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 March 31, 2019

OR

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

For the transition period from _______ to _______

PathFinder BANCORP, INC.

(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 Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T (§232.405 of this Chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit 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 ☐

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 ☒

Securities registered pursuant to Section 12(b) of the Act:

Title of each class	Trading Symbol(s)	Name of each exchange on which registered
Common Stock, $0.01 par value	PBHC	The NASDAQ Stock Market LLC

As of May 14, 2019, there were 4,694,221 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)	March 31, 2019	December 31, 2018
ASSETS:		
Cash and due from banks	$ 8,193	$ 9,610
Interest-earning deposits (including restricted balances of $4,632 and $3,993, respectively)	16,623	16,706
Total cash and cash equivalents	24,816	26,316
Available-for-sale securities, at fair value	155,302	177,664
Held-to-maturity securities, at amortized cost (fair value of $79,488 and $53,769, respectively)	78,861	53,908
Marketable equity securities, at fair value	494	453
Federal Home Loan Bank stock, at cost	4,088	5,937
Loans	657,590	620,270
Less: Allowance for loan losses	7,284	7,306
Loans receivable, net	650,306	612,964
Premises and equipment, net	21,539	20,623
Operating lease right-of-use assets	2,462	-
Accrued interest receivable	3,364	3,068
Foreclosed real estate	623	1,173
Intangible assets, net	161	165
Goodwill	4,536	4,536
Bank owned life insurance	17,062	16,941
Other assets	11,458	9,367
Total assets	$ 975,072	$ 933,115
LIABILITIES AND SHAREHOLDERS' EQUITY:		
Deposits:		
Interest-bearing	$ 705,734	$ 623,936
Noninterest-bearing	99,794	103,124
Total deposits	805,528	727,060
Short-term borrowings	13,000	39,000
Long-term borrowings	64,434	79,534
Subordinated loans	15,102	15,094
Accrued interest payable	471	304
Operating lease liabilities	2,711	-
Other liabilities	7,388	7,664
Total liabilities	908,634	868,656
Shareholders' equity:		
Common stock, par value $0.01; 25,000,000 authorized shares; 4,387,244 and 4,362,328 shares outstanding, respectively	44	44
Additional paid in capital	29,454	29,139
Retained earnings	42,133	42,114
Accumulated other comprehensive loss	(4,462)	(6,042)
Unearned ESOP	(989)	(1,034)
Total Pathfinder Bancorp, Inc. shareholders' equity	66,180	64,221
Noncontrolling interest	258	238
Total equity	66,438	64,459
Total liabilities and shareholders' equity	$ 975,072	$ 933,115

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

Table of Contents

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

(In thousands, except per share data)	For the three months ended March 31, 2019	For the three months ended March 31, 2018
Interest and dividend income:		
Loans, including fees	$ 7,575	$ 6,718
Debt securities:		
Taxable	1,799	1,128
Tax-exempt	108	248
Dividends	77	68
Federal funds sold and interest earning deposits	110	47
Total interest and dividend income	9,669	8,209
Interest expense:		
Interest on deposits	2,345	1,345
Interest on short-term borrowings	167	93
Interest on long-term borrowings	393	175
Interest on subordinated loans	217	203
Total interest expense	3,122	1,816
Net interest income	6,547	6,393
Provision for loan losses	144	613
Net interest income after provision for loan losses	6,403	5,780
Noninterest income:		
Service charges on deposit accounts	282	274
Earnings and gain on bank owned life insurance	121	73
Loan servicing fees	27	41
Net gains (losses) on sales and redemptions of investment securities	79	(107)
Gains on marketable equity securities	41	13
Net (losses) gains on sales of loans and foreclosed real estate	(8)	3
Debit card interchange fees	144	143
Insurance agency revenue	243	229
Other charges, commissions & fees	164	226
Total noninterest income	1,093	895
Noninterest expense:		
Salaries and employee benefits	3,780	3,084
Building occupancy	656	591
Data processing	593	479
Professional and other services	336	331
Advertising	244	191
FDIC assessments	111	120
Audits and exams	100	105
Insurance agency expense	199	164
Community service activities	138	87
Foreclosed real estate expenses	237	26
Other expenses	317	281
Total noninterest expense	6,711	5,459
Income before income taxes	785	1,216
Provision for income taxes	251	182
Net income attributable to noncontrolling interest and Pathfinder Bancorp, Inc.	534	1,034
Net income attributable to noncontrolling interest	20	30
Net income attributable to Pathfinder Bancorp Inc.	$ 514	$ 1,004
Earnings per common share - basic	$ 0.12	$ 0.24
Earnings per common share - diluted	$ 0.12	$ 0.24
Dividends per common share	$ 0.06	$ 0.06

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

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

	For the three months ended	
(In thousands)	March 31, 2019	March 31, 2018
Net Income	$ 534	$ 1,034
Other Comprehensive Income (Loss)		
Retirement Plans:		
Retirement plan net losses recognized in plan expenses	84	43
Unrealized holding gains (losses) on available-for-sale securities		
Unrealized holding gains (losses) arising during the period	1,988	(1,189)
Reclassification adjustment for net (gains) losses included in net income	(79)	107
Net unrealized gains (losses) on available-for-sale securities	1,909	(1,082)
Accretion of net unrealized loss on securities transferred to held-to-maturity(1)	6	22
Other comprehensive income (loss), before tax	1,999	(1,017)
Tax effect	(419)	266
Other comprehensive income (loss), net of tax	1,580	(751)
Comprehensive income	$ 2,114	$ 283
Comprehensive income, attributable to noncontrolling interest	$ 20	$ 30
Comprehensive income attributable to Pathfinder Bancorp, Inc.	$ 2,094	$ 253
Tax Effect Allocated to Each Component of Other Comprehensive Income (Loss)		
Retirement plan net losses recognized in plan expenses	$ (19)	$ (11)
Unrealized holding gains (losses) arising during the period	(416)	311
Reclassification adjustment for net (gains) losses included in net income	17	(28)
Accretion of net unrealized loss on securities transferred to held-to-maturity(1)	(1)	(6)
Income tax effect related to other comprehensive income (loss)	$ (419)	$ 266

(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.

Table of Contents

Pathfinder Bancorp, Inc.
Consolidated Statements of Changes in Shareholders' Equity
Three months ended March 31, 2019 and March 31, 2018
(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, 2019	$ 44	$ 29,139	$ 42,114	$ (6,042)	$ (1,034)	$ 238	$64,459
Net income	-	-	514	-	-	20	534
Other comprehensive income, net of tax	-	-	-	1,580	-	-	1,580
ESOP shares earned (6,111 shares)	-	42	-	-	45	-	87
Stock based compensation	-	73	-	-	-	-	73
Stock options exercised	-	200	-	-	-	-	200
Cumulative effect of change in measurement of operating leases [1]	-	-	(239)	-	-	-	(239)
Common stock dividends declared ($0.06 per share)	-	-	(256)	-	-	-	(256)
Balance, March 31, 2019	$ 44	$ 29,454	$ 42,133	$ (4,462)	$ (989)	$ 258	$66,438
Balance, January 1, 2018	$ 43	$ 28,170	$ 39,020	$ (4,208)	$ (1,214)	$ 333	$62,144
Net income	-	-	1,004	-	-	30	1,034
Other comprehensive loss, net of tax	-	-	-	(751)	-	-	(751)
ESOP shares earned (6,111 shares)	-	49	-	-	45	-	94
Stock based compensation	-	81	-	-	-	-	81
Stock options exercised	-	84	-	-	-	-	84
Cumulative effect of change in measurement of equity securities [2]	-	-	53	(53)	-	-	-
Common stock dividends declared ($0.06 per share)	-	-	(248)	-	-	-	(248)
Balance, March 31, 2018	$ 43	$ 28,384	$ 39,829	$ (5,012)	$ (1,169)	$ 363	$62,438

(1) Cumulative effect of the adoption of ASU 2016-02, Leases (Topic 842), based on the difference in the right-of-use asset and lease liability as of January 1, 2019.

(2) 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.

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

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

	For the three months ended March 31,	
(In thousands)	2019	2018
OPERATING ACTIVITIES		
Net income attributable to Pathfinder Bancorp, Inc.	$ 514	$ 1,004
Adjustments to reconcile net income to net cash flows from operating activities:		
Provision for loan losses	144	613
Amortization of operating leases	11	-
Realized losses (gains) on sales, redemptions and calls of:		
Real estate acquired through foreclosure	8	(3)
Available-for-sale investment securities	(86)	100
Held-to-maturity investment securities	7	7
Marketable equity securities	(41)	(13)
Depreciation	360	278
Amortization of mortgage servicing rights	3	25
Amortization of deferred loan costs	66	86
Amortization of deferred financing from subordinated debt	8	9
Earnings and gain on bank owned life insurance	(121)	(73)
Net amortization of premiums and discounts on investment securities	228	405
Amortization of intangible assets	4	4
Stock based compensation and ESOP expense	160	175
Net change in accrued interest receivable	(296)	47
Net change in other assets and liabilities	(2,532)	(1,195)
Net cash flows from operating activities	(1,563)	1,469
INVESTING ACTIVITIES		
Purchase of investment securities available-for-sale	(5,081)	(22,294)
Purchase of investment securities held-to-maturity	(26,835)	-
Purchase of Federal Home Loan Bank stock	(1,346)	(2,606)
Proceeds from redemption of Federal Home Loan Bank stock	3,195	3,056
Proceeds from maturities and principal reductions of investment securities available-for-sale	6,879	14,918
Proceeds from maturities and principal reductions of investment securities held-to-maturity	1,906	2,121
Proceeds from sales, redemptions and calls of:		
Available-for-sale investment securities	22,277	17,704
Held-to-maturity investment securities	30	30
Real estate acquired through foreclosure	1,020	434
Net change in loans	(38,031)	(27,663)
Purchase of premises and equipment	(1,276)	(951)
Net cash flows from investing activities	(37,262)	(15,251)
FINANCING ACTIVITIES		
Net change in demand deposits, NOW accounts, savings accounts, money management deposit accounts, MMDA accounts and escrow deposits	960	(38)
Net change in time deposits	43,477	5,202
Net change in brokered deposits	34,031	15,038
Net change in short-term borrowings	(26,000)	(10,000)
Payments on long-term borrowings	(15,100)	-
Proceeds from exercise of stock options	200	84
Cash dividends paid to common shareholders	(263)	(246)
Change in noncontrolling interest, net	20	30
Net cash flows from financing activities	37,325	10,070
Change in cash and cash equivalents	(1,500)	(3,712)
Cash and cash equivalents at beginning of period	26,316	21,991
Cash and cash equivalents at end of period	$ 24,816	$ 18,279
CASH PAID DURING THE PERIOD FOR:		
Interest	$ 2,955	$ 1,784
Income taxes	-	125
NON-CASH INVESTING ACTIVITY		
Real estate acquired in exchange for loans	479	71
RESTRICTED CASH		
Federal Reserve Bank Reserve Requirements included in interest earning deposits	4,632	5,109

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 2018 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 months ended March 31, 2019 are not necessarily indicative of the results that may be expected for the full year ending December 31, 2019 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 FASB (“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 standards adopted in the first quarter of 2019 as well as standards that are not currently effective, but could have an impact on the Company's consolidated financial statements upon adoption.

<u>Standards Adopted in 2019</u>

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

Effect on Consolidated Financial Statements: The Company occupies certain banking offices and uses certain equipment under noncancelable operating lease agreements which were not reflected in its consolidated balance sheet at December 31, 2018. Upon adoption of this ASU on January 1, 2019, the Company recorded an asset of $2.5 million and a corresponding liability of $2.7 million, as a result of recognizing right-of-use assets and lease liabilities on its consolidated statement of financial condition. The Company elected to adopt the transition relief under Topic 842, Leases, using the modified retrospective transition method recognizing a cumulative effect adjustment to the opening balance of retained earnings of $239,000. The periods presented prior to January 1, 2019 continue to be in accordance with ASC 840. Under the new lease standard, disclosures are required to meet the objective of enabling users of financial statements to assess the amount, timing, and uncertainty of cash flows arising from leases. The Company uses its incremental borrowing rate based on the information available in determining the present value of lease payments. We elected all applicable practical expedients and implemented internal controls and key system functionality to enable the preparation of financial information on adoption.

The Company owns certain properties that it leases to unaffiliated third parties at market rates. Lease rental income was $34,000 and $30,000 for the twelve months ended March 31, 2019 and 2018, respectively. All lease agreements are accounted for as operating leases. The Company has no unamortized initial direct costs related to the establishment of these lease agreements at January 1, 2019.

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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

Effect on Consolidated Financial Statements: The Company has consistently employed accounting methodologies with respect to securities with purchased premiums that are consistent with the guidance provided in this Update. Accordingly, the adoption of this guidance had no material impact on the Company's 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 ASU affect all entities that enter into share-based payment transactions for acquiring goods and services from nonemployees.

Required Date of Implementation: January 1, 2019

Effect on Consolidated Financial Statements: The amendments should be applied using a prospective transition method. The Company is not currently party to any nonemployee share-based payment awards whereby the participant is obligated to any specific performance requirement other than to remain in the service of the Company through a specified vesting date, or schedule of vesting dates. Accordingly, the adoption of this ASU had no material impact on the Company's consolidated financial statements.

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Standards Not Yet Adopted as of March 31, 2019

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: Fair Value Measurement (*ASU 2018-13: Fair Value Measurement [Topic 820]: Disclosure Framework Changes to the Disclosure Requirements for Fair Value Measurement*

Description: The FASB is issuing the amendments in this ASU as part of the disclosure framework project. The disclosure framework project's objective and primary focus are to improve the effectiveness of disclosures in the notes to financial statements by facilitating clear communication of the information required by GAAP that is most important to users of each entity's financial statements. The amendments in this ASU modify the disclosure requirements for entities such as the Company on fair value measurements in Topic 820, Fair Value Measurement.

The following disclosure requirements were removed from Topic 820:
1. The amount of and reasons for transfers between Level 1 and Level 2 of the fair value hierarchy
2. The policy for timing of transfers between levels
3. The valuation processes for Level 3 fair value measurements

The following disclosure requirements were modified in Topic 820:
1. In lieu of a rollforward for Level 3 fair value measurements, a nonpublic entity is required to disclose transfers into and out of Level 3 of the fair value hierarchy and purchases and issues of Level 3 assets and liabilities.
2. For investments in certain entities that calculate net asset value, an entity is required to disclose the timing of liquidation of an investee's assets and the date when restrictions from redemption might lapse only if the investee has communicated the timing to the entity or announced the timing publicly.
3. The amendments clarify that the measurement uncertainty disclosure is to communicate information about the uncertainty in measurement as of the reporting date.

The following disclosure requirements were added to Topic 820:
1. The changes in unrealized gains and losses for the period included in other comprehensive income for recurring Level 3 fair value measurements held at the end of the reporting period
2. The range and weighted average of significant unobservable inputs used to develop Level 3 fair value measurements. For certain unobservable inputs, an entity may disclose other quantitative information (such as the median or arithmetic average) in lieu of the weighted average if the entity determines that other quantitative information would be a more reasonable and rational method to reflect the distribution of unobservable inputs used to develop Level 3 fair value measurements.

Required Date of Implementation: The amendments in this ASU are effective for all entities for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2019. The amendments on changes in unrealized gains and losses, the range and weighted average of significant unobservable inputs used to develop Level 3 fair value measurements, and the narrative description of measurement uncertainty should be applied prospectively for only the most recent interim or annual period presented in the initial fiscal year of adoption. All other amendments should be applied retrospectively to all periods presented upon their effective date. Early adoption is permitted upon issuance of this Update. An entity is permitted to early adopt any removed or modified disclosures upon issuance of this ASU and delay adoption of the additional disclosures until their effective date.

Effect on Consolidated Financial Statements: The Company does not expect the new guidance will have a material impact to its consolidated statements of condition or income.

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Table of Contents

Standard: Compensation (*ASU 2018-14: Compensation - Retirement Benefits - Defined Benefit Plans - General [Subtopic 715 – 20]: Disclosure Framework - Changes to the Disclosure Requirements for Defined Benefit Plans)*

Description: The FASB is issuing the amendments in this ASU as part of the disclosure framework project. The amendments in this ASU modify the disclosure requirements for employers that sponsor defined benefit pension or other postretirement plans.

The following disclosure requirements are removed from Subtopic 715-20:

1. The amounts in accumulated other comprehensive income expected to be recognized as components of net periodic benefit cost over the next fiscal year.
2. The amount and timing of plan assets expected to be returned to the employer.
3. Related party disclosures about the amount of future annual benefits covered by insurance and annuity contracts and significant transactions between the employer or related parties and the plan.
4. The effects of a one-percentage-point change in assumed health care cost trend rates on the (a) aggregate of the service and interest cost components of net periodic benefit costs and (b) benefit obligation for postretirement health care benefits.

The following disclosure requirements are added to Subtopic 715-20:

1. The weighted-average interest crediting rates for cash balance plans and other plans with promised interest crediting rates.
2. An explanation of the reasons for significant gains and losses related to changes in the benefit obligation for the period.

The amendments in this ASU also clarify the disclosure requirements in paragraph 715-20-50-3, which state that the following information for defined benefit pension plans should be disclosed:

1. The projected benefit obligation (PBO) and fair value of plan assets for plans with PBOs in excess of plan assets.
2. The accumulated benefit obligation (ABO) and fair value of plan assets for plans with ABOs in excess of plan assets.

Required Date of Implementation: The amendments in this ASU are effective for fiscal years ending after December 15, 2020, for public business entities and for fiscal years ending after December 15, 2021, for all other entities. Early adoption is permitted for all entities.

Effect on Consolidated Financial Statements: The Company does not expect the new guidance will have a material impact to its consolidated statements of condition or income.

Standard: Leases (*ASU 2019-1: Leases [Topic 842] Codification Improvements)*

Description: On February 25, 2016, the FASB issued Accounting Standards ASU No. 2016- 02, Leases [Topic 842], to increase transparency and comparability among organizations by recognizing lease assets and lease liabilities on the balance sheet and disclosing essential information about leasing transactions. ASU 2019-1 addresses three Issues: (1) Determining the fair value of the underlying asset by lessors that are not manufacturers or dealers; (2) Presentation on the statement of cash flows for sales-type and direct financing leases; and (3) Transition disclosures related to Topic 250, *Accounting Changes and Error Corrections*.

The amendments in this ASU address Issue 1, described above, and reinstate the exception in Topic 842 for lessors that are not manufacturers or dealers (generally financial institutions and captive finance companies). Specifically, those lessors will use their cost, reflecting any volume or trade discounts that may apply, as the fair value of the underlying asset. However, if significant time lapses between the acquisition of the underlying asset and lease commencement, those lessors will be required to apply the definition of fair value (exit price) in Topic 820.

Topic 840 does not provide guidance on how cash received from leases by lessors from sales-type and direct financing leases should be presented in the cash flow statement. The amendments in this ASU address Issue 2, described above, as to the concerns of lessors within the scope of Topic 942 about where "principal payments received under leases" should be presented. Specifically, lessors that are depository and lending institutions within the scope of Topic 942 will present all "principal payments received under leases" within investing activities in the Statement of Cash Flows.

Required Date of Implementation: The amendments in this ASU amend Topic 842. The effective date of those amendments for public business entities, such as the Company, is for fiscal years beginning after December 15, 2019 and interim periods within those fiscal years.

Effect on Consolidated Financial Statements: The Company does not expect the new guidance will have a material impact to its consolidated statements of condition or income.

Standard: Various Codification Improvements *(ASU 2019-4: Codification Improvements to Topic 326, Financial Instruments—Credit Losses, Topic 815, Derivatives and Hedging, and Topic 825, Financial Instruments)*

Description: Since 2016, the FASB has issued the following Updates related to financial instruments:

1. Accounting Standards Update No. 2016-01, *Financial Instruments— Overall [Subtopic 825-10]: Recognition and Measurement of Financial Assets and Financial Liabilities*;
2. Accounting Standards Update No. 2016-13, *Financial Instruments— Credit Losses [Topic 326]: Measurement of Credit Losses on Financial Instruments;* and
3. Accounting Standards Update No. 2017-12, *Derivatives and Hedging [Topic 815]: Targeted Improvements to Accounting for Hedging Activities.*

The FASB has an ongoing project on its agenda for improving the Codification or correcting its unintended application. The items addressed in that project generally are not expected to have a significant effect on current accounting practice or to create a significant administrative cost for most entities. The amendments in this ASU are similar to those items and are summarized below.

For Codification Improvements specific to ASU 2016-01, the following topics were covered within ASU 2019-04:

- Scope Clarifications
- Held-to-Maturity Debt Securities Fair Value Disclosures
- Applicability of Topic 820 to the Measurement Alternative
- Remeasurement of Equity Securities at Historical Exchange Rates

The amendments to Topic 326 and other Topics in this Update include items related to the amendments in Update 2016-13 discussed at the June 2018 and November 2018 Credit Losses Transition Resource Group ("TRG") meetings. The amendments clarify or address stakeholders' specific issues about certain aspects of the amendments in Update 2016-13 on a number of different topics, including the following:

- Accrued Interest
- Transfers between Classifications or Categories for Loans and Debt Securities
- Recoveries
- Consideration of Prepayments in Determining the Effective Interest Rate
- Consideration of Estimated Costs to Sell When Foreclosure Is Probable
- Vintage Disclosures— Line-of-Credit Arrangements Converted to Term Loans
- Contractual Extensions and Renewals

The ASU also covered a number of issues that related to hedge accounting (ASU-2017-12) including:

- Partial-Term Fair Value Hedges of Interest Rate Risk
- Amortization of Fair Value Hedge Basis Adjustments
- Disclosure of Fair Value Hedge Basis Adjustments

- Consideration of the Hedged Contractually Specified Interest Rate under the Hypothetical Derivative Method
- Scoping for Not-for-Profit Entities
- Hedge Accounting Provisions Applicable to Certain Private Companies and Not-for- Profit Entities
- Application of a First- Payments-Received Cash Flow Hedging Technique to Overall Cash Flows on a Group of Variable Interest Payments
- Transition Guidance

Required Dates of Implementation: This ASU 2019-04 has various implementation dates dependent on a number of factors as it pertains to the above items. The Company has adopted ASU 2016-01 and ASU 2016-01.

Effect on Consolidated Financial Statements: The Company does not expect the new guidance will have a material impact to its consolidated statements of condition or income.

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. 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 months ended March 31, 2019 and March 31, 2018, respectively. 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 March 31,	
(In thousands, except per share data)	2019	2018
Basic Earnings Per Common Share		
Net income available to common shareholders	$ 514	$ 1,004
Weighted average common shares outstanding	4,244	4,119
Basic earnings per common share	$ 0.12	$ 0.24
Diluted Earnings Per Common Share		
Net income available to common shareholders	$ 514	$ 1,004
Weighted average common shares outstanding	4,244	4,119
Effect of assumed exercise of stock options	64	117
Diluted weighted average common shares outstanding	4,308	4,236
Diluted earnings per common share	$ 0.12	$ 0.24

Note 4: Investment Securities

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

	March 31, 2019			
(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	$ 10,075	$ 2	$ (63)	$ 10,014
State and political subdivisions	19,968	26	(152)	19,842
Corporate	15,348	204	(184)	15,368
Asset backed securities	17,638	64	(69)	17,633
Residential mortgage-backed - US agency	28,110	16	(369)	27,757
Collateralized mortgage obligations - US agency	42,984	12	(1,250)	41,746
Collateralized mortgage obligations - Private label	22,898	42	(203)	22,737
Total	157,021	366	(2,290)	155,097
Equity investment securities:				
Common stock - financial services industry	205	-	-	205
Total	205	-	-	205
Total available-for-sale	$ 157,226	$ 366	$ (2,290)	$ 155,302
Held-to-Maturity Portfolio				
Debt investment securities:				
US Treasury, agencies and GSEs	$ 2,990	$ -	$ (19)	$ 2,971
State and political subdivisions	5,048	43	(27)	5,064
Corporate	15,851	178	(132)	15,897
Asset backed securities	1,508	-	(9)	1,499
Residential mortgage-backed - US agency	16,806	350	(11)	17,145
Collateralized mortgage obligations - US agency	18,121	238	(23)	18,336
Collateralized mortgage obligations - Private label	18,537	67	(28)	18,576
Total held-to-maturity	$ 78,861	$ 876	$ (249)	$ 79,488

(In thousands)	December 31, 2018 Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Available-for-Sale Portfolio				
Debt investment securities:				
US Treasury, agencies and GSEs	$ 17,171	$ 18	$ (158)	$ 17,031
State and political subdivisions	23,661	6	(602)	23,065
Corporate	17,389	220	(409)	17,200
Asset backed securities	18,243	13	(137)	18,119
Residential mortgage-backed - US agency	32,409	34	(777)	31,666
Collateralized mortgage obligations - US agency	48,101	31	(1,691)	46,441
Collateralized mortgage obligations - Private label	24,317	17	(398)	23,936
Total	181,291	339	(4,172)	177,458
Equity investment securities:				
Common stock - financial services industry	206	-	-	206
Total	206	-	-	206
Total available-for-sale	$ 181,497	$ 339	$ (4,172)	$ 177,664
Held-to-Maturity Portfolio				
Debt investment securities:				
US Treasury, agencies and GSEs	$ 3,987	$ -	$ (35)	$ 3,952
State and political subdivisions	5,089	22	(84)	5,027
Corporate	9,924	4	(182)	9,746
Asset backed securities	1,509	-	(13)	1,496
Residential mortgage-backed - US agency	11,601	124	(47)	11,678
Collateralized mortgage obligations - US agency	13,972	93	(13)	14,052
Collateralized mortgage obligations - Private label	7,826	17	(25)	7,818
Total held-to-maturity	$ 53,908	$ 260	$ (399)	$ 53,769

The amortized cost and estimated fair value of debt investments at March 31, 2019 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.

(In thousands)	**Available-for-Sale** Amortized Cost	Estimated Fair Value	**Held-to-Maturity** Amortized Cost	Estimated Fair Value
Due in one year or less	$ 5,390	$ 5,362	$ 2,108	$ 2,112
Due after one year through five years	22,720	22,797	11,748	11,793
Due after five years through ten years	17,989	17,874	8,755	8,834
Due after ten years	16,930	16,824	2,786	2,692
Sub-total	63,029	62,857	25,397	25,431
Residential mortgage-backed - US agency	28,110	27,757	16,806	17,145
Collateralized mortgage obligations - US agency	42,984	41,746	18,121	18,336
Collateralized mortgage obligations - Private label	22,898	22,737	18,537	18,576
Totals	$ 157,021	$ 155,097	$ 78,861	$ 79,488

Table of Contents

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:

	March 31, 2019								
	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	-	$ -	$ -	3	$ (63)	$ 7,992	3	$ (63)	$ 7,992
State and political subdivisions	1	(16)	2,992	17	(136)	10,667	18	(152)	13,659
Corporate	2	(7)	1,695	7	(177)	6,000	9	(184)	7,695
Asset backed securities	3	(31)	3,897	4	(38)	5,585	7	(69)	9,482
Residential mortgage-backed - US agency	-	-	-	24	(369)	23,708	24	(369)	23,708
Collateralized mortgage obligations - US agency	4	(2)	3,354	28	(1,248)	36,251	32	(1,250)	39,605
Collateralized mortgage obligations - Private label	1	(12)	1,493	10	(190)	16,058	11	(203)	17,551
Totals	11	$ (68)	$13,431	93	$ (2,221)	$106,261	104	$ (2,290)	$119,692
Held-to-Maturity Portfolio									
US Treasury, agencies and GSE's	-	$ -	$ -	3	$ (19)	$ 2,972	3	$ (19)	$ 2,972
State and political subdivisions	-	-	-	6	(27)	2,328	6	(27)	2,328
Corporate	2	(32)	2,926	3	(100)	3,321	5	(132)	6,247
Asset backed securities	1	(9)	1,500	-	-	-	1	(9)	1,500
Residential mortgage-backed - US agency	1	(8)	2,222	1	(3)	259	2	(11)	2,481
Collateralized mortgage obligations - US agency	4	(23)	4,261	-	-	-	4	(23)	4,261
Collateralized mortgage obligations - Private label	1	(11)	2,000	2	(17)	1,630	3	(28)	3,630
Totals	9	$ (83)	$12,909	15	$ (166)	$ 10,510	24	$ (249)	$ 23,419

	December 31, 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	1	$ (22)	$ 977	2	$ (136)	$12,017	3	$ (158)	$ 12,994
State and political subdivisions	5	(76)	5,213	26	(526)	14,206	31	(602)	19,419
Corporate	10	(137)	8,266	4	(272)	3,374	14	(409)	11,640
Asset backed securities	7	(91)	10,470	2	(46)	3,059	9	(137)	13,529
Residential mortgage-backed - US agency	6	(83)	3,519	21	(694)	24,154	27	(777)	27,673
Collateralized mortgage obligations - US agency	3	(98)	2,792	28	(1,593)	35,765	31	(1,691)	38,557
Collateralized mortgage obligations - Private label	7	(275)	14,011	5	(123)	5,907	12	(398)	19,918
Totals	39	$ (782)	$45,248	88	$ (3,390)	$98,482	127	$ (4,172)	$143,730
Held-to-Maturity Portfolio									
US Treasury, agencies and GSE's	1	$ (8)	$ 982	3	$ (27)	$ 2,970	4	$ (35)	$ 3,952
State and political subdivisions	-	-	-	6	(84)	2,310	6	(84)	2,310
Corporate	4	(41)	3,214	2	(141)	2,507	6	(182)	5,721
Asset backed securities	1	(13)	1,496	-	-	-	1	(13)	1,496
Residential mortgage-backed - US agency	3	(8)	1,447	2	(39)	1,769	5	(47)	3,216
Collateralized mortgage obligations - US agency	4	(13)	3,972	-	-	-	4	(13)	3,972
Collateralized mortgage obligations - Private label	-	-	-	2	(25)	1,874	2	(25)	1,874
Totals	13	$ (83)	$11,111	15	$ (316)	$11,430	28	$ (399)	$ 22,541

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 March 31, 2019 represents OTTI. At March 31, 2019, 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.

- Seventeen state and political subdivision securities, categorized as available-for-sale, with an aggregate amortized historical cost of $10.8 million and an aggregate market value of $10.7 million (unrealized aggregate loss of $136,000, or 1.27%). Each of the securities maintains a credit rating established by one or more nationally-recognized statistical rating organization ("NRSRO") that is well above the level required to be considered minimum investment grade and, therefore, no credit-related OTTI is deemed to be present.

- Seven corporate securities, categorized as available-for-sale, with an aggregate amortized historical cost of $6.2 million and an aggregate market value of $6.0 million (unrealized loss of $177,000, or 2.95%). These securities each maintain credit ratings established by one or more NRSRO above the minimum level required to be considered investment grade and, therefore, no credit-related OTTI is deemed to be present.

- Four privately-issued asset-backed securities, categorized as available-for-sale, with an aggregate amortized historical cost of $5.6 million and an aggregate market value of $5.6 million (unrealized loss of $38,000, or 0.67%). These securities each maintain credit ratings established by one or more NRSRO above the minimum level required to be considered as investment grade and therefore, no credit-related OTTI is deemed to be present.

- Seven privately-issued collateralized mortgage obligation securities, categorized as available-for-sale, with an aggregate amortized historical cost of $12.0 million and an aggregate market value of $11.9 million (unrealized loss of $136,000, or 1.14%). These securities each maintain credit ratings established by one or more NRSRO above the level considered to be minimum investment grade and therefore, no credit-related OTTI is deemed to be present.

- Three privately-issued collateralized mortgage obligation securities, categorized as available-for-sale, with an aggregate amortized historical cost of $4.2 million and an aggregate market value of $4.2 million (unrealized loss of $54,000, or 1.29%). These securities were not rated at the time of their issuance by any NRSRO but each security remains significantly collateralized through subordination. Therefore, no credit-related OTTI is deemed to be present.

- Six state and political subdivision securities, categorized as held-to-maturity, with an aggregate amortized historical cost of $2.4 million and an aggregate market value of $2.3 million (unrealized aggregate loss of

$27,000, or 1.17%). Three of these securities with an aggregate book value of $2.0 million each maintain a credit rating established by one or more NRSRO that is well above the minimum level required to be considered investment grade and, therefore, no credit-related OTTI is deemed to be present. The remaining three securities have an aggregate book value of $307,000 and are issuances of a local community school district well known to the management of the Company. The aggregate unrealized loss for these securities totals approximately $1,000 and no OTTI is deemed present.

- Three corporate securities, categorized as held-to-maturity, with an aggregate amortized historical cost of $3.4 million and an aggregate market value of $3.3 million (unrealized aggregate loss of $100,000, or 3.01%). This security maintains a credit rating established by one or more NRSRO above the minimum level required to be considered investment grade and, therefore, no credit-related OTTI is deemed to be present.

- One privately-issued collateralized mortgage obligation security, categorized as held-to-maturity, with an amortized historical cost of $947,000 and a market value of $937,000 (unrealized loss of $11,000, or 1.19%). The security maintains a credit rating established by one or more NRSRO that is well above the minimum level required to be considered investment grade and, therefore, no credit-related OTTI is deemed to be present. Therefore, no credit-related OTTI is deemed to be present.

- One privately-issued collateralized mortgage obligation security, categorized as held-to-maturity, with an amortized historical cost of $699,000 and a market value of $693,000 (unrealized loss of $6,000, or 0.91%). The security was not rated at its issuance by any NRSRO but remains significantly collateralized through subordination and, therefore, no credit-related OTTI is deemed to be present.

All other securities with market values less than their amortized historical costs 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 March 31, 2019 or December 31, 2018.

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

	For the three months ended March 31,	
(In thousands)	2019	2018
Realized gains on investments	$ 222	$ 27
Realized losses on investments	(143)	(134)
	$ 79	$ (107)
Gains on equity securities	$ 41	$ 13
	$ 41	$ 13

As of March 31, 2019 and December 31, 2018, securities with a fair value of $100.0 million and $69.8 million, respectively, were pledged to collateralize certain municipal deposit relationships. As of the same dates, securities with a fair value of $16.4 million and $19.5 million were pledged against certain borrowing arrangements.

Management has reviewed its mortgage-backed securities portfolios and determined that, to the best of its knowledge, little 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	
	For the three months ended March 31,			
(In thousands)	2019	2018	2019	2018
Service cost	$ -	$ -	$ -	$ -
Interest cost	124	118	5	5
Expected return on plan assets	(234)	(259)	-	-
Amortization of prior service credits	-	-	(1)	(1)
Amortization of net losses	82	41	3	3
Net periodic benefit plan (benefit) cost	$ (28)	$ (100)	$ 7	$ 7

The Company will evaluate the need for further contributions to the defined benefit pension plan during 2019. The prepaid pension asset is recorded in other assets on the statement of condition as of March 31, 2019 and December 31, 2018.

Table of Contents

Note 6: Loans

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

(In thousands)	March 31, 2019	December 31, 2018
Residential mortgage loans:		
1-4 family first-lien residential mortgages	$ 237,917	$ 232,523
Construction	3,855	7,121
Total residential mortgage loans	241,772	239,644
Commercial loans:		
Real estate	208,388	212,314
Lines of credit	55,238	44,235
Other commercial and industrial	67,542	63,359
Tax exempt loans	9,256	9,320
Total commercial loans	340,424	329,228
Consumer loans:		
Home equity and junior liens	26,212	26,109
Other consumer	49,272	25,424
Total consumer loans	75,484	51,533
Total loans	657,680	620,405
Net deferred loan fees	(90)	(135)
Less allowance for loan losses	(7,284)	(7,306)
Loans receivable, net	$ 650,306	$ 612,964

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, $10.2 million, and $24.6 million of loans originated by an unrelated financial institution, located outside of the Bank's market area, in January 2017, April 2017, and March 2019, respectively. The acquired loan pools represented a 90% participating interest in a total of 2,283 loans secured by liens on automobiles with maturities ranging primarily from two to six years. These loans will be serviced through their respective maturities by the originating financial institution. At March 31, 2019 and December 31, 2018, there were 1,902 loans outstanding with a remaining outstanding carrying value of $35.8 million and 909 loans outstanding with a remaining outstanding carrying value of $13.3 million, respectively. Since the acquisition of these loan pools, a total of 22 loans had cumulative net charge-offs totaling $156,000 with $37,000 in net charge-offs for the three months ended March 31, 2019.

As of March 31, 2019 and December 31, 2018, residential mortgage loans with a carrying value of $165.8 million and $154.9 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 2018 Annual Report on Form 10-K filed with the Securities and Exchange Commission on March 27, 2019 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 March 31, 2019				
(In thousands)	Pass	Special Mention	Substandard	Doubtful	Total
Residential mortgage loans:					
1-4 family first-lien residential mortgages	$ 233,985	$ 1,241	$ 1,351	$ 1,340	$ 237,917
Construction	3,855	-	-	-	3,855
Total residential mortgage loans	237,840	1,241	1,351	1,340	241,772
Commercial loans:					
Real estate	198,270	8,629	1,184	305	208,388
Lines of credit	53,491	1,389	336	22	55,238
Other commercial and industrial	63,298	3,234	897	113	67,542
Tax exempt loans	9,256	-	-	-	9,256
Total commercial loans	324,315	13,252	2,417	440	340,424
Consumer loans:					
Home equity and junior liens	25,737	171	220	84	26,212
Other consumer	48,987	148	137	-	49,272
Total consumer loans	74,724	319	357	84	75,484
Total loans	$ 636,879	$ 14,812	$ 4,125	$ 1,864	$ 657,680

	As of December 31, 2018				
(In thousands)	Pass	Special Mention	Substandard	Doubtful	Total
Residential mortgage loans:					
1-4 family first-lien residential mortgages	$ 228,563	$ 999	$ 1,190	$ 1,771	$ 232,523
Construction	7,121	-	-	-	7,121
Total residential mortgage loans	235,684	999	1,190	1,771	239,644
Commercial loans:					
Real estate	201,997	8,299	1,947	71	212,314
Lines of credit	42,489	1,491	233	22	44,235
Other commercial and industrial	59,344	3,268	612	135	63,359
Tax exempt loans	9,320	-	-	-	9,320
Total commercial loans	313,150	13,058	2,792	228	329,228
Consumer loans:					
Home equity and junior liens	25,706	144	173	86	26,109
Other consumer	25,294	95	35	-	25,424
Total consumer loans	51,000	239	208	86	51,533
Total loans	$ 599,834	$ 14,296	$ 4,190	$ 2,085	$ 620,405

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 March 31, 2019 and December 31, 2018, are detailed in the following tables:

	As of March 31, 2019					
(In thousands)	30-59 Days Past Due	60-89 Days Past Due	90 Days and Over	Total Past Due	Current	Total Loans Receivable
Residential mortgage loans:						
1-4 family first-lien residential mortgages	$ 1,204	$ 481	$ 1,197	$ 2,882	$ 235,035	$ 237,917
Construction	-	-	-	-	3,855	3,855
Total residential mortgage loans	1,204	481	1,197	2,882	238,890	241,772
Commercial loans:						
Real estate	5,028	964	828	6,820	201,568	208,388
Lines of credit	3,724	175	117	4,016	51,222	55,238
Other commercial and industrial	2,405	449	925	3,779	63,763	67,542
Tax exempt loans	-	-	-	-	9,256	9,256
Total commercial loans	11,157	1,588	1,870	14,615	325,809	340,424
Consumer loans:						
Home equity and junior liens	89	63	36	188	26,024	26,212
Other consumer	138	125	118	381	48,891	49,272
Total consumer loans	227	188	154	569	74,915	75,484
Total loans	$ 12,588	$ 2,257	$ 3,221	$ 18,066	$ 639,614	$ 657,680

	As of December 31, 2018					
(In thousands)	30-59 Days Past Due	60-89 Days Past Due	90 Days and Over	Total Past Due	Current	Total Loans Receivable
Residential mortgage loans:						
1-4 family first-lien residential mortgages	$ 1,507	$ 505	$ 1,176	$ 3,188	$ 229,335	$ 232,523
Construction	-	-	-	-	7,121	7,121
Total residential mortgage loans	1,507	505	1,176	3,188	236,456	239,644
Commercial loans:						
Real estate	4,261	364	323	4,948	207,366	212,314
Lines of credit	1,033	111	22	1,166	43,069	44,235
Other commercial and industrial	814	44	387	1,245	62,114	63,359
Tax exempt loans	-	-	-	-	9,320	9,320
Total commercial loans	6,108	519	732	7,359	321,869	329,228
Consumer loans:						
Home equity and junior liens	247	6	35	288	25,821	26,109
Other consumer	226	65	107	398	25,026	25,424
Total consumer loans	473	71	142	686	50,847	51,533
Total loans	$ 8,088	$ 1,095	$ 2,050	$ 11,233	$ 609,172	$ 620,405

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

(In thousands)	March 31, 2019	December 31, 2018
Residential mortgage loans:		
1-4 family first-lien residential mortgages	$ 1,273	$ 1,176
	1,273	1,176
Commercial loans:		
Real estate	917	415
Lines of credit	117	28
Other commercial and industrial	924	387
	1,958	830
Consumer loans:		
Home equity and junior liens	36	35
Other consumer	118	107
	154	142
Total nonaccrual loans	$ 3,385	$ 2,148

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 March 31, 2019.

The table below details loans that have been modified as TDRs for the three months ended March 31, 2018.

	For the three months ended March 31, 2018			
(In thousands)	Number of loans	Pre-modification outstanding recorded investment	Post-modification outstanding recorded investment	Additional provision for loan losses
Commercial real estate loans	1	$ 300	$ 300	$ -

The TDR evaluated for impairment for the three months ended March 31, 2018, had 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 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 March 31, 2019, which had subsequently defaulted during the three months ended March 31, 2019.

The Company had no loans that had been modified as TDRs during the twelve months prior to March 31, 2018, which had subsequently defaulted during the three months ended March 31, 2018.

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 tables summarize impaired loan information by portfolio class at the indicated dates:

	March 31, 2019			December 31, 2018		
(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	$ 893	$ 897	$ -	$ 1,221	$ 1,226	$ -
Commercial real estate	2,379	2,442	-	2,387	2,448	-
Commercial lines of credit	226	226	-	228	228	-
Other commercial and industrial	417	425	-	451	452	-
Other consumer	58	58	-	-	-	-
With an allowance recorded:						
1-4 family first-lien residential mortgages	529	529	104	606	606	108
Commercial real estate	484	484	98	486	486	100
Commercial lines of credit	92	92	92	28	28	28
Other commercial and industrial	635	635	464	373	373	255
Home equity and junior liens	207	207	139	207	207	140
Other consumer	43	43	9	-	-	-
Total:						
1-4 family first-lien residential mortgages	1,422	1,426	104	1,827	1,832	108
Commercial real estate	2,863	2,926	98	2,873	2,934	100
Commercial lines of credit	318	318	92	256	256	28
Other commercial and industrial	1,052	1,060	464	824	825	255
Home equity and junior liens	207	207	139	207	207	140
Other consumer	101	101	9	-	-	-
Totals	$ 5,963	$ 6,038	$ 906	$ 5,987	$ 6,054	$ 631

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

	For the three months ended March 31,	
(In thousands)	2019	2018
1-4 family first-lien residential mortgages	$ 1,625	$ 1,853
Commercial real estate	2,868	5,456
Commercial lines of credit	287	545
Other commercial and industrial	938	1,055
Home equity and junior liens	207	250
Other consumer	51	-
Total	$ 5,976	$ 9,159

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

	For the three months ended March 31,	
(In thousands)	2019	2018
1-4 family first-lien residential mortgages	$ 12	$ 18
Commercial real estate	28	48
Commercial lines of credit	4	11
Other commercial and industrial	14	6
Home equity and junior liens	3	3
Total	$ 61	$ 86

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.

(In thousands)	March 31, 2019 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	$ 766	$ -	$ 3,578	$ 730	$ 1,285
Charge-offs	-	-	-	(107)	(1)
Recoveries	-	-	-	-	-
Provisions (credits)	(44)	-	(208)	179	276
Ending balance	$ 722	$ -	$ 3,370	$ 802	$ 1,560
Ending balance: related to loans individually evaluated for impairment	104	-	98	92	464
Ending balance: related to loans collectively evaluated for impairment	$ 618	$ -	$ 3,272	$ 710	$ 1,096
Loans receivables:					
Ending balance	$ 237,917	$ 3,855	$ 208,388	$ 55,238	$ 67,542
Ending balance: individually evaluated for impairment	1,422	-	2,863	318	1,052
Ending balance: collectively evaluated for impairment	$ 236,495	$ 3,855	$ 205,525	$ 54,920	$ 66,490

	Tax exempt	Home equity and junior liens	Other Consumer	Unallocated	Total
Allowance for loan losses:					
Beginning Balance	$ 1	$ 409	$ 385	$ 152	$ 7,306
Charge-offs	-	-	(67)	-	(175)
Recoveries	-	-	9	-	9
Provisions (credits)	-	21	72	(152)	144
Ending balance	$ 1	$ 430	$ 399	$ -	$ 7,284
Ending balance: related to loans individually evaluated for impairment	-	139	9	-	906
Ending balance: related to loans collectively evaluated for impairment	$ 1	$ 291	$ 390	$ -	$ 6,378
Loans receivables:					
Ending balance	$ 9,256	$ 26,212	$ 49,272		$ 657,680
Ending balance: individually evaluated for impairment	-	207	101		5,963
Ending balance: collectively evaluated for impairment	$ 9,256	$ 26,005	$ 49,171		$ 651,717

Table of Contents

(In thousands)	March 31, 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	(118)	-	-	-	(124)
Recoveries	21	-	-	-	-
Provisions (credits)	(17)	-	306	(16)	219
Ending balance	$ 751	$ -	$ 3,895	$ 719	$ 1,309
Ending balance: related to loans individually evaluated for impairment	111	-	412	40	276
Ending balance: related to loans collectively evaluated for impairment	$ 640	$ -	$ 3,483	$ 679	$ 1,033
Loans receivables:					
Ending balance	$ 219,059	$ 5,559	$ 206,951	$ 52,482	$ 60,385
Ending balance: individually evaluated for impairment	1,847	-	5,411	542	1,060
Ending balance: collectively evaluated for impairment	$ 217,212	$ 5,559	$ 201,540	$ 51,940	$ 59,325

	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)	(63)	-	(322)
Recoveries	-	-	13	-	34
Provisions (credits)	-	10	102	9	613
Ending balance	$ 1	$ 507	$ 260	$ 9	$ 7,451
Ending balance: related to loans individually evaluated for impairment	-	141	-	-	980
Ending balance: related to loans collectively evaluated for impairment	$ 1	$ 366	$ 260	$ 9	$ 6,471
Loans receivables:					
Ending balance	$ 10,233	$ 26,116	$ 27,601		$ 608,386
Ending balance: individually evaluated for impairment	-	209	-		9,069
Ending balance: collectively evaluated for impairment	$ 10,233	$ 25,907	$ 27,601		$ 599,317

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:

(In thousands)	March 31, 2019 1-4 family first-lien residential mortgage	Residential construction mortgage	Commercial real estate	Commercial lines of credit	Other commercial and industrial
Specifically reserved	$ 104	$ -	$ 98	$ 92	$ 464
Historical loss rate	65	-	151	18	26
Qualitative factors	553	-	3,121	692	1,070
Total	$ 722	$ -	$ 3,370	$ 802	$ 1,560

	Tax exempt	Home equity and junior liens	Other consumer	Unallocated	Total
Specifically reserved	$ -	$ 139	$ 9	$ -	$ 906
Historical loss rate	-	13	149	-	422
Qualitative factors	1	278	241	-	5,956
Total	$ 1	$ 430	$ 399	$ -	$ 7,284

(In thousands)	March 31, 2018 1-4 family first-lien residential mortgage	Residential construction mortgage	Commercial real estate	Commercial lines of credit	Other commercial and industrial
Specifically reserved	$ 111	$ -	$ 412	$ 40	$ 276
Historical loss rate	83	-	88	29	-
Qualitative factors	557	-	3,395	650	1,033
Total	$ 751	$ -	$ 3,895	$ 719	$ 1,309

	Tax exempt	Home equity and junior liens	Other consumer	Unallocated	Total
Specifically reserved	$ -	$ 141	$ -	$ -	$ 980
Historical loss rate	-	34	96	-	330
Qualitative factors	1	332	164	-	6,132
Other	-	-	-	9	9
Total	$ 1	$ 507	$ 260	$ 9	$ 7,451

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	March 31, 2019	Number of properties	December 31, 2018
Foreclosed residential real estate	3	$ 535	2	$ 73

At March 31, 2019 and December 31, 2018, the Company reported $575,000 and $951,000, respectively, 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 $2.1 million of standby letters of credit as of March 31, 2019. 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.

The Company holds two corporate investment securities, categorized as Level 2, with an aggregate amortized historical cost of $4.8 million and an aggregate fair market value of $5.0 million. These securities have valuations that are determined using published net asset values (NAV) derived by analyses of the securities' underlying assets. These securities are comprised primarily of broadly-diversified real estate and adjustable-rate senior secured business loans and are traded in secondary markets on an infrequent basis. While these securities are redeemable at least annually through tender offers made by their respective issuers, the liquidation value of the securities may be below their stated NAVs and also subject to restrictions as to the amount of securities that can be redeemed at any single scheduled redemption. The

Company anticipates that these securities will be redeemed by their respective issuers on indeterminate future dates as a consequence of the ultimate liquidation strategies employed by the management of these investments.

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:

	March 31, 2019			
(In thousands)	Level 1	Level 2	Level 3	Total Fair Value
Available-for-Sale Portfolio				
Debt investment securities:				
US Treasury, agencies and GSEs	$ -	$ 10,014	$ -	$ 10,014
State and political subdivisions	-	19,842	-	19,842
Corporate	-	10,366	-	10,366
Asset backed securities	-	17,633	-	17,633
Residential mortgage-backed - US agency	-	27,757	-	27,757
Collateralized mortgage obligations - US agency	-	41,746	-	41,746
Collateralized mortgage obligations - Private label	-	22,737	-	22,737
Total		150,095		150,095
Corporate measured at NAV	-	-	-	5,002
Total available-for-sale securities	$ -	$ -	$ -	$ 155,097
Marketable equity securities	$ -	$ 494	$ -	$ 494

(In thousands)	December 31, 2018 Level 1		Level 2		Level 3		Total Fair Value
Available-for-Sale Portfolio							
Debt investment securities:							
US Treasury, agencies and GSEs	$	-	$	17,031	$	-	$ 17,031
State and political subdivisions		-		23,065		-	23,065
Corporate		-		12,141		-	12,141
Asset backed securities		-		18,119		-	18,119
Residential mortgage-backed - US agency		-		31,666		-	31,666
Collateralized mortgage obligations - US agency		-		46,441		-	46,441
Collateralized mortgage obligations - Private label		-		23,936		-	23,936
Total				172,399			172,399
Corporate measured at NAV		-		-		-	5,059
Total available-for-sale securities	$	-	$	-	$	-	$ 177,458
Marketable equity securities	$	-	$	453	$	-	$ 453

Pathfinder Bank had the following assets measured at fair value on a nonrecurring basis as of March 31, 2019 and December 31, 2018:

(In thousands)	March 31, 2019 Level 1	Level 2	Level 3	Total Fair Value
Impaired loans	$ -	$ -	$ 212	$ 212
Foreclosed real estate	$ -	$ -	$ 479	$ 479

(In thousands)	December 31, 2018 Level 1	Level 2	Level 3	Total Fair Value
Impaired loans	$ -	$ -	$ 1,098	$ 1,098
Foreclosed real estate	$ -	$ -	$ 1,173	$ 1,173

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 March 31, 2019			
Impaired loans	Appraisal of collateral	Appraisal Adjustments	5% - 10% (5%)
	(Sales Approach)	Costs to Sell	5% - 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, 2018			
Impaired loans	Appraisal of collateral	Appraisal Adjustments	5% - 15% (6%)
	(Sales Approach)	Costs to Sell	5% - 13% (11%)
	Discounted Cash Flow		
Foreclosed real estate	Appraisal of collateral	Appraisal Adjustments	15% - 15% (15%)
	(Sales Approach)	Costs to Sell	6% - 8% (7%)

There have been no transfers of assets into or out of any fair value measurement level during the three months ended March 31, 2019.

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.

The Company holds two corporate investment securities, categorized as Level 2, with an aggregate amortized historical cost of $4.8 million and an aggregate fair market value of $5.0 million. These securities have valuations that are determined using published NAV derived by analyses of the securities' underlying assets. These securities are comprised primarily of broadly-diversified real estate and adjustable-rate senior secured business loans and are traded in secondary markets on an infrequent basis. While these securities are redeemable at least annually through tender offers made by their respective issuers, the liquidation value of the securities may be below their stated NAVs and also subject to restrictions as to the amount of securities that can be redeemed at any single scheduled redemption. The Company anticipates that these securities will be redeemed by their respective issuers on indeterminate future dates as a consequence of the ultimate liquidation strategies employed by the management of these investments.

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:

		March 31, 2019		December 31, 2018	
(In thousands)	Fair Value Hierarchy	Carrying Amounts	Estimated Fair Values	Carrying Amounts	Estimated Fair Values
Financial assets:					
Cash and cash equivalents	1	$ 24,816	$ 24,816	$ 26,316	$ 26,316
Investment securities - available-for-sale	2	150,095	150,095	172,399	172,399
Investment securities - available-for-sale	NAV	5,002	5,002	5,059	5,059
Investment securities - marketable equity	2	494	494	453	453
Investment securities - held-to-maturity	2	78,861	79,488	53,908	53,769
Federal Home Loan Bank stock	2	4,088	4,088	5,937	5,937
Net loans	3	650,306	643,776	612,964	601,789
Accrued interest receivable	1	3,364	3,364	3,068	3,068
Financial liabilities:					
Demand Deposits, Savings, NOW and MMDA	1	$ 451,234	$ 451,234	$ 450,267	$ 450,267
Time Deposits	2	354,294	354,230	276,793	275,727
Borrowings	2	77,434	77,582	118,534	118,379
Subordinated loans	2	15,102	14,609	15,094	14,485
Accrued interest payable	1	471	471	304	304

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.

The Company did not have any hedging activities for the three months ended March 31, 2019 or 2018, but expects to utilize hedging in the future to improve the management of its risk profiles.

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.

(In thousands)	Retirement Plans	Unrealized Gains and Losses on Available-for-Sale Securities	Unrealized Loss on Securities Transferred to Held-to-Maturity	Total
	For the three months ended March 31, 2019			
Beginning balance	$ (3,152)	$ (2,832)	$ (58)	$ (6,042)
Other comprehensive income before reclassifications	-	1,572	5	1,577
Amounts reclassified from AOCI	65	(62)	-	3
Ending balance	$ (3,087)	$ (1,322)	$ (53)	$ (4,462)

(In thousands)	Retirement Plans	Unrealized Gains and Losses on Available-for-Sale Securities	Unrealized Loss on Securities Transferred to Held-to-Maturity	Total
	For the three months ended March 31, 2018			
Beginning balance	$ (2,220)	$ (1,558)	$ (430)	$ (4,208)
Other comprehensive income before reclassifications	-	(878)	16	(862)
Amounts reclassified from AOCI	32	79	-	111
Cumulative effect of change in measurement of equity securities (1)	-	(53)	-	(53)
Ending balance	$ (2,188)	$ (2,410)	$ (414)	$ (5,012)

(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.

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		
Details about AOCI (1) components	March 31, 2019	March 31, 2018	Affected Line Item in the Statement of Income
Retirement plan items			
Retirement plan net losses recognized in plan expenses (2)	$ (84)	$ (43)	Salaries and employee benefits
Tax effect	23	11	Provision for income taxes
	$ (61)	$ (32)	Net Income
Available-for-sale securities			
Realized gain (loss) on sale of securities	$ 79	$ (107)	Net gains (losses) on sales and redemptions of investment securities
Tax effect	(21)	28	Provision for income taxes
	$ 58	$ (79)	Net Income

(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 March 31, 2019 and 2018, the Company recognized credit cards reward program expense as a reduction of noninterest income in the amounts of $22,000 and $15,000, respectively.

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

(In thousands)	For the three months ended March 31, 2019	2018
Service fees		
Insufficient funds fees	$ 208	$ 200
Deposit related fees	52	52
ATM fees	22	22
Total service fees	282	274
Fee Income		
Insurance commissions	235	229
Investment services revenue	48	66
ATM fees surcharge	46	46
Banking house rents collected	34	30
Total fee income	363	371
Card income		
Debit card interchange fees	144	143
Merchant card fees	16	13
Total card income	160	156
Mortgage fee income and realized gain on sale of loans and foreclosed real estate		
Loan servicing fees	27	41
Net (losses) gains on sales of loans and foreclosed real estate	(8)	3
Total mortgage fee income and realized gain on sale of loans and foreclosed real estate	19	44
Total	824	845
Earnings and gain on bank owned life insurance	121	73
Net gains (losses) on sales and redemptions of investment securities	79	(107)
Gains on equity securities	41	13
Other miscellaneous income	28	71
Total noninterest income	$ 1,093	$ 895

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 at 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 and securities sales, ATM surcharge fees, and banking house rents collected. The Company earns investment advisory fee income by providing investment

management services to customers under investment management contracts. As the direction of investment management accounts is provided over time, the performance obligation to investment management 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, sales of government guarantees portions of SBA loans, and sales of foreclosed real estate, and is earned as the transaction occurs.

Note 14: Leases

The Company has operating leases for certain banking offices and land under noncancelable agreements. Our leases have remaining lease terms that vary from less than one year up to 31 years, some of which include options to extend the leases for various renewal periods. All options to renew are included in the current lease term when we believe it is reasonably certain that the renewal options will be exercised.

The components of the lease expense are as follows:

	For the three months ended March 31,	
(In thousands)	2019	
Operating lease cost	$	59

Supplemental cash flow information related to leases was as follows:

	For the three months ended March 31,	
(In thousands)	2019	
Cash paid for amount included in the measurement of lease liabilities:		
Operating cash flows from operating leases	$	48

Supplemental balance sheet information related to leases was as follows:

	For the three months ended March 31,	
(In thousands, except lease term and discount rate)	2019	
Operating Leases:		
Operating lease right-of-use assets	$	2,462
Operating lease liabilities	$	2,711
Weighted Average Remaining Lease Term:		
Operating Leases		20.16 years
Weighted Average Discount Rate:		
Operating Leases		3.71%

Maturities of lease liabilities were as follows:

Year End March 31, (In thousands)		
2020		111
2021		107
2022		103
2023		111
2024		120
Thereafter		2,159
Total minimum lease payments	$	2,711

The Company owns certain properties that it leases to unaffiliated third parties at market rates. Lease rental income was $34,000 and $30,000 for the twelve months ended March 31, 2019 and 2018, respectively. All lease agreements are accounted for as operating leases. The Company has no unamortized initial direct costs related to the establishment of these lease agreements at January 1, 2019.

Note 15: Subsequent Events

On May 8, 2019, the Company entered into a Securities Purchase Agreement (the "Securities Purchase Agreement") with Castle Creek Capital Partners VII, L.P. ("Castle Creek"), pursuant to which the Company sold: (i) 37,700 shares of the Company's common stock, par value $0.01 per share, at a purchase price of $14.25 per share (the "Common Stock"); (ii) 1,155,283 shares of a new series of preferred stock, Series B convertible perpetual preferred stock, par value $0.01 per share, at a purchase price of $14.25 per share (the "Series B Preferred Stock"); and (iii) a warrant, with an approximate fair value of $373,000, to purchase 125,000 shares of Common Stock at an exercise price equal to $14.25 per share (the "Warrant"), in a private placement transaction (the "Private Placement") for gross proceeds of approximately $17.0 million. The Securities Purchase Agreement contains representations, warranties, and covenants of the Company and Castle Creek.

The Company also entered into subscription agreements dated as of May 8, 2019 (the "Subscription Agreements") with certain directors and executive officers of the Company as well as other accredited investors. Pursuant to the Subscription Agreements, the investors purchased an aggregate of 269,277 shares of Common Stock at $14.25 per share for gross proceeds of approximately $3.8 million, before payment of placement fees and related costs and expenses. The Subscription Agreements contain representations, warranties, and covenants of the purchasers and the Company that are customary in private placement transactions.

In total, therefore, the Company issued 306,977 shares of Common Stock, 1,155,283 shares of Series B Preferred Stock and the Warrant at the conclusion of the Private Placement. The transaction raised $20.8 million in gross proceeds and it is anticipated that the final proceeds of the Private Placement, after all issuance expenses, including placement fees and all other issuance/due diligence costs of approximately $927,000 and $300,000, respectively, will be approximately $19.6 million. The Company intends to use the net proceeds of the Private Placement to strengthen the Company's current balance sheet, improve the regulatory capital of the Bank, support organic growth opportunities and for general corporate purposes.

On May 8, 2019, the Company filed Articles Supplementary with the Maryland Department of Assessments and Taxation to issue 1,155,283 shares of Series B Preferred Stock to Castle Creek. Each share of the Series B Preferred Stock will be convertible on a one for one basis into either (i) Common Stock under certain circumstances or (ii) non-voting common stock, par value $0.01 per share (which will also be convertible into Common Stock), subject to approval of the creation of such class of non-voting common stock by the Company's stockholders.

Pursuant to Nasdaq rules, Castle Creek may not convert the Series B Preferred Stock or, in the future the non-voting common stock into Common Stock, or exercise the Warrant if doing so would cause Castle Creek when combined with the purchases of certain directors and executive officers of the Company as well as other accredited investors in the Private Placement to own more than 19.99% of the Common Stock outstanding immediately prior to the execution of the

Securities Purchase Agreement (the "Exchange Cap"). The Company must request stockholder approval to eliminate the Exchange Cap no later than at the 2021 annual meeting of Company shareholders. In addition, Castle Creek will need the approval or non-objection of the Board of Governors of the Federal Reserve System and the New York State Department of Financial Services if it seeks to increase its ownership of shares of Common Stock in excess of 9.9% of the outstanding shares of Common Stock.

Holders of the Series B Preferred Stock will be entitled to receive dividends if declared by the Company's board of directors, in the same per share amount as paid on the Common Stock. No dividends would be payable on the Common Stock unless a dividend identical to that paid on the Common Stock is payable at the same time on the Series B Preferred Stock. The Series B Preferred Stock will rank, as to payments of dividends and distribution of assets upon dissolution, liquidation or winding up of the Company, *pari passu* with the Common Stock pro rata. Holders of Series B Preferred Stock will have no voting rights except as may be required by law. The Series B Preferred Stock will not be redeemable by either the Company or by the holder.

As discussed above, pursuant to the Securities Purchase Agreement, on May 8, 2019, the Company issued a Warrant to Castle Creek to purchase 125,000 shares of Common Stock at an exercise price equal to $14.25 per share. At the same time, the Company entered into a Warrant Agreement with Castle Creek, to, among other things, authorize and establish the terms of the Warrant. The Warrant is exercisable at any time after May 8, 2019, and from time to time, in whole or in part, until May 8, 2026. However, the exercise of such Warrant remains subject to certain contractual provisions and regulatory approval if Castle Creek's ownership of Common Stock would exceed 9.9%. At May 8, 2019, Castle Creek owned 9.9% of the Company's common stock.

Pursuant to the terms of the Securities Purchase Agreement, Castle Creek will be entitled to have one representative appointed to the Company's board of directors for so long as Castle Creek, together with its respective affiliates, owns, in the aggregate, 4.9% or more of all of the outstanding shares of the Company's Common Stock. If Castle Creek, together with its respective affiliates, owns, in the aggregate, 4.9% or more of all of the outstanding shares of the Company's Common Stock and does not have a board representative appointed to the Company's board of directors, the Company will invite a person designated by Castle Creek to attend meetings of the Company's Board of Directors as an observer.

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 March 31, 2019, the Company and subsidiaries had total assets of $975.1 million, total liabilities of $908.6 million and shareholders' equity of $66.2 million plus noncontrolling interest of $258,000, which represents the 49% of FitzGibbons not owned by the Company.

The following discussion reviews the Company's financial condition at March 31, 2019 and the results of operations for the three month periods ended March 31, 2019 and 2018. Operating results for the three months ended March 31, 2019 are not necessarily indicative of the results that may be expected for the year ending December 31, 2019.

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 2018 Annual Report on Form 10-K filed with the Securities and Exchange Commission on March 27, 2019 ("the consolidated annual financial statements") as of December 31, 2018 and 2017 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 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. In the quarter ended March 31, 2019, the Company established, through a charge to earnings, a valuation allowance in the amount of $136,000 in order to reserve against deferred tax assets related to New York State income taxes. Effective in January 2018, the Company adopted a modification methodology, made available following changes to the New York State tax code, effecting how the Company’s state income tax liability is computed. Under this adopted methodology it is unlikely that the Company will pay income taxes to New York in future periods and it is therefore probable that the Company’s deferred tax assets related to New York State income taxes are unlikely to further reduce the Company’s state income tax rate in the future. Accordingly, a valuation allowance against the value of those deferred tax assets was established to reduce the net deferred tax asset related to New York income taxes to $-0- at March 31, 2019. At March 31, 2019, the Company had a valuation allowance of $33,000 established against the future projected benefits of deferred tax assets related to New York State income tax obligations. There were no valuation allowances against deferred tax assets at December 31, 2018. The Company’s effective tax rate typically differs from the 21% federal statutory tax rate due primarily to tax-exempt income from specific types of investment securities and loans, bank owned life insurance, and, to a much lesser degree, the utilization of low income housing tax credits. These factors, which typically lower the effective tax rate for the Company, were offset by the establishment of the valuation allowance described above in the quarter ended March 31, 2019, resulting in an effective tax rate of 33.8% for that period.

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 other-than-temporary impairment (“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 nationally recognized statistical rating organization (“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 available-for-sale and marketable equity investment securities, intangible assets, foreclosed real estate, and the value of loan collateral when valuing 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.

Management performs an annual evaluation of our goodwill for possible impairment at each of our reporting units. Based on the results of the December 31, 2018 evaluation, management has determined that the carrying value of goodwill was not impaired as of that date. The evaluation approach is described in Note 10 of the consolidated annual financial statements. Further information on the estimation of fair values can be found in Note 22 to the consolidated annual financial statements.

Recent Events

On March 29, 2019, the Company announced that its Board of Directors declared a quarterly cash dividend of $0.06 per common share. The dividend is payable on May 10, 2019 to shareholders of record on April 18, 2019.

On May 8, 2019, the Company entered into a Securities Purchase Agreement (the “Securities Purchase Agreement”) with Castle Creek Capital Partners VII, L.P. (“Castle Creek”), pursuant to which the Company sold: (i) 37,700 shares of the Company’s common stock, par value $0.01 per share, at a purchase price of $14.25 per share (the “Common Stock”); (ii) 1,155,283 shares of a new series of preferred stock, Series B convertible perpetual preferred stock, par value $0.01 per share, at a purchase price of $14.25 per share (the “Series B Preferred Stock”); and (iii) a warrant, with an approximate fair value of $373,000, to purchase 125,000 shares of Common Stock at an exercise price equal to $14.25 per share (the “Warrant”), in a private placement transaction (the “Private Placement”) for gross proceeds of approximately $17.0 million. The Securities Purchase Agreement contains representations, warranties, and covenants of the Company and Castle Creek.

The Company also entered into subscription agreements dated as of May 8, 2019 (the “Subscription Agreements”) with certain directors and executive officers of the Company as well as other accredited investors. Pursuant to the Subscription Agreements, the investors purchased an aggregate of 269,277 shares of Common Stock at $14.25 per share for gross proceeds of approximately $3.8 million, before payment of placement fees and related costs and expenses. The Subscription Agreements contain representations, warranties, and covenants of the purchasers and the Company that are customary in private placement transactions.

In total, therefore, the Company issued 306,977 shares of Common Stock, 1,155,283 shares of Series B Preferred Stock and the Warrant at the conclusion of the Private Placement offering period. The transaction raised $20.8 million in gross proceeds and it is anticipated that the final proceeds of the Private Placement, after all issuance expenses, including placement fees and all other issuance/due diligence costs of approximately $927,000 and $300,000, respectively, will be approximately $19.6 million. The Company intends to use the net proceeds of the Private Placement to strengthen the Company’s current balance sheet, improve the regulatory capital of the Bank, support organic growth opportunities and for general corporate purposes.

On May 8, 2019, the Company filed Articles Supplementary with the Maryland Department of Assessments and Taxation to issue 1,155,283 shares of Series B Preferred Stock to Castle Creek. Each share of the Series B Preferred Stock will be convertible on a one for one basis into either (i) Common Stock under certain circumstances or (ii) non-voting common stock, par value $0.01 per share (which will also be convertible into Common Stock), subject to approval of the creation of such class of non-voting common stock by the Company’s stockholders.

Pursuant to Nasdaq rules, Castle Creek may not convert the Series B Preferred Stock or, in the future the non-voting common stock into Common Stock, or exercise the Warrant if doing so would cause Castle Creek when combined with the purchases of certain directors and executive officers of the Company as well as other accredited investors in the Private Placement to own more than 19.99% of the Common Stock outstanding immediately prior to the execution of the Securities Purchase Agreement (the "Exchange Cap"). The Company must request stockholder approval to eliminate the Exchange Cap no later than at the 2021 annual meeting of Company shareholders. In addition, Castle Creek will need the approval or non-objection of the Board of Governors of the Federal Reserve System and the New York State Department of Financial Services if it seeks to increase its ownership of shares of Common Stock in excess of 9.9% of the outstanding shares of Common Stock.

Holders of the Series B Preferred Stock will be entitled to receive dividends if declared by the Company's board of directors, in the same per share amount as paid on the Common Stock. No dividends would be payable on the Common Stock unless a dividend identical to that paid on the Common Stock is payable at the same time on the Series B Preferred Stock. The Series B Preferred Stock will rank, as to payments of dividends and distribution of assets upon dissolution, liquidation or winding up of the Company, *pari passu* with the Common Stock pro rata. Holders of Series B Preferred Stock will have no voting rights except as may be required by law. The Series B Preferred Stock will not be redeemable by either the Company or by the holder.

As discussed above, pursuant to the Securities Purchase Agreement, on May 8, 2019, the Company issued a Warrant to Castle Creek to purchase 125,000 shares of Common Stock at an exercise price equal to $14.25 per share. At the same time, the Company entered into a Warrant Agreement with Castle Creek, to, among other things, authorize and establish the terms of the Warrant. The Warrant is exercisable at any time after May 8, 2019, and from time to time, in whole or in part, until May 8, 2026. However, the exercise of such Warrant remains subject to certain contractual provisions and regulatory approval if Castle Creek's ownership of Common Stock would exceed 9.9%. At May 8, 2019, Castle Creek owned 9.9% of the Company's common stock.

Pursuant to the terms of the Securities Purchase Agreement, Castle Creek will be entitled to have one representative appointed to the Company's board of directors for so long as Castle Creek, together with its respective affiliates, owns, in the aggregate, 4.9% or more of all of the outstanding shares of the Company's Common Stock. If Castle Creek, together with its respective affiliates, owns, in the aggregate, 4.9% or more of all of the outstanding shares of the Company's Common Stock and does not have a board representative appointed to the Company's board of directors, the Company will invite a person designated by Castle Creek to attend meetings of the Company's Board of Directors as an observer.

Overview and Results of Operations

The following represents the significant highlights of the Company's operating results between the first quarter of 2019 and the first quarter of 2018.

- Net income decreased $490,000, or 48.80%, to $514,000.
- Basic and diluted earnings per share both decreased $0.12 to $0.12 per share.
- Return on average assets decreased 23 basis points to 0.22% as the decrease in income outpaced the increase in average assets.
- Net interest income, after provision for loan losses, increased $623,000, or 10.8% to $6.4 million. This increase in earnings was primarily due to the increase in average balances of interest-earning assets, coupled with a decrease in the provision for loan losses, which is reflective of ongoing stable asset quality metrics.
- Net interest margin decreased by ten basis points to 2.92%, primarily as a result of a $97.9 million increase in the average balance of time deposits, coupled with an 84 basis points increase in the average interest rate paid on time deposits.
- Total interest-earning assets were $913.0 million, an increase of $68.4 million, or 8.1%.
- Total deposits increased $61.7 million, or 8.3%, to $805.5 million.
- The effective income tax rate increased 18.0% to 33.8% for the three months ended March 31, 2019 as compared to 15.8% for the same three month period in 2018. This increase was primarily related to the nonrecurring establishment, through a charge to earnings, of a $136,000 valuation allowance to reserve against deferred tax assets related to New York State income taxes.

The following reflects the significant changes in financial condition between March 31, 2018, December 31, 2018 and March 31, 2019.

- Total assets increased $42.0 million, or 4.5%, to $975.1 million primarily due to increases in loans. These increases were funded largely by increases in deposits.

- Asset quality metrics remained stable in comparison to recent reporting periods. 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. The annualized net loan charge-offs to average loans ratio was 0.10% for the first quarter of 2019, compared to 0.19% for the first quarter of 2018, and 0.22% for the fourth quarter of 2018. Nonperforming loans to total loans decreased 55 basis points to 0.51% at March 31, 2019, compared to 1.06% at March 31, 2018. Nonperforming loans to total loans increased 16 basis points to 0.51% at March 31, 2019, compared to 0.35% at December 31, 2018. Correspondingly, the ratio of the allowance for loan losses to nonperforming loans for first quarter 2019 was 215.18%, as compared to 115.45% at March 31, 2018, and 340.13% at December 31, 2018.

The Company had net income of $514,000 for the three months ended March 31, 2019 compared to net income of $1.0 million for the three months ended March 31, 2018. The $490,000 decrease in net income was due primarily to a $1.3 million increase in both interest and noninterest expense and a $69,000 increase in income tax expense. These increases were partially offset by a $1.5 million increase in interest income, a $469,000 decrease in the provision for loan losses, and a $198,000 increase in noninterest income.

Net interest income before the provision for loan losses increased $154,000 to $6.5 million for the three months ended March 31, 2019 as compared to $6.4 million for the same three month period in 2018. The increase was primarily the result of the increase in average interest-earning asset balances, primarily due to increases in average loans and average taxable investment securities. The increase in interest income that was derived from the increase in interest-earning asset balances was partially offset by increases in the average balance and average cost of interest-bearing liabilities between the year-over-year first quarter periods. The positive effects of increased average interest-earning assets for the three months ended March 31, 2019, as compared to the same three month period in 2018, were also enhanced by an increase in the average yield of those assets of 43 basis points to 4.31% for the three months ended March 31, 2019 from 3.88% for the same three month period of the previous year.

The $198,000 increase in noninterest income in the quarter ended March 31, 2019, as compared to the same quarterly period in 2018, was primarily the result of an increase of $186,000 in gains on the sales and redemptions of investment securities. Absent the effects of the quarter over quarter increase in gains on the sale of investment securities, all other noninterest income categories increased by $12,000, or 1.2%, to $1.0 million in the quarter ended March 31, 2019 as compared with $1.0 million in the same quarter of 2018.

Total noninterest expense in the first quarter of 2019 was $6.7 million, an increase of $1.3 million, or 22.9%, compared to $5.5 million for the prior year quarter. The $1.3 million increase in noninterest expense in the quarter ended March 31, 2019, as compared to the same quarterly period in 2018, was primarily due to an increase of $696,000, or 22.6%, 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, foreclosed real estate expenses increased $211,000, which was related to the final disposition of a single foreclosed commercial property. Further, data processing expenses increased $114,000, building and occupancy costs increased $65,000, and advertising expenses increased $53,000. The increases in these operating costs were partially due to expenses related to our two new banking locations in Oneida and Onondaga counties. All other noninterest expenses increased $113,000, or 10.4%, in aggregate during the quarter ended March 31, 2019, as compared to the same three-month period in 2018.

The $469,000 decrease in the provision for loan losses in the quarter ended March 31, 2019, as compared with the same quarter of 2018, was reflective of favorable changes to both the quantitative and environmental factors deemed to be appropriate for the Bank's loan portfolio, as well as ongoing stable asset quality metrics. These factors were partially offset by an increase in the provision for loan losses recorded due to an increase of $40.5 million, or 6.8%, in the average loan balances in the first quarter of 2019 as compared with the same quarter of 2018 and the corresponding increase in the estimable and probable loan losses inherent in the loan portfolio. The provision for loan losses in the quarter ended March 31, 2019 was further increased, as compared to the same quarter in 2018, by the effects of an increase in the ratio of delinquent loans to total loans, which increased to 2.75% at March 31, 2019 as compared to 2.31% at March 31, 2018, offset by a decrease in nonaccrual loans that decreased $3.1 million to $3.4 million at March 31, 2019 as compared to $6.5 million at March 31, 2018.

In comparing the year-over-year first quarter periods, the return on average assets decreased 23 basis points to 0.22% due to the combined effects of the decrease 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 investment securities of $40.5 million and $8.3 million, respectively in the first quarter of 2019 as compared to the same quarter of 2018. Average deposits increased $27.8 million in the first quarter of 2019, as compared with the same quarter in 2018, due to strong growth in retail deposits, along with the seasonally-normal strong deposit inflows related to the Bank's municipal depositor relationships.

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.

Table of Contents

The following table sets 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 table 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 March 31,					
	2019			2018		
(Dollars in thousands)	Average Balance	Interest	Average Yield / Cost	Average Balance	Interest	Average Yield / Cost
Interest-earning assets:						
Loans	$ 633,823	$ 7,575	4.78%	$ 593,360	$ 6,718	4.53%
Taxable investment securities	224,646	1,799	3.20%	216,298	1,196	2.21%
Tax-exempt investment securities	18,473	108	2.34%	22,952	248	4.32%
Fed funds sold and interest-earning deposits	20,547	187	3.64%	13,681	47	1.37%
Total interest-earning assets	897,489	9,669	4.31%	846,291	8,209	3.88%
Noninterest-earning assets:						
Other assets	65,808			53,303		
Allowance for loan losses	(7,276)			(7,102)		
Net unrealized losses						
on available-for-sale securities	(3,260)			(2,833)		
Total assets	$ 952,761			$ 889,659		
Interest-bearing liabilities:						
NOW accounts	$ 70,367	$ 28	0.16%	$ 71,712	$ 26	0.15%
Money management accounts	14,229	5	0.14%	14,914	6	0.16%
MMDA accounts	184,570	434	0.94%	255,119	472	0.74%
Savings and club accounts	84,296	25	0.12%	81,888	21	0.10%
Time deposits	322,003	1,853	2.30%	224,076	820	1.46%
Subordinated loans	15,092	217	5.75%	15,062	203	5.39%
Borrowings	86,781	560	2.58%	68,509	268	1.56%
Total interest-bearing liabilities	777,338	3,122	1.61%	731,280	1,816	0.99%
Noninterest-bearing liabilities:						
Demand deposits	101,283			89,344		
Other liabilities	8,363			6,153		
Total liabilities	886,984			826,777		
Shareholders' equity	65,777			62,882		
Total liabilities & shareholders' equity	$ 952,761			$ 889,659		
Net interest income		$ 6,547			$ 6,393	
Net interest rate spread			2.70%			2.89%
Net interest margin			2.92%			3.02%
Ratio of average interest-earning assets						
to average interest-bearing liabilities			115.46%			115.73%

As indicated in the above table, net interest income, before provision for loan losses, increased $154,000, or 2.4%, to $6.5 million for the three months ended March 31, 2019 as compared to $6.4 million for the same prior year period. This increase was due principally to the $51.2 million, or 6.1%, increase in the average balance of interest-earning assets, and an increase of 43 basis points on the average interest rate 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 $46.1 million, or 6.3%, and an increase of 62 basis points on the average interest rate paid on those liabilities. In total, net interest margin decreased 10 basis points to 2.92% due largely to the increase in average rates paid on average interest-bearing liabilities, as noted above, which was primarily due to a $97.9 million increase in the average balance of time deposits, coupled with an 84 basis points increase in the interest rate paid on those deposits. 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 $1.5 million, or 17.8%, to $9.7 million for the three months ended March 31, 2019 compared to $8.2 million for the same three-month period in 2018. The increase in interest income was due principally to the increase in average balances of loans and taxable investment securities which increased 6.8% and 3.9%, respectively, between the year-over-year first quarter periods. The average balance of loans increased by $40.5 million and the average yield on that portfolio improved 25 basis points to 4.78%. The increase in the average balance of loans reflected 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 balance of taxable investment securities increased by $8.3 million and the average yield on that portfolio improved 99 basis points to 3.20%. The increase in the average yield on taxable investment securities was the result of an increase the rates received 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 March 31, 2019 increased $1.3 million, or 71.9%, to $3.1 million when compared to the same prior year period. Deposit interest expense increased $1.0 million, or 74.4%, to $2.3 million due to a $27.8 million increase in the average balance of interest-bearing deposits accompanied by a 56 basis points increase in the average annualized rate paid on these deposits to 1.39% for the three months ended March 31, 2019, as compared with the same three-month period in 2018. This increase was primarily due to 84 and 20 basis points increases in the average rates paid on time deposits and money market deposit accounts ("MMDA"), respectively, during the three months ended March 31, 2019 as compared to the same time period in 2018. These increases in the average rates paid on time deposits and MMDA accounts reflected the competitive environment for such deposits within the Company's marketplace as well as a general increase in short-term interest rates nationally. In addition, interest expense on borrowed funds increased by $306,000 in the three months ended March 31, 2019, as compared with the same three-month period in 2018 primarily due to general increases in the short-term interest rate environment.

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 March 31, 2019 vs. 2018 Increase/(Decrease) Due to		
(In thousands)	**Volume**	**Rate**	**Total Increase (Decrease)**
Interest Income:			
Loans	$ 473	$ 384	$ 857
Taxable investment securities	48	555	603
Tax-exempt investment securities	(42)	(98)	(140)
Interest-earning deposits	33	107	140
Total interest income	512	948	1,460
Interest Expense:			
NOW accounts	(3)	5	2
Money management accounts	-	(1)	(1)
MMDA accounts	(536)	498	(38)
Savings and club accounts	1	3	4
Time deposits	445	588	1,033
Subordinated loans	-	14	14
Borrowings	85	207	292
Total interest expense	(8)	1,314	1,306
Net change in net interest income	$ 520	$ (366)	$ 154

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 $144,000 in provision for loan losses for the three-month period ended March 31, 2019, as compared to $613,000 for the three-month period ended March 31, 2018. The decrease in the provision for loan losses was reflective of favorable changes to both the quantitative and environmental factors deemed to be appropriate for the Bank's loan portfolio, as well as ongoing stable asset quality metrics. These factors were partially offset by an increase in the provision for loan losses recorded due to an increase of $40.5 million, or 6.8%, in the average loan balances in the first quarter of 2019 as compared with the same quarter of 2018 and the corresponding increase in the estimable and probable loan losses inherent in the loan portfolio.

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 increased to 2.75% at March 31, 2019 as compared to 1.81% at December 31, 2018.

Delinquent loans increased at a rate that was modestly more than the rate of increase in total loan balances, primarily driven by an increase of $4.5 million in loans delinquent 30-59 days, an increase of $1.2 million in loans 60-89 days past due, and an increase of $1.2 million in loans delinquent more than 90 days. At March 31, 2019, there were $18.1 million in loans past due including $12.6 million in loans 30-59 days past due, $2.3 million in loans 60-89 days past due and $3.2 million in loans 90 or more days past due. At December 31, 2018, there were $11.2 million in loans past due including $8.1 million in loans 30-59 days past due, $1.1 million in loans 60-89 days past due and $2.0 million in loans 90 or more days past due.

The increase of $6.8 million in total loans past due at March 31, 2019, as compared to December 31, 2018, was primarily due to an increase of $4.5 million in loans 30-59 days past due. The increase in loans 30-59 days past due at March 31, 2019 as compared to December 31, 2018 was primarily due to the addition of one commercial line of credit with an outstanding balance of $2.0 million and three commercial and industrial loans with a total outstanding balance of $2.9 million. Total loans with delinquent balances 60-89 days past due increased in aggregate primarily due to the addition of one commercial real estate loan in the amount of $875,000. The increase in loans 90 days or more past due was primarily a result of three commercial real estate loans with an outstanding balance of $510,000 and three commercial and industrial loans with a total outstanding balance of $559,000.

The determination of the overall adequacy of the allowance for loan losses is also influenced by individual loan and borrower analyses that include reviews of such factors as the delinquency status of loans, assessments of underlying collateral sufficiency and/or the borrower's documented resources outside of the specific loan relationship (referred to as the borrower's "global" capacity to repay), personal or corporate guarantees, and the conclusions drawn from detailed discussions with borrowers. Therefore, the level of loan delinquencies, while generally indicative of the potential levels of future loan charge-offs, are not wholly-definitive in making that determination. Management believes that the allowance for loan losses was adequate at March 31, 2019 based on its analyses of the totality of factors related to making that determination, notwithstanding the increased levels of delinquent loans at March 31, 2019, as compared to December 31, 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.

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

	Three months ended March 31,			
(Dollars in thousands)	2019	2018	Change	
Service charges on deposit accounts	$ 282	$ 274	$ 8	2.9%
Earnings and gain on bank owned life insurance	121	73	48	65.8%
Loan servicing fees	27	41	(14)	-34.1%
Debit card interchange fees	144	143	1	0.7%
Insurance agency revenue	243	229	14	6.1%
Other charges, commissions and fees	164	226	(62)	-27.4%
Noninterest income before gains (losses)	981	986	(5)	-0.5%
Net gains (losses) on sales and redemptions of investment securities	79	(107)	186	173.8%
Gains on equity securities	41	13	28	215.4%
Net (losses) gains on sales of loans and foreclosed real estate	(8)	3	(11)	-366.7%
Total noninterest income	$ 1,093	$ 895	$ 198	22.1%

The $198,000, or 22.1%, increase in noninterest income in the quarter ended March 31, 2019, as compared to the same quarterly period in 2018, was primarily the result of an increase of $186,000 in gains on the sales and redemptions of investment securities. Security sales were completed in the first quarter of 2019 primarily to provide additional liquidity for loan purchases and originations. Absent the effects of the quarter over quarter increase in gains on the sale of investment securities, all other noninterest income categories increased by $12,000, or 1.2%, to $1.0 million in the quarter ended March 31, 2019 as compared with the same quarter of 2018. This $12,000 quarter over quarter increase in noninterest income, excluding the effects of gains on the sales and redemptions of investment securities, was due primarily to an increase of $48,000 in earnings and gain on bank owned life insurance and a $28,000 increase in gains on marketable equity securities. These increases were offset by a decrease in other charges, commissions and fees of $62,000, which was the result of a nonrecurring recovery in the first quarter of 2018 of an escrowed balance in the amount of $57,000 that had been established to settle claims related to a previously disposed of ORE property upon the statutory expiration of all potential claimants rights.

Noninterest Expense

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

	Three months ended March 31,			
(Dollars in thousands)	2019	2018	Change	
Salaries and employee benefits	$ 3,780	$ 3,084	$ 696	22.6%
Building occupancy	656	591	65	11.0%
Data processing	593	479	114	23.8%
Professional and other services	336	331	5	1.5%
Advertising	244	191	53	27.7%
FDIC assessments	111	120	(9)	-7.5%
Audits and exams	100	105	(5)	-4.8%
Insurance agency expense	199	164	35	21.3%
Community service activities	138	87	51	58.6%
Foreclosed real estate expenses	237	26	211	811.5%
Other expenses	317	281	36	12.8%
Total noninterest expenses	$ 6,711	$ 5,459	$ 1,252	22.9%

The $1.3 million, or 22.9%, increase in noninterest expense between year-over-year first quarter periods was principally due to an increase in salaries and employee benefits expense which increased by $696,000. All other noninterest expenses in aggregate increased $556,000, or 23.4%, for the three months ended March 31, 2019 as compared to the same three-month period in 2018. The detail of the components of the overall increase in noninterest expense follows:

- The $696,000 increase in salaries and employee benefits expense in the first quarter of 2019, as compared to the same three-month period in 2018, was primarily due to $421,000 in salary expense increases, $239,000 in employee benefits expense increases, including employee payroll tax expenses, and a $36,0000 net increase in all other salaries and employee benefit expenses. Salaries expense increased primarily as the result of additional staff members supporting current and planned asset growth and risk management activities as well as increased customer service and other operating costs reflecting the ramp-up period for our two new banking locations in Oneida and Onondaga counties. The year-over-year increases in employee benefit expenses were consistent with the salary increases discussed above.
- The $65,000 increase in building and occupancy expenses was primarily due to $17,000 in additional depreciation expense related to recently completed building modernization and refurbishment projects, a $16,000 increase in utilities, a $14,000 increase in building and machine maintenance, and $18,000 of additional expenses in all other building and occupancy expenses.
- The $114,000 increase in data processing costs was primarily due to $65,000 in additional depreciation related to recently completed projects, an additional $27,000 in processing fees paid by the Bank that were based on increased levels of customer activity transacted through its electronic delivery channels and $22,000 of additional expenses in all other data processing expenses.
- Advertising expense increased $53,000 primarily as the result of increases in the level of brand awareness advertising expenditures primarily focused on the Onondaga County market.
- Foreclosed real estate expenses increased $211,000 as a result of a foreclosed property that the Bank paid taxes on. This foreclosed property was sold in February 2019 and is no longer in foreclosed real estate at March 31, 2019.

- All other noninterest expenses increased in aggregate in the year-over-year three-month periods by a total of $113,000, or 10.4%, due primarily to an increase in community service activities and insurance agency expenses of $51,000 and $35,000, respectively.

Income Tax Expense

Income tax expense increased $69,000 to $251,000, with an effective tax rate of 33.8% for the quarter ended March 31, 2019 as compared to $182,000, with an effective tax rate of 15.8%, for the same three month period in 2018. In the quarter ended March 31, 2019, the Company established, through a charge to earnings, a valuation allowance in the amount of $136,000, increasing the Company's effective tax rate by 18.3%, in order to establish a reserve against deferred tax assets related to New York State income taxes. Effective in January 2018, the Company adopted a modification methodology, made available following changes to the New York State tax code, effecting how the Company's state income tax liability is computed. Under this adopted methodology, it is unlikely that the Company will pay income taxes to New York in future periods and it is therefore probable that the Company's deferred tax assets related to New York State income taxes are unlikely to further reduce the Company's State tax rate in the future. Accordingly, a valuation allowance against the recorded value of those deferred tax assets was established in order to reduce the net deferred tax asset related to New York income taxes to $-0- at March 31, 2019. There were no valuation allowances against deferred tax assets at December 31, 2018.

The Company's effective tax rate differs from the statutory federal tax rate of 21% due primarily to tax-exempt income from specific types of investment securities and loans, bank owned life insurance, and, to a much lesser degree, the utilization of low income housing credits. In addition, the tax effects of certain incentive stock option activity may also reduce the Company's effective tax rate on a sporadic basis. During the quarter ended March 31, 2019 these effects reduced the Company's effective tax rate by 5.4%. Excluding the nonrecurring charge related to the deferred tax asset valuation allowance, income tax expense in 2019 would have been $67,000 less than the prior year, and the effective tax rate would have been 15.5%. The reduction in income tax expense and the effective tax rate in 2019, as compared to the previous year, was primarily attributable to the year-over-year first quarter reduction in pre-tax net income.

Earnings per Share

Basic and diluted earnings per share were $0.12 for the first quarter of 2019, as compared to $0.24 per basic and diluted share for the same quarter of 2018. These $0.12 decreases in basic and fully diluted earnings per share, respectively, were driven principally by the decrease in net income between these two 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 $42.0 million, or 4.5%, to $975.1 million at March 31, 2019 as compared to $933.1 million at December 31, 2018. This increase was due primarily to an increase in loans and investment securities, partially offset by decreases in cash and cash equivalents.

Total net loans receivable increased $37.3 million, or 6.1%, to $650.3 million at March 31, 2019 from $613.0 million at December 31, 2018. Consumer loans, commercial lines of credit, commercial and industrial loans, and residential loans recorded increases between these two dates, with increases of $24.0 million, $11.0 million, $4.2 million, and $2.1 million, respectively. These increases were partially offset by a decrease of $3.9 million in commercial real estate loans. The increase in consumer loans was primarily the result of the March 2019 acquisition of $23.4 million in automobile loans from an unrelated financial institution.

Investment securities increased $2.6 million, or 1.1%, to $234.7 million at March 31, 2019, as compared to $232.0 million at December 31, 2018, due principally to purchases of securities during the first quarter of 2019.

Cash and cash equivalents decreased $1.5 million, or 5.7%, to $24.8 million at March 31, 2019, as compared to $26.3 million at December 31, 2018. The $1.5 million decrease in cash and cash equivalents was primarily due to deployment of cash balances at December 31, 2018 into loan fundings during the quarter ended March 31, 2019. The Bank considers its statutorily required cash reserve balances held at the Federal Reserve Bank to be restricted cash. Total restricted cash was $4.6 million and $4.0 million at March 31, 2019 and December 31, 2018, respectively.

Liabilities

Total liabilities increased $40.0 million to $908.6 million at March 31, 2019 compared to $868.7 million at December 31, 2018. Deposits increased $78.5 million, or 10.8%, to $805.5 million at March 31, 2019, compared to $727.1 million at December 31, 2018. This increase was the result of an increase in deposits obtained directly from customers within the Bank's marketplace of $35.6, primarily due to increases in time deposits. This increase was further enhanced by the seasonally-normal strong deposit inflows related to the Bank's municipal depositor relationships, which increased $25.4 million. The increase in these customer deposits during the three months ended March 31, 2019 was partially offset by a decrease in business deposits of $16.6 million. In March 2019, the Bank took on additional brokered time deposits through an unrelated financial institution in the amount of $24.0 million. The Bank utilizes the Certificates of Deposit Account Registry Service ("CDARS") provided by Promontory Interfinancial Network and other deposits acquired through unaffiliated financial institutions as forms of brokered deposits. At March 31, 2019, deposits obtained through the use of this service increased $9.1 million to $50.5 million as compared to $41.4 million at December 31, 2018. Borrowed funds balances from the FHLB-NY decreased $41.1 million, or 34.7%, to $77.4 million at March 31, 2019 from $118.5 million at December 31, 2018.

Shareholders' Equity

The Company's shareholders' equity, exclusive of the noncontrolling interest, increased $2.0 million to $66.2 million at March 31, 2019 from $64.2 million at December 31, 2018. This increase was principally due to the $1.6 million increase in comprehensive income, a $315,000 increase in additional paid-in capital, a $45,000 increase in ESOP shares earned, and a $19,000 increase in retained earnings. Comprehensive income was primarily the result of the appreciation in the fair market value of our available-for-sale investment securities during the three months ended March 31, 2019. The slight increase in retained earnings resulted from $514,000 in net income recorded in the first three months of 2019. Partially offsetting the increase in retained earnings was a $239,000 one-time adjustment related to the cumulative effect of the capitalization of the operating lease right-of-use-assets based on the adoption of *ASU 2016-02 - Leases (Topic 842).* In addition, retained earnings was further reduced by $256,000 for cash dividends declared on our common stock.

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 March 31, 2019, 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 is now fully implemented at 2.5% of risk-weighted assets as of January 1, 2019. At March 31, 2019, the Bank exceeded all regulatory required minimum capital ratios, including the capital buffer requirements.

On May 24, 2018, The Economic Growth, Regulatory Relief and Consumer Protection Act of 2018 (the "EGRRCPA") was enacted, which repeals or modifies certain provisions of the Dodd-Frank Act and eases regulations on all but the largest banks. The EGRRCPA's provisions include, among other things: (i) exempting banks with less than $10 billion in assets from the ability-to-repay requirements for certain qualified residential mortgage loans held in portfolio; (ii) not requiring appraisals for certain transactions valued at less than $400,000 in rural areas; (iii) exempting banks that originate fewer than 500 open-end and 500 closed-end mortgages from HMDA's expanded data disclosures; (iv) clarifying that, subject to various conditions, reciprocal deposits of another depository institution obtained using a deposit broker through a deposit placement network for purposes of obtaining maximum deposit insurance would not be considered brokered deposits subject to the FDIC's brokered-deposit regulations; (v) raising eligibility for the 18-month exam cycle from $1 billion to banks with $3 billion in assets; and (vi) simplifying capital calculations by requiring regulators to establish for institutions under $10 billion in assets a community bank leverage ratio (tangible equity to average consolidated assets) at a percentage not less than 8% and not greater than 10% that such institutions may elect to replace the general applicable risk-based capital requirements for determining well-capitalized status. The federal banking agencies have proposed that the community bank leverage ratio be set at 9.0%. However, until the federal banking regulators finalize the proposed rule, the current capital rues remain in effect. In addition, the law required the Federal Reserve Board to raise the asset threshold under its Small Bank Holding Company Policy Statement from $1 billion to $3 billion for bank or savings and loan holding companies that are exempt from consolidated capital requirements, provided that such companies meet certain other conditions such as not engaging in significant nonbanking activities.

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		Minimum For Capital Adequacy with Buffer	
(Dollars in thousands)	Amount	Ratio	Amount	Ratio	Amount	Ratio	Amount	Ratio
As of March 31, 2019:								
Total Core Capital (to Risk-Weighted Assets)	$83,613	12.82%	$52,185	8.00%	$65,232	10.00%	$68,493	10.50%
Tier 1 Capital (to Risk-Weighted Assets)	$76,329	11.70%	$39,139	6.00%	$52,185	8.00%	$55,447	8.50%
Tier 1 Common Equity (to Risk-Weighted Assets)	$76,329	11.70%	$29,354	4.50%	$42,400	6.50%	$45,662	7.00%
Tier 1 Capital (to Assets)	$76,329	8.08%	$37,767	4.00%	$47,209	5.00%	$47,209	5.00%
As of December 31, 2018:								
Total Core Capital (to Risk-Weighted Assets)	$83,177	13.69%	$48,593	8.00%	$60,741	10.00%	$63,778	10.50%
Tier 1 Capital (to Risk-Weighted Assets)	$75,871	12.49%	$36,445	6.00%	$48,593	8.00%	$51,630	8.50%
Tier 1 Common Equity (to Risk-Weighted Assets)	$75,871	12.49%	$27,334	4.50%	$39,482	6.50%	$42,519	7.00%
Tier 1 Capital (to Assets)	$75,871	8.31%	$36,522	4.00%	$45,652	5.00%	$45,652	5.00%

Table of Contents

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 provided 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)	March 31, 2019	December 31, 2018
Regulatory Capital Ratios (Bank Only)		
Total capital (to risk-weighted assets)		
Total equity (GAAP)	$ 85,488	$ 86,614
Goodwill	(4,536)	(4,536)
Intangible assets	(161)	(165)
Addback: Accumulated other comprehensive income	(4,462)	(6,042)
Total Tier 1 Capital	$ 76,329	$ 75,871
Allowance for loan and lease losses	7,284	7,306
Total Tier 2 Capital	$ 7,284	$ 7,306
Total Tier 1 plus Tier 2 Capital (numerator)	$ 83,613	$ 83,177
Risk-weighted assets (denominator)	652,315	607,414
Total core capital to risk-weighted assets	12.82 %	13.69 %
Tier 1 capital (to risk-weighted assets)		
Total Tier 1 capital (numerator)	$ 76,329	$ 75,871
Risk-weighted assets (denominator)	652,315	607,414
Total capital to risk-weighted assets	11.70 %	12.49 %
Tier 1 capital (to adjusted assets)		
Total Tier 1 capital (numerator)	$ 76,329	$ 75,871
Total average assets	948,867	917,740
Goodwill	(4,536)	(4,536)
Intangible assets	(161)	(165)
Adjusted assets (denominator)	$ 944,170	$ 913,039
Total capital to adjusted assets	8.08 %	8.31 %
Tier 1 Common Equity (to risk-weighted assets)		
Total Tier 1 capital (numerator)	$ 76,329	$ 75,871
Risk-weighted assets (denominator)	652,315	607,414
Total Tier 1 Common Equity to risk-weighted assets	11.70 %	12.49 %

Table of Contents

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)	March 31, 2019	December 31, 2018	March 31, 2018
Nonaccrual loans:			
Commercial and commercial real estate loans	$ 1,958	$ 830	$ 4,077
Consumer	154	142	261
Residential mortgage loans	1,273	1,176	2,116
Total nonaccrual loans	3,385	2,148	6,454
Total nonperforming loans	3,385	2,148	6,454
Foreclosed real estate	623	1,173	108
Total nonperforming assets	$ 4,008	$ 3,321	$ 6,562
Accruing troubled debt restructurings	$ 2,660	$ 2,574	$ 2,788
Nonperforming loans to total loans	0.51%	0.35%	1.06%
Nonperforming assets to total assets	0.41%	0.36%	0.74%

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 at the dates indicated in the table above. 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 three nonaccruing TDR loans, with an aggregate carrying value of $143,000 included among the nonaccrual loans detailed in the table above at March 31, 2019.

As indicated in the table above, nonperforming assets at March 31, 2019 were $4.0 million and were $687,000 higher than the $3.3 million reported at December 31, 2018, due primarily to an increase of $1.1 million in nonperforming commercial and commercial real estate loans, partially offset by a decrease of $550,000 in FRE.

As indicated in the nonperforming asset table above, FRE balances decreased $550,000 at March 31, 2019 from December 31, 2018, following two sales from the portfolio and two additions to the portfolio during the three-month period ended March 31, 2019. More information regarding foreclosed real estate can be found in Note 8 of this quarterly report on 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 $7.3 million at both March 31, 2019 and December 31, 2018. The ratio of the allowance for loan losses to total loans decreased 7 basis points to 1.11% at March 31, 2019 from 1.18% at December 31, 2018. 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 March 31, 2019.

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 quicker 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 both March 31, 2019 and December 31, 2018, the Company had $6.0 million in loans which were deemed to be impaired, having established specific reserves of $906,000 and $631,000, respectively, on these loans. Impaired commercial and industrial loans, other consumer loans, and commercial lines of credit increased $228,000, $101,000, and $62,000, respectively. These increases were offset by impaired residential real estate loans and commercial real estate loans, which decreased $405,000 and $10,000, respectively. The $275,000 increase in specific reserves for impaired loans at March 31, 2019, as compared to December 31, 2018 was primarily due to a $209,000 increase in specific reserves for impaired commercial and industrial loans.

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 $14.8 million as of March 31, 2019, an increase of $254,000, or 1.7%, as compared to $14.6 million at December 31, 2018. 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 three months of 2019, as indicated in the consolidated statement of cash flows, the Company reported net cash flows from financing activities of $37.3 million generated principally by increased balances of time deposit, demand, savings, and money market accounts in the amount of $44.4 million and net increases in the aggregate balances of brokered deposits of $34.0 million. Partially offsetting these cash flows from funding activities were decreases in the balance of borrowings of $41.1 million and dividends paid to common shareholders of $263,000. The increase in deposits was the result of organic growth within our existing marketplace coupled with targeted promotions for our time deposit products. Deposit growth occurred in the consumer and municipal customer segments during the first three months of 2019.

In June 2018, the Company renewed 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 alternative means of collateralizing 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 March 31, 2019, total credit available to the Company under the existing lines of credit was approximately $197.2 million at FHLBNY, the Federal Reserve Bank, and two other correspondent banks. As of March 31, 2019, the Company had $89.4 million of the available lines of credit utilized, including encumbrances supporting outstanding letters of credit, described above, on its existing lines of credit with $107.8 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 March 31, 2019, 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 March 31, 2019, the Company had $145.6 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 reasonably likely to materially affect, the Company’s internal control over financial reporting.

Table of Contents

PART II – OTHER INFORMATION

Item 1 – Legal Proceedings

At March 31, 2019, 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
January 1, 2019 through January 31, 2019	-	$	-	-	74,292
February 1, 2019 through February 28, 2019	-	$	-	-	74,292
March 1, 2019 through March 31, 2019	-	$	-	-	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)

May 14, 2019	/s/ Thomas W. Schneider Thomas W. Schneider President and Chief Executive Officer
May 14, 2019	/s/ Walter F. Rusnak Walter F. Rusnak Senior Vice President, Chief Financial Officer