan costs, segregated by portfolio segment and class of loans, as of June 30, 2018 and December 31, 2017, are detailed in the following tables:

	As of June 30, 2018					
(In thousands)	30-59 Days Past Due And Accruing	60-89 Days Past Due And Accruing	90 Days and Over	Total Past Due	Current	Total Loans Receivable
Residential mortgage loans:						
1-4 family first-lien residential mortgages	$ 1,095	$ 87	$ 2,090	$ 3,272	$ 222,592	$ 225,864
Construction	-	-	-	-	3,288	3,288
Total residential mortgage loans	1,095	87	2,090	3,272	225,880	229,152
Commercial loans:						
Real estate	54	387	2,469	2,910	204,050	206,960
Lines of credit	161	17	133	311	49,003	49,314
Other commercial and industrial	100	9	550	659	58,083	58,742
Tax exempt loans	-	238	-	238	9,622	9,860
Total commercial loans	315	651	3,152	4,118	320,758	324,876
Consumer loans:						
Home equity and junior liens	55	10	140	205	26,057	26,262
Other consumer	107	64	63	234	26,803	27,037
Total consumer loans	162	74	203	439	52,860	53,299
Total loans	$ 1,572	$ 812	$ 5,445	$ 7,829	$ 599,498	$ 607,327

	As of December 31, 2017					
(In thousands)	30-59 Days Past Due And Accruing	60-89 Days Past Due And Accruing	90 Days and Over	Total Past Due	Current	Total Loans Receivable
Residential mortgage loans:						
1-4 family first-lien residential mortgages	$ 1,196	$ 925	$ 2,088	$ 4,209	$ 212,584	$ 216,793
Construction	-	-	-	-	5,558	5,558
Total residential mortgage loans	1,196	925	2,088	4,209	218,142	222,351
Commercial loans:						
Real estate	720	2,056	1,545	4,321	188,204	192,525
Lines of credit	1,482	31	132	1,645	49,640	51,285
Other commercial and industrial	575	60	766	1,401	48,696	50,097
Tax exempt loans	-	-	-	-	10,405	10,405
Total commercial loans	2,777	2,147	2,443	7,367	296,945	304,312
Consumer loans:						
Home equity and junior liens	94	74	300	468	25,467	25,935
Other consumer	192	50	63	305	28,341	28,646
Total consumer loans	286	124	363	773	53,808	54,581
Total loans	$ 4,259	$ 3,196	$ 4,894	$ 12,349	$ 568,895	$ 581,244

Nonaccrual loans, segregated by class of loan, were as follows:

(In thousands)		June 30, 2018		December 31, 2017
Residential mortgage loans:				
1-4 family first-lien residential mortgages	$	2,090	$	2,088
		2,090		2,088
Commercial loans:				
Real estate		2,469		1,545
Lines of credit		133		132
Other commercial and industrial		550		766
		3,152		2,443
Consumer loans:				
Home equity and junior liens		140		300
Other consumer		63		63
		203		363
Total nonaccrual loans	$	5,445	$	4,894

The Company is required to disclose certain activities related to Troubled Debt Restructurings ("TDR") in accordance with accounting guidance. Certain loans have been modified in a TDR where economic concessions have been granted to a borrower who is experiencing, or expected to experience, financial difficulties. These economic concessions could include a reduction in the loan interest rate, extension of payment terms, reduction of principal amortization, or other actions that it would not otherwise consider for a new loan with similar risk characteristics.

The Company is required to disclose new TDRs for each reporting period for which an income statement is being presented. The pre-modification outstanding recorded investment is the principal loan balance less the provision for loan losses before the loan was modified as a TDR. The post-modification outstanding recorded investment is the principal balance less the provision for loan losses after the loan was modified as a TDR. Additional provision for loan losses is the change in the allowance for loan losses between the pre-modification outstanding recorded investment and post-modification outstanding recorded investment.

The Company had no loans that have been modified as TDRs for the three months ended June 30, 2018.

The table below details a loan that has been modified as a TDR for the six months ended June 30, 2018.

	For the six months ended June 30, 2018						
(In thousands)	Number of loans		Pre-modification outstanding recorded investment		Post-modification outstanding recorded investment		Additional provision for loan losses
Other commercial and industrial loans	1	$	300	$	300	$	-

The TDR evaluated for impairment for the six months ended June 30, 2018, has been classified as a TDR due to economic concessions granted, which included an extended maturity date that will result in a delay in payment from the original contractual maturity.

The Company had no loans that have been modified as TDRs for the three or six months ended June 30, 2017.

The Company is required to disclose loans that have been modified as TDRs within the previous 12 months in which there was payment default after the restructuring. The Company defines payment default as any loans 90 days past due on contractual payments.

The Company had no loans that had been modified as TDRs during the twelve months prior to June 30, 2018, which had subsequently defaulted during the six months ended June 30, 2018.

The Company had no loans that had been modified as TDRs during the twelve months prior to June 30, 2017, which had subsequently defaulted during the six months ended June 30, 2017.

When the Company modifies a loan within a portfolio segment that is individually evaluated for impairment, a potential impairment is analyzed either based on the present value of the expected future cash flows discounted at the interest rate of the original loan terms or the fair value of the collateral less costs to sell. If it is determined that the value of the loan is less than its recorded investment, then impairment is recognized as a component of the provision for loan losses, an associated increase to the allowance for loan losses or as a charge-off to the allowance for loan losses in the current period.

Impaired Loans

The following table summarizes impaired loan information by portfolio class at the indicated dates:

	June 30, 2018			December 31, 2017		
(In thousands)	Recorded Investment	Unpaid Principal Balance	Related Allowance	Recorded Investment	Unpaid Principal Balance	Related Allowance
With no related allowance recorded:						
1-4 family first-lien residential mortgages	$ 872	$ 876	$ -	$ 900	$ 909	$ -
Commercial real estate	2,351	2,405	-	3,314	3,360	-
Commercial lines of credit	162	162	-	507	507	-
Other commercial and industrial	732	733	-	523	524	-
Home equity and junior liens	-	-	-	80	80	-
With an allowance recorded:						
1-4 family first-lien residential mortgages	972	972	111	958	958	210
Commercial real estate	2,179	2,179	596	2,186	2,187	320
Commercial lines of credit	47	47	47	40	40	40
Other commercial and industrial	306	306	276	525	525	391
Home equity and junior liens	207	207	141	210	210	142
Total:						
1-4 family first-lien residential mortgages	1,844	1,848	111	1,858	1,867	210
Commercial real estate	4,530	4,584	596	5,500	5,547	320
Commercial lines of credit	209	209	47	547	547	40
Other commercial and industrial	1,038	1,039	276	1,048	1,049	391
Home equity and junior liens	207	207	141	290	290	142
Totals	$ 7,828	$ 7,887	$ 1,171	$ 9,243	$ 9,300	$ 1,103

The following table presents the average recorded investment in impaired loans for the periods indicated:

	For the three months ended June 30,		For the six months ended June 30,	
(In thousands)	2018	2017	2018	2017
1-4 family first-lien residential mortgages	$ 1,846	$ 1,416	$ 1,850	$ 1,482
Commercial real estate	4,971	4,508	5,147	4,696
Commercial lines of credit	376	418	433	412
Other commercial and industrial	1,050	984	1,049	997
Home equity and junior liens	208	215	235	305
Total	$ 8,451	$ 7,541	$ 8,714	$ 7,892

The following table presents the cash basis interest income recognized on impaired loans for the periods indicated:

	For the three months ended June 30,		For the six months ended June 30,	
(In thousands)	2018	2017	2018	2017
1-4 family first-lien residential mortgages	$ 14	$ 10	$ 32	$ 21
Commercial real estate	18	50	66	95
Commercial lines of credit	10	7	21	13
Other commercial and industrial	13	6	19	13
Home equity and junior liens	3	3	6	4
Total	$ 58	$ 76	$ 144	$ 146

Table of Contents

Note 7: Allowance for Loan Losses

Summarized in the tables below are changes in the allowance for loan losses for the indicated periods and information pertaining to the allocation of the allowance for loan losses, balances of the allowance for loan losses, loans receivable based on individual, and collective impairment evaluation by loan portfolio class. An allocation of a portion of the allowance to a given portfolio class does not limit the Company's ability to absorb losses in another portfolio class.

	For the three months ended June 30, 2018				
(In thousands)	1-4 family first-lien residential mortgage	Residential construction mortgage	Commercial real estate	Commercial lines of credit	Other commercial and industrial
Allowance for loan losses:					
Beginning Balance	$ 751	$ -	$ 3,895	$ 719	$ 1,309
Charge-offs	(74)	-	-	(50)	(48)
Recoveries	-	-	-	66	-
Provisions (credits)	45	-	246	(4)	10
Ending balance	$ 722	$ -	$ 4,141	$ 731	$ 1,271
Ending balance: related to loans individually evaluated for impairment	111	-	596	47	276
Ending balance: related to loans collectively evaluated for impairment	$ 611	$ -	$ 3,545	$ 684	$ 995
Loans receivables:					
Ending balance	$ 225,864	$ 3,288	$ 206,960	$ 49,314	$ 58,742
Ending balance: individually evaluated for impairment	1,844	-	4,530	209	1,038
Ending balance: collectively evaluated for impairment	$ 224,020	$ 3,288	$ 202,430	$ 49,105	$ 57,704

	Tax exempt	Home equity and junior liens	Other Consumer	Unallocated	Total
Allowance for loan losses:					
Beginning Balance	$ 1	$ 507	$ 260	$ 9	$ 7,451
Charge-offs	-	-	(48)	-	(220)
Recoveries	-	1	10	-	77
Provisions (credits)	-	(74)	69	5	297
Ending balance	$ 1	$ 434	$ 291	$ 14	$ 7,605
Ending balance: related to loans individually evaluated for impairment	-	141	-	-	1,171
Ending balance: related to loans collectively evaluated for impairment	$ 1	$ 293	$ 291	$ 14	$ 6,434
Loans receivables:					
Ending balance	$ 9,860	$ 26,262	$ 27,037		$ 607,327
Ending balance: individually evaluated for impairment	-	207	-		7,828
Ending balance: collectively evaluated for impairment	$ 9,860	$ 26,055	$ 27,037		$ 599,499

(In thousands)	For the six months ended June 30, 2018 1-4 family first-lien residential mortgage	Residential construction mortgage	Commercial real estate	Commercial lines of credit	Other commercial and industrial
Allowance for loan losses:					
Beginning Balance	$ 865	$ -	$ 3,589	$ 735	$ 1,214
Charge-offs	(192)	-	-	(50)	(171)
Recoveries	20	-	-	66	-
Provisions (credits)	29	-	552	(20)	228
Ending balance	$ 722	$ -	$ 4,141	$ 731	$ 1,271

	Tax exempt	Home equity and junior liens	Other consumer	Unallocated	Total
Allowance for loan losses:					
Beginning Balance	$ 1	$ 514	$ 208	$ -	$ 7,126
Charge-offs	-	(17)	(111)	-	(541)
Recoveries	-	1	23	-	110
Provisions (credits)	-	(64)	171	14	910
Ending balance	$ 1	$ 434	$ 291	$ 14	$ 7,605

(In thousands)	For the three months ended June 30, 2017 1-4 family first-lien residential mortgage	Residential construction mortgage	Commercial real estate	Commercial lines of credit	Other commercial and industrial
Allowance for loan losses:					
Beginning Balance	$ 943	$ -	$ 2,532	$ 365	$ 1,480
Charge-offs	(143)	-	-	-	(1)
Recoveries	-	-	-	-	13
Provisions	13	-	272	8	119
Ending balance	$ 813	$ -	$ 2,804	$ 373	$ 1,611
Ending balance: related to loans individually evaluated for impairment	193	-	-	7	376
Ending balance: related to loans collectively evaluated for impairment	$ 620	$ -	$ 2,804	$ 366	$ 1,235
Loans receivables:					
Ending balance	$ 204,117	$ 6,640	$ 175,737	$ 21,132	$ 74,375
Ending balance: individually evaluated for impairment	1,220	-	4,474	421	967
Ending balance: collectively evaluated for impairment	$ 202,897	$ 6,640	$ 171,263	$ 20,711	$ 73,408

	Tax exempt	Home equity and junior liens	Other Consumer	Unallocated	Total
Allowance for loan losses:					
Beginning Balance	$ 1	$ 509	$ 133	$ 1	$ 5,964
Charge-offs	-	-	(8)	-	(152)
Recoveries	-	1	9	-	23
Provisions (credits)	-	(17)	29	(1)	423
Ending balance	$ 1	$ 493	$ 163	$ -	$ 6,258
Ending balance: related to loans individually evaluated for impairment	-	142	-	-	718
Ending balance: related to loans collectively evaluated for impairment	$ 1	$ 351	$ 163	$ -	5,540
Loans receivables:					
Ending balance	$ 11,446	$ 25,257	$ 30,497		$ 549,201
Ending balance: individually evaluated for impairment	-	214	-		7,296
Ending balance: collectively evaluated for impairment	$ 11,446	$ 25,043	$ 30,497		$ 541,905

(In thousands)	For the six months ended June 30, 2017 1-4 family first-lien residential mortgage	Residential construction mortgage	Commercial real estate	Commercial lines of credit	Other commercial and industrial
Allowance for loan losses:					
Beginning Balance	$ 759	$ -	$ 2,935	$ 397	$ 1,658
Charge-offs	(156)	-	(505)	(53)	(17)
Recoveries	1	-	-	-	15
Provisions (credits)	209	-	374	29	(45)
Ending balance	$ 813	$ -	$ 2,804	$ 373	$ 1,611

	Tax exempt	Home equity and junior liens	Other consumer	Unallocated	Total
Allowance for loan losses:					
Beginning Balance	$ 1	$ 331	$ 166	$ -	$ 6,247
Charge-offs	-	(69)	(40)	-	(840)
Recoveries	-	1	22	-	39
Provisions	-	230	15	-	812
Ending balance	$ 1	$ 493	$ 163	$ -	$ 6,258

The Company’s methodology for determining its allowance for loan losses includes an analysis of qualitative factors that are added to the historical loss rates in arriving at the total allowance for loan losses needed for this general pool of loans. The qualitative factors include:

- Changes in national and local economic trends;
- The rate of growth in the portfolio;
- Trends of delinquencies and nonaccrual balances;
- Changes in loan policy; and
- Changes in lending management experience and related staffing.

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. These qualitative factors, applied to each product class, make the evaluation inherently subjective, as it requires material estimates that may be susceptible to significant revision as more information becomes available. Adjustments to the factors are supported through documentation of changes in conditions in a narrative accompanying the allowance for loan losses analysis and calculation.

The allocation of the allowance for loan losses summarized on the basis of the Company's calculation methodology was as follows:

	June 30, 2018				
(In thousands)	1-4 family first-lien residential mortgage	Residential construction mortgage	Commercial real estate	Commercial lines of credit	Other commercial and industrial
Specifically reserved	$ 111	$ -	$ 596	$ 47	$ 276
Historical loss rate	111	-	86	24	17
Qualitative factors	500	-	3,459	660	978
Total	$ 722	$ -	$ 4,141	$ 731	$ 1,271

	Tax exempt	Home equity and junior liens	Other consumer	Unallocated	Total
Specifically reserved	$ -	$ 141	$ -	$ -	$ 1,171
Historical loss rate	-	24	112	-	374
Qualitative factors	1	269	179	-	6,046
Other	-	-	-	14	14
Total	$ 1	$ 434	$ 291	$ 14	$ 7,605

	June 30, 2017				
(In thousands)	1-4 family first-lien residential mortgage	Residential construction mortgage	Commercial real estate	Commercial lines of credit	Other commercial and industrial
Specifically reserved	$ 193	$ -	$ -	$ 7	$ 376
Historical loss rate	75	-	105	39	24
Qualitative factors	545	-	2,699	327	1,211
Total	$ 813	$ -	$ 2,804	$ 373	$ 1,611

	Tax exempt	Home equity and junior liens	Other consumer	Unallocated	Total
Specifically reserved	$ -	$ 142	$ -	$ -	$ 718
Historical loss rate	-	50	29	-	322
Qualitative factors	1	301	134	-	5,218
Total	$ 1	$ 493	$ 163	$ -	$ 6,258

Note 8: Foreclosed Real Estate

The Company is required to disclose the carrying amount of foreclosed residential real estate properties held as a result of obtaining physical possession of the property at each reporting period.

(Dollars in thousands)	Number of properties	June 30, 2018	Number of properties	December 31, 2017
Foreclosed residential real estate	4	$ 97	5	$ 468

At June 30, 2018, the Company reported $1.3 million in residential real estate loans in the process of foreclosure.

Note 9: Guarantees

The Company does not issue any guarantees that would require liability recognition or disclosure, other than its standby letters of credit. Generally, all letters of credit, when issued have expiration dates within one year. The credit risks involved in issuing letters of credit is essentially the same as those that are involved in extending loan facilities to customers. The Company generally holds collateral and/or personal guarantees supporting these commitments. The Company had $1.8 million of standby letters of credit as of June 30, 2018. Management believes that the proceeds obtained through a liquidation of collateral and the enforcement of guarantees would be sufficient to cover the potential amount of future payments required under the corresponding guarantees. The fair value of standby letters of credit was not significant to the Company's consolidated financial statements.

Note 10: Fair Value Measurements

Accounting guidance related to fair value measurements and disclosures specifies a hierarchy of valuation techniques based on whether the inputs to those valuation techniques are observable or unobservable. Observable inputs reflect market data obtained from independent sources, while unobservable inputs reflect the Company's market assumptions. These two types of inputs have created the following fair value hierarchy:

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

Level 2 – Quoted prices for similar assets and liabilities in active markets; quoted prices for identical or similar assets or liabilities in markets that are not active; and model-derived valuations in which all significant inputs and significant value drivers are observable in active markets.

Level 3 – Model-derived valuations in which one or more significant inputs or significant value drivers are unobservable.

An asset's or liability's level within the fair value hierarchy is based on the lowest level of input that is significant to the fair value measurement.

In determining fair value, the Company utilizes valuation techniques that maximize the use of observable inputs, minimize the use of unobservable inputs, to the extent possible, and considers counterparty credit risk in its assessment of fair value.

The Company used the following methods and significant assumptions to estimate fair value:

Investment securities: The fair values of available-for-sale and marketable equity securities are obtained from an independent third party and are based on quoted prices on nationally recognized securities exchanges where available (Level 1). If quoted prices are not available, fair values are measured by utilizing matrix pricing, which is a mathematical technique used widely in the industry to value debt securities without relying exclusively on quoted prices for specific securities but rather by relying on the securities' relationship to other benchmark quoted securities (Level 2). Management made no adjustment to the fair value quotes that were received from the independent third party pricing service. Level 3 securities are assets whose fair value cannot be determined by using observable measures, such as market prices or pricing models. Level 3 assets are typically very illiquid, and fair values can only be calculated using estimates or risk-adjusted value ranges. Management applies known factors, such as currently applicable discount rates, to the valuation of those investments in order to determine fair value at the reporting date.

Impaired loans: Impaired loans are those loans in which the Company has measured impairment based on the fair value of the loan's collateral or the discounted value of expected future cash flows. Fair value is generally determined based upon market value evaluations by third parties of the properties and/or estimates by management of working capital collateral or discounted cash flows based upon expected proceeds. These appraisals may include up to three approaches to value: the sales comparison approach, the income approach (for income-producing property), and the cost approach. Management modifies the appraised values, if needed, to take into account recent developments in the market or other factors, such as, changes in absorption rates or market conditions from the time of valuation and anticipated sales values considering management's plans for disposition. Such modifications to the appraised values could result in lower valuations of such collateral. Estimated costs to sell are based on current amounts of disposal costs for similar assets. These measurements are classified as Level 3 within the valuation hierarchy. Impaired loans are subject to nonrecurring fair value adjustment upon initial recognition or subsequent impairment. A portion of the allowance for loan losses is allocated to impaired loans if the value of such loans is deemed to be less than the unpaid balance.

Foreclosed real estate: Fair values for foreclosed real estate are initially recorded based on market value evaluations by third parties, less costs to sell ("initial cost basis"). Any write-downs required when the related loan receivable is exchanged for the underlying real estate collateral at the time of transfer to foreclosed real estate are charged to the allowance for loan losses. Values are derived from appraisals, similar to impaired loans, of underlying collateral or discounted cash flow analysis. Subsequent to foreclosure, valuations are updated periodically and assets are marked to current fair value, not to exceed the initial cost basis. In the determination of fair value subsequent to foreclosure, management also considers other factors or recent developments, such as, changes in absorption rates and market conditions from the time of valuation and anticipated sales values considering management's plans for disposition. Either change could result in adjustment to lower the property value estimates indicated in the appraisals. These measurements are classified as Level 3 within the fair value hierarchy.

The following tables summarize assets measured at fair value on a recurring basis as of the indicated dates, segregated by the level of valuation inputs within the hierarchy utilized to measure fair value:

	June 30, 2018			
(In thousands)	Level 1	Level 2	Level 3	Total Fair Value
Available-for-Sale Portfolio				
Debt investment securities:				
US Treasury, agencies and GSEs	$ -	$ 21,035	$ -	$ 21,035
State and political subdivisions	-	27,988	-	27,988
Corporate	-	13,005	-	13,005
Asset backed securities	-	10,785	-	10,785
Residential mortgage-backed - US agency	-	33,033	-	33,033
Collateralized mortgage obligations - US agency	-	58,120	-	58,120
Collateralized mortgage obligations - Private label	-	19,859	-	19,859
Equity investment securities:				
Common stock - Financial services industry	-	205		205
Total available-for-sale securities	$ -	$ 184,030	$ -	$ 184,030
Marketable equity securities	$ -	$ 541	$ -	$ 541

	December 31, 2017			
(In thousands)	Level 1	Level 2	Level 3	Total Fair Value
Available-for-Sale Portfolio				
Debt investment securities:				
US Treasury, agencies and GSEs	$ -	$ 41,336	$ -	$ 41,336
State and political subdivisions	-	13,681	-	13,681
Corporate	-	8,600	-	8,600
Asset backed securities	-	6,644	-	6,644
Residential mortgage-backed - US agency	-	35,742	-	35,742
Collateralized mortgage obligations - US agency	-	53,348	-	53,348
Collateralized mortgage obligations - Private label	-	11,052	-	11,052
Equity investment securities:				
Common stock - Financial services industry	-	220	515	735
Total available-for-sale securities	$ -	$ 170,623	$ 515	$ 171,138

The following table summarizes the valuation techniques and significant unobservable inputs used for the Company's investments that are categorized within Level 3 of the fair value hierarchy at the indicated dates:

(In thousands)	At December 31, 2017				
Investment Type		Fair Value	Valuation Techniques	Unobservable Input	Weight
Common Stock - Financial Services Industry	$	515	Inputs to comparables	Weight ascribed to comparable companies	100%

Pathfinder Bank had the following assets measured at fair value on a nonrecurring basis as of June 30, 2018 and December 31, 2017:

	June 30, 2018							
(In thousands)		Level 1		Level 2		Level 3		Total Fair Value
Impaired loans	$	-	$	-	$	1,832	$	1,832
Foreclosed real estate	$	-	$	-	$	61	$	61

	December 31, 2017							
(In thousands)		Level 1		Level 2		Level 3		Total Fair Value
Impaired loans	$	-	$	-	$	4,887	$	4,887
Foreclosed real estate	$	-	$	-	$	434	$	434

The following table presents additional quantitative information about assets measured at fair value on a nonrecurring basis and for which Level 3 inputs were used to determine fair value at the indicated dates.

	Quantitative Information about Level 3 Fair Value Measurements		
	Valuation Techniques	Unobservable Input	Range (Weighted Avg.)
At June 30, 2018			
Impaired loans	Appraisal of collateral	Appraisal Adjustments	5% - 10% (5%)
	(Sales Approach)	Costs to Sell	7% - 13% (11%)
	Discounted Cash Flow		
Foreclosed real estate	Appraisal of collateral	Appraisal Adjustments	15% - 15% (15%)
	(Sales Approach)	Costs to Sell	6% - 8% (7%)

	Quantitative Information about Level 3 Fair Value Measurements		
	Valuation Techniques	Unobservable Input	Range (Weighted Avg.)
At December 31, 2017			
Impaired loans	Appraisal of collateral	Appraisal Adjustments	5% - 30% (9%)
	(Sales Approach)	Costs to Sell	7% - 13% (11%)
	Discounted Cash Flow		
Foreclosed real estate	Appraisal of collateral	Appraisal Adjustments	15% - 15% (15%)
	(Sales Approach)	Costs to Sell	6% - 8% (7%)

The Company owns a small percentage of the common stock of a single, otherwise unaffiliated, financial institution with a fair market value of $541,000 at June 30, 2018. This financial institution had been recently formed, was relatively limited in the scope of its business activities, and was relatively small in asset size at the time the shares of common stock were initially acquired by the Company. The shares of this financial institution are not, and have never been, listed on any public stock exchange. Through December 31, 2017, the Company determined the fair market value of these shares using Level 3 methodologies. The relatively unique characteristics of the institution precluded the use of significant inputs and value drivers observable in active markets through that date. During the three months ended March 31, 2018, the Company's management reevaluated the fair value methodology it had previously used with respect to this investment and determined that the institution's increased size and current business activities had become reasonably comparable over time with applicable peer institutions. Consequently, relevant significant inputs and value drivers observable in active markets were deemed to be present and available beginning with the three months ended March 31, 2018. Accordingly, the Company transferred this asset from Level 3 to Level 2 at March 31, 2018 for purposes of the accompanying fair value disclosure. The investment was valued using Level 2 methodologies at June 30, 2018 and it is expected to be valued using Level 2 methodologies prospectively. There have been no transfers of assets into or out of any fair value measurement during the three months ended June 30, 2018.

Required disclosures include fair value information of financial instruments, whether or not recognized in the consolidated statement of condition, for which it is practicable to estimate that value. In cases where quoted market prices are not available, fair values are based on estimates using present value or other valuation techniques. Those techniques are significantly affected by the assumptions used, including the discount rate and estimates of future cash flows. In that regard, the derived fair value estimates cannot be substantiated by comparison to independent markets and, in many cases, could not be realized in immediate settlement of the instrument.

The Company has various processes and controls in place to ensure that fair value is reasonably estimated. The Company performs due diligence procedures over third-party pricing service providers in order to support their use in the valuation process.

While the Company believes its valuation methods are appropriate and consistent with other market participants, the use of different methodologies or assumptions to determine the fair value of certain financial instruments could result in a different estimate of fair value at the reporting date.

Management uses its best judgment in estimating the fair value of the Company's financial instruments; however, there are inherent weaknesses in any estimation technique. Therefore, for substantially all financial instruments, the fair value estimates herein are not necessarily indicative of the amounts the Company could have realized in a sales transaction on the dates indicated. The estimated fair value amounts have been measured as of their respective period-ends, and have not been re-evaluated or updated for purposes of these financial statements subsequent to those respective dates. As such, the estimated fair values of these financial instruments subsequent to the respective reporting dates may be different than the amounts reported at each period-end.

FASB ASC Topic 820 for Fair Value Measurements and Disclosures, the financial assets and liabilities were valued at a price that represents the Company's exit price or the price at which these instruments would be sold or transferred.

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 Company, in estimating its fair value disclosures for financial instruments, used the following methods and assumptions:

Cash and cash equivalents – The carrying amounts of these assets approximate their fair value and are classified as Level 1.

Investment securities – The fair values of available-for-sale, held-to-maturity and marketable equity securities are obtained from an independent third party and are based on quoted prices on nationally recognized exchange where available (Level 1). If quoted prices are not available, fair values are measured by utilizing matrix pricing, which is a mathematical technique used widely in the industry to value debt securities without relying exclusively on quoted prices for specific securities, but rather by relying on the securities' relationship to other benchmark quoted securities (Level 2). Management made no adjustment to the fair value quotes that were received from the independent third party pricing service. Level 3 securities are assets whose fair value cannot be determined by using observable measures, such as market prices or pricing models. Level 3 assets are typically very illiquid, and fair values can only be calculated using estimates or risk-adjusted value ranges. Management applies known factors, such as currently applicable discount rates, to the valuation of those investments in order to determine fair value at the reporting date.

Federal Home Loan Bank stock – The carrying amount of these assets approximates their fair value and are classified as Level 2.

Net loans – For variable-rate loans that re-price frequently, fair value is based on carrying amounts. The fair value of other loans (for example, fixed-rate commercial real estate loans, mortgage loans, and commercial and industrial loans) is estimated using discounted cash flow analysis, based on interest rates currently being offered in the market for loans with similar terms to borrowers of similar credit quality. Loan value estimates include judgments based on expected prepayment rates. The measurement of the fair value of loans, including impaired loans, is classified within Level 3 of the fair value hierarchy.

Accrued interest receivable and payable – The carrying amount of these assets approximates their fair value and are classified as Level 1.

Deposits – The fair values disclosed for demand deposits (e.g., interest-bearing and noninterest-bearing checking, passbook savings and certain types of money management accounts) are, by definition, equal to the amount payable on demand at the reporting date (i.e., their carrying amounts) and are classified within Level 1 of the fair value hierarchy. 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 of deposits to a schedule of aggregated expected monthly maturities on time deposits. Measurements of the fair value of time deposits are classified within Level 2 of the fair value hierarchy.

Borrowings – Fixed/variable term “bullet” structures are valued using a replacement cost of funds approach. These borrowings are discounted to the FHLBNY advance curve. Option structured borrowings’ fair values are determined by the FHLB for borrowings that include a call or conversion option. If market pricing is not available from this source, current market indications from the FHLBNY are obtained and the borrowings are discounted to the FHLBNY advance curve less an appropriate spread to adjust for the option. These measurements are classified as Level 2 within the fair value hierarchy.

Subordinated loans – The Company secures quotes from its pricing service based on a discounted cash flow methodology or utilizes observations of recent highly-similar transactions which result in a Level 2 classification.

The carrying amounts and fair values of the Company’s financial instruments as of the indicated dates are presented in the following table:

		June 30, 2018		December 31, 2017	
(In thousands)	Fair Value Hierarchy	Carrying Amounts	Estimated Fair Values	Carrying Amounts	Estimated Fair Values
Financial assets:					
Cash and cash equivalents	1	$ 36,740	$ 36,740	$ 21,991	$ 21,991
Investment securities - available-for-sale	2	184,030	184,030	170,623	170,623
Investment securities - available-for-sale	3	-	-	515	515
Investment securities - marketable equity	2	541	541	-	-
Investment securities - held-to-maturity	2	26,647	26,244	66,196	66,426
Federal Home Loan Bank stock	2	4,388	4,388	3,855	3,855
Net loans	3	599,580	587,127	573,705	570,439
Accrued interest receivable	1	2,725	2,725	3,047	3,047
Financial liabilities:					
Demand Deposits, Savings, NOW and MMDA	1	$ 507,549	$ 507,549	$ 510,176	$ 510,176
Time Deposits	2	225,620	223,874	213,427	212,453
Borrowings	2	84,103	83,704	73,888	73,575
Subordinated loans	2	15,076	14,793	15,059	14,953
Accrued interest payable	1	255	255	186	186

Note 11: Interest Rate Derivatives

Derivative instruments are entered into by the Company primarily as a risk management tool. Financial derivatives are recorded at fair value as other liabilities. The accounting for changes in the fair value of a derivative depends on whether it has been designated and qualifies as part of a hedging relationship. For a fair value hedge, changes in the fair value of the derivative instrument and changes in the fair value of the hedged asset or liability are recognized currently in earnings. For a cash flow hedge, changes in the fair value of the derivative instrument, to the extent that it is effective, are recorded in other comprehensive income and subsequently reclassified to earnings as the hedged transaction impacts net income. Any ineffective portion of a cash flow hedge is recognized currently in earnings.

On four occasions during the first half of 2017, the Company sold, and subsequently repurchased, a U.S. Treasury security in the approximate amount of $40.0 million for each transaction. These transactions were intended to act as hedges against rising short-term interest rates. The Company was in controlling possession of, but did not own, the securities at the time of each sale. The securities had been received by the Company, under industry-standard repurchase agreements, from an unrelated third party as collateral for a series of 30-day loans of approximately $40.0 million on each occasion which were made at market rates of interest to that third party. The security sale on each occasion provided the funds necessary to advance the loan to the third party and placed the Company in what is generally described as a “short position” with respect to the sold U.S. Treasury security. These transactions acted as a hedge against rising short-term interest rates because the price of each sold security would be expected to decline in a rising short-term interest rate environment and could therefore be re-acquired at the conclusion of each 30-day loan period at a price lower than the price at which the security was originally sold. Short-term rates rose over the combined duration of these transactions and, consequently, the Company recognized aggregate gains on the sale and repurchase of the securities in the amounts of $156,000 and $250,000 for the three and six months ended June 30, 2017, respectively. The transactions’ gains were characterized as capital gains for tax purposes. These capital gains utilized existing, previously reserved-for, capital loss tax carryforwards that were established in 2013. The Company recognized tax benefits related to these transactions of $60,000 and $96,000 for the three and six months ended June 30, 2017, respectively. The tax benefits arose from the reversal of reserves established in 2013 against the portion of the Company’s deferred tax asset related to existing capital loss carryforward positions. The reserves were originally established due to the uncertainty of the Company’s ability to generate future capital gain income within the five-year statutory life of the capital loss carryforward position under the Internal Revenue Code. The recognized tax benefit from the reversal of those reserves reduced the Company’s effective tax rate from what would have been 26.7% to 21.3% in the second quarter of 2017 and from would have been 27.1% to 22.6% for the six months ended June 30, 2017.

The capital gain income and the additional recognized tax benefits derived from these transactions during the three months ended June 30, 2017, were partially offset by an additional $137,000 in after-tax interest expense on borrowings derived from additional pre-tax interest expense on those borrowings of $222,000 that reduced pretax net interest margin by that amount in the three-month period. The capital gain income and the additional recognized tax benefits derived from these transactions were partially offset by an additional $266,000 in after-tax interest expense on borrowings derived from additional pre-tax interest expense on borrowings of $430,000 that reduced pretax net interest margin by that amount in the six-month period. In total, after-tax net income increased by $79,000 and $80,000 for the three and six months ended June 30, 2017, respectively, as a result of these hedging transactions. The Company did not have any hedging activities in the first half of 2018.

The Company adopted *ASU 2017-12: Derivatives and Hedging [Topic 815]: Targeted Improvements to Accounting for Hedging Activities*, effective January 1, 2018, in the second quarter of 2018. The amended guidance within this Update expands and clarifies hedge accounting for nonfinancial and financial risk components, aligns the recognition and presentation of the effects of the hedging instrument and hedged item in the financial statements, and simplifies the requirements for assessing effectiveness in a hedging relationship. The Company did not have any hedging activities in the first half of 2018 but expects to utilize hedging in the future to improve the management of its risk profiles. In order to facilitate potential future hedging activities, the Company transferred 52 investment securities with an aggregate amortized cost before transfer of $35.2 million from the held-to-maturity classification to the available-for-sale classification at the date of adoption.

Table of Contents

Note 12: Accumulated Other Comprehensive Income (Loss)

Changes in the components of accumulated other comprehensive income (loss) ("AOCI"), net of tax, for the periods indicated are summarized in the table below.

	For the three months ended June 30, 2018			
(In thousands)	Retirement Plans	Unrealized Gains and Losses on Available-for-Sale Securities	Unrealized Loss on Securities Transferred to Held-to-Maturity	Total
Beginning balance	$ (2,188)	$ (2,410)	$ (414)	$ (5,012)
Other comprehensive income before reclassifications	-	(854)	347	(507)
Amounts reclassified from AOCI	32	16	-	48
Ending balance	$ (2,156)	$ (3,248)	$ (67)	$ (5,471)

	For the three months ended June 30, 2017			
(In thousands)	Retirement Plans	Unrealized Gains and Losses on Available-for-Sale Securities	Unrealized Loss on Securities Transferred to Held-to-Maturity	Total
Beginning balance	$ (1,490)	$ (1,275)	$ (442)	$ (3,207)
Other comprehensive income before reclassifications	-	832	13	845
Amounts reclassified from AOCI	22	(80)	-	(58)
Ending balance	$ (1,468)	$ (523)	$ (429)	$ (2,420)

	For the six months ended June 30, 2018			
(In thousands)	Retirement Plans	Unrealized Gains and Losses on Available-for-Sale Securities	Unrealized Loss on Securities Transferred to Held-to-Maturity	Total
Beginning balance	$ (2,220)	$ (1,558)	$ (430)	$ (4,208)
Other comprehensive income before reclassifications	-	(1,848)	120	(1,728)
Amounts reclassified from AOCI	64	95	-	159
Cumulative effect of change in measurement of equity securities (1)	-	(53)	-	(53)
Cumulative effect of change in investment securities transfer (2)	-	116	243	359
Ending balance	$ (2,156)	$ (3,248)	$ (67)	$ (5,471)

(1) Cumulative effect of unrealized gain on marketable equity securities based on the adoption of ASU 2016-01 - Financial Instruments - Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Liabilities.

(2) Cumulative effect of unrealized gains on the transfer of 52 investment securities from held-to-maturity classification to available-for-sale classification based on the adoption of ASU 2017-12: Derivatives and Hedging (Topic 815): Targeted Improvements to Accounting for Hedging Activities.

	For the six months ended June 30, 2017			
(In thousands)	Retirement Plans	Unrealized Gains and Losses on Available-for-Sale Securities	Securities reclassified from AFS to HTM	Total
Beginning balance	$ (1,513)	$ (1,845)	$ (464)	$ (3,822)
Other comprehensive income before reclassifications	-	1,445	35	1,480
Amounts reclassified from AOCI	45	(123)	-	(78)
Ending balance	$ (1,468)	$ (523)	$ (429)	$ (2,420)

The following table presents the amounts reclassified out of each component of AOCI for the indicated period:

(In thousands)	Amount Reclassified from AOCI (1) (Unaudited) For the three months ended			Amount Reclassified from AOCI1 (Unaudited) For the six months ended	
Details about AOCI (1) components	June 30, 2018	June 30, 2017	Affected Line Item in the Statement of Income	June 30, 2018	June 30, 2017
Retirement plan items					
Retirement plan net losses recognized in plan expenses (2)	$ (43)	$ (37)	Salaries and employee benefits	$ (86)	$ (73)
Tax effect	11	15	Provision for income taxes	22	28
	$ (32)	$ (22)	Net Income	$ (64)	$ (45)
Available-for-sale securities					
Realized gain on sale of securities	$ (22)	$ 135	Net gains on sales and redemptions of investment securities	$ (129)	$ 206
Tax effect	6	(55)	Provision for income taxes	34	(83)
	$ (16)	$ 80	Net Income	$ (95)	$ 123

(1) Amounts in parentheses indicates debits in net income.
(2) These items are included in net periodic pension cost.
See Note 5 for additional information.

Table of Contents

Note 13: Noninterest Income

The Company adopted the revenue recognition guidance effective January 1, 2018, and applied the new accounting guidance using a modified retrospective approach for reporting purposes. A significant amount of the Company's revenues are derived from net interest income on financial assets and liabilities, which are excluded from the scope of the amended guidance.

The Company recognizes revenue as it is earned. The adoption of ASU 2014-09 required that credit card interchange revenue be presented net of rewards expense in noninterest income. For the three months ended June 30, 2018 and 2017, the Company recognized credit cards reward program expense as a reduction of noninterest income in the amounts of $24,000 and $13,000, respectively. For the six months ended June 30, 2018 and 2017, the Company recognized credit cards reward program expense as a reduction of noninterest income in the amounts of $38,000 and $39,000, respectively.

The Company has included the following table regarding the Company's noninterest income for the periods presented.

	For the three months ended June 30,		For the six months ended June 30,	
(In thousands)	2018	2017	2018	2017
Service fees				
Insufficient funds fees	$ 200	$ 205	$ 400	$ 394
Deposit related fees	48	44	99	95
ATM fees	25	25	48	48
Total service fees	273	274	547	537
Fee Income				
Insurance commissions	234	234	460	451
Investment services revenue	83	65	149	146
ATM fees surcharge	61	60	106	106
Banking house rents collected	36	31	66	55
Total fee income	414	390	781	758
Card income				
Debit card interchange fees	148	147	291	268
Merchant card fees	20	12	33	25
Total card income	168	159	324	293
Mortgage fee income and realized gain on sale of loans and foreclosed real estate				
Loan servicing fees	42	32	83	68
Net gains (losses) on sales of loans and foreclosed real estate	13	(21)	16	(45)
Total mortgage fee income and realized gain on sale of loans and foreclosed real estate	55	11	99	23
Total	910	834	1,751	1,611
Earnings and gain on bank owned life insurance	108	62	181	133
Net (losses) gains on sales and redemptions of investment securities	(22)	135	(129)	206
Gains on equity securities	13	-	26	-
Other miscellaneous income	15	19	90	37
Total noninterest income	$ 1,024	$ 1,050	$ 1,919	$ 1,987

The following is a discussion of key revenues within the scope of the new revenue guidance:

- *Service fees* – Revenue is earned through insufficient funds fees, customer initiated activities or passage of time for deposit related fees, and ATM service fees. Transaction-based fees are recognized as the time the transaction is executed, which is the same time the Company's performance obligation is satisfied. Account maintenance fees are earned over the course of the month as the monthly maintenance performance obligation to the customer is satisfied.

- *Fee income* – Revenue is earned through commissions on insurance, investment products and investment advisory services, ATM surcharge fees, and banking house rents collected. The Company earns investment advisory services fee income by providing investment management services to customers under investment management contracts. As investment management services are provided over time, the performance obligation to customers is satisfied over time, and therefore, revenue is recognized over time.
- *Card income* – Card income consists of interchange fees from consumer debit card networks and other related services. Interchange rates are set by the card networks. Interchange fees are based on purchase volumes and other factors and are recognized as transactions occur.
- *Mortgage fee income and realized gain on sale of loans and foreclosed real estate* – Revenue from mortgage fee income and realized gain on sale of loans and foreclosed real estate is earned through the origination of residential and commercial mortgage loans, sales of one-to-four family residential mortgage loans and sales of foreclosed real estate, and is earned as the individual transactions occur.

Item 2 - Management's Discussion and Analysis of Financial Condition and Results of Operations (Unaudited)

General

The Company is a Maryland corporation headquartered in Oswego, New York. The Company is 100% owned by public shareholders. The primary business of the Company is its investment in Pathfinder Bank (the "Bank"), a New York State chartered commercial bank, which is 100% owned by the Company. The Bank has two wholly owned operating subsidiaries, Pathfinder Risk Management Company, Inc. (“PRMC”) and Whispering Oaks Development Corp. All significant inter-company accounts and activity have been eliminated in consolidation. Although the Company owns, through its subsidiary PRMC, 51% of the membership interest in FitzGibbons Agency, LLC (“Agency”), the Company is required to consolidate 100% of FitzGibbons within the consolidated financial statements. The 49% of which the Company does not own is accounted for separately as noncontrolling interests within the consolidated financial statements. At June 30, 2018, the Company and subsidiaries had total consolidated assets of $903.5 million, total consolidated liabilities of $840.6 million and shareholders' equity of $62.6 million plus noncontrolling interest of $252,000, which represents the 49% of FitzGibbons not owned by the Company.

The following discussion reviews the Company's financial condition at June 30, 2018 and the results of operations for the three and six month periods ended June 30, 2018 and 2017. Operating results for the three and six months ended June 30, 2018 are not necessarily indicative of the results that may be expected for the year ending December 31, 2018.

The following material under the heading "Management's Discussion and Analysis of Financial Condition and Results of Operations" is written with the presumption that the users of the interim financial statements have read, or have access to, the Company's latest audited financial statements and notes thereto, together with Management's Discussion and Analysis of Financial Condition and Results of Operations included in the 2017 Annual Report on Form 10-K filed with the Securities and Exchange Commission on March 30, 2018 (“the consolidated annual financial statements”) as of December 31, 2017 and 2016 and for the two years then ended. Therefore, only material changes in financial condition and results of operations are discussed in the remainder of Item 2.

Statement Regarding Forward-Looking Statements

This report contains forward-looking statements that are based on assumptions and may describe future plans, strategies and expectations of the Company. These forward-looking statements are generally identified by use of the words “believe,” “expect,” “intend,” “anticipate,” “estimate,” “project” or similar expressions. The Company’s ability to predict results or the actual effect of future plans or strategies is inherently uncertain. Factors which could have a material adverse effect on the operations of the Company and its subsidiaries include, but are not limited to:

- Credit quality and the effect of credit quality on the adequacy of our allowance for loan losses;
- Deterioration in financial markets that may result in impairment charges relating to our securities portfolio;
- Competition in our primary market areas;
- Changes in interest rates and national or regional economic conditions;

- Changes in monetary and fiscal policies of the U.S. Government, including policies of the U.S. Treasury and the Federal Reserve Board;
- Significant government regulations, legislation and potential changes thereto;
- A reduction in our ability to generate or originate revenue-producing assets as a result of compliance with heightened capital standards;
- Increased cost of operations due to greater regulatory oversight, supervision and examination of banks and bank holding companies, and higher deposit insurance premiums;
- Cyberattacks, computer viruses and other technological threats that may breach the security of our websites or other systems;
- Technological changes that may be more difficult or expensive than expected;
- Limitations on our ability to expand consumer product and service offerings due to anticipated stricter consumer protection laws and regulations; and
- Other risks described herein and in the other reports and statements we file with the SEC.

These risks and uncertainties should be considered in evaluating forward-looking statements and undue reliance should not be placed on such statements. Except as required by applicable law or regulation, the Company does not undertake, and specifically disclaims any obligation, to release publicly the result of any revisions that may be made to any forward-looking statements to reflect events or circumstances after the date of the statements or to reflect the occurrence of anticipated or unanticipated events.

Application of Critical Accounting Policies

The Company's consolidated annual financial statements are prepared in accordance with accounting principles generally accepted in the United States and follow practices within the banking industry. Application of these principles requires management to make estimates, assumptions, and judgments that affect the amounts reported in the consolidated annual financial statements and accompanying notes. These estimates, assumptions, and judgments are based on information available as of the date of the financial statements; accordingly, as this information changes, the financial statements could reflect different estimates, assumptions, and judgments. Certain accounting policies inherently have a greater reliance on the use of estimates, assumptions, and judgments and, as such, have a greater possibility of producing results that could be materially different than originally reported. Estimates, assumptions, and judgments are necessary when assets and liabilities are required to be recorded at fair value or when an asset or liability needs to be recorded contingent upon a future event. Carrying assets and liabilities at fair value inherently results in more financial statement volatility. The fair values and information used to record valuation adjustments for certain assets and liabilities are based on quoted market prices or are provided by unaffiliated third-party sources, when available. When third party information is not available, valuation adjustments are estimated in good faith by management.

The most significant accounting policies followed by the Company are presented in Note 1 to the annual audited consolidated financial statements. These policies, along with the disclosures presented in the other financial statement notes and in this discussion, provide information on how significant assets and liabilities are valued in the consolidated annual financial statements and how those values are determined. Based on the valuation techniques used and the sensitivity of financial statement amounts to the methods, assumptions, and estimates underlying those amounts, management has identified the allowance for loan losses, deferred income taxes, pension obligations, the evaluation of investment securities for other than temporary impairment, the estimation of fair values for accounting and disclosure purposes, and the evaluation of goodwill for impairment to be the accounting areas that require the most subjective and complex judgments. These areas could be the most subject to revision as new information becomes available.

The allowance for loan losses represents management's estimate of probable loan losses inherent in the loan portfolio. Determining the amount of the allowance for loan losses is considered a critical accounting estimate because it requires significant judgment on the use of estimates related to the amount and timing of expected future cash flows on impaired loans, estimated losses on pools of homogeneous loans based on historical loss experience, and consideration of current economic trends and conditions, all of which may be susceptible to significant change.

Our Allowance for Loan and Lease Losses policy establishes criteria for selecting loans to be measured for impairment based on the following:

Residential and Consumer Loans:

- All loans rated substandard or worse, on nonaccrual, and above our total related credit ("TRC") threshold balance of $300,000.
- All Troubled Debt Restructured Loans

Commercial Lines and Loans, Commercial Real Estate and Tax-exempt loans:

- All loans rated substandard or worse, on nonaccrual, and above our TRC threshold balance of $100,000.
- All Troubled Debt Restructured Loans

Impairment is measured by determining the present value of expected future cash flows or, for collateral-dependent loans, the fair value of the collateral adjusted for market conditions and selling expenses as compared to the loan carrying value. For all other loans and leases, the Company uses the general allocation methodology that establishes an allowance to estimate the probable incurred loss for each risk-rating category.

Deferred income tax assets and liabilities are determined using the liability method. Under this method, the net deferred tax asset or liability is recognized for the future tax consequences. This is attributable to the differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases as well as net operating and capital loss carry forwards. Deferred tax assets and liabilities are measured using enacted tax rates applied to taxable income in the years in which those 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 tax expense in the period that includes the enactment date. If current available evidence about the future raises doubt about the likelihood of a deferred tax asset being realized, a valuation allowance is established. The judgment about the level of future taxable income, including that which is considered capital, is inherently subjective and is reviewed on a continual basis as regulatory and business factors change. No valuation allowances were maintained at June 30, 2018 and December 31, 2017. The Tax Cuts and Jobs Act of 2017 ("Tax Act"), which was effective on January 1, 2018, reduced the Company's corporate federal tax rate from 34% to 21%, starting on that date, and affected the valuation of its net deferred tax assets calculated under GAAP, at December 31, 2017. The Company's effective tax rate differs from the federal statutory tax rate due primarily to tax-exempt income from specific types of investment securities and loans, and bank owned life insurance. The Company's effective New York State tax rate differs from the state statutory tax rate of 6.5% due primarily to state tax-exempt income that can now be calculated under a newly-available modification of the state's tax laws. This modification allows the Company to exclude up to 50% of interest income derived from qualified lending activities within the State from its state taxable income. The exclusion of this substantial portion of interest income from the Company's New York State tax calculation significantly reduces the Company's state income-based tax to a level where only immaterial capital-based or minimum franchise taxes apply.

We maintain a noncontributory defined benefit pension plan covering most employees. The plan provides defined benefits based on years of service and final average salary. On May 14, 2012, we informed our employees of our decision to freeze participation and benefit accruals under the plan, primarily to reduce some of the volatility in earnings that can accompany the maintenance of a defined benefit plan. Pension and post-retirement benefit plan liabilities and expenses are based upon actuarial assumptions of future events; including fair value of plan assets, interest rates, and the length of time the Company will have to provide those benefits. The assumptions used by management are discussed in Note 14 to the consolidated annual financial statements.

The Company carries all of its available-for-sale investments at fair value with any unrealized gains or losses reported, net of tax, as an adjustment to shareholders' equity and included in accumulated other comprehensive income (loss), except for the credit-related portion of debt securities impairment losses and OTTI of equity securities which are charged to earnings. The Company's ability to fully realize the value of its investments in various securities, including corporate debt securities, is dependent on the underlying creditworthiness of the issuing organization. In evaluating the debt securities (both available-for-sale and held-to-maturity) portfolio for other-than-temporary impairment losses, management considers (1) if we intend to sell the security; (2) if it is "more likely than not" we will be required to sell the security before recovery of its amortized cost basis; or (3) if the present value of expected cash flows is not sufficient to recover the entire amortized cost basis. When the fair value of a held-to-maturity or available-for-sale security is less than its amortized cost basis, an assessment is made as to whether OTTI is present. The Company considers numerous factors when determining whether a potential OTTI exists and the period over which the debt security is expected to recover. The principal factors considered are (1) the length of time and the extent to which the fair value has been less than the amortized cost basis, (2) the financial condition of the issue and (guarantor, if any) and adverse conditions specifically related to the security, industry or geographic area, (3) failure of the issuer of the security to make scheduled interest or principal payments, (4) any changes to the rating of the security by a NRSRO, and (5) the presence of credit enhancements, if any, including the guarantee of the federal government or any of its agencies.

The estimation of fair value is significant to several of our assets; including loans, available-for-sale and marketable equity investment securities, intangible assets, foreclosed real estate, and the value of loan collateral when valuing impaired loans. These are all recorded at either fair value, or the lower of cost or fair value. Fair values are determined based on third party sources, when available. Furthermore, accounting principles generally accepted in the United States require disclosure of the fair value of financial instruments as a part of the notes to the annual audited consolidated financial statements. Fair values on our available-for-sale securities may be influenced by a number of factors; including market interest rates, prepayment speeds, discount rates, and the shape of yield curves.

Fair values for securities available-for-sale are obtained from unaffiliated third party pricing services. Where available, fair values are based on quoted prices on a nationally recognized securities exchange. If quoted prices are not available, fair values are measured using quoted market prices for similar benchmark securities. Management made no adjustments to the fair value quotes that were provided by the pricing sources. Fair values for marketable equity securities are based on quoted prices on a nationally recognized securities exchange for similar benchmark securities. The fair values of foreclosed real estate and the underlying collateral value of impaired loans are typically determined based on evaluations by third parties, less estimated costs to sell. When necessary, appraisals are updated to reflect changes in market conditions. On January 1, 2018, the Company adopted *Accounting Standards Update (ASU) 2016-01: Financial Instruments – Overall [Subtopic 825-10]: Recognition and Measurement of Financial Assets and Financial Liabilities*. The ASU requires the use of exit pricing in disclosures related to the fair value of financial instruments. Accordingly, at June 30, 2018, the financial assets and liabilities of the Company were valued at a price that represents the Company's exit price or the price at which these instruments would be sold or transferred. The adoption of the ASU did not materially affect the fair value evaluations of the financial assets and financial liabilities of the Company at the adoption date. Further information on the estimation of fair values can be found in Note 22 to the consolidated annual financial statements.

Management performs an evaluation of our goodwill for possible impairment of the recorded value of goodwill for each of our reporting units at fiscal each year end or if events or circumstances warrant an evaluation. Based on the results of the December 31, 2017 evaluation, management has determined that the carrying value of goodwill was not impaired as of that date. No events or circumstances arose during the six months ended June 30, 2018 to adversely affect the Company's recorded goodwill. The evaluation approach is described in Note 10 of the consolidated annual financial statements.

Recent Events

On June 29, 2018, the Company announced that the Board of Directors declared a quarterly cash dividend of $0.06 per common share. The dividend is payable on August 10, 2018 to shareholders of record on July 20, 2018.

Overview and Results of Operations

The following represents the significant highlights of the Company's operating results between the second quarter of 2018 and the second quarter of 2017.

- Net income increased $25,000, or 2.7%, to $945,000.
- Basic and diluted earnings per share each remained unchanged at $0.23 and $0.22 per share, respectively.
- Return on average assets decreased three basis points to 0.43% as the increase in average assets outpaced the increase in net income.

- Net interest income, after provision for loan losses, increased $1.0 million, or 19.6% to $6.2 million. This increase in earnings was primarily due to the increase in average balances of interest-earning assets and an increase in the average yield earned on those assets of 34 basis points.
- Net interest margin increased by 14 basis points to 3.07%, primarily as a result of a 34 basis point increase in the average yield earned on interest-earning assets.
- The effective income tax rate decreased 7.0% to 14.3% for the three months ended June 30, 2018 as compared to 21.3% for the same three month period in 2017. This eduction in the effective tax rate was primarily the result of the combined effects of the Tax Act and changes to the New York State tax code that became effective on January 1, 2018.

The following represents significant highlights of the Company's operating results between the first six months of 2018 and the first six months of 2017.

- Net income improved by $229,000, or 13.3%, to $1.9 million.
- Basic and diluted earnings per share each improved by $0.05 to $0.47 and $0.46 per share, respectively.
- Return on average assets increased by one basis point to 0.44% as the increase in the Company's net income slightly outpaced the increase in average assets.
- Net interest income, after provision for loan losses, increased by $1.7 million, or 16.4%, to $12.0 million. This increase in earnings was primarily due to the increase in average balances of interest earning assets, accompanied by an increase in the yield earned on interest-earning assets.
- Net interest margin increased by 10 basis points to 3.05%, primarily as a result of a 25 basis point increase in average yields earned on investments and loans in aggregate.
- The effective income tax rate decreased 7.5% to 15.1% for the six months ended June 30, 2018 as compared to 22.6% for the same six month period in 2017. This reduction in the effective tax rate was primarily the result of the combined effects of the Tax Act and changes to the New York State tax code that became effective on January 1, 2018.

The following reflects the significant changes in financial condition between the periods of December 31, 2017 and June 30, 2018. In addition, the following reflects significant changes in asset quality metrics between June 30, 2017 and June 30, 2018.

- Total assets increased $22.2 million, or 2.5% to $903.5 million at June 30, 2018, as compared to December 31, 2017, primarily due to increases in loans and cash and cash equivalents partially offset by a decrease in investment securities. These increases were funded largely by increases in long-term borrowing from the FHLB and increases in deposits, including brokered deposits, as well as the cash flow from the sale and maturity of investment securities.

- Asset quality metrics remained stable in comparison to recent reporting periods and are comparable to peer group averages. The Company's consistent asset quality metrics are reflective of its disciplined risk management process, along with the relative economic stability of its Central New York State market area. During the first quarter of 2018, a single commercial real estate loan with an outstanding balance of $1.7 million was added to nonperforming assets. This loan currently is expected to be financed with a new borrower and no materially significant additional losses are anticipated beyond the specific reserves previously recorded during the fourth quarter of 2017 and the second quarter of 2018. Primarily as a result of this addition, nonperforming loans to total loans increased to 0.90% at June 30, 2018, compared to 0.84% at December 31, 2017, and 0.80% at June 30, 2017. Correspondingly, the ratio of the allowance for loan losses to nonperforming loans for second quarter 2018 was 139.7%, as compared to 145.6% at December 31, 2017 and 142.5% at June 30, 2017. Annualized net loan charge-offs to average loans ratio remained favorable and was 0.14% for the second quarter of 2018, compared to 0.16% for the fourth quarter of 2017 and 0.31% for the second quarter of 2017.

The Company had net income of $945,000 for the three months ended June 30, 2018 compared to net income of $920,000 for the three months ended June 30, 2017. The $25,000 increase in net income was due primarily to a $1.4 million increase in interest and dividend income, a decrease of $126,000 in provision for loan losses and a $72,000 decrease in income tax expense. These increases were partially offset by a $1.1 million increase in noninterest expense, a $546,000 increase in interest expense, and a decrease in noninterest income of $26,000.

Net interest income before the provision for loan losses increased $886,000, or 15.9%, to $6.5 million for the three months ended June 30, 2018 as compared to $5.6 million for the same three month period in 2017. The increase was primarily the result of the increase in average interest-earning asset balances due to increases in average loans, and average taxable and tax-exempt investment securities. The positive effects of increased average interest-earning assets for the three months ended June 30, 2018, as compared to the same three month period in 2017, were also enhanced by an increase in the average yield of those assets of 34 basis points to 4.05% for the three months ended June 30, 2018 from 3.71% for the same three month period of the previous year. This increase in net interest income was partially offset by an increase in the average balance and average cost of interest-bearing liabilities between the year-over-year second quarter periods.

The $26,000, or 2.5%, decrease in noninterest income in the quarter ended June 30, 2018, as compared to the same quarterly period in 2017, was primarily the result of a net decrease of $157,000 in the net gains on the sales and redemptions of investment securities from a gain of $135,000 for the three months ended June 30, 2017 to a net loss of $22,000 for the same quarter in 2018. The net gains on investment securities during the quarter ended June 30, 2017 were primarily the result of $94,000 in net gains recorded on short-term interest rate hedging activities in that period. There were no hedging activities of this type in the three months ended June 30, 2018. During the three months ended June 30, 2018, Company-initiated sales and issuer-initiated redemptions of investment securities in the amount of $11.4 million, generated a net loss of $22,000, or 0.19%. The investment securities sales were part of the Company's portfolio optimization and liquidity management strategies. It is the intention of management to reinvest the proceeds of these investment securities transactions into potentially higher yielding interest-earning assets in future periods.

Excluding the effects of the quarter over quarter reduction in gains on the sale of investment securities, all other noninterest income categories increased in the aggregate by $131,000, or 14.3% to $1.0 million in the quarter ended June 30, 2018 as compared with $915,000 in the same quarter of 2017. This $131,000 quarter over quarter increase in noninterest income, excluding the effects of gains on the sales and redemptions of investment securities, was due primarily to increases of $46,000 in earnings and gains on bank owned life insurance, $34,000 net gains on sales of loans and foreclosed real estate, and $28,000 in other charges, commissions and fees.The $26,000 decrease in noninterest income in the quarter ended June 30, 2018, as compared to the same quarterly period in 2017, was primarily the result of a decrease of $157,000 in gains on the sales and redemptions of investment securities. Absent the effects of the quarter over quarter reduction in gains on the sale of investment securities, all other noninterest income categories increased by $131,000, or 14.3% to $1.0 million in the quarter ended June 30, 2018 as compared with $915,000 in the same quarter of 2017.

The $1.1 million increase in noninterest expense in the quarter ended June 30, 2018, as compared to the same quarterly period in 2017, was due primarily to an increase of $610,000, or 21.6%, in salaries and employee benefits expense that reflected an increase in staffing levels intended to meet increased loan demand and to better serve customers and potential customers as the Bank's operations continue to expand primarily into Onondaga County, New York. In addition, professional and other services increased $186,000, advertising expenses increased $113,000, data processing increased $60,000, and FDIC assessments increased $54,000. All other noninterest expense categories increased $93,000, or 7.1%, in aggregate during the quarter ended June 30, 2018, as compared to the same three month period in 2017.

The $126,000 decrease in the provision for loan losses in the quarter ended June 30, 2018, as compared with the same quarter of 2017, was primarily due to improvements in the majority of credit quality metrics throughout the loan portfolio. The ratio of delinquent loans to total loans improved to 1.29% at June 30, 2018 as compared to 2.12% at December 31, 2017 as a result of a decrease in total delinquent loans to $7.8 million at June 30, 2018 as compared to $12.3 million at June 30, 2017. Partially offsetting the effects of these improvements in credit quality metrics was the increase in the estimable and probable loan losses inherent in the loan portfolio due to increases of $68.4 million, or 12.7%, in average loan balances in the second quarter of 2018 as compared with the same quarter of 2017.

In comparing the year-over-year second quarter periods, the return on average assets decreased three basis points to 0.43% due to the combined effects of the increase in net income (the numerator in the ratio) and the increase in average assets (the denominator in the ratio). Average assets increased due to increases in average loans, and average taxable and tax-exempt investment securities of $68.4 million and $8.1 million, respectively, in the second quarter of 2018 as compared to the same quarter of 2017. Average interest-bearing deposits increased $56.4 million in the second quarter of 2018, as compared with the same quarter in 2017, due to increased brokered and consumer deposits, and increased commercial deposits resulting in part from new loan account relationships, particularly in Onondaga County. These increases in average deposits were partially offset by decreases in municipal deposits that are considered to be seasonal in nature.

The Company had net income of $1.9 million for the six months ended June 30, 2018 compared to net income of $1.7 million for the six months ended June 30, 2017. The $229,000 increase in net income available to common shareholders was due primarily to a $2.8 million increase in interest and dividend income, and a $135,000 decrease in income tax expense, partially offset by an increase of $1.6 million in noninterest expense, a $989,000 increase in interest expense, an increase of $98,000 in provision for loan losses, and a $68,000 decrease in noninterest income.

Net interest income before the provision for loan losses increased $1.8 million, or 16.1%, to $12.9 million for the six months ended June 30, 2018 as compared to the same six month period in the previous year. The increase was a result of the increase in average balances on loans and taxable investment securities and an increase in the average yield earned on those balances, partially offset by an increase in the average balance and average cost of interest-bearing liabilities between the year-over-year six month periods.

The $68,000, or 3.4% decrease in noninterest income in the six months ended June 30, 2018, as compared to the same six month period in 2017, was primarily the result of a net decrease of $335,000 in the net gains on the sales and redemptions of investment securities from a gain of $206,000 for the six months ended June 30, 2017 to a net loss of $129,000 for the same six month period in 2018. The net gains on investment securities during the six months ended June 30, 2017 were primarily the result of $250,000 in net gains recorded on short-term interest rate hedging activities in that period. There were no hedging activities of this type in the six months ended June 30, 2018. During the six months ended June 30, 2018, Company-initiated sales and issuer-initiated redemptions of investment securities in the amount of $29.2 million, generated a net loss of $129,000, or 0.44%. The investment securities sales were part of the Company’s portfolio optimization and liquidity management strategies. It is the intention of management to reinvest the proceeds of these investment securities transactions into potentially higher yielding interest-earning assets in future periods.

Excluding the effects of the period over period reduction in gains on the sale of investment securities, all other noninterest income categories increased in the aggregate by $267,000, or 15.0% to $2.0 million in the six months ended June 30, 2018 as compared with $1.8 million in the same six month period of 2017. This $267,000 period over period increase in noninterest income, excluding the effects of gains on the sales and redemptions of investment securities, was due primarily to increases of $84,000 in other charges, commissions and fees, $61,000 net gains on sales of loans and foreclosed real estate, and $48,000 in earnings and gains on bank owned life insurance.

The $1.6 million increase in noninterest expense was due primarily to an increase of $844,000, or 14.9%, in salary and employee benefits expense that reflected in part an increase in staffing levels intended to meet increased loan demand and to better serve customers and potential customers as the Bank’s operations continue to expand into Onondaga County. In addition, professional and other services expense increased $326,000, advertising expense increased $128,000, FDIC assessments increased $118,000 and data processing expense increased $112,000. All other noninterest expense categories increased $74,000, or 2.9%, in aggregate for the six month period ended June 30, 2018, as compared to the same six month period in 2017.

For the three months ended June 30, 2018, we recorded $297,000 in provision for loan losses as compared to $423,000 in the same prior year three month period. This $126,000 decrease in the provision for loan losses was due principally to favorable changes to both the quantitative and environmental factors assigned to the Bank’s loan portfolio in aggregate, partially offset by $68.4 million, or 12.7%, increase in average loan balances in the first three months of 2018 as compared with the same three month period of 2017 and the resultant increase in the estimable and probable loan losses inherent in the loan portfolio.

For the first six months of 2018, we recorded $910,000 in provision for loan losses as compared to $812,000 in the same prior year six month period. This $98,000 increase in the provision for loan losses was due principally to the $77.5 million, or 14.8%, increase in average loan balances in the first six months of 2018 as compared with the same six month period of 2017 and the resultant increase in the estimable and probable loan losses inherent in the loan portfolio, partially offset by favorable changes to both the quantitative and environmental factors assigned to the Bank's loan portfolio in aggregate.

Return on average assets increased one basis point to 0.44% between the year-over-year six month periods as the net income increases in the six month period ended June 30, 2018 (the numerator of the ratio) increased by a slightly higher percentage than did total average assets (the denominator of the ratio) during the period.

Net Interest Income

Net interest income is the Company's primary source of operating income for payment of operating expenses and providing for loan losses. It is the amount by which interest earned on loans, interest-earning deposits, and investment securities, exceeds the interest paid on deposits and other interest-bearing liabilities. Changes in net interest income and net interest margin result from the interaction between the volume and composition of interest-earning assets, interest-bearing liabilities, related yields, and associated funding costs.

The following tables set forth information concerning average interest-earning assets and interest-bearing liabilities and the average yields and rates thereon for the periods indicated. Interest income and resultant yield information in the tables has not been adjusted for tax equivalency. Averages are computed on the daily average balance for each month in the period divided by the number of days in the period. Yields and amounts earned include loan fees. Nonaccrual loans have been included in interest-earning assets for purposes of these calculations.

	For the three months ended June 30,					
	2018			2017		
(Dollars in thousands)	Average Balance	Interest	Average Yield / Cost	Average Balance	Interest	Average Yield / Cost
Interest-earning assets:						
Loans	$ 607,286	$ 7,018	4.62%	$ 538,926	$ 5,869	4.36%
Taxable investment securities	186,147	1,232	2.65%	182,489	875	1.92%
Tax-exempt investment securities	33,302	217	2.61%	28,880	312	4.32%
Fed funds sold and interest-earning deposits	15,135	49	1.30%	12,845	28	0.87%
Total interest-earning assets	841,870	8,516	4.05%	763,140	7,084	3.71%
Noninterest-earning assets:						
Other assets	55,763			50,724		
Allowance for loan losses	(7,544)			(6,062)		
Net unrealized losses						
on available-for-sale securities	(3,876)			(1,542)		
Total assets	$ 886,213			$ 806,260		
Interest-bearing liabilities:						
NOW accounts	$ 64,157	$ 27	0.17%	$ 63,458	$ 25	0.16%
Money management accounts	13,584	5	0.15%	13,531	6	0.18%
MMDA accounts	250,502	599	0.96%	239,811	317	0.53%
Savings and club accounts	85,892	22	0.10%	85,167	21	0.10%
Time deposits	226,358	913	1.61%	182,099	526	1.16%
Subordinated loans	15,071	210	5.57%	15,036	197	5.24%
Borrowings	65,470	273	1.67%	59,086	411	2.78%
Total interest-bearing liabilities	721,034	2,049	1.14%	658,188	1,503	0.91%
Noninterest-bearing liabilities:						
Demand deposits	96,226			82,071		
Other liabilities	5,772			5,186		
Total liabilities	823,032			745,445		
Shareholders' equity	63,181			60,815		
Total liabilities & shareholders' equity	$ 886,213			$ 806,260		
Net interest income		$ 6,467			$ 5,581	
Net interest rate spread			2.91%			2.80%
Net interest margin			3.07%			2.93%
Ratio of average interest-earning assets						
to average interest-bearing liabilities			116.76%			115.95%

(Dollars in thousands)	For the six months ended June 30, 2018 Average Balance	2018 Interest	2018 Average Yield / Cost	2017 Average Balance	2017 Interest	2017 Average Yield / Cost
Interest-earning assets:						
Loans	$ 600,548	$ 13,736	4.57%	$ 523,025	$ 11,610	4.44%
Taxable investment securities	193,731	2,428	2.51%	175,236	1,681	1.92%
Tax-exempt investment securities	35,564	465	2.62%	30,371	590	3.89%
Fed funds sold and interest-earning deposits	14,412	96	1.33%	22,929	73	0.64%
Total interest-earning assets	844,255	16,725	3.96%	751,561	13,954	3.71%
Noninterest-earning assets:						
Other assets	54,540			52,733		
Allowance for loan losses	(7,324)			(6,177)		
Net unrealized (losses) gains on available for sale securities	(3,358)			(2,065)		
Total assets	$ 888,113			$ 796,052		
Interest-bearing liabilities:						
NOW accounts	$ 68,100	$ 52	0.15%	$ 64,492	$ 48	0.15%
Money management accounts	14,246	11	0.15%	13,992	14	0.20%
MMDA accounts	252,798	1,072	0.85%	227,420	560	0.49%
Savings and club accounts	83,901	43	0.10%	84,340	41	0.10%
Time deposits	225,223	1,733	1.54%	180,854	997	1.10%
Subordinated loans	15,066	413	5.48%	15,032	390	5.19%
Borrowings	66,981	541	1.62%	63,087	826	2.62%
Total interest-bearing liabilities	726,315	3,865	1.06%	649,217	2,876	0.89%
Noninterest-bearing liabilities:						
Demand deposits	92,803			81,724		
Other liabilities	5,960			5,031		
Total liabilities	825,078			735,972		
Shareholders' equity	63,035			60,080		
Total liabilities & shareholders' equity	$ 888,113			$ 796,052		
Net interest income		$ 12,860			$ 11,078	
Net interest rate spread			2.90%			2.82%
Net interest margin			3.05%			2.95%
Ratio of average interest-earning assets to average interest-bearing liabilities			116.24%			115.76%

As indicated in the above tables, net interest income, before provision for loan losses, increased $886,000, or 15.9%, to $6.5 million for the three months ended June 30, 2018 as compared to $5.6 million for the same prior year period. This increase was due principally to the $78.7 million, or 10.3%, increase in the average balance of interest-earning assets, and an increase of 34 basis points on the average interest yield earned on those assets. These positive factors on net interest income were partially offset by an increase in the average balance of interest-bearing liabilities of $62.8 million, or 9.55%, and an increase of 23 basis points on the average interest rate paid on those liabilities. In total, net interest margin increased 14 basis points to 3.07% due largely to the increase in yields earned on average interest-earning assets, as noted above. The following analysis should also be viewed in conjunction with the table below which reports the changes in net interest income attributable to rate and volume.

Interest and dividend income increased $1.4 million, or 20.2%, to $8.5 million for the three months ended June 30, 2018 compared to $7.1 million for the same three month period in 2017. The increase in interest income was due principally to the increase in average interest-earning assets (primarily loans, and taxable and tax-exempt investment securities) which increased between the year-over-year second quarter periods by 10.2%. The increase in the average balances of loans reflects the Company’s continued success in its expansion within the greater Syracuse, New York market. Further supporting the quarter-over-quarter increase in interest income, the average yield on the loans and taxable investment portfolio improved 26 basis points to 4.62% and 73 basis points to 2.65%, respectively. This increase in the average yield on loans was the result of new loan production being added to the loan portfolio at rates slightly higher than the average rates of the previously existing portfolio. The increase in the average yield on taxable investment securities was the result of an increase in book yields on adjustable-rate securities and the purchase of new securities, often with longer durations or more credit risk exposure, at rates higher than the average yields of securities within the previously-existing portfolio whose balances continue to be reduced by amortization and maturities.

Interest expense for the three months ended June 30, 2018 increased $546,000, or 36.3%, to $2.0 million when compared to the same prior year period. Deposit interest expense increased $671,000, or 75.0%, to $1.6 million due to a $56.4 million increase in the average balance of interest-bearing deposits accompanied by a 37 basis point increase in the average annualized rate paid on these deposits to 0.98% for the three months ended June 30, 2018, as compared with the same three month period in 2017. This increase in average rates was primarily due to 45 and 43 basis points increases in the average rates paid on time deposits and money market deposit accounts (“MMDA”), respectively, during the three months ended June 30, 2018 as compared to the same three month period in 2017. These increases in the average rates paid on time deposits and MMDA deposits reflected the competitive environment for such deposits within the Company’s marketplace as well as a general increase in short-term interest rates nationally. Partially offsetting the increase in interest expense on deposits in the three months ended June 30, 2018, as compared with the same three month period in 2017, was a decrease of $138,000 in interest expense on borrowed funds, primarily due to the Bank’s use of certain interest rate risk hedging strategies in the second quarter of 2017 that added $222,000 to interest expense in the second quarter of that year. The Bank did not engage in those activities during 2018.

For the six month period ended June 30, 2018, net interest income, before the provision for loan losses, increased $1.8 million, or 16.1%, to $12.9 million compared to $11.1 million for the six months ended June 30, 2017. Interest and dividend income increased $2.8 million, or 19.9%, to $16.7 million for the six months ended June 30, 2018 from $14.0 million for the same six month period in 2017. The increase in interest income was due principally to the increase in average balances of loans, and the aggregate balances of taxable and tax-exempt investment securities, which increased 14.8% and 11.5%, respectively, between the year-over-year six month periods. The increase in the average balances of loans reflects the Company’s continued success in its expansion within the greater Syracuse market. These increases were also positively affected by the increase in the average yield on loans and taxable investment securities of 13 basis points to 4.57% and 59 basis points to 2.51%, respectively. This increase in the average yield on loans was the result of new loan production being added to the loan portfolio at rates slightly higher than the average rates of the previously existing portfolio. The increase in the average yield on taxable investment securities was the result of an increase in book yields on adjustable-rate securities and the purchase of new securities, often with longer durations or more credit risk exposure, at rates higher than the average rates of securities within the previously-existing portfolio whose balances continue to be reduced by amortization, maturities and sales.

Interest expense for the six months ended June 30, 2018 increased $989,000, or 34.4%, to $3.9 million as compared to $2.9 million for the six months ended June 30, 2017. The increase in interest expense was due principally to the increase in average interest-bearing liabilities of $77.1 million, along with a 17 basis point increase in the average rate paid on these liabilities to 1.06%. The increase in average rates paid on interest-bearing liabilities was due to a $1.3 million increase in deposit interest expense, partially offset by a $285,000 decrease in interest expense paid on borrowed funds. The average balances of interest-bearing deposits, which include brokered deposits, increased $73.2 million between the year-over-year six month periods. Deposit interest expense increased 32 basis points to 0.90% for the six months ended June 30, 2018 as compared with the same six month period in 2017. This increase was primarily due to a 44 and 36 basis point increase in the average rate paid on time deposits and MMDA deposits, respectively, during the six months ended June 30, 2018 as compared to the same time period in 2017. The increases in rates paid on those deposits reflected the competitive environment for such deposits within the Company’s marketplace and a general increase in short-term interest rates nationally.

The $285,000 decrease in interest expense related to borrowings between the year-over-year six month periods was primarily due to a reduction of $430,000 in pretax interest expense paid that was related to the Bank’s short-term interest rate risk hedging activities in 2017. This reduction in interest expense paid on borrowings was partially offset by an increase of $145,000 in interest expense related to non-hedge related borrowings. There were no hedging activities in the first six months of 2018. During the six months of 2017, the Bank paid $430,000 in net interest on a $40 million U.S. Treasury security that it had received from an unrelated entity as collateral for a short term loan. The U.S. Treasury security was sold by the Bank which placed the Bank in what is commonly referred to as a “short” position with respect to that security. During the period of time that the Bank was in a short position with respect to the security, short-term interest rates generally rose and the Bank reacquired the security with a realized gain, net of tax benefits, of $346,000. The $145,000 increase in non-hedge related borrowings interest expense was primarily due to a 36 basis point increase in the average rate paid on non-hedge related borrowings to 1.62% in the six months ended June 30, 2018 from 1.26% in the same six month period of 2017. This increase in the average rate paid on non-hedge related borrowings was primarily due to a general year-over-year increase in short-term interest rates.

Rate/Volume Analysis

Net interest income can also be analyzed in terms of the impact of changing interest rates on interest-earning assets and interest-bearing liabilities and changes in the volume or amount of these assets and liabilities. The following table represents the extent to which changes in interest rates and changes in the volume of interest-earning assets and interest-bearing liabilities have affected the Company's interest income and interest expense during the periods indicated. Information is provided in each category with respect to: (i) changes attributable to changes in volume (change in volume multiplied by prior rate); (ii) changes attributable to changes in rate (changes in rate multiplied by prior volume); and (iii) total increase or decrease. Changes attributable to both rate and volume have been allocated ratably.

	Three months ended June 30, 2018 vs. 2017 Increase/(Decrease) Due to			Six months ended June 30, 2018 vs. 2017 Increase/(Decrease) Due to		
(In thousands)	**Volume**	**Rate**	**Total Increase (Decrease)**	**Volume**	**Rate**	**Total Increase (Decrease)**
Interest Income:						
Loans	$ 775	$ 374	$ 1,149	$ 1,764	$ 362	$ 2,126
Taxable investment securities	18	339	357	191	556	747
Tax-exempt investment securities	249	(344)	(95)	222	(347)	(125)
Interest-earning deposits	6	15	21	(75)	98	23
Total interest income	1,048	384	1,432	2,102	669	2,771
Interest Expense:						
NOW accounts	-	2	2	3	1	4
Money management accounts	-	(1)	(1)	1	(4)	(3)
MMDA accounts	15	267	282	69	443	512
Savings and club accounts	-	1	1	(1)	3	2
Time deposits	147	240	387	282	454	736
Subordinated loans	-	13	13	1	22	23
Borrowings	250	(388)	(138)	136	(421)	(285)
Total interest expense	412	134	546	491	498	989
Net change in net interest income	$ 636	$ 250	$ 886	$ 1,611	$ 171	$ 1,782

Provision for Loan Losses

We establish a provision for loan losses, which is charged to operations, at a level management believes is appropriate to absorb probable incurred credit losses in the loan portfolio. In evaluating the level of the allowance for loan losses, management considers historical loss experience, the types of loans and the amount of loans in the loan portfolio, adverse situations that may affect the borrower's ability to repay, estimated value of any underlying collateral, and prevailing economic conditions. This evaluation is inherently subjective as it requires estimates that are susceptible to significant revision as more information becomes available or as future events change. The provision for loan losses represents management's estimate of the amount necessary to maintain the allowance for loan losses at an adequate level.

Management extensively reviews recent trends in historical losses, qualitative factors and specific reserve needs on loans individually evaluated for impairment in its determination of the adequacy of the allowance for loan losses. We recorded $297,000 in provision for loan losses for the three month period ended June 30, 2018, as compared to $423,000 for the three month period ended June 30, 2017. The $126,000 decrease in the provision for loan losses was primarily due to favorable changes to both the quantitative and environmental factors deemed to be appropriate for the Bank's loan portfolio in aggregate, partially offset by the effects of an increase in the estimable and probable loan losses inherent in the loan portfolio that resulted from the $68.4 million, or 12.7%, increase in average loan balances in the second quarter of 2018, as compared with the same quarter of 2017.

For the three months ended June 30, 2018, we recorded $297,000 in provision for loan losses as compared to $423,000 in the same prior year three month period. This $126,000 decrease in the provision for loan losses was due principally to favorable changes to both the quantitative and environmental factors assigned to the Bank’s loan portfolio in aggregate, partially offset by $68.4 million, or 12.7%, increase in average loan balances in the first three months of 2018 as compared with the same three month period of 2017 and the resultant increase in the estimable and probable loan losses inherent in the loan portfolio.

For the first six months of 2018, we recorded $910,000 in provision for loan losses as compared to $812,000 in the same prior year six month period. This $98,000 increase in the provision for loan losses was due principally to the $77.5 million, or 14.8%, increase in average loan balances in the first six months of 2018 as compared with the same six month period of 2017 and the resultant increase in the estimable and probable loan losses inherent in the loan portfolio, partially offset by favorable changes to both the quantitative and environmental factors assigned to the Bank’s loan portfolio in aggregate.

The Company measures delinquency based on the amount of past due loans as a percentage of total loans. The ratio of delinquent loans to total loans decreased to 1.29% at June 30, 2018 as compared to 2.12% at December 31, 2017. Delinquent loans (numerator) decreased $4.5 million while total loan balances (denominator) increased $26.1 million at June 30, 2018, as compared to December 31, 2017. The decline in past due loans was primarily driven by a decrease of $2.7 million in loans delinquent 30-59 days and $2.4 million in loans delinquent 60-89, partially offset by an increase of $551,000 in loans delinquent more than 90 days. At June 30, 2018, there were $7.8 million in loans past due including $1.6 million in loans 30-59 days past due, $812,000 in loans 60-89 days past due and $5.4 million in loans 90 or more days past due. At December 31, 2017, there were $12.3 million in loans past due, including $4.3 million in loans 30-59 days past due, $3.2 million in loans 60-89 days past due and $4.9 million in loans 90 or more days past due.

The decrease of $4.5 million in total loans past due at June 30, 2018, as compared to December 31, 2017, was primarily due to a decrease of $2.7 million in loans 30-59 days past due and a decrease of $2.4 million in loans 60-89 days past due. The decrease in loans 30-59 days past due at June 30, 2018 as compared to December 31, 2017 was primarily due to a decrease in the commercial lines of credit that were delinquent 30-59 days. At December 31, 2017, there were four commercial lines of credit with an outstanding balance of $1.5 million (outstanding loan balances of $600,000, $450,000, $400,000, and $32,000, respectively) that were 30-59 days past due, while at June 30, 2018, there were only two commercial lines of credit with an outstanding balance of $161,000 (outstanding loan amounts of $71,000 and $90,000, respectively) that were 30-59 days past due. Total loans with delinquent balances 60-89 days past due decreased by $2.4 million in aggregate, primarily as a result of one commercial real estate loan with an outstanding balance of $1.7 million that was 60-89 days delinquent at December 31, 2017 and was over 90 days past due at June 30, 2018.

Noninterest Income

The Company's noninterest income is primarily comprised of fees on deposit account balances and transactions, loan servicing, commissions, including insurance agency commissions, and net gains on sales of securities, loans, and foreclosed real estate.

Table of Contents

The following table sets forth certain information on noninterest income for the periods indicated:

	Three months ended June 30,				Six months ended June 30,			
(Dollars in thousands)	2018	2017	Change		2018	2017	Change	
Service charges on deposit accounts	$ 273	$ 274	$ (1)	-0.4%	$ 547	$ 537	$ 10	1.9%
Earnings and gain on bank owned life insurance	108	62	46	74.2%	181	133	48	36.1%
Loan servicing fees	42	32	10	31.3%	83	68	15	22.1%
Debit card interchange fees	148	147	1	0.7%	291	268	23	8.6%
Other charges, commissions and fees	449	421	28	6.7%	904	820	84	10.2%
Noninterest income before gains (losses)	1,020	936	84	9.0%	2,006	1,826	180	9.9%
Net (losses) gains on sales and redemptions of investment securities	(22)	135	(157)	-116.3%	(129)	206	(335)	-162.6%
Gains on equity securities	13	-	13	-	26	-	26	-
Net gains (losses) on sales of loans and foreclosed real estate	13	(21)	34	-161.9%	16	(45)	61	-135.6%
Total noninterest income	$ 1,024	$ 1,050	$ (26)	-2.5%	$ 1,919	$ 1,987	$ (68)	-3.4%

The $26,000, or 2.5%, decrease in noninterest income in the quarter ended June 30, 2018, as compared to the same quarterly period in 2017, was primarily the result of a net decrease of $157,000 in the net gains on the sales and redemptions of investment securities from a gain of $135,000 for the three months ended June 30, 2017 to a net loss of $22,000 for the same quarter in 2018. The net gains on investment securities during the quarter ended June 30, 2017 were primarily the result of $94,000 in net gains recorded on short-term interest rate hedging activities in that period. There were no hedging activities of this type in the three months ended June 30, 2018. During the three months ended June 30, 2018, Company-initiated sales and issuer-initiated redemptions of investment securities in the amount of $11.4 million, generated a net loss of $22,000, or 0.19%. The investment securities sales were part of the Company's portfolio optimization and liquidity management strategies. It is the intention of management to reinvest the proceeds of these investment securities transactions into potentially higher yielding interest-earning assets in future periods.

Excluding the effects of the quarter over quarter reduction in gains on the sale of investment securities, all other noninterest income categories increased in the aggregate by $131,000, or 14.3% to $1.0 million in the quarter ended June 30, 2018 as compared with $915,000 in the same quarter of 2017. This $131,000 quarter over quarter increase in noninterest income, excluding the effects of gains on the sales and redemptions of investment securities, was due primarily to increases of $46,000 in earnings and gains on bank owned life insurance, $34,000 net gains on sales of loans and foreclosed real estate, and $28,000 in other charges, commissions and fees.

The $68,000, or 3.4% decrease in noninterest income in the six months ended June 30, 2018, as compared to the same six month period in 2017, was primarily the result of a net decrease of $335,000 in the net gains on the sales and redemptions of investment securities from a gain of $206,000 for the six months ended June 30, 2017 to a net loss of $129,000 for the same six month period in 2018. The net gains on investment securities during the six months ended June 30, 2017 were primarily the result of $250,000 in net gains recorded on short-term interest rate hedging activities in that period. There were no hedging activities of this type in the six months ended June 30, 2018. During the six months ended June 30, 2018, Company-initiated sales and issuer-initiated redemptions of investment securities in the amount of $29.2 million, generated a net loss of $129,000, or 0.44%. The investment securities sales were part of the Company's portfolio optimization and liquidity management strategies. It is the intention of management to reinvest the proceeds of these investment securities transactions into potentially higher yielding interest-earning assets in future periods.

Excluding the effects of the period over period reduction in gains on the sale of investment securities, all other noninterest income categories increased in the aggregate by $267,000, or 15.0% to $2.0 million in the six months ended June 30, 2018 as compared with $1.8 million in the same six month period of 2017. This $267,000 period over period increase in noninterest income, excluding the effects of gains on the sales and redemptions of investment securities, was due primarily to increases of $84,000 in other charges, commissions and fees, $61,000 net gains on sales of loans and foreclosed real estate, and $48,000 in earnings and gains on bank owned life insurance.

Noninterest Expense

The following table sets forth certain information on noninterest expense for the periods indicated:

	Three months ended June 30,				Six months ended June 30,			
(Dollars in thousands)	2018	2017	Change		2018	2017	Change	
Salaries and employee benefits	$ 3,429	$ 2,819	$ 610	21.6%	$ 6,513	$ 5,669	$ 844	14.9%
Building occupancy	553	531	22	4.1%	1,144	1,070	74	6.9%
Data processing	476	416	60	14.4%	955	843	112	13.3%
Professional and other services	405	219	186	84.9%	736	410	326	79.5%
Advertising	285	172	113	65.7%	476	348	128	36.8%
FDIC assessments	135	81	54	66.7%	255	137	118	86.1%
Audits and exams	105	85	20	23.5%	210	169	41	24.3%
Other expenses	739	688	51	7.4%	1,297	1,338	(41)	-3.1%
Total noninterest expenses	$ 6,127	$ 5,011	$ 1,116	22.3%	$ 11,586	$ 9,984	$ 1,602	16.0%

The $1.1 million, or 22.3%, increase in noninterest expense between the year-over-year second quarter periods was principally due to an increase in salaries and employee benefits expense of $610,000, or 21.6%. All other noninterest expenses in aggregate increased $506,000, or 23.1%, for the three months ended June 30, 2018 as compared to the same three month period in 2017. The detail of the components of the overall increase in noninterest expense is as follows:

- The $610,000 increase in salaries and employee benefits expense in the second quarter of 2018, as compared to the same three month period in 2017, was primarily due to increases of $221,000 in salary expense, increases of $185,000 in commissions expense, increases of $109,000 in employee benefits expense, including employee payroll tax expenses, and the establishment of a $100,000 reserve, through expense recognition, for the potential acceleration of postemployment benefits related to the earlier than originally planned retirement of a senior officer. Partially offsetting these increases was a net decrease in all other salaries and employee benefits expenses of $5,000. Salaries expense increased primarily as the result of the addition of staff members supporting current and planned asset growth and risk management activities. Commissions expense increased primarily due to $113,000 in additional accruals in the second quarter of 2018 that related to the timing of commissions payments, primarily to the senior management team of the Agency under a revised compensation formula established at the end of 2017. These timing factors are expected to partially reverse themselves in the remainder of 2018. The increases in employee benefits expenses for the three months ended June 30, 2018, as compared to the same three-month period in 2017, were also affected by certain timing factors and were consistent with the salary and commissions expense increases discussed above.
- The $60,000 increase in data processing costs was primarily due to an additional $28,000 in processing fees paid by the Bank that were based on increased levels of customer activity primarily transacted through its electronic delivery channels and $22,000 of additional equipment depreciation expenses.
- The $186,000 increase in professional and other services fees was primarily due to fees paid to an unaffiliated consulting firm during the quarter for assistance with operational and strategic planning.
- Advertising expense increased $113,000 primarily as the result of increases in the level of brand awareness advertising expenditures primarily focused on the Onondaga County market.
- FDIC assessments increased $54,000 due to an increase in the Bank's risk-weighted assessment resulting from the phase-out of a benefit the Bank received in the FDIC's risk-weighting methodology as a result of the dissolution of Pathfinder Commercial Bank.
- All other noninterest expenses decreased in aggregate in the year-over-year three month periods by a total of $93,000, or 7.1%, due to a broad range of individually immaterial variances.

The $1.6 million, or 16.0%, increase in noninterest expenses between the six month period ended June 30, 2018 and the same six month period in the prior year was principally due to an increase in salaries and employee benefits expense, data processing expense, professional and other service fees, advertising expense, FDIC assessments, and other expenses. The detail of the components of the overall increase in noninterest expense is as follows:

- The $844,000 increase in salaries and employee benefits expense in the first six months of 2018, as compared to the same six month period in 2017, was primarily due to $447,000 in salary expense increases, increases of $151,000 in employee benefits expense, including employee payroll tax expenses, the establishment of a $150,000 reserve, through expense recognition, for the potential acceleration of postemployment benefits related to the earlier than originally planned retirement of a senior officer, and increases of $134,000 in commissions expense, partially offset by a net decrease in all other salaries and employee benefits expenses of $38,000. Salaries expense increased as the result of the additions of staff members supporting current and planned asset growth and risk management activities. Commissions expense increased primarily due to $113,000 in additional accruals in the second quarter of 2018 that related to the timing of commissions payments, primarily to the senior management team of the Agency under a revised compensation formula established at the end of 2017. These timing factors are expected to partially reverse themselves in the remainder of 2018. The increases in employee benefits expenses for the six months ended June 30, 2018, as compared to the same six-month period in 2017, were consistent with the salary and commissions expense increases discussed above.
- The $112,000 increase in data processing expenses was primarily related to increases of $42,000, $32,000 and $31,000 in third-party processing charges, equipment depreciation and equipment maintenance expenses, respectively, for the six months ended June 30, 2018, as compared with the same six month period in 2017.
- The $326,000 increase in professional and other services fees was primarily due to fees paid to an unaffiliated consulting firm for the six months ended June 30, 2018 for assistance with operational and strategic planning.
- Advertising expense increased $128,000 primarily as the result of increases in the level of brand awareness advertising expenditures primarily focused on the Onondaga County market.
- FDIC assessments increased $118,000 due to an increase in the Bank's risk-weighted assessment resulting from the phase-out of a benefit the Bank received in the FDIC's risk-weighting methodology as a result of the dissolution of Pathfinder Commercial Bank.
- All other noninterest expenses decreased in aggregate in the year-over-year six month periods by a total of $74,000, or 2.9%, due to a broad range of individually immaterial variances.

At June 30, 2018, the Bank serviced 220 residential mortgage loans in the aggregate amount of $31.2 million that have been sold on a non-recourse basis to FNMA. FNMA is the only unrelated third-party that has acquired loans originated by the Bank. On an infrequent basis, loans previously sold to FNMA that subsequently default may be found to have underwriting defects that place the loans out of compliance with the representations and warranties made by the Bank. This can occur at any time while the loan is outstanding. In such cases, the Bank is required to repurchase the defaulted loans from FNMA. Repurchase losses sustained by the Bank include all costs incurred by FNMA as part of the foreclosure process, including items such as delinquent property taxes and legal fees. Management continues to monitor the underwriting standards applied to all residential mortgage loan originations and subsequent sales through its quality control processes and considers these occurrences and their related expenses to be isolated instances.

Income Tax Expense

Income tax expense decreased $72,000 to $166,000, with an effective tax rate of 14.3% for the quarter ended June 30, 2018 as compared to $238,000, with an effective tax rate of 21.3%, for the same three month period in 2017. The reduction in income tax expense was primarily the result of a reduction in statutory tax rates applicable to the Company and, to a lesser extent, a reduction in net income before income taxes of $130,000. The reduction in the second quarter 2018 effective tax rate, compared to the effective tax rate in the same quarter of 2017, was primarily the result of the enactment of the Tax Act, which reduced the federal statutory corporate tax rate applicable to the Company from 34% to 21%, and favorable changes to the New York State tax code. During both the second quarters of 2018 and 2017, the Company derived tax benefits from its investments in tax-exempt securities issued by municipalities and political subdivisions, and from its investments in bank owned life insurance. In the second quarter of 2018, these benefits reduced the effective tax rate to 18.9%. In addition, the Company recognized tax benefits of $52,000 and $19,000 related to the nonqualified redemption of employee incentive stock options and the utilization of low-income housing tax credits, respectively, that further reduced the overall effective tax rate for the first half of 2018 to the reported 14.3%.

During the second quarter of 2017, the sale of certain U.S. Treasury assets, positioned as part of the Company's short-term interest rate hedge strategies, resulted in realized capital gains in the amount of $156,000. These gains enabled the partial utilization of previously reserved-for capital loss carryforwards resulting in a reduction in income tax expense of $60,000 during that quarter. Absent this capital loss carryforward utilization effect in the second quarter of 2017, the Company's income tax expense would have been $298,000 and its effective tax rate for that quarter would have been 26.7%.

Income tax expense decreased $135,000 to $348,000, with an effective tax rate of 15.1% for the six months ended June 30, 2018 as compared to $483,000, with an effective tax rate of 22.6%, for the same six month period in 2017. The reduction in the first half 2018 effective tax rate, compared to the effective tax rate in the same six month period in 2017, was primarily the result of the enactment of the Tax Act, which reduced the federal statutory corporate tax rate applicable to the Company from 34% to 21%, and favorable changes to the New York State tax code. During both the first six months of 2018 and 2017, the Company derived effective tax rate benefits from its investments in tax-exempt securities issued by municipalities and political subdivisions, and from its investments in bank owned life insurance. In the first six months of 2018, these benefits reduced the effective tax rate to 19.0%. In addition, the Company recognized tax benefits of $74,000 and $19,000 related to the nonqualified redemption of employee incentive stock options and the utilization of low-income housing tax credits, respectively, reducing the overall effective tax rate for the first half of 2018 to the reported 15.1%.

During the first six months of 2017, the sale of certain U.S. Treasury assets, positioned as part of the Company's short-term interest rate hedge strategies, resulted in realized capital gains in the amount of $250,000. These gains enabled the partial utilization of previously reserved-for capital loss carryforwards resulting in a reduction in income tax expense of $96,000 during the six months ended June 30, 2018. Absent this capital loss carryforward utilization effect in the first half of 2017, the Company's income tax expense would have been $298,000 and its effective tax rate for that six month period would have been 27.1%.

Earnings per Share

Basic and diluted earnings per share were unchanged at $0.23 and $0.22, respectively, for the second quarters of 2018 and 2017.

Basic and diluted earnings per share were $0.47 and $0.46, respectively, for the six month period ended June 30, 2018 as compared to $0.42 and $0.41, respectively, for the same prior year period. The increase in earnings per share between these two periods was due to the increase in net income between these two time periods. Further information on earnings per share can be found in Note 3 of this Form 10-Q.

Changes in Financial Condition

Assets

Total assets increased $22.2 million, or 2.5%, to $903.5 million at June 30, 2018 as compared to $881.3 million at December 31, 2017. This increase was due primarily to an increase in loans and cash and cash equivalents, partially offset by decreases in investment securities.

Total loans receivable increased $26.4 million, or 4.5%, to $607.2 million at June 30, 2018 from $580.8 million at December 31, 2017. Commercial loans and residential loans recorded increases between these two dates, with increases of $20.6 million, and $6.8 million, respectively. These increases were partially offset by a decrease of $1.3 million in consumer loans.

Investment securities decreased $26.1 million, or 11.0%, to $211.2 million at June 30, 2018, as compared to $237.3 million at December 31, 2017, due principally to sales and maturities of securities during the first six months of 2018.

Cash and cash equivalents increased $14.7 million, or 67.1%, to $36.7 million at June 30, 2018, as compared to $22.0 million at December 31, 2017. The $14.7 million increase in cash and cash equivalents was primarily due to a strategic increase in short-term liquidity in anticipation of continued high levels of demand for loan fundings in the second half of 2018. The Bank considers its statutorily required cash reserve balances held at the Federal Reserve Bank to be restricted cash. Total restricted cash was $4.4 million and $6.3 million at June 30, 2018 and December 31, 2017, respectively.

Liabilities

Total liabilities increased $21.5 million, or 2.6%, to $840.6 million at June 30, 2018 compared to $819.1 million at December 31, 2017. Deposits increased $9.6 million, or 1.3%, to $733.2 million at June 30, 2018, compared to $723.6 million at December 31, 2017. This increase was the result of an increase in brokered deposits of $10.4 million, partially offset by a decrease in deposits obtained directly from customers within the Bank's marketplace of $792,000. The net decrease in customer deposits during the six months ended June 30, 2018 was due primarily to decreases in municipal deposits of $18.7 million, partially offset by growth in consumer and business deposit categories of $17.9 million in aggregate. The Bank utilizes the Certificates of Deposit Account Registry Service ("CDARS") provided by Promontory Interfinancial Network as a form of brokered deposits. At June 30, 2018, deposits obtained through the use of this service increased $10.4 million to $69.9 million as compared to $59.5 million at December 31, 2017. Borrowed funds balances at June 30, 2018 increased $10.2 million, or 13.8%, to $84.1 million from $73.9 million at December 31, 2017.

Shareholders' Equity

The Company's shareholders' equity, exclusive of the noncontrolling interest, increased $806,000, or 1.3%, to $62.6 million at June 30, 2018 from $61.8 million at December 31, 2017. This increase was principally due to an increase of $1.5 million in retained earnings, a $459,000 increase in additional paid-in capital, resulting from activity within the Company's stock-based compensation programs, and a $90,000 increase in ESOP shares earned. In addition, the Company adopted *ASU 2017-12: Derivatives and Hedging [Topic 815]: Targeted Improvements to Accounting for Hedging Activities*, effective January 1, 2018, in the second quarter of 2018. As a result of the adoption of this guidance, the Company transferred investment securities from HTM to AFS with an amortized historical cost before transfer of $35.2 million. This transfer resulted in the addition of $359,000 to accumulated other comprehensive income as of the effective date. Partially offsetting these increases in shareholders' equity was an increase of $1.3 million in accumulated other comprehensive loss. The increase in retained earnings primarily resulted from $1.9 million in net income recorded in the first six months of 2018 and a $53,000 one-time adjustment related to the cumulative effect of an unrealized gain on marketable equity securities based on the adoption of *ASU 2016-01 - Financial Instruments - Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Liabilities* in the first quarter of 2018. Partially offsetting these increases in retained earnings was a reduction of $497,000 for cash dividends declared on our common stock. The increase in accumulated comprehensive loss was primarily the result of the decline in the fair market value of our available-for-sale investment securities during the six months ended June 30, 2018.

Capital

Capital adequacy is evaluated primarily by the use of ratios which measure capital against total assets, as well as against total assets that are weighted based on defined risk characteristics. The Company's goal is to maintain a strong capital position, consistent with the risk profile of its banking operations. This strong capital position serves to support growth and expansion activities while at the same time exceeding regulatory standards. At June 30, 2018, the Bank met the regulatory definition of a "well-capitalized" institution, i.e. a leverage capital ratio exceeding 5%, a Tier 1 risk-based capital ratio exceeding 8%, Tier 1 common equity exceeding 6.5%, and a total risk-based capital ratio exceeding 10%.

In addition to establishing the minimum regulatory capital requirements, the regulations limit capital distributions and certain discretionary bonus payments to management if the institution does not hold a "capital conservation buffer" consisting of 2.5% of common equity Tier 1 capital to risk-weighted assets above the amount necessary to meet its minimum risk-based capital requirements. The buffer is separate from the capital ratios required under the Prompt Corrective Actions ("PCA") standards. In order to avoid these restrictions, the capital conservation buffer effectively increases the minimum levels of the following capital to risk-weighted assets ratios: (1) Core Capital, (2) Total Capital and (3) Common Equity. The capital conservation buffer requirement began being phased in beginning January 1, 2016 at 0.625% of risk-weighted assets and is increasing each year until fully implemented at 2.5% on January 1, 2019. For

2018, the capital buffer is 1.875% of risk-weighted assets. At June 30, 2018, the Bank exceeded all current and projected regulatory required minimum capital ratios, including the maximum capital buffer level that will be required on January 1, 2019.

As a result of the recently enacted Economic Growth, Regulatory Relief, and Consumer Protection Act, the federal banking agencies are required to develop a “Community Bank Leverage Ratio” (the ratio of a bank’s tangible equity capital to average total consolidated assets) for financial institutions with assets of less than $10 billion. A “qualifying community bank” that exceeds this ratio will be deemed to be in compliance with all other capital and leverage requirements, including the capital requirements to be considered “well capitalized” under Prompt Corrective Action statutes. The federal banking agencies may consider a financial institution’s risk profile when evaluating whether it qualifies as a community bank for purposes of the capital ratio requirement. The federal banking agencies must set the minimum capital for the new Community Bank Leverage Ratio at not less than 8% and not more than 10%. A financial institution can elect to be subject to this new definition.

Pathfinder Bank’s capital amounts and ratios as of the indicated dates are presented in the following tables:

	Actual		Minimum For Capital Adequacy Purposes		Minimum To Be "Well-Capitalized" Under Prompt Corrective Provisions		Well-Capitalized With Buffer, Fully Phased In 2019	
(Dollars in thousands)	Amount	Ratio	Amount	Ratio	Amount	Ratio	Amount	Ratio
As of June 30, 2018:								
Total Core Capital (to Risk-Weighted Assets)	$80,812	13.79%	$46,892	8.00%	$58,616	10.00%	$61,546	10.50%
Tier 1 Capital (to Risk-Weighted Assets)	$73,482	12.54%	$35,169	6.00%	$46,892	8.00%	$49,823	8.50%
Tier 1 Common Equity (to Risk-Weighted Assets)	$73,482	12.54%	$26,377	4.50%	$38,100	6.50%	$41,031	7.00%
Tier 1 Capital (to Assets)	$73,482	8.35%	$35,215	4.00%	$44,019	5.00%	$44,019	5.00%
As of December 31, 2017:								
Total Core Capital (to Risk-Weighted Assets)	$78,105	13.97%	$44,733	8.00%	$55,916	10.00%	$58,712	10.50%
Tier 1 Capital (to Risk-Weighted Assets)	$71,114	12.72%	$33,550	6.00%	$44,733	8.00%	$47,529	8.50%
Tier 1 Common Equity (to Risk-Weighted Assets)	$71,114	12.72%	$25,162	4.50%	$36,345	6.50%	$39,141	7.00%
Tier 1 Capital (to Assets)	$71,114	8.16%	$34,863	4.00%	$43,579	5.00%	$43,579	5.00%

Non-GAAP Financial Measures

Regulation G, a rule adopted by the Securities and Exchange Commission (SEC), applies to certain SEC filings, including earnings releases, made by registered companies that contain "non-GAAP financial measures." GAAP is generally accepted accounting principles in the United States of America. Under Regulation G, companies making public disclosures containing non-GAAP financial measures must also disclose, along with each non-GAAP financial measure, certain additional information, including a reconciliation of the non-GAAP financial measure to the closest comparable GAAP financial measure (if a comparable GAAP measure exists) and a statement of the Company's reasons for utilizing the non-GAAP financial measure as part of its financial disclosures. The SEC has exempted from the definition of "non-GAAP financial measures" certain commonly used financial measures that are not based on GAAP. When these exempted measures are included in public disclosures, supplemental information is not required. Financial institutions like the Company and its subsidiary bank are subject to an array of bank regulatory capital measures that are financial in nature but are not based on GAAP. The Company follows industry practice in disclosing its financial condition under these various regulatory capital measures, including period-end regulatory capital ratios for its subsidiary bank, in its periodic reports filed with the SEC. The Company provides, below, an explanation of the calculations, as supplemental information, for non-GAAP measures included in the consolidated annual financial statements. In addition, the Company provides a reconciliation of its subsidiary bank's disclosed regulatory capital measures, below.

(Dollars in thousands)		June 30, 2018			December 31, 2017	
Regulatory Capital Ratios (Bank Only)						
Total capital (to risk-weighted assets)						
Total equity (GAAP)	$	72,721		$	71,535	
Goodwill		(4,536)			(4,536)	
Intangible assets		(174)			(146)	
Addback: Accumulated other comprehensive income		5,471			4,261	
Total Tier 1 Capital	$	73,482		$	71,114	
Allowance for loan and lease losses		7,330			6,991	
Unrealized Gain on available-for-sale securities		-			-	
Total Tier 2 Capital	$	7,330		$	6,991	
Total Tier 1 plus Tier 2 Capital (numerator)	$	80,812		$	78,105	
Risk-weighted assets (denominator)		586,155			559,161	
Total core capital to risk-weighted assets		13.79	%		13.97	%
Tier 1 capital (to risk-weighted assets)						
Total Tier 1 capital (numerator)	$	73,482		$	71,114	
Risk-weighted assets (denominator)		586,155			559,161	
Total capital to risk-weighted assets		12.54	%		12.72	%
Tier 1 capital (to adjusted assets)						
Total Tier 1 capital (numerator)	$	73,482		$	71,114	
Total average assets		885,095			876,263	
Goodwill		(4,536)			(4,536)	
Intangible assets		(174)			(146)	
Adjusted assets (denominator)	$	880,385		$	871,581	
Total capital to adjusted assets		8.35	%		8.16	%
Tier 1 Common Equity (to risk-weighted assets)						
Total Tier 1 capital (numerator)	$	73,482		$	71,114	
Risk-weighted assets (denominator)		586,155			559,161	
Total Tier 1 Common Equity to risk-weighted assets		12.54	%		12.72	%

Loan and Asset Quality and Allowance for Loan Losses

The following table represents information concerning the aggregate amount of non-performing assets at the indicated dates:

(Dollars In thousands)	June 30, 2018	December 31, 2017	June 30, 2017
Nonaccrual loans:			
Commercial and commercial real estate loans	$ 3,152	$ 2,443	$ 2,049
Consumer	203	363	388
Residential mortgage loans	2,090	2,088	1,956
Total nonaccrual loans	5,445	4,894	4,393
Total nonperforming loans	5,445	4,894	4,393
Foreclosed real estate	97	468	678
Total nonperforming assets	$ 5,542	$ 5,362	$ 5,071
Accruing troubled debt restructurings	$ 2,756	$ 2,539	$ 4,761
Nonperforming loans to total loans	0.90%	0.84%	0.80%
Nonperforming assets to total assets	0.61%	0.61%	0.63%

Nonperforming assets include nonaccrual loans, nonaccrual troubled debt restructurings ("TDR"), and foreclosed real estate (''FRE"). The Company generally places a loan on nonaccrual status and ceases accruing interest when loan payment performance is deemed unsatisfactory and the loan is past due 90 days or more. There are no loans that are past due 90 days or more and still accruing interest. Loans are considered modified in a TDR when, due to a borrower's financial difficulties, the Company makes a concession(s) to the borrower that it would not otherwise consider. These modifications may include, among others, an extension of the term of the loan, and granting a period when interest-only payments can be made, with the principal payments made over the remaining term of the loan or at maturity. TDRs are included in the above table within the categories of nonaccrual loans or accruing TDRs. There were two nonaccruing TDR loans, with an aggregate carrying value of $69,000 included among the nonaccrual loans detailed in the table above at June 30, 2018.

As indicated in the table above, nonperforming assets at June 30, 2018 were $5.5 million and were $180,000 higher than the $5.4 million reported at December 31, 2017, due primarily to an increase of $709,000 in nonperforming commercial and commercial real estate loans, partially offset by a decrease of $371,000 in FRE and $160,000 in nonperforming consumer loans.

As indicated in the nonperforming asset table above, FRE balances decreased $371,000 to $97,000 at June 30, 2018 from $468,000 at December 31, 2017, following five sales from the portfolio and four additions to the portfolio during the six-month period ended June 30, 2018. More information regarding foreclosed real estate can be found in Note 8 of this Form 10-Q.

Fair values for commercial FRE are initially recorded based on market value evaluations by third parties, less costs to sell ("initial cost basis"). On a prospective basis, residential FRE assets will be initially recorded at the lower of the net amount of loan receivable or the real estate's fair value less costs to sell. Any write-downs required when the related loan receivable is exchanged for the underlying real estate collateral at the time of transfer to FRE are charged to the allowance for loan losses. Values are derived from appraisals, similar to impaired loans, of underlying collateral or discounted cash flow analysis. Subsequent to foreclosure, valuations are updated periodically and assets are marked to current fair value, not to exceed the initial cost basis for the FRE property.

The allowance for loan losses represents management's estimate of the probable losses inherent in the loan portfolio as of the date of the statement of condition. The allowance for loan losses was $7.6 million and $7.1 million at June 30, 2018 and December 31, 2017, respectively. The ratio of the allowance for loan losses to total loans increased two basis points to 1.25% at June 30, 2018 from 1.23% at December 31, 2017. Management performs a quarterly evaluation of the allowance for loan losses based on quantitative and qualitative factors and has determined that the current level of the allowance for loan losses is adequate to absorb the losses in the loan portfolio as of June 30, 2018.

The Company considers a loan impaired when, based on current information and events, it is probable that the Company will be unable to collect the scheduled payments of principal and interest when due according to the contractual terms of the loan. The measurement of impaired loans is generally based upon the fair value of the collateral, with a portion of the impaired loans measured based upon the present value of future cash flows discounted at the historical effective interest rate. A specific reserve is established for an impaired loan if its carrying value exceeds its estimated fair value. The estimated fair values of the majority of the Company's impaired loans are measured based on the estimated fair value of the loan's collateral. For loans secured by real estate, estimated fair values are determined primarily through third-party appraisals or broker price opinions. When a loan is determined to be impaired, the Bank will reevaluate the collateral which secures the loan. For real estate, the Company will obtain a new appraisal or broker's opinion whichever is considered to provide the most accurate value in the event of sale. An evaluation of equipment held as collateral will be obtained from a firm able to provide such an evaluation. Collateral will be inspected not less than annually for all impaired loans and will be reevaluated not less than every two years. Appraised values and broker opinion values are discounted due to the market's perception of a reduced price of Bank-owned property and the Bank's desire to sell the property more quickly to arrive at the estimated selling price of the collateral, which is considered to be the estimated fair value. The discounts also include estimated costs to sell the property.

At June 30, 2018 and December 31, 2017, the Company had $7.8 million and $9.2 million in loans, respectively, which were deemed to be impaired, having established specific reserves of $1.2 million and $1.1 million, respectively, on these loans. The decrease in impaired loans between these two dates was primarily driven by decreases of $970,000 and $348,000 in impaired commercial real estate and other commercial loans, respectively. The $68,000 increase in specific reserves for impaired loans at June 30, 2018, as compared to December 31, 2017 was primarily due to a $276,000 increase in specific reserves for commercial real estate loans, partially offset by a $208,000 decrease in reserves for all other loans in aggregate.

Management has identified potential credit problems which may result in the borrowers not being able to comply with the current loan repayment terms and which may result in those loans being included in future impaired loan reporting. Potential problem loans totaled $3.8 million as of June 30, 2018, a decrease of $138,000, or 3.5%, as compared to $3.9 million at December 31, 2017. These loans have been internally classified as special mention, substandard, or doubtful, yet are not currently considered impaired.

Appraisals are obtained at the time a real estate secured loan is originated. For commercial real estate held as collateral, the property is inspected every two years.

In the normal course of business, the Bank has infrequently sold residential mortgage loans and participation interests in commercial loans. As is typical in the industry, the Bank makes certain representations and warranties to the buyer. The Bank maintains a quality control program for closed loans and considers the risks and uncertainties associated with potential repurchase requirements to be minimal.

Liquidity

Liquidity management involves the Company's ability to generate cash or otherwise obtain funds at reasonable rates to support asset growth, meet deposit withdrawals, maintain reserve requirements, and otherwise operate the Company on an ongoing basis. The Company's primary sources of funds are deposits, borrowed funds, amortization and prepayment of loans and maturities of investment securities and other short-term investments, and earnings and funds provided from operations. While scheduled principal repayments on loans are a relatively predictable source of funds, deposit flows and loan prepayments are greatly influenced by general interest rates, economic conditions and competition. The Company manages the pricing of deposits to maintain a desired deposit composition and balance. In addition, the Company invests excess funds in short-term interest-earning and other assets, which provide liquidity to meet lending requirements.

The Company's liquidity has been enhanced by its ability to borrow from the Federal Home Loan Bank of New York (“FHLBNY”), whose competitive advance programs and lines of credit provide the Company with a safe, reliable, and convenient source of funds. A significant decrease in deposits in the future could result in the Company having to seek other sources of funds for liquidity purposes. Such sources could include, but are not limited to, additional borrowings, brokered deposits, negotiated time deposits, the sale of "available-for-sale" investment securities, the sale of securitized loans, or the sale of whole loans. Such actions could result in higher interest expense and/or losses on the sale of securities or loans.

Through the first six months of 2018, as indicated in the consolidated statement of cash flows, the Company reported net cash flows from operating activities of $5.1 million and net cash outflows of $9.7 million related to investing activities. The net cash outflows from investing activities primarily was due to a net $27.0 million increase in loan balances, partially offset by a $17.3 million decrease in all other investing activities in aggregate. The Company reported net cash flows from financing activities of $19.4 million generated principally by increased balances of long-term borrowings of $14.2 million and brokered deposits of $10.4 million, partially offset by an aggregate decrease in net cash of $5.2 million from all other financing sources, including dividends paid to common shareholders of $502,000.

In June 2018, the Company renewed for the period ended June 12, 2019, a $12.0 million portion of an expiring $26.0 million Irrevocable Stand-By Letter of Credit (“LOC”), first established in June 2016, with the FHLBNY as an alternative means of collateralizing certain public funds deposits. A LOC is a conditional commitment issued by the FHLBNY to guarantee the performance of the Bank with respect to large public funds deposits. These deposits are placed with the Bank by entities, such as municipalities and other political subdivisions within the Bank’s market area, and typically exceed the statutory FDIC deposit insurance limits for individual accounts. As a matter of statute, these depositors require that collateral be directly deposited by the Bank with an independent safekeeping agent, or in certain cases, that LOCs be issued by a third party that is acceptable to the depositor. The Bank finds that, with certain depositor relationships, this method of collateralization for the benefit of the municipal depositors is more economically efficient than posting specific securities with a safekeeping agent. The Bank committed a portion of its mortgage loan portfolio as pledged collateral to the FHLBNY for the LOC. Loans encumbered as collateral for letters of credit reduce the Bank’s available liquidity position in that available borrowing capacity with the FHLBNY is decreased substantially on a dollar-for-dollar basis.

The Company has a number of existing credit facilities available to it. At June 30, 2018, total credit available to the Company under the existing lines of credit was approximately $194.4 million at FHLBNY, the Federal Reserve Bank, and two other correspondent banks. As of June 30, 2018, the Company had $96.1 million of the available lines of credit utilized, including encumbrances supporting outstanding letters of credit, described above, on its existing lines of credit with $98.3 million available.

The Asset Liability Management Committee of the Company is responsible for implementing the policies and guidelines for the maintenance of prudent levels of liquidity. As of June 30, 2018, management reported to the Board of Directors that the Company is in compliance with its liquidity policy guidelines.

Off-Balance Sheet Arrangements

The Company is also a party to financial instruments with off-balance sheet risk in the normal course of business to meet the financing needs of its customers. These financial instruments include commitments to extend credit and standby letters of credit. At June 30, 2018, the Company had $108.8 million in outstanding commitments to extend credit and standby letters of credit.

Item 3 – Quantitative and Qualitative Disclosures About Market Risk

A smaller reporting company is not required to provide the information relating to this item.

Item 4 – Controls and Procedures

Under the supervision and with the participation of the Company’s management, including our Chief Executive Officer and Chief Financial Officer, the Company has evaluated the effectiveness of the design and operation of its disclosure controls and procedures (as defined in Rule 13a-15(e) and 15d-15(e) under the Exchange Act) as of the end of the period covered by this quarterly report. Based upon that evaluation, the Chief Executive Officer and Chief Financial Officer concluded that, as of the end of the period covered by this report, the Company's disclosure controls and procedures are effective to ensure that information required to be disclosed in the reports that the Company files or submits under the Securities Exchange Act of 1934 is recorded, processed, summarized and reported, within the time periods specified in the Securities and Exchange Commission's rules and forms. There has been no change in the Company's internal control over financial reporting during the most recent fiscal quarter that has materially affected, or is reasonable likely to materially affect, the Company's internal control over financial reporting.

Table of Contents

PART II – OTHER INFORMATION

Item 1 – Legal Proceedings

At June 30, 2018, the Company is not currently a named party in a legal proceeding, the outcome of which would have a material and adverse effect on the financial condition or results of operations of the Company.

Item 1A – Risk Factors

A smaller reporting company is not required to provide the information relating to this item.

Item 2 – Unregistered Sales of Equity Securities and Use of Proceeds

Period	Total Number of Shares Purchased (1)	Average Price Paid Per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs	Maximum Number of Shares That May Yet Be Purchased Under the Plans or Programs
April 1, 2018 through April 30, 2018	-	$ -	-	74,292
May 1, 2018 through May 31, 2018	-	$ -	-	74,292
June 1, 2018 through June 30, 2018	-	$ -	-	74,292

(1) On August 29, 2016, our Board of Directors authorized the repurchase of up to 217,692 shares of our common stock, or 5% of the Company's shares outstanding as of that date.

Item 3 – Defaults Upon Senior Securities

None

Item 4 – Mine Safety Disclosures

Not applicable

Item 5 – Other Information

None

Item 6 – Exhibits

Exhibit No.	Description
31.1	Rule 13a-14(a)/15d-14(a) Certification of the Chief Executive Officer
31.2	Rule 13a-14(a)/15d-14(a) Certification of the Chief Financial Officer
32	Section 1350 Certification of the Chief Executive Officer and Chief Financial Officer
101	Interactive data files pursuant to Rule 405 of Regulation S-T formatted in Extensible Business Reporting Language (XBRL): (i) the Consolidated Statements of Condition, (ii) the Consolidated Statements of Income (iii) the Consolidated Statements of Comprehensive Income, (iv) the Consolidated Statements of Changes in Shareholders' Equity, (v) Consolidated Statements of Cash Flows, and (vi) the Notes to the Consolidated Financial Statements tagged as blocks of text.

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

PATHFINDER BANCORP, INC.
(registrant)

August 10, 2018	/s/ Thomas W. Schneider Thomas W. Schneider President and Chief Executive Officer
August 10, 2018	/s/ James A. Dowd James A. Dowd Executive Vice President, Chief Operating Officer and Chief Financial Officer

EXHIBIT 31.1: Rule 13a-14(a) / 15d-14(a) Certification of the Chief Executive Officer

Certification of Chief Executive Officer

Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002

I, Thomas W. Schneider, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of Pathfinder Bancorp, Inc.;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:

   (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

   (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting, to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

   (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

   (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors:

   (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

   (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

August 10, 2018

/s/ Thomas W. Schneider
Thomas W. Schneider
President and Chief Executive Officer

EXHIBIT 31.2: Rule 13a-14(a) / 15d-14(a) Certification of the Chief Financial Officer

Certification of Chief Financial Officer

Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002

I, James A. Dowd, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of Pathfinder Bancorp, Inc.;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:

    a. Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
    b. Designed such internal control over financial reporting, or caused such internal control over financial reporting, to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
    c. Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
    d. Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors:

    a. All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
    b. Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

August 10, 2018

/s/ James A. Dowd
James A. Dowd
Executive Vice President, Chief Operating Officer and
Chief Financial Officer

EXHIBIT 32 Section 1350 Certification of the Chief Executive Officer and Chief Financial Officer

Certification pursuant to 18 U.S.C. §1350, as adopted pursuant to §906 of the Sarbanes-Oxley Act of 2002

In connection with the Quarterly Report of Pathfinder Bancorp, Inc. (the "Company") on Form 10-Q for the period ended June 30, 2018 as filed with the Securities and Exchange Commission (the "Report"), the undersigned hereby certify, pursuant to 18 U.S.C. §1350, as adopted pursuant to §906 of the Sarbanes-Oxley Act of 2002, that:

1. The Report fully complies with the requirements of Sections 13(a) or 15(d) of the Securities Exchange Act of 1934; and

2. The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company as of and for the period covered by the Report.

The purpose of this statement is solely to comply with Title 18, Chapter 63, Section 1350 of the United States Code, as amended by Section 906 of the Sarbanes-Oxley Act of 2002.

August 10, 2018	/s/ Thomas W. Schneider Thomas W. Schneider President and Chief Executive Officer
August 10, 2018	/s/ James A. Dowd James A. Dowd Executive Vice President, Chief Operating Officer and Chief Financial Officer