

PATHFINDER BANCORP INC  
Form 10-Q  
May 14, 2013

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

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FORM 10-Q

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

For the quarterly period ended March 31, 2013

OR

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission File Number: 000-23601

PATHFINDER BANCORP, INC.  
(Exact Name of Company as Specified in its Charter)

FEDERAL  
(State or Other Jurisdiction of Incorporation or  
Organization)

16-1540137  
(I.R.S. Employer Identification Number)

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 T NO \*

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (Section 232.405 of this Chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

YES T NO \*

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

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Large accelerated filer\*  
filer\*

Accelerated filer\*

Non-accelerated

Smaller reporting company T

(Do not check if a smaller reporting company)

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

As of May 9, 2013, there were 2,979,969 shares issued and 2,618,182 shares outstanding of the registrant's common stock.

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## PART I - FINANCIAL INFORMATION

## Item 1 – Consolidated Financial Statements

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

| (In thousands, except share data)  | March 31,<br>2013 | December 31,<br>2012 |
|--|-------------------|----------------------|
| <b>ASSETS:</b>   |                   |                      |
| Cash and due from banks  | \$ 5,982          | \$ 6,435             |
| Interest earning deposits  | 7,236             | 2,230                |
| Total cash and cash equivalents  | 13,218            | 8,665                |
| Interest earning time deposits   | 2,000             | 2,000                |
| Investment securities, at fair value   | 125,955           | 108,339              |
| Federal Home Loan Bank stock, at cost  | 1,505             | 1,929                |
| Loans  | 338,944           | 333,748              |
| Less: Allowance for loan losses  | 4,686             | 4,501                |
| Loans receivable, net  | 334,258           | 329,247              |
| Premises and equipment, net  | 10,168            | 10,108               |
| Accrued interest receivable  | 1,912             | 1,717                |
| Foreclosed real estate   | 372               | 426                  |
| Goodwill   | 3,840             | 3,840                |
| Bank owned life insurance  | 8,105             | 8,046                |
| Other assets   | 3,631             | 3,479                |
| Total assets   | \$ 504,964        | \$ 477,796           |
| <b>LIABILITIES AND SHAREHOLDERS' EQUITY:</b>   |                   |                      |
| Deposits:  |                   |                      |
| Interest-bearing   | \$ 378,709        | \$ 347,892           |
| Noninterest-bearing  | 49,676            | 43,913               |
| Total deposits   | 428,385           | 391,805              |
| Short-term borrowings  | -                 | 9,000                |
| Long-term borrowings   | 25,936            | 25,964               |
| Junior subordinated debentures   | 5,155             | 5,155                |
| Accrued interest payable   | 142               | 140                  |
| Other liabilities  | 4,297             | 4,985                |
| Total liabilities  | 463,915           | 437,049              |
| Shareholders' equity:  |                   |                      |
| Preferred stock - SBLF, par value \$0.01 per share; \$1,000 liquidation preference;<br>13,000 shares authorized; 13,000 shares issued and outstanding                  | 13,000            | 13,000               |
| Common stock, par value \$0.01; authorized 10,000,000 shares;<br>2,979,969 and 2,980,469 shares issued and 2,618,182 and 2,618,182 shares<br>outstanding, respectively | 30                | 30                   |
| Additional paid in capital   | 8,141             | 8,120                |
| Retained earnings  | 27,115            | 26,685               |
| Accumulated other comprehensive loss   | (1,500 )          | (1,318 )             |
| Unearned ESOP  | (909 )            | (936 )               |
| Treasury stock, at cost; 361,787, and 362,287 shares, respectively   | (4,828 )          | (4,834 )             |

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|  |            |            |
|--|------------|------------|
| Total shareholders' equity                 | 41,049     | 40,747     |
| Total liabilities and shareholders' equity | \$ 504,964 | \$ 477,796 |

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

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

|   | For the<br>three<br>months<br>ended<br>March 31,<br>2013 | For the<br>three<br>months<br>ended<br>March 31,<br>2012 |
|---|--|--|
| (In thousands, except per share data)                           |  |  |
| Interest and dividend income:                                   |  |  |
| Loans, including fees   | \$4,125  | \$4,011  |
| Debt securities:  |  |  |
| Taxable   | 384  | 458  |
| Tax-exempt  | 191  | 163  |
| Dividends   | 34   | 33   |
| Interest earning time deposits                                  | 6  | 7  |
| Federal funds sold and interest earning deposits                | 1  | 1  |
| Total interest income   | 4,741  | 4,673  |
| Interest expense:   |  |  |
| Interest on deposits  | 659  | 761  |
| Interest on short-term borrowings                               | 8  | 3  |
| Interest on long-term borrowings                                | 229  | 252  |
| Total interest expense  | 896  | 1,016  |
| Net interest income   | 3,845  | 3,657  |
| Provision for loan losses                                       | 324  | 225  |
| Net interest income after provision for loan losses             | 3,521  | 3,432  |
| Noninterest income:   |  |  |
| Service charges on deposit accounts                             | 255  | 273  |
| Earnings and gain on bank owned life insurance                  | 61   | 93   |
| Loan servicing fees   | 44   | 41   |
| Net gains on sales and redemptions of investment securities     | 39   | 112  |
| Net gains (losses) on sales of loans and foreclosed real estate | 29   | (24)   |
| Debit card interchange fees                                     | 106  | 97   |
| Other charges, commissions & fees                               | 142  | 136  |
| Total noninterest income  | 676  | 728  |
| Noninterest expense:  |  |  |
| Salaries and employee benefits                                  | 1,910  | 1,974  |
| Building occupancy  | 365  | 383  |
| Data processing   | 368  | 341  |
| Professional and other services                                 | 159  | 153  |
| Advertising   | 116  | 60   |
| FDIC assessments  | 84   | 77   |
| Audits and exams  | 61   | 56   |
| Other expenses  | 442  | 411  |
| Total noninterest expenses                                      | 3,505  | 3,455  |
| Income before income taxes                                      | 692  | 705  |
| Provision for income taxes                                      | 187  | 176  |
| Net income  | 505  | 529  |
| Preferred stock dividends                                       | -  | 138  |

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|   |        |        |
|---|--------|--------|
| Net income available to common shareholders | \$505  | \$391  |
| Earnings per common share - basic           | \$0.20 | \$0.16 |
| Earnings per common share - diluted         | \$0.20 | \$0.16 |
| Dividends per common share                  | \$0.03 | \$0.03 |

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

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

| (In thousands)  | For the<br>three<br>months<br>ended<br>March 31,<br>2013 | For the<br>three<br>months<br>ended<br>March 31,<br>2012 |
|---|--|--|
| Net Income  | \$505  | \$529  |
| Other Comprehensive Income  |  |  |
| Retirement Plans:   |  |  |
| Retirement plan net losses recognized in plan expenses                  | 95   | 134  |
| Unrealized holding gain on financial derivative:                        |  |  |
| Change in unrealized holding loss on financial derivative               | -  | (8 )   |
| Reclassification adjustment for interest expense included in net income | 15   | 14   |
| Net unrealized gain on financial derivative                             | 15   | 6  |
| Unrealized holding (losses) gains on available-for-sale securities:     |  |  |
| Unrealized holding (losses) gains arising during the period             | (374 )   | 167  |
| Reclassification adjustment for net gains included in net income        | (39 )  | (112 )   |
| Net unrealized (losses) gains on securities available-for-sale          | (413 )   | 55   |
| Other comprehensive (loss) income , before tax                          | (303 )   | 195  |
| Tax effect  | 121  | (78 )  |
| Other comprehensive (loss) income, net of tax                           | (182 )   | 117  |
| Comprehensive Income  | \$323  | \$646  |
| Tax Effect Allocated to Each Component of Other Comprehensive Income    |  |  |
| Retirement plan net losses recognized in plan expenses                  | \$(38 )  | \$(53 )  |
| Change in unrealized holding loss on financial derivative               | -  | 3  |
| Reclassification adjustment for interest expense included in net income | (6 )   | (6 )   |
| Unrealized holding (losses) gains arising during the period             | 149  | (67 )  |
| Reclassification adjustment for net gains included in net income        | 16   | 45   |
| Income tax effect related to other comprehensive income                 | \$121  | \$(78 )  |

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



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PATHFINDER BANCORP, INC.  
CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY  
Three months ended March 31, 2013 and March 31, 2012

| (In thousands, except<br>share and per<br>share data)    | Preferred<br>Stock | Common<br>Stock | Additional<br>Paid in<br>Capital | Retained<br>Earnings | Accumulated<br>Other Com-<br>prehensive<br>Loss | Unearned<br>ESOP | Treasury<br>Stock | Total    |
|--|--------------------|-----------------|----------------------------------|----------------------|---|------------------|-------------------|----------|
| Balance, January 1,<br>2013                              | \$13,000           | \$30            | \$ 8,120                         | \$26,685             | \$ (1,318 )                                     | \$(936 )         | \$(4,834 )        | \$40,747 |
| Net income   | -                  | -               | -                                | 505                  | -   | -                | -                 | 505      |
| Other<br>comprehensive loss,<br>net of tax:              | -                  | -               | -                                | -                    | (182 )  | -                | -                 | (182 )   |
| ESOP shares earned<br>(3,125 shares)                     | -                  | -               | 7                                | -                    | -   | 27               | -                 | 34       |
| Stock based<br>compensation                              | -                  | -               | 20                               | -                    | -   | -                | -                 | 20       |
| Stock options<br>exercised                               | -                  | -               | (6 )                             | -                    | -   | -                | 6                 | -        |
| Common stock<br>dividends declared<br>(\$0.03 per share) | -                  | -               | -                                | (75 )                | -   | -                | -                 | (75 )    |
| Balance, March 31,<br>2013                               | \$13,000           | \$30            | \$ 8,141                         | \$27,115             | \$ (1,500 )                                     | \$(909 )         | \$(4,828 )        | \$41,049 |
| Balance, January 1,<br>2012                              | \$13,000           | \$30            | \$ 8,730                         | \$24,618             | \$ (2,664 )                                     | \$(1,039 )       | \$(4,834 )        | \$37,841 |
| Net income   | -                  | -               | -                                | 529                  | -   | -                | -                 | 529      |
| Other<br>comprehensive<br>income, net of tax:            | -                  | -               | -                                | -                    | 117   | -                | -                 | 117      |
| Purchase of CPP<br>Warrants from<br>Treasury             | -                  | -               | (706 )                           | 169                  | -   | -                | -                 | (537 )   |
|  | -                  | -               | -                                | (138 )               | -   | -                | -                 | (138 )   |

Preferred stock  
dividends - SBLF

|  |          |      |          |          |             |            |            |          |
|--|----------|------|----------|----------|-------------|------------|------------|----------|
| ESOP shares earned<br>(3,602 shares)                     | -        | -    | 1        | -        | -           | 32         | -          | 33       |
| Stock based<br>compensation                              | -        | -    | 23       | -        | -           | -          | -          | 23       |
| Common stock<br>dividends declared<br>(\$0.03 per share) | -        | -    | -        | (75 )    | -           | -          | -          | (75 )    |
| Balance, March 31,<br>2012                               | \$13,000 | \$30 | \$ 8,048 | \$25,103 | \$ (2,547 ) | \$(1,007 ) | \$(4,834 ) | \$37,793 |

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

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

| (In thousands)  | For the three months<br>ended March 31, |          |
|---|---|----------|
|   | 2013                                    | 2012     |
| <b>OPERATING ACTIVITIES</b>   |   |          |
| Net income  | \$ 505                                  | \$ 529   |
| Adjustments to reconcile net income to net cash flows from operating activities:  |   |          |
| Provision for loan losses   | 324                                     | 225      |
| Proceeds from sales of loans  | 182                                     | 41       |
| Originations of loans held-for-sale   | (172)                                   | (40)     |
| Realized (gains) losses on sales and redemptions of:  |   |          |
| Real estate acquired through foreclosure  | (19)                                    | 25       |
| Loans   | (10)                                    | (1)      |
| Available-for-sale investment securities  | (39)                                    | (112)    |
| Depreciation  | 176                                     | 199      |
| Amortization of mortgage servicing rights   | -                                       | 4        |
| Amortization of deferred loan costs   | 34                                      | 51       |
| Earnings on bank owned life insurance   | (59)                                    | (93)     |
| Realized gain on proceeds from bank owned life insurance  | (2)                                     | -        |
| Net amortization of premiums and discounts on investment securities   | 222                                     | 285      |
| Stock based compensation and ESOP expense   | 54                                      | 56       |
| Net change in accrued interest receivable   | (195)                                   | (284)    |
| Pension plan contribution   | -                                       | (2,600)  |
| Net change in other assets and liabilities  | (505)                                   | (129)    |
| Net cash flows from operating activities  | 496                                     | (1,844)  |
| <b>INVESTING ACTIVITIES</b>   |   |          |
| Purchase of investment securities available-for-sale  | (28,173)                                | (37,225) |
| Redemptions of Federal Home Loan Bank stock   | 424                                     | 129      |
| Proceeds from maturities and principal reductions of investment securities available-for-sale                                       | 8,067                                   | 4,937    |
| Proceeds from sales and redemptions of:   |   |          |
| Available-for-sale investment securities  | 1,893                                   | 5,052    |
| Real estate acquired through foreclosure  | 55                                      | 46       |
| Proceeds from bank owned life insurance   | 2                                       | -        |
| Net change in loans   | (5,369)                                 | 494      |
| Purchase of premises and equipment  | (236)                                   | (43)     |
| Net cash flows from investing activities  | (23,337)                                | (26,610) |
| <b>FINANCING ACTIVITIES</b>   |   |          |
| Net change in demand deposits, NOW accounts, savings accounts, money management deposit accounts, MMDA accounts and escrow deposits | 30,973                                  | 18,341   |
| Net change in time deposits and brokered deposits   | 5,607                                   | 10,795   |
| Net change in short-term borrowings   | (9,000)                                 | -        |
| Payments on long-term borrowings  | (28)                                    | (1,028)  |
| Redemption of preferred stock - CPP   | -                                       | (537)    |
| Cash dividends paid to preferred shareholder - SBLF   | (83)                                    | (142)    |
| Cash dividends paid to common shareholders  | (75)                                    | (75)     |
| Net cash flows from financing activities  | 27,394                                  | 27,354   |
| Change in cash and cash equivalents   | 4,553                                   | (1,100)  |

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|  |          |         |
|--|----------|---------|
| Cash and cash equivalents at beginning of period | 8,665    | 10,218  |
| Cash and cash equivalents at end of period       | \$13,218 | \$9,118 |
| CASH PAID DURING THE PERIOD FOR:                 |          |         |
| Interest   | \$894    | \$1,012 |
| Income taxes                                     | 140      | -       |
| NON-CASH INVESTING ACTIVITY                      |          |         |
| Real estate acquired in exchange for loans       | -        | 108     |

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

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Notes to Consolidated Financial Statements (Unaudited)

(1) Basis of Presentation

The accompanying unaudited consolidated financial statements of Pathfinder Bancorp, Inc. and its 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 10 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 2012 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.

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 as of December 31, 2012 and 2011 and for the two years then ended. Therefore, only material changes in financial condition and results of operations are discussed in the remainder of Part 1.

Operating results for the three months ended March 31, 2013 are not necessarily indicative of the results that may be expected for the year ending December 31, 2013.

(2) New Accounting Pronouncements

In February 2013, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") 2013-02 - Reporting of Amounts Reclassified Out of Accumulated Other Comprehensive Income. The objective of this ASU is to improve the reporting of reclassifications out of accumulated other comprehensive income. The amendments in this Update seek to attain that objective by requiring an entity to report the effect of significant reclassifications out of accumulated other comprehensive income on the respective line items in net income if the amount being reclassified is required under U.S. generally accepted accounting principles ("U.S. GAAP") to be reclassified in its entirety to net income. For other amounts that are not required under U.S. GAAP to be reclassified in their entirety to net income in the same reporting period, an entity is required to cross-reference other disclosures required under U.S. GAAP that provide additional detail about those amounts. The amendments do not change the current requirements for reporting net income or other comprehensive income in financial statements. However, the amendments require an entity to provide information about the amounts reclassified out of accumulated other comprehensive income by component. In addition, an entity is required to present either on the face of the statement where net income is presented or in the notes, significant amounts reclassified out of accumulated other comprehensive income by the respective line items of net income but only if the amount reclassified is required under U.S. GAAP to be reclassified to net income in its entirety in the same reporting period. The amendments are effective prospectively for reporting periods beginning after December 15, 2012. The adoption did not have a material impact on our consolidated statements of condition, results of operations, or cash flows.

(3) Earnings per Common Share

Basic earnings per share are calculated by dividing net income available to common shareholders by the weighted average number of common shares outstanding during the period. Net income available to common shareholders is

net income less the total of preferred dividends declared. 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. 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.

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

| (In thousands, except share and per share data)    | Three months ended |        |
|--|--------------------|--------|
|  | March 31,<br>2013  | 2012   |
| <b>Basic Earnings Per Common Share</b>             |                    |        |
| Net income available to common shareholders        | \$505              | \$391  |
| Weighted average common shares outstanding         | 2,512              | 2,500  |
| Basic earnings per common share                    | \$0.20             | \$0.16 |
| <b>Diluted Earnings Per Common Share</b>           |                    |        |
| Net income available to common shareholders        | \$505              | \$391  |
| Weighted average common shares outstanding         | 2,512              | 2,500  |
| Effect of assumed exercise of stock options        | -                  | 3      |
| Effect of assumed exercise of stock warrants       | -                  | 16     |
| Diluted weighted average common shares outstanding | 2,512              | 2,519  |
| Diluted earnings per common share                  | \$0.20             | \$0.16 |

## (4) Investment Securities - Available-for-Sale

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

| (In thousands)                              | Amortized<br>Cost | March 31, 2013               |                               | Estimated<br>Fair<br>Value |
|---|-------------------|------------------------------|-------------------------------|----------------------------|
|   |                   | Gross<br>Unrealized<br>Gains | Gross<br>Unrealized<br>Losses |                            |
| <b>Debt investment securities:</b>          |                   |                              |                               |                            |
| US Treasury, agencies and GSEs              | \$19,953          | \$15                         | \$(34 )                       | \$19,934                   |
| State and political subdivisions            | 25,540            | 864                          | (93 )                         | 26,311                     |
| Corporate                                   | 21,774            | 420                          | (341 )                        | 21,853                     |
| Residential mortgage-backed - US agency     | 53,440            | 1,056                        | (149 )                        | 54,347                     |
| Residential mortgage-backed - private label | 261               | 8                            | -                             | 269                        |
| Total                                       | 120,968           | 2,363                        | (617 )                        | 122,714                    |
| <b>Equity investment securities:</b>        |                   |                              |                               |                            |
| <b>Mutual funds:</b>                        |                   |                              |                               |                            |
| Ultra short mortgage fund                   | 1,286             | -                            | -                             | 1,286                      |
| Large cap equity fund                       | 905               | 303                          | -                             | 1,208                      |
| Other mutual funds                          | 183               | 128                          | -                             | 311                        |
| Common stock - financial services industry  | 420               | 16                           | -                             | 436                        |
| Total                                       | 2,794             | 447                          | -                             | 3,241                      |
| Total investment securities                 | \$123,762         | \$2,810                      | \$(617 )                      | \$125,955                  |

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| (In thousands)                              | December 31, 2012 |                              |                               | Estimated<br>Fair<br>Value |
|---|-------------------|------------------------------|-------------------------------|----------------------------|
|   | Amortized<br>Cost | Gross<br>Unrealized<br>Gains | Gross<br>Unrealized<br>Losses |                            |
| Debt investment securities:                 |                   |                              |                               |                            |
| US Treasury, agencies and GSEs              | \$6,175           | \$16                         | \$(8 )                        | \$6,183                    |
| State and political subdivisions            | 26,413            | 1,065                        | (7 )                          | 27,471                     |
| Corporate                                   | 22,942            | 468                          | (404 )                        | 23,006                     |
| Residential mortgage-backed - US agency     | 47,113            | 1,139                        | (1 )                          | 48,251                     |
| Residential mortgage-backed - private label | 296               | 9                            | -                             | 305                        |
| Total                                       | 102,939           | 2,697                        | (420 )                        | 105,216                    |
| Equity investment securities:               |                   |                              |                               |                            |
| Mutual funds:                               |                   |                              |                               |                            |
| Ultra short mortgage fund                   | 1,286             | 5                            | -                             | 1,291                      |
| Large cap equity fund                       | 905               | 176                          | -                             | 1,081                      |
| Other mutual funds                          | 183               | 136                          | -                             | 319                        |
| Common stock - financial services industry  | 420               | 12                           | -                             | 432                        |
| Total                                       | 2,794             | 329                          | -                             | 3,123                      |
| Total investment securities                 | \$105,733         | \$3,026                      | \$(420 )                      | \$108,339                  |

The amortized cost and estimated fair value of debt investments at March 31, 2013 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)                         | Amortized<br>Cost | Estimated<br>Fair Value |
|--|-------------------|-------------------------|
| Due in one year or less                | \$7,032           | \$7,062                 |
| Due after one year through five years  | 27,261            | 27,689                  |
| Due after five years through ten years | 15,308            | 15,674                  |
| Due after ten years                    | 17,666            | 17,673                  |
| Mortgage-backed securities             | 53,701            | 54,616                  |
| Totals                                 | \$120,968         | \$122,714               |



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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:

|                                  | Less than Twelve Months         |                   |            | March 31, 2013<br>Twelve Months or More |                   |            | Total                           |                   |            |
|----------------------------------|---------------------------------|-------------------|------------|---|-------------------|------------|---------------------------------|-------------------|------------|
|                                  | Number of Individual Securities | Unrealized Losses | Fair Value | Number of Individual Securities         | Unrealized Losses | Fair Value | Number of Individual Securities | Unrealized Losses | Fair Value |
|                                  |                                 |                   |            |   |                   |            |                                 |                   |            |
| (Dollars in thousands)           |                                 |                   |            |   |                   |            |                                 |                   |            |
| US Treasury, agencies and GSE's  | 13                              | \$ (34 )          | \$ 14,858  | -                                       | \$ -              | \$ -       | 13                              | \$ (34 )          | \$ 14,858  |
| State and political subdivisions | 7                               | (93 )             | 3,888      | -                                       | -                 | -          | 7                               | (93 )             | 3,888      |
| Corporate                        | 1                               | (6 )              | 403        | 2                                       | (335 )            | 1,635      | 3                               | (341 )            | 2,038      |
| Residential mortgage-backed -    |                                 |                   |            |   |                   |            |                                 |                   |            |
| US agency                        | 12                              | (149 )            | 13,696     | -                                       | -                 | -          | 12                              | (149 )            | 13,696     |
| Totals                           | 33                              | \$ (282 )         | \$ 32,845  | 2                                       | \$ (335 )         | \$ 1,635   | 35                              | \$ (617 )         | \$ 34,480  |

|                                  | Less than Twelve Months         |                   |            | December 31, 2012<br>Twelve Months or More |                   |            | Total                           |                   |            |
|----------------------------------|---------------------------------|-------------------|------------|--|-------------------|------------|---------------------------------|-------------------|------------|
|                                  | Number of Individual Securities | Unrealized Losses | Fair Value | Number of Individual Securities            | Unrealized Losses | Fair Value | Number of Individual Securities | Unrealized Losses | Fair Value |
|                                  |                                 |                   |            |  |                   |            |                                 |                   |            |
| (Dollars in thousands)           |                                 |                   |            |  |                   |            |                                 |                   |            |
| US Treasury, agencies and GSE's  | 1                               | \$ (8 )           | \$ 992     | -  | \$ -              | \$ -       | 1                               | \$ (8 )           | \$ 992     |
| State and political subdivisions | 8                               | (7 )              | 2,008      | -  | -                 | -          | 8                               | (7 )              | 2,008      |
| Corporate                        | 2                               | (14 )             | 974        | 2  | (390 )            | 1,580      | 4                               | (404 )            | 2,554      |
| Residential mortgage-backed -    |                                 |                   |            |  |                   |            |                                 |                   |            |
| US agency                        | 2                               | (1 )              | 1,411      | -  | -                 | -          | 2                               | (1 )              | 1,411      |
| Totals                           | 13                              | \$ (30 )          | \$ 5,385   | 2  | \$ (390 )         | \$ 1,580   | 15                              | \$ (420 )         | \$ 6,965   |

The Company conducts a formal review of investment securities on a quarterly basis for the presence of other-than-temporary impairment ("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.

The Company's investment securities portfolio includes two corporate securities representing trust preferred issuances from large money center financial institutions. The securities have been in an unrealized loss position for more than 12 months. The securities are both floating rate notes that adjust quarterly to LIBOR ("London Interbank Offered Rate"). These securities are reflecting a net unrealized loss due to current similar offerings being originated at higher spreads to LIBOR, as the market currently demands a greater pricing premium for the associated risk. Management has performed a detailed credit analysis on the underlying companies and has concluded that neither issue is credit impaired. Due to the fact that each security has approximately 15 years until final maturity, and management has determined that there is no related credit impairment, the associated pricing risk is managed similar to long-term, low yielding, 15 and 30-year fixed rate residential mortgages carried in the Company's loan portfolio. The risk is managed through the Company's extensive interest rate risk management procedures. The Company expects the present value of expected cash flows will be sufficient to recover the amortized cost basis. Thus, the securities are not deemed to be other-than-temporarily impaired.

Management does not believe any individual unrealized loss in other securities within the portfolio as of March 31, 2013 represents OTTI. All related securities are rated A2 or better by Moody's and have been in an unrealized loss position for five months or less, with the exception of the two corporate securities noted above. The unrealized losses in the portfolio are primarily attributable to changes in interest rates. 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.

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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. Management has determined that we have the intent and ability to retain the equity securities for a sufficient period of time to allow for recovery. All of the Company's equity securities had a fair value greater than the book value at March 31, 2013.

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

| (In thousands)  | For the three months<br>ended March 31, |       |
|-----------------|---|-------|
|                 | 2013                                    | 2012  |
| Realized gains  | \$39                                    | \$112 |
| Realized losses | -                                       | -     |
|                 | \$39                                    | \$112 |

As of March 31, 2013 and December 31, 2012, securities with a fair value of \$67.5 million and \$46.0 million, respectively, were pledged to collateralize certain municipal deposit relationships. As of the same dates, securities with a fair value of \$32.8 million and \$37.8 million were pledged against certain borrowing arrangements. Total borrowings of \$5.0 million were outstanding relating to the above noted collateralized borrowing arrangements as of both March 31, 2013 and December 31, 2012.

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

#### (5) Pension and Postretirement Benefits

The Company had a non-contributory defined benefit pension plan that covered substantially all employees. 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 freeze became effective June 30, 2012. Compensation earned by employees up to June 30, 2012 is used for purposes of calculating benefits under the plan but there will be 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.

Prior to being frozen, the plan provided defined benefits based on years of service and final average salary. Although the plan was frozen, the Company maintains the responsibility for funding the plan, and its funding practice is to contribute at least the minimum amount annually to meet minimum funding requirements. The funded status of the plan has and will continue to be affected by market conditions. We expect to continue to fund this plan on an as needed basis and do not foresee any issues or conditions that could negatively impact the payment of benefit obligations to plan participants. In addition, the Company provides certain health and life insurance benefits for 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.

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

| (In thousands)                          | Pension Benefits                     |        | Postretirement Benefits |      |
|---|--------------------------------------|--------|-------------------------|------|
|   | For the three months ended March 31, |        |                         |      |
|   | 2013                                 | 2012   | 2013                    | 2012 |
| Service cost                            | \$-                                  | \$111  | \$-                     | \$-  |
| Interest cost                           | 95                                   | 111    | 4                       | 4    |
| Expected return on plan assets          | (214 )                               | (198 ) | -                       | -    |
| Amortization of transition obligation   | -                                    | -      | -                       | 4    |
| Amortization of net losses              | 90                                   | 130    | 5                       | -    |
| Net periodic benefit plan (benefit)cost | \$(29 )                              | \$154  | \$9                     | \$8  |

The Company made a contribution in the amount of \$2.6 million to the defined benefit pension plan in January of 2012. The Company will evaluate any need for further contributions to the defined benefit pension plan during 2013.

## (6) Loans

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

| (In thousands)                              | March 31,<br>2013 | December<br>31,<br>2012 |
|---|-------------------|-------------------------|
| Residential mortgage loans:                 |                   |                         |
| 1-4 family first-lien residential mortgages | \$177,411         | \$173,955               |
| Construction                                | 778               | 2,655                   |
| Total residential mortgage loans            | 178,189           | 176,610                 |
| Commercial loans:                           |                   |                         |
| Real estate                                 | 84,308            | 82,329                  |
| Lines of credit                             | 13,461            | 13,748                  |
| Other commercial and industrial             | 32,826            | 31,477                  |
| Municipal                                   | 4,538             | 3,588                   |
| Total commercial loans                      | 135,133           | 131,142                 |
| Consumer loans:                             |                   |                         |
| Home equity and junior liens                | 21,552            | 22,073                  |
| Other consumer                              | 3,643             | 3,469                   |
| Total consumer loans                        | 25,195            | 25,542                  |
| Total loans                                 | 338,517           | 333,294                 |
| Net deferred loan costs                     | 427               | 454                     |
| Less allowance for loan losses              | (4,686 )          | (4,501 )                |
| Loans receivable, net                       | \$334,258         | \$329,247               |

The Company originates residential mortgage, commercial, and consumer loans largely to customers throughout Oswego and Onondaga counties. Although the Company has a diversified loan portfolio, a substantial portion of its borrowers' abilities to honor their contracts is dependent upon the counties' employment and economic conditions.



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As of March 31, 2013 and December 31, 2012, residential mortgage loans with a carrying value of \$121.4 million and \$58.6 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 consolidated financial statements included in the 2012 Annual Report filed on Form 10-K on March 18, 2013, and have not changed.

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 and 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       | 1-4 family<br>Mortgage first-lien<br>Loans residential<br>mortgages<br>Construction              |
| Commercial        | Loans Real estate<br>Lines of<br>credit<br>Other<br>commercial<br>and<br>industrial<br>Municipal |
| Consumer          | Home equity<br>Loans and junior<br>liens<br>Other<br>consumer                                    |

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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:

| (In thousands)                              | As of March 31, 2013 |                    |             |          |           |
|---|----------------------|--------------------|-------------|----------|-----------|
|   | Pass                 | Special<br>Mention | Substandard | Doubtful | Total     |
| Residential mortgage loans:                 |                      |                    |             |          |           |
| 1-4 family first-lien residential mortgages | \$169,774            | \$1,177            | \$6,432     | \$28     | \$177,411 |
| Construction                                | 778                  | -                  | -           | -        | 778       |
| Total residential mortgage loans            | 170,552              | 1,177              | 6,432       | 28       | 178,189   |
| Commercial loans:                           |                      |                    |             |          |           |
| Real estate                                 | 78,694               | 1,429              | 4,002       | 183      | 84,308    |
| Lines of credit                             | 11,868               | 396                | 1,197       | -        | 13,461    |
| Other commercial and industrial             | 30,987               | 400                | 1,139       | 300      | 32,826    |
| Municipal                                   | 4,538                | -                  | -           | -        | 4,538     |
| Total commercial loans                      | 126,087              | 2,225              | 6,338       | 483      | 135,133   |
| Consumer loans:                             |                      |                    |             |          |           |
| Home equity and junior liens                | 19,600               | 85                 | 1,780       | 87       | 21,552    |
| Other consumer                              | 3,515                | 49                 | 55          | 24       | 3,643     |
| Total consumer loans                        | 23,115               | 134                | 1,835       | 111      | 25,195    |
| Total loans                                 | \$319,754            | \$3,536            | \$14,605    | \$622    | \$338,517 |

| (In thousands)                              | As of December 31, 2012 |                    |             |          |           |
|---|-------------------------|--------------------|-------------|----------|-----------|
|   | Pass                    | Special<br>Mention | Substandard | Doubtful | Total     |
| Residential mortgage loans:                 |                         |                    |             |          |           |
| 1-4 family first-lien residential mortgages | \$166,801               | \$1,323            | \$5,831     | \$-      | \$173,955 |
| Construction                                | 2,655                   | -                  | -           | -        | 2,655     |
| Total residential mortgage loans            | 169,456                 | 1,323              | 5,831       | -        | 176,610   |
| Commercial loans:                           |                         |                    |             |          |           |
| Real estate                                 | 76,719                  | 1,685              | 3,925       | -        | 82,329    |
| Lines of credit                             | 12,026                  | -                  | 1,647       | 75       | 13,748    |
| Other commercial and industrial             | 29,705                  | 237                | 1,500       | 35       | 31,477    |
| Municipal                                   | 3,588                   | -                  | -           | -        | 3,588     |
| Total commercial loans                      | 122,038                 | 1,922              | 7,072       | 110      | 131,142   |
| Consumer loans:                             |                         |                    |             |          |           |
| Home equity and junior liens                | 20,078                  | 145                | 1,801       | 49       | 22,073    |
| Other consumer                              | 3,199                   | 133                | 111         | 26       | 3,469     |
| Total consumer loans                        | 23,277                  | 278                | 1,912       | 75       | 25,542    |
| Total loans                                 | \$314,771               | \$3,523            | \$14,815    | \$185    | \$333,294 |

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Management has reviewed its loan portfolio and determined that, to the best of its knowledge, no 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 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, segregated by portfolio segment and class of loans, as of March 31, 2013 and December 31, 2012, are detailed in the following tables:

| (In thousands)                              | As of March 31, 2013   |                        |                     |                   | Current   | Total Loans<br>Receivable |
|---|------------------------|------------------------|---------------------|-------------------|-----------|---------------------------|
|   | 30-59 Days<br>Past Due | 60-89 Days<br>Past Due | 90 Days<br>and Over | Total<br>Past Due |           |                           |
| Residential mortgage loans:                 |                        |                        |                     |                   |           |                           |
| 1-4 family first-lien residential mortgages | \$1,646                | \$1,153                | \$1,605             | \$4,404           | \$173,007 | \$177,411                 |
| Construction                                | -                      | -                      | -                   | -                 | 778       | 778                       |
| Total residential mortgage loans            | 1,646                  | 1,153                  | 1,605               | 4,404             | 173,785   | 178,189                   |
| Commercial loans:                           |                        |                        |                     |                   |           |                           |
| Real estate                                 | 525                    | 552                    | 3,140               | 4,217             | 80,091    | 84,308                    |
| Lines of credit                             | 504                    | 271                    | 263                 | 1,038             | 12,423    | 13,461                    |
| Other commercial and industrial             | 923                    | 1,360                  | 593                 | 2,876             | 29,950    | 32,826                    |
| Municipal                                   | -                      | -                      | -                   | -                 | 4,538     | 4,538                     |
| Total commercial loans                      | 1,952                  | 2,183                  | 3,996               | 8,131             | 127,002   | 135,133                   |
| Consumer loans:                             |                        |                        |                     |                   |           |                           |
| Home equity and junior liens                | 347                    | 182                    | 337                 | 866               | 20,686    | 21,552                    |
| Other consumer                              | 21                     | 18                     | 45                  | 84                | 3,559     | 3,643                     |
| Total consumer loans                        | 368                    | 200                    | 382                 | 950               | 24,245    | 25,195                    |
| Total loans                                 | \$3,966                | \$3,536                | \$5,983             | \$13,485          | \$325,032 | \$338,517                 |



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| (In thousands)                              | As of December 31, 2012 |                        |                     |                   | Current   | Total Loans<br>Receivable |
|---|-------------------------|------------------------|---------------------|-------------------|-----------|---------------------------|
|   | 30-59 Days<br>Past Due  | 60-89 Days<br>Past Due | 90 Days<br>and Over | Total<br>Past Due |           |                           |
| Residential mortgage loans:                 |                         |                        |                     |                   |           |                           |
| 1-4 family first-lien residential mortgages | \$2,698                 | \$1,161                | \$2,046             | \$5,905           | \$168,050 | \$173,955                 |
| Construction                                | -                       | -                      | -                   | -                 | 2,655     | 2,655                     |
| Total residential mortgage loans            | 2,698                   | 1,161                  | 2,046               | 5,905             | 170,705   | 176,610                   |
| Commercial loans:                           |                         |                        |                     |                   |           |                           |
| Real estate                                 | 1,706                   | 1,833                  | 1,794               | 5,333             | 76,996    | 82,329                    |
| Lines of credit                             | 496                     | 153                    | 334                 | 983               | 12,765    | 13,748                    |
| Other commercial and industrial             | 1,279                   | 85                     | 598                 | 1,962             | 29,515    | 31,477                    |
| Municipal                                   | -                       | -                      | -                   | -                 | 3,588     | 3,588                     |
| Total commercial loans                      | 3,481                   | 2,071                  | 2,726               | 8,278             | 122,864   | 131,142                   |
| Consumer loans:                             |                         |                        |                     |                   |           |                           |
| Home equity and junior liens                | 207                     | 405                    | 730                 | 1,342             | 20,731    | 22,073                    |
| Other consumer                              | 26                      | 42                     | 46                  | 114               | 3,355     | 3,469                     |
| Total consumer loans                        | 233                     | 447                    | 776                 | 1,456             | 24,086    | 25,542                    |
| Total loans                                 | \$6,412                 | \$3,679                | \$5,548             | \$15,639          | \$317,655 | \$333,294                 |

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

| (In thousands)                              | March 31,<br>2013 | December<br>31,<br>2012 |
|---|-------------------|-------------------------|
| Residential mortgage loans:                 |                   |                         |
| 1-4 family first-lien residential mortgages | \$1,605           | \$2,046                 |
|   | 1,605             | 2,046                   |
| Commercial loans:                           |                   |                         |
| Real estate                                 | 3,140             | 1,794                   |
| Lines of credit                             | 263               | 334                     |
| Other commercial and industrial             | 593               | 598                     |
|   | 3,996             | 2,726                   |
| Consumer loans:                             |                   |                         |
| Home equity and junior liens                | 337               | 730                     |
| Other consumer                              | 45                | 46                      |
|   | 382               | 776                     |
| Total nonaccrual loans                      | \$5,983           | \$5,548                 |

There were no loans past due ninety days or more and still accruing interest at March 31, 2013 or December 31, 2012.

The Company is required to disclose certain activities related to Troubled Debt Restructurings (“TDR”s) 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.



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The Company is required to disclose new TDRs for each reporting period for which an income statement is being presented. The Company has determined that there were no new TDRs for the three month periods ending March 31, 2013 and March 31, 2012.

There are four loans that are in payment default within the three month period ended March 31, 2013 which were modified during the preceding twelve month period. Two of these loans are commercial real estate loans in the amount of \$746,000, one is a commercial line of credit in the amount of \$87,000, and the other is a commercial loan in the amount of \$110,000.

When the Company modifies a loan within a portfolio segment, 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:

| (In thousands)                              | March 31, 2013      |                          |                   | December 31, 2012   |                          |                   |
|---|---------------------|--------------------------|-------------------|---------------------|--------------------------|-------------------|
|   | 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 | \$1,354             | \$1,354                  | \$-               | \$844               | \$844                    | \$-               |
| Commercial real estate                      | 1,924               | 1,948                    | -                 | 1,554               | 1,571                    | -                 |
| Commercial lines of credit                  | 356                 | 369                      | -                 | 358                 | 370                      | -                 |
| Other commercial and industrial             | 575                 | 729                      | -                 | 657                 | 801                      | -                 |
| Home equity and junior liens                | 474                 | 474                      | -                 | 380                 | 380                      | -                 |
| Other consumer                              | -                   | -                        | -                 | -                   | -                        | -                 |
| With an allowance recorded:                 |                     |                          |                   |                     |                          |                   |
| 1-4 family first-lien residential mortgages | 1,016               | 1,016                    | 172               | 1,307               | 1,307                    | 215               |
| Commercial real estate                      | 1,928               | 1,928                    | 451               | 1,182               | 1,182                    | 401               |
| Commercial lines of credit                  | 100                 | 100                      | 100               | -                   | -                        | -                 |
| Other commercial and industrial             | 261                 | 266                      | 242               | 225                 | 230                      | 207               |
| Home equity and junior liens                | 158                 | 158                      | 93                | 155                 | 155                      | 95                |
| Other consumer                              | 3                   | 3                        | 3                 | 5                   | 5                        | 5                 |
| Total:                                      |                     |                          |                   |                     |                          |                   |
| 1-4 family first-lien residential mortgages | 2,370               | 2,370                    | 172               | 2,151               | 2,151                    | 215               |
| Commercial real estate                      | 3,852               | 3,876                    | 451               | 2,736               | 2,753                    | 401               |
| Commercial lines of credit                  | 456                 | 469                      | 100               | 358                 | 370                      | -                 |
| Other commercial and industrial             | 836                 | 995                      | 242               | 882                 | 1,031                    | 207               |
| Home equity and junior liens                | 632                 | 632                      | 93                | 535                 | 535                      | 95                |
| Other consumer                              | 3                   | 3                        | 3                 | 5                   | 5                        | 5                 |
| Totals                                      | \$8,149             | \$8,345                  | \$1,061           | \$6,667             | \$6,845                  | \$923             |



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

| (In thousands)                              | For the three months<br>ended March 31, |         |
|---|---|---------|
|   | 2013                                    | 2012    |
| 1-4 family first-lien residential mortgages | \$2,261                                 | \$1,252 |
| Commercial real estate                      | 3,294                                   | 2,097   |
| Commercial lines of credit                  | 407                                     | 452     |
| Other commercial and industrial             | 859                                     | 586     |
| Home equity and junior liens                | 583                                     | 452     |
| Other consumer                              | 4                                       | -       |
| Total                                       | \$7,408                                 | \$4,839 |

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

| (In thousands)                              | For the three months<br>ended March 31, |      |
|---|---|------|
|   | 2013                                    | 2012 |
| 1-4 family first-lien residential mortgages | \$30                                    | \$15 |
| Commercial real estate                      | 45                                      | 23   |
| Commercial lines of credit                  | 4                                       | 5    |
| Other commercial and industrial             | 5                                       | 6    |
| Home equity and junior liens                | 15                                      | 4    |
| Other consumer                              | -                                       | -    |
| Total                                       | \$99                                    | \$53 |

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## (7) Allowance for Loan Losses

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

|   | For the three months ended March 31, 2013           |   |                           |                                  |  |
|---|---|---|---------------------------|----------------------------------|--|
|   | 1-4 family<br>first-lien<br>residential<br>mortgage | Residential<br>construction<br>mortgage | Commercial<br>real estate | Commercial<br>lines of<br>credit | Other<br>commercial<br>and<br>industrial |
| (In thousands)  |   |   |                           |                                  |  |
| Allowance for loan losses:  |   |   |                           |                                  |  |
| Beginning Balance   | \$811   | \$-                                     | \$1,748                   | \$440                            | \$750                                    |
| Charge-offs   | (12)  | ) -                                     | -                         | (49)                             | ) (10)                                   |
| Recoveries  | 12  | -                                       | -                         | -                                | -  |
| Provisions  | 17  | -                                       | 147                       | 82                               | 114                                      |
| Ending balance  | \$828   | \$-                                     | \$1,895                   | \$473                            | \$854                                    |
| Ending balance: related to loans<br>individually evaluated for impairment | \$172   | \$-                                     | \$451                     | \$100                            | \$242                                    |
| Ending balance: related to loans<br>collectively evaluated for impairment | \$656   | \$-                                     | \$1,444                   | \$373                            | \$612                                    |
| Loans receivables:  |   |   |                           |                                  |  |
| Ending balance  | \$177,411   | \$778                                   | \$84,308                  | \$13,461                         | \$32,826                                 |
| Ending balance: individually<br>evaluated for impairment                  | \$2,370   | \$-                                     | \$3,852                   | \$456                            | \$836                                    |
| Ending balance: collectively<br>evaluated for impairment                  | \$175,041   | \$778                                   | \$80,456                  | \$13,005                         | \$31,990                                 |
|   |   |   |                           |                                  |  |
|   |   | Home<br>equity<br>and junior<br>liens   | Other<br>consumer         | Unallocated                      | Total                                    |
| Allowance for loan losses:  |   |   |                           |                                  |  |
| Beginning Balance   | \$2   | \$494                                   | \$168                     | \$88                             | \$4,501                                  |
| Charge-offs   | -   | (81)                                    | ) (28)                    | ) -                              | (180)                                    |
| Recoveries  | -   | 13                                      | 16                        | -                                | 41                                       |
| Provisions  | -   | 63                                      | (17)                      | ) (82)                           | ) 324                                    |
| Ending balance  | \$2   | \$489                                   | \$139                     | \$6                              | \$4,686                                  |
| Ending balance: related to loans<br>individually evaluated for impairment | \$-   | \$93                                    | \$3                       | \$-                              | \$1,061                                  |
| Ending balance: related to loans<br>collectively evaluated for impairment | \$2   | \$396                                   | \$136                     | \$6                              | \$3,625                                  |
| Loans receivables:  |   |   |                           |                                  |  |
| Ending balance  | \$4,538   | \$21,552                                | \$3,643                   |                                  | \$338,517                                |
| Ending balance: individually<br>evaluated for impairment                  | \$-   | \$632                                   | \$3                       |                                  | \$8,149                                  |
| Ending balance: collectively  |   |   |                           |                                  |  |

|                          |         |           |          |           |
|--------------------------|---------|-----------|----------|-----------|
| evaluated for impairment | \$4,538 | \$ 20,920 | \$ 3,640 | \$330,368 |
|--------------------------|---------|-----------|----------|-----------|

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For the three months ended March 31, 2012

| (In thousands)  | 1-4 family<br>first-lien<br>residential<br>mortgage | Residential<br>construction<br>mortgage | Commercial<br>real estate | Commercial<br>lines of<br>credit | Other<br>commercial<br>and<br>industrial |
|---|---|---|---------------------------|----------------------------------|--|
| Allowance for loan losses:  |   |   |                           |                                  |  |
| Beginning Balance   | \$664   | \$ -                                    | \$ 1,346                  | \$ 463                           | \$649                                    |
| Charge-offs   | (20 )   | -                                       | (54 )                     | -                                | (43 )                                    |
| Recoveries  | 28  | -                                       | 14                        | -                                | -  |
| Provisions  | 47  | -                                       | 159                       | 52                               | 113                                      |
| Ending balance  | \$719   | \$ -                                    | \$ 1,465                  | \$ 515                           | \$719                                    |
| Ending balance: related to loans<br>individually evaluated for impairment | 161   | -                                       | 228                       | 228                              | 277                                      |
| Ending balance: related to loans<br>collectively evaluated for impairment | \$558   | \$ -                                    | \$ 1,237                  | \$ 287                           | \$442                                    |
| Loans receivables:  |   |   |                           |                                  |  |
| Ending balance  | \$160,339   | \$ 2,919                                | \$ 73,003                 | \$ 13,978                        | \$21,393                                 |
| Ending balance: individually<br>evaluated for impairment                  | 1,206   | -                                       | 2,491                     | 452                              | 794                                      |
| Ending balance: collectively<br>evaluated for impairment                  | \$159,133   | \$ 2,919                                | \$ 70,512                 | \$ 13,526                        | \$20,599                                 |

|   | Municipal | Home<br>equity<br>and junior<br>liens | Other<br>Consumer | Unallocated | Total     |
|---|-----------|---------------------------------------|-------------------|-------------|-----------|
| Allowance for loan losses:  |           |                                       |                   |             |           |
| Beginning Balance   | \$2       | \$ 501                                | \$ 162            | \$ 193      | \$3,980   |
| Charge-offs   | -         | -                                     | (41 )             | -           | (158 )    |
| Recoveries  | -         | 2                                     | 21                | -           | 65        |
| Provisions  | -         | (8 )                                  | (8 )              | (130 )      | 225       |
| Ending balance  | \$2       | \$ 495                                | \$ 134            | \$ 63       | \$4,112   |
| Ending balance: related to loans<br>individually evaluated for impairment | -         | 61                                    | -                 | -           | 955       |
| Ending balance: related to loans<br>collectively evaluated for impairment | \$2       | \$ 434                                | \$ 134            | \$ 63       | \$3,157   |
| Loans receivables:  |           |                                       |                   |             |           |
| Ending balance  | \$4,203   | \$ 23,673                             | \$ 3,933          |             | \$303,441 |
| Ending balance: individually<br>evaluated for impairment                  | -         | 447                                   | -                 |             | 5,390     |
| Ending balance: collectively<br>evaluated for impairment                  | \$4,203   | \$ 23,226                             | \$ 3,933          |             | \$298,051 |





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(8) Guarantees

The Company does not issue any guarantees that would require liability recognition or disclosure, other than its standby letters of credit. Standby letters of credit are conditional commitments issued by the Company to guarantee the performance of a customer to a third party. Generally, all letters of credit when issued have expiration dates within one year of issuance. The credit risk involved in issuing letters of credit is essentially the same as those that are involved in extending loan facilities to customers. The Company generally holds collateral and/or personal guarantees supporting these commitments. The Company had \$1.5 million of standby letters of credit outstanding as of March 31, 2013. 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.

(9) 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 securities available for sale 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.

Interest rate swap derivative: The fair value of the interest rate swap derivative is calculated based on a discounted cash flow model. All future floating cash flows are projected and both floating and fixed cash flows are discounted to the valuation date. The curve utilized for discounting and projecting is built by obtaining publicly available third

party market quotes for various swap maturity terms.

Impaired loans: Impaired loans are those loans in which the Company has measured impairment generally based on the fair value of the loan's collateral. 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.

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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:

| (In thousands)                              | March 31, 2013 |           |         | Total Fair Value |
|---|----------------|-----------|---------|------------------|
|   | Level 1        | Level 2   | Level 3 |                  |
| Debt investment securities:                 |                |           |         |                  |
| US Treasury, agencies and GSEs              | \$-            | \$19,934  | \$-     | \$19,934         |
| State and political subdivisions            | -              | 26,311    | -       | 26,311           |
| Corporate                                   | -              | 21,853    | -       | 21,853           |
| Residential mortgage-backed - US agency     | -              | 54,347    | -       | 54,347           |
| Residential mortgage-backed - private label | -              | 269       | -       | 269              |
| Equity investment securities:               |                |           |         |                  |
| Mutual funds:                               |                |           |         |                  |
| Ultra short mortgage fund                   | 1,286          | -         | -       | 1,286            |
| Large cap equity fund                       | 1,208          | -         | -       | 1,208            |
| Other mutual funds                          | -              | 311       | -       | 311              |
| Common stock - financial services industry  | 36             | 400       | -       | 436              |
| Total investment securities                 | \$2,530        | \$123,425 | \$-     | \$125,955        |
| Interest rate swap derivative               | \$-            | \$(180    | ) \$-   | \$(180 )         |

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| (In thousands)                              | December 31, 2012 |           |         | Total Fair Value |
|---|-------------------|-----------|---------|------------------|
|   | Level 1           | Level 2   | Level 3 |                  |
| Debt investment securities:                 |                   |           |         |                  |
| US Treasury, agencies and GSEs              | \$-               | \$6,183   | \$-     | \$6,183          |
| State and political subdivisions            | -                 | 27,471    | -       | 27,471           |
| Corporate                                   | -                 | 23,006    | -       | 23,006           |
| Residential mortgage-backed - US agency     | -                 | 48,251    | -       | 48,251           |
| Residential mortgage-backed - private label | -                 | 305       | -       | 305              |
| Equity investment securities:               |                   |           |         |                  |
| Mutual funds:                               |                   |           |         |                  |
| Ultra short mortgage fund                   | 1,291             | -         | -       | 1,291            |
| Large cap equity fund                       | 1,081             | -         | -       | 1,081            |
| Other mutual funds                          | -                 | 319       | -       | 319              |
| Common stock - financial services industry  | 33                | 399       | -       | 432              |
| Total investment securities                 | \$2,405           | \$105,934 | \$-     | \$108,339        |
| Interest rate swap derivative               | \$-               | \$(195)   | \$-     | \$(195)          |

The Bank had the following assets measured at fair value on a nonrecurring basis as of March 31, 2013 and December 31, 2012:

| (In thousands)         | March 31, 2013 |         |         | Total Fair Value |
|------------------------|----------------|---------|---------|------------------|
|                        | Level 1        | Level 2 | Level 3 |                  |
| Impaired loans         | \$-            | \$-     | \$904   | \$904            |
| Foreclosed real estate | \$-            | \$-     | \$-     | \$-              |

| (In thousands)         | December 31, 2012 |         |         | Total Fair Value |
|------------------------|-------------------|---------|---------|------------------|
|                        | Level 1           | Level 2 | Level 3 |                  |
| Impaired loans         | \$-               | \$-     | \$1,951 | \$1,951          |
| Foreclosed real estate | \$-               | \$-     | \$301   | \$301            |

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.

| Quantitative Information about Level 3 Fair Value Measurements |                         |                       |                       |
|--|-------------------------|-----------------------|-----------------------|
|  | Valuation Techniques    | Unobservable Input    | Range (Weighted Avg.) |
| March 31, 2013   |                         |                       |                       |
| Impaired loans   | Appraisal of collateral | Appraisal Adjustments | 5% - 30% (21%)        |
|  |                         | Costs to Sell         | 6% - 50% (12%)        |
|  | Appraisal of collateral | Appraisal Adjustments |                       |

Foreclosed real  
estate

15% - 15%  
(15%)  
6% - 7%  
(6%)

Costs to Sell

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|                           | Valuation<br>Techniques | Quantitative Information about Level 3 Fair<br>Value Measurements |                          |
|---------------------------|-------------------------|---|--------------------------|
|                           |                         | Unobservable<br>Input   | Range<br>(Weighted Avg.) |
| December 31,<br>2012      |                         |   |                          |
| Impaired loans            | Appraisal of collateral | Appraisal Adjustments   | 5% - 30%<br>(21%)        |
|                           |                         | Costs to Sell   | 6% - 15%<br>(12%)        |
| Foreclosed real<br>estate | Appraisal of collateral | Appraisal Adjustments   | 15% - 15%<br>(15%)       |
|                           |                         | Costs to Sell   | 6% - 7%<br>(6%)          |

There have been no transfers of assets in or out of any fair value measurement level.

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.

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.

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.

Interest earning time deposits – The carrying amounts of these assets approximate their fair value.

Investment securities – The fair values of securities available for sale 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.

Federal Home Loan Bank stock – The carrying amount of these assets approximates their fair value.

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.



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Accrued interest receivable and payable – The carrying amount of these assets approximates their fair value.

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 FHLB NY 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 FHLB NY are obtained and the borrowings are discounted to the FHLB NY advance curve less an appropriate spread to adjust for the option. These measurements are classified as Level 2 within the fair value hierarchy.

Junior subordinated debentures – Current economic conditions have rendered the market for this liability inactive. As such, the Company was formerly unable to determine a good estimate of fair value, resulting in a Level 3 classification at December 31, 2012. As of March 31, 2013, the Company was able to secure a quote from its pricing service of a security with similar characteristics which resulted in a Level 2 classification for this borrowing.

Interest rate swap derivative – The fair value of the interest rate swap derivative is obtained from a third party pricing agent and is calculated based on a discounted cash flow model. All future floating cash flows are projected and both floating and fixed cash flows are discounted to the valuation date. The curve utilized for discounting and projecting is built by obtaining publicly available third party market quotes for various swap maturity terms, and therefore is classified within Level 2 of the fair value hierarchy.

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

| (Dollars In thousands)                 | Fair Value Hierarchy | March 31, 2013   |                       | December 31, 2012 |                       |
|--|----------------------|------------------|-----------------------|-------------------|-----------------------|
|  |                      | Carrying Amounts | Estimated Fair Values | Carrying Amounts  | Estimated Fair Values |
| Financial assets:                      |                      |                  |                       |                   |                       |
| Cash and cash equivalents              | 1                    | \$13,218         | \$13,218              | \$8,665           | \$8,665               |
| Interest earning time deposits         | 1                    | 2,000            | 2,000                 | 2,000             | 2,000                 |
| Investment securities                  | 1                    | 2,530            | 2,530                 | 2,405             | 2,405                 |
| Investment securities                  | 2                    | 123,425          | 123,425               | 105,934           | 105,934               |
| Federal Home Loan Bank stock           | 2                    | 1,505            | 1,505                 | 1,929             | 1,929                 |
| Net loans                              | 3                    | 334,258          | 344,647               | 329,247           | 341,389               |
| Accrued interest receivable            | 1                    | 1,912            | 1,912                 | 1,717             | 1,717                 |
| Financial liabilities:                 |                      |                  |                       |                   |                       |
| Demand Deposits, Savings, NOW and MMDA | 1                    | \$259,458        | \$259,458             | \$228,484         | \$228,484             |
| Time Deposits                          | 2                    | 168,927          | 170,776               | 163,321           | 165,491               |
| Borrowings                             | 2                    | 25,936           | 26,846                | 34,964            | 36,054                |

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|                                |   |       |       |       |       |
|--------------------------------|---|-------|-------|-------|-------|
| Junior subordinated debentures | 2 | 5,155 | 4,429 | -     | -     |
| Junior subordinated debentures | 3 | -     | -     | 5,155 | 5,155 |
| Accrued interest payable       | 1 | 142   | 142   | 140   | 140   |
| Interest rate swap derivative  | 2 | 180   | 180   | 195   | 195   |

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## (10) Interest Rate Derivatives

Derivative instruments are entered into primarily as a risk management tool of the Company. Financial derivatives are recorded at fair value as other assets and 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. See Note 9 for further discussion of the fair value of the interest rate derivative.

The Company has \$5 million of floating rate trust preferred debt indexed to 3-month LIBOR. As a result, it is exposed to variability in cash flows related to changes in projected interest payments caused by changes in the benchmark interest rate. During the fourth quarter of fiscal 2009, the Company entered into an interest rate swap agreement, with a \$2 million notional amount, to convert a portion of the variable-rate junior subordinated debentures to a fixed rate for a term of approximately 7 years at a rate of 4.96%. The derivative is designated as a cash flow hedge. The hedging strategy ensures that changes in cash flows from the derivative will be highly effective at offsetting changes in interest expense from the hedged exposure.

The following table summarizes the fair value of the outstanding derivative and its presentation on the statements of condition:

| (In thousands)    | March 31,<br>2013 | December<br>31,<br>2012 |
|-------------------|-------------------|-------------------------|
| Cash flow hedge:  |                   |                         |
| Other liabilities | \$ 180            | \$ 195                  |

The change in accumulated other comprehensive loss on a pretax basis and the impact on earnings from the interest rate swap that qualifies as a cash flow hedge for the periods indicated below were as follows:

| (In thousands)  | Three Months Ended<br>March 31, |          |
|---|---------------------------------|----------|
|   | 2013                            | 2012     |
| Balance as of January 1:  | \$(195 )                        | \$(200 ) |
| Amount of losses recognized in other comprehensive income   | -                               | (8 )     |
| Amount of loss reclassified from other comprehensive income<br>and recognized as interest expense | 15                              | 14       |
| Balance as of March 31:   | \$(180 )                        | \$(194 ) |

No amount of ineffectiveness has been included in earnings and the changes in fair value have been recorded in other comprehensive income. Some, or all, of the amount included in accumulated other comprehensive loss would be reclassified into current earnings should a portion of, or the entire hedge no longer be considered effective, but at this time, management expects the hedge to remain fully effective during the remaining term of the swap.

The Company posted cash, of \$200,000, under arrangements to satisfy collateral requirements associated with the interest rate swap contract.



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## (11) 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.

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

| Details about AOCI Components (In thousands)   | For the three months ended March 31, 2013 |  |
|--|---|--|
|  | Amount<br>Reclassified<br>from<br>AOCI1   | Affected Line Item in the<br>Statement of Net Income   |
| Unrealized holding gain on financial derivative:<br>Reclassification adjustment for interest expense included in net<br>income | \$(15)<br>6<br>\$(9)                      | ) Interest on long term liabilities<br>Provision for income taxes<br>) Net Income                            |
| Retirement plan items<br>Retirement plan net losses recognized in plan expenses 2  | \$(95)<br>38<br>\$(57)                    | ) Salaries and employee benefits<br>Provision for income taxes<br>) Net Income                               |
| Available-for-sale securities<br><br>Realized gain on sale of securities   | <br><br>\$39<br>(16)<br>\$23              | Net gains on sales and redemptions of<br>investment securities<br>) Provision for income taxes<br>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

## (12) Subsequent Events

The Company has evaluated subsequent events for recognition and/or disclosures through the date that these consolidated financial statements were issued.

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

General

Throughout Management's Discussion and Analysis ("MD&A") the term, "the Company", refers to the consolidated entity of Pathfinder Bancorp, Inc. Pathfinder Bank and Pathfinder Statutory Trust II are wholly owned subsidiaries of Pathfinder Bancorp, Inc., however, Pathfinder Statutory Trust II is not consolidated for reporting purposes. Pathfinder Commercial Bank, Pathfinder REIT, Inc., Pathfinder Risk Management, Inc., and Whispering Oaks Development Corp. are wholly owned subsidiaries of Pathfinder Bank. At March 31, 2013, Pathfinder Bancorp, M.H.C., the Company's mutual holding company parent, whose activities are not included in the consolidated financial statements or the MD&A, held 60.5% of the Company's outstanding common stock and public shareholders, including shares held by the Employee Stock Ownership Plan ("ESOP"), held the remaining 39.5% of the outstanding common stock.

The following discussion reviews the Company's financial condition at March 31, 2013 and the results of operations for the three months ended March 31, 2013 and 2012.

Statement Regarding Forward-Looking Statements

When used in this quarterly report the words or phrases "will likely result", "are expected to", "will continue", "is anticipated", "estimate", "project", or similar expression are intended to identify "forward-looking statements" within the meaning of the Private Securities Litigation Reform Act of 1995. Such statements are subject to certain risks and uncertainties. By identifying these forward-looking statements for you in this manner, the Company is alerting you to the possibility that its actual results and financial condition may differ, possibly materially, from the anticipated results and financial condition indicated in these forward-looking statements. The Company wishes to caution readers not to place undue reliance on any such forward-looking statements, which speak only as of the date made. The Company wishes to advise readers that various factors could affect the Company's financial performance and could cause the Company's actual results for future periods to differ materially from any opinions or statements expressed with respect to future periods in any current statements. Additionally, all statements in this document, including forward-looking statements, speak only as of the date they are made, and the Company undertakes no obligation to update any statement in light of new information or future 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 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 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 other 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 included in the 2012 Annual Report filed on form 10-K on March 18, 2013 ("the

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 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, and the estimation of fair values for accounting and disclosure purposes 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.

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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. The Company establishes a specific allowance for all loans identified as being impaired with a balance in excess of \$100,000 which are on nonaccrual and have been risk rated under the Company's risk rating system as substandard, doubtful, or loss. In addition, an accruing substandard loan could be identified as being impaired. The measurement of impaired loans is generally based upon the present value of future cash flows discounted at the historical effective interest rate, except that all collateral-dependent loans are measured for impairment based on the fair value of the collateral, less costs to sell. The majority of the Company's impaired loans are collateral-dependent. 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. The loan portfolio also represents the largest asset type on the consolidated statement of condition. Note 1 to the consolidated financial statements describes the methodology used to determine the allowance for loan losses and a discussion of the factors driving changes in the amount of the allowance for loan losses is included in this report.

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 affect 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. A valuation allowance of \$458,000 was maintained at March 31, 2013, as management believes it may not generate sufficient capital gains to offset its capital loss carry forward. The Company's effective tax rate differs from the statutory rate due primarily to non-taxable income from investment securities and bank owned life insurance.

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 12 to the consolidated annual financial statements.

The Company carries all of its 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 security 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 security 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. 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. Management continually analyzes the portfolio to determine if further impairment has occurred that may be deemed as other-than-temporary. Further charges are possible depending on future economic conditions.





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The estimation of fair value is significant to several of our assets; including investment securities available for sale, the interest rate derivative, 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 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 an independent third party pricing service. 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 source. 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.

### Recent Events

As reported by the Company on its Form 10-K filed on March 29, 2012, the purchase of the 51% controlling interest in the Fitzgibbons Agency, pending the completion of the final stages of due diligence, was expected to close in the early part of the second quarter of 2012. The Company and the Fitzgibbons Agency are addressing the final elements of the transaction and are working to expedite a closing at the earliest possible time.

### Overview and Results of Operations

For the first quarter of 2013, net income was \$505,000 as compared to \$529,000 for the first quarter of 2012 due to an increase in the provision for loan losses, a reduction in noninterest income, and an increase in noninterest expenses. Partially offsetting these reductions to net income was a \$188,000 increase in net interest income between the year over year first quarter periods.

The Company's return on average assets and return on average equity for the first quarter of 2013 were 0.41% and 4.92%, respectively, as compared to 0.47% and 5.52% for the same prior year period.

Average assets for the first quarter of 2013 were \$496.1 million, or 9.2% greater than the comparable prior year period. The increase was attributable to increases in residential real estate loans, commercial loans, commercial real estate, and to a lesser extent, tax-exempt securities. Commercial loans increased \$11.6 million or 29.2% between these same periods in direct support of the Company's initiative to diversify its portfolio and increase its penetration within this segment.

### 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.

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The following table sets forth information concerning average interest-earning assets and interest-bearing liabilities and the yields and rates thereon for the periods indicated. Interest income and resultant yield information in the table is on a fully tax-equivalent basis using marginal federal income tax rates of 34%. 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.

| (Dollars in thousands)                                | For the three months Ended March 31, |          |                      |  |                 |          |                      |  |
|---|--------------------------------------|----------|----------------------|--|-----------------|----------|----------------------|--|
|   | 2013                                 |          |                      |  | 2012            |          |                      |  |
|   | Average Balance                      | Interest | Average Yield / Cost |  | Average Balance | Interest | Average Yield / Cost |  |
| Interest-earning assets:                              |                                      |          |                      |  |                 |          |                      |  |
| Real estate loans                                     |                                      |          |                      |  |                 |          |                      |  |
| residential   | \$ 177,934                           | \$ 2,059 | 4.63 %               |  | \$ 162,741      | \$ 2,071 | 5.09 %               |  |
| Real estate loans commercial                          | 81,951                               | 1,109    | 5.41 %               |  | 72,990          | 1,039    | 5.69 %               |  |
| Commercial loans                                      | 51,144                               | 608      | 4.76 %               |  | 39,578          | 511      | 5.16 %               |  |
| Consumer loans  | 25,339                               | 359      | 5.67 %               |  | 27,968          | 398      | 5.69 %               |  |
| Taxable investment securities                         | 93,820                               | 418      | 1.78 %               |  | 93,747          | 492      | 2.10 %               |  |
| Tax-exempt investment securities                      | 25,979                               | 289      | 4.45 %               |  | 20,324          | 246      | 4.84 %               |  |
| Interest-earning time deposit                         | 2,000                                | 6        | 1.20 %               |  | 2,000           | 7        | 1.40 %               |  |
| Interest-earning deposits                             | 7,117                                | 1        | 0.06 %               |  | 1,294           | 1        | 0.31 %               |  |
| Total interest-earning assets                         | 465,284                              | 4,849    | 4.17 %               |  | 420,642         | 4,765    | 4.53 %               |  |
| Noninterest-earning assets:                           |                                      |          |                      |  |                 |          |                      |  |
| Other assets  | 32,845                               |          |                      |  | 35,512          |          |                      |  |
| Allowance for loan losses                             | (4,551 )                             |          |                      |  | (4,042 )        |          |                      |  |
| Net unrealized gains on available for sale securities | 2,525                                |          |                      |  | 2,161           |          |                      |  |
| Total assets  | \$ 496,103                           |          |                      |  | \$ 454,273      |          |                      |  |
| Interest-bearing liabilities:                         |                                      |          |                      |  |                 |          |                      |  |
| NOW accounts  | \$ 39,355                            | 19       | 0.19 %               |  | \$ 31,275       | 19       | 0.24 %               |  |
| Money management accounts                             | 14,444                               | 9        | 0.25 %               |  | 14,374          | 14       | 0.39 %               |  |
| MMDA accounts   | 81,206                               | 96       | 0.47 %               |  | 77,186          | 114      | 0.59 %               |  |
| Savings and club accounts                             | 67,870                               | 14       | 0.08 %               |  | 62,267          | 15       | 0.10 %               |  |
| Time deposits   | 164,150                              | 521      | 1.27 %               |  | 154,928         | 599      | 1.55 %               |  |
| Junior subordinated debentures                        | 5,155                                | 40       | 3.10 %               |  | 5,155           | 42       | 3.26 %               |  |
| Borrowings  | 32,437                               | 197      | 2.43 %               |  | 27,557          | 213      | 3.09 %               |  |
|   | 404,617                              | 896      | 0.89 %               |  | 372,742         | 1,016    | 1.09 %               |  |

|  |            |          |            |          |          |
|--|------------|----------|------------|----------|----------|
| Total interest-bearing liabilities   |            |          |            |          |          |
| Noninterest-bearing liabilities:   |            |          |            |          |          |
| Demand deposits  | 46,765     |          | 38,955     |          |          |
| Other liabilities  | 3,632      |          | 4,258      |          |          |
| Total liabilities  | 455,014    |          | 415,955    |          |          |
| Shareholders' equity   | 41,089     |          | 38,318     |          |          |
| Total liabilities & shareholders' equity   | \$ 496,103 |          | \$ 454,273 |          |          |
| Net interest income  |            | \$ 3,953 |            | \$ 3,749 |          |
| Net interest rate spread   |            |          | 3.28 %     |          | 3.44 %   |
| Net interest margin  |            |          | 3.40 %     |          | 3.57 %   |
| Ratio of average interest-earning assets to average interest-bearing liabilities |            |          | 114.99 %   |          | 112.85 % |

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Net interest income, on a tax-equivalent basis, increased to \$4.0 million for the three months ended March 31, 2013, from \$3.7 million for the three months ended March 31, 2012. This was due to a greater increase in average earning assets between the year over year quarters, compared with interest bearing liabilities, partially offset by the decrease in net interest rate spread. This was reflected in a decrease in net interest margin during the comparative periods. The largest increases in earning assets were within the real estate loans residential and commercial loan product segments of the balance sheet as the Company continued to experience strong loan demand within its marketplace.

As indicated in the three month table above and in the rate/volume analysis below, total interest income on a tax-equivalent basis increased \$84,000 due principally to an increase in average balances of commercial loans, commercial real estate loans, and tax-exempt investment securities, partially offset by reductions in the yield for each of these products. The yield on all classes of interest earning asset products decreased, with the most significant yield decrease of 46 basis points reported in residential real estate loans. Residential real estate loans yield decreased due to maturing loans and payoffs being replaced with those of lower rates reflecting current market conditions. The average yield on tax- exempt investment securities decreased by 39 basis points, however, the average yield was significantly greater than the average yield on taxable investment securities through the first quarter of 2013. In this same time period, management elected to invest in longer term securities to take advantage of the positive slope of the yield curve for this product. Consumer loans, generally comprised of home equity loans and lines of credit, auto loans, and personal loans, reported a 9.4% decline in average balances but only a nominal decline in average yield.

Interest expense decreased \$120,000 between year over year first quarter periods, as indicated in the above three month table. The primary reason for the decline was lower rates paid on time deposits as higher cost maturing certificates of deposit were replaced with lower cost certificates of deposits at current market rates. In addition, interest expense on money market deposit accounts declined as the Company was able to gather an increase in average balances of these short term deposit accounts at lower rates and in support of consumers' desire to invest in short term products.

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## 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.

| (In thousands)                    | Three months ended March 31,<br>2013 vs. 2012 |          |                                 |
|-----------------------------------|---|----------|---------------------------------|
|                                   | Volume  | Rate     | Total<br>Increase<br>(Decrease) |
| Interest Income:                  |   |          |                                 |
| Real estate loans residential     | \$755   | \$(767 ) | \$(12 )                         |
| Real estate loans commercial      | 342   | (272 )   | 70                              |
| Commercial loans                  | 327   | (230 )   | 97                              |
| Consumer loans                    | (38 )   | (1 )     | (39 )                           |
| Taxable investment securities     | 3   | (77 )    | (74 )                           |
| Tax-exempt investment securities  | 156   | (113 )   | 43                              |
| Interest-earning time deposits    | -   | (1 )     | (1 )                            |
| Interest-earning deposits         | 5   | (5 )     | -                               |
| Total interest income             | 1,550   | (1,466 ) | 84                              |
| Interest Expense:                 |   |          |                                 |
| NOW accounts                      | 17  | (17 )    | -                               |
| Money management accounts         | -   | (5 )     | (5 )                            |
| MMDA accounts                     | 34  | (52 )    | (18 )                           |
| Savings and club accounts         | 7   | (8 )     | (1 )                            |
| Time deposits                     | 196   | (274 )   | (78 )                           |
| Junior subordinated debentures    | -   | (2 )     | (2 )                            |
| Borrowings                        | 158   | (174 )   | (16 )                           |
| Total interest expense            | 412   | (532 )   | (120 )                          |
| Net change in net interest income | \$1,138                                       | \$(934 ) | \$204                           |

## Provision for Loan Losses

The provision for loan losses represents management's estimate of the amount necessary to maintain the allowance for loan losses at an adequate level. The Company recorded \$324,000 in provision for loan losses for the three-month period ended March 31, 2013, as compared to \$225,000 for the three-month period ended March 31, 2012. This increase was due primarily to the specific reserve required from the addition of a large commercial relationship newly categorized as impaired in the first quarter of 2013. Net charge-offs for the first quarter of 2013 were \$139,000 as compared to net charge-offs of \$93,000 for the first quarter of 2012.

Delinquency trends of all of the Company's loan segments improved as of March 31, 2013 when compared to December 31, 2012, most notable in 1-4 family first lien residential mortgages and consumer loans, the latter including home equity loans and lines of credit. The most significant improvements seen in this product segment was seen in the 30-59 days past due category. Delinquencies of commercial and municipal loans improved modestly as the decrease in delinquencies within the 30-59 days category was partially offset by the increase in delinquencies in the over 90 days category.

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## Noninterest Income

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

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

| (Dollars in thousands)  | Three Months Ended March 31, |       |        | Change |        |   |
|---|------------------------------|-------|--------|--------|--------|---|
|   | 2013                         | 2012  |        |        |        |   |
| Service charges on deposit accounts                             | \$255                        | \$273 | \$(18) | )      | -6.6   | % |
| Earnings and gain on bank owned life insurance                  | 61                           | 93    | (32)   | )      | -34.4  | % |
| Loan servicing fees   | 44                           | 41    | 3      |        | 7.3    | % |
| Debit card interchange fees                                     | 106                          | 97    | 9      |        | 9.3    | % |
| Other charges, commissions and fees                             | 142                          | 136   | 6      |        | 4.4    | % |
| Noninterest income before gains (losses)                        | 608                          | 640   | (32)   | )      | -5.0   | % |
| Net gains on sales and redemptions of investment securities     | 39                           | 112   | (73)   | )      | -65.2  | % |
| Net gains (losses) on sales of loans and foreclosed real estate | 29                           | (24)  | ) 53   |        | -220.8 | % |
| Total noninterest income  | \$676                        | \$728 | \$(52) | )      | -7.1   | % |

As indicated above, noninterest income for the first quarter of 2013 decreased when compared to the same prior year period due principally to significant net gains from the sale of investment securities in 2012 due to portfolio restructuring and greater earnings on bank owned life insurance in 2012. These decreases were partially offset by net gains on the sales of loans and foreclosed real estate as the Company elected to take advantage of current market prices of residential real estate loans and concurrently improve the interest rate risk profile of the balance sheet.

## Noninterest Expense

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

| (Dollars in thousands)          | Three Months Ended March 31, |         |        | Change |      |   |
|---------------------------------|------------------------------|---------|--------|--------|------|---|
|                                 | 2013                         | 2012    |        |        |      |   |
| Salaries and employee benefits  | \$1,910                      | \$1,974 | \$(64) | )      | -3.2 | % |
| Building occupancy              | 365                          | 383     | (18)   | )      | -4.7 | % |
| Data processing                 | 368                          | 341     | 27     |        | 7.9  | % |
| Professional and other services | 159                          | 153     | 6      |        | 3.9  | % |
| Advertising                     | 116                          | 60      | 56     |        | 93.3 | % |
| FDIC assessments                | 84                           | 77      | 7      |        | 9.1  | % |
| Audits and exams                | 61                           | 56      | 5      |        | 8.9  | % |
| Other expenses                  | 442                          | 411     | 31     |        | 7.5  | % |
| Total noninterest expenses      | \$3,505                      | \$3,455 | \$50   |        | 1.4  | % |

As indicated above, noninterest expense for the year over year first quarter increased due principally to an increase in advertising expenses. This increase was in direct response to the Company's initiative to improve its market position through expanded media exposure and direct mail marketing in the central New York marketplace. The Company recorded a decrease in personnel expenses due principally to a reduction in costs related to its defined benefit pension plan ("plan"). Total costs for the plan were \$183,000 less in the first quarter of 2013 as compared to the first quarter of 2012. The plan was frozen on May 14, 2012, after which the Company recorded significantly lower periodic costs. Partially offsetting the savings in the plan costs were increased costs due to wage increases, 401(K) plan



expenses, and medical benefits costs.

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### Income Tax Expense

Income taxes expense increased by \$11,000 for the quarter ended March 31, 2013 as compared to the same period in 2012 primarily due to an increase in the effective tax rate to 27.0% as compared to 25.0% for the same prior year period. The effective tax rate increase principally reflects a smaller proportion of tax-exempt investments as a proportion of our taxable income in the first quarter of 2013 as compared to the first quarter of 2012. The Company has reduced its effective tax rate from the combined federal and state statutory rate of 38.7% primarily through the ownership of tax-exempt investment securities, bank owned life insurance, and other tax saving strategies.

### Earnings per Share

Basic and diluted earnings per share were \$0.20 in the first quarter of 2013 as compared to basic and diluted earnings per share of \$0.16 in the first quarter of 2012. This increase was due to net income available to common shareholders being greater in the first quarter of 2013 stemming from the lack of need for SBLF dividend payments through the first quarter of 2013 as positive updated lending information provided to the U.S. Treasury resulted in a credit against the dividend rate for this quarter. Assuming our present lending activity continues, the amount of unused credit presently available would negate the need for any dividend payments in 2013.

### Changes in Financial Condition

#### Assets

Total assets increased to \$505.0 million at March 31, 2013, from \$477.8 million at December 31, 2012. The increase in total assets was primarily the result of an increase of \$17.6 million in investment securities and a \$5.2 million increase in gross loans. The increase in investment securities was primarily in U.S. Treasury and Agency securities in addition to residential mortgage-backed securities issued or guaranteed by U.S. Agencies. The growth in gross loans was primarily in commercial real estate and commercial and industrial loans.

#### Liabilities

Total liabilities increased to \$463.9 million at March 31, 2013, from \$437.0 million at December 31, 2012. Deposits increased \$36.6 million as the Company was able to take advantage of competitive changes in the marketplace to improve deposit gathering across all markets. A smaller component of the increase was due to the normal first quarter seasonal impact. Included was an aggregate increase of \$23.9 million in lower cost demand deposits, NOW accounts, and savings deposits. These increases in customer deposits allowed short term borrowings to decrease \$9.0 million over this same time period.

#### Capital

Shareholders' equity increased \$302,000 to \$41.0 million at March 31, 2013, as compared to December 31, 2012 due principally to \$505,000 in net income. This increase was partially offset by \$75,000 in dividends payable to common shareholders and a \$182,000 decrease in accumulated other comprehensive income stemming primarily from the after tax impact of the change in market value of the Company's available for sale securities.

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 subsidiary banks that supports growth and expansion activities while at the same time exceeding regulatory standards. At March 31, 2013, Pathfinder Bank exceeded all regulatory

required minimum capital ratios and 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 6%, and a total risk-based capital ratio exceeding 10%.

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The Bank's actual capital amounts and ratios as of the indicated dates are presented in the following table.

| (Dollars in thousands)                          | Actual   |       | Minimum<br>For Capital<br>Adequacy Purposes |       |            |       | Minimum<br>To Be "Well-<br>Capitalized"<br>Under Prompt<br>Corrective Provisions |  |
|---|----------|-------|---|-------|------------|-------|--|--|
|   | Amount   | Ratio | Amount                                      | Ratio | Amount     | Ratio |  |  |
| As of March 31, 2013:                           |          |       |   |       |            |       |  |  |
| Total Core Capital (to<br>Risk-Weighted Assets) | \$46,473 | 14.1  | % \$26,409                                  | 8.0   | % \$33,012 | 10.0  | %  |  |
| Tier 1 Capital (to<br>Risk-Weighted Assets)     | \$42,139 | 12.8  | % \$13,205                                  | 4.0   | % \$19,807 | 6.0   | %  |  |
| Tier 1 Capital (to Assets)                      | \$42,139 | 8.5   | % \$19,939                                  | 4.0   | % \$24,924 | 5.0   | %  |  |
| As of December 31, 2012:                        |          |       |   |       |            |       |  |  |
| Total Core Capital (to<br>Risk-Weighted Assets) | \$45,763 | 14.2  | % \$25,808                                  | 8.0   | % \$32,259 | 10.0  | %  |  |
| Tier 1 Capital (to<br>Risk-Weighted Assets)     | \$41,574 | 12.9  | % \$12,904                                  | 4.0   | % \$19,356 | 6.0   | %  |  |
| Tier 1 Capital (to Assets)                      | \$41,574 | 8.8   | % \$18,831                                  | 4.0   | % \$23,539 | 5.0   | %  |  |
| As of December 31, 2011:                        |          |       |   |       |            |       |  |  |
| Total Core Capital (to<br>Risk-Weighted Assets) | \$43,670 | 14.9  | % \$23,386                                  | 8.0   | % \$29,233 | 10.0  | %  |  |
| Tier 1 Capital (to<br>Risk-Weighted Assets)     | \$39,917 | 13.7  | % \$11,693                                  | 4.0   | % \$17,540 | 6.0   | %  |  |
| Tier 1 Capital (to Average<br>Assets)           | \$39,917 | 9.4   | % \$17,041                                  | 4.0   | % \$21,301 | 5.0   | %  |  |

(1) As of March 31, 2012, the Federal Financial Institutions Examination Council changed the computation for the Tier 1 Capital ratio as it applies to the Bank's designation as a savings association. The denominator has changed from using the average assets over the prior three months to the assets on the statement of condition as of the end of the March 31, 2012 and subsequent reporting quarters.

#### 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,<br>2013 | December<br>31,<br>2012 | March 31,<br>2012 |
|---|-------------------|-------------------------|-------------------|
| Nonaccrual loans:                                 |                   |                         |                   |
| Commercial real estate and commercial<br>Consumer | \$3,996           | \$2,726                 | \$2,877           |
| Residential real estate                           | 382               | 776                     | 872               |
| Total nonaccrual loans                            | 1,605             | 2,046                   | 1,063             |
| Total non-performing loans                        | 5,983             | 5,548                   | 4,812             |
| Foreclosed real estate                            | 5,983             | 5,548                   | 4,812             |
|   | 372               | 426                     | 556               |

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|   |         |   |         |   |         |   |
|---|---------|---|---------|---|---------|---|
| Total non-performing assets                     | \$6,355 |   | \$5,974 |   | \$5,368 |   |
| Troubled debt restructurings not included above | \$1,371 |   | \$1,937 |   | \$592   |   |
| Non-performing loans to total loans             | 1.77    | % | 1.66    | % | 1.58    | % |
| Non-performing assets to total assets           | 1.26    | % | 1.25    | % | 1.15    | % |

Non-performing assets include nonaccrual loans, troubled debt restructurings (“TDR”), and foreclosed real estate. 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 following categories of nonaccrual loans or TDRs not included above (the latter also known as accruing TDRs).

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As indicated in the above table, total non-performing loans increased modestly at March 31, 2013, when compared to December 31, 2012, due principally to an increase in commercial real estate and commercial loans. This increase stemmed from the addition of one large commercial relationship to nonperforming status. This event largely caused the additional provision for loan losses required in the first quarter of 2013. Management continues to monitor and react to national and local economic trends as well as general portfolio conditions, which may impact the quality of the portfolio. Management believes that the current level of the allowance for loan losses, at \$4.7 million, adequately addresses the current level of risk within the loan portfolio. The Company has also maintained strict loan underwriting standards and carefully monitors the performance of the loan portfolio.

Foreclosed real estate ("FRE") balances decreased to \$372,000 at March 31, 2013, from \$426,000 at December 31, 2012 as the Company successfully reduced FRE properties from eight to seven, in addition to writing down an existing property as new fair value information became available. Of the existing inventory of properties, two are commercial properties and the remaining five are 1-4 family residential properties. Additionally, the Company is carrying a repossessed boat in other assets with a carrying value of \$235,000 at March 31, 2013 and December 31, 2012, respectively.

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. 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. The Company used the fair value of collateral to measure impairment on commercial loans and commercial real estate loans. At March 31, 2013 and December 31, 2012, the Company had \$8.1 million and \$6.7 million in loans, which were deemed to be impaired, having established specific reserves of \$1.1 million and \$923,000, respectively on these loans. The increase in impaired loans was principally due to the addition of one commercial borrower whose relationship with the Bank (consisting of five loans), totaled \$1.1 million.

Management has identified potential problem loans totaling \$10.0 million as of March 31, 2013, compared to \$11.7 million as of December 31, 2012. These loans have been internally classified as special mention or substandard, yet are not currently considered impaired or in non-accrual status. This decrease in potential problem loans reflects increases in loans categorized as newly impaired during the first quarter of 2013, including the above mentioned large commercial real estate relationship. 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 it being included in future impaired loan reporting. Management believes that the current allowance for loan losses is adequate to cover probable credit losses in the current loan portfolio. As a result, the ratio of the allowance to loan and lease losses to period-end loans at March 31, 2013 was 1.38% as compared to 1.35% at December 31, 2012. The increase reflects the allowance for impaired loans and the modest increase in gross loans reported in the first quarter of 2013.

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. When evaluating our ability to collect from secondary sources, appraised values are adjusted to reflect the age of appraisal, the condition of the property, the current local real estate market, and cost to sell. Properties are re-appraised when our evaluation of the current property condition and the local real estate market suggests values may not be accurate.

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

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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, 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 costs and/or losses on the sale of securities or loans.

Through the first quarter of 2013, as indicated in the Consolidated Statement of Cash Flows, the Company reported net cash flows from financing activities of \$27.4 million generated by increased balances of demand and savings deposits, money market deposit accounts, and certificates of deposit. This was invested in available-for-sale investment securities of \$17.8 million, net, and loan generation of \$5.4 million. As a recurring source of liquidity, the Company's investment securities provided \$8.1 million in proceeds from maturities and principal reductions through the first three months of 2013. Net cash provided by operating activities for this same period was \$496,000.

The Company has a number of existing credit facilities available to it. At March 31, 2013, total credit available to the Company under the existing lines of credit is approximately \$166.8 million. At March 31, 2013, the Company has \$25.0 million outstanding on its existing lines of credit with \$141.8 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, 2013, management reported to the Board of Directors that the Company is in compliance with its liquidity policy guidelines.

Item 3 - Quantitative and Qualitative Disclosures About Market Risk

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

Item 4 - Controls and Procedures

Under the supervision and with the participation of the Company's management, including our Chief Executive Officer and Chief Financial Officer, the Company has evaluated the effectiveness of the design and operation of its disclosure controls and procedures (as defined in Rule 13a-15(e) and 15d-15(e) under the Exchange Act) as of the end of the period covered by this quarterly report. Based upon that evaluation, the Chief Executive Officer and Chief Financial Officer concluded that, as of the end of the period covered by this report, the Company's disclosure controls and procedures are effective to ensure that information required to be disclosed in the reports that the Company files or submits under the Securities Exchange Act of 1934 is recorded, processed, summarized and reported, within the



time periods specified in the Securities and Exchange Commission's rules and forms. There has been no change in the Company's internal control over financial reporting during the most recent fiscal quarter that has materially affected, or is reasonable likely to materially affect, the Company's internal control over financial reporting.

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PART II - OTHER INFORMATION

Item 1 - Legal Proceedings

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

None

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               |
| 32.1 | Section 1350 Certification of the Chief Executive Officer and Chief Financial Officer |

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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.

May 14, 2013 /s/ Thomas W. Schneider  
Thomas W. Schneider  
President and Chief Executive Officer

May 14, 2013 /s/ James A. Dowd  
James A. Dowd  
Senior Vice President and Chief Financial Officer

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

Certification of Chief Executive Officer

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

I, Thomas W. Schneider, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of Pathfinder Bancorp, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
  - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting, to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors:

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

May 14, 2013

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

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

Certification of Chief Financial Officer

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

I, James A. Dowd, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of Pathfinder Bancorp, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
  - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting, to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors:

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

May 14, 2013

/s/ James A. Dowd  
James A. Dowd  
Senior Vice President and Chief  
Financial Officer

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EXHIBIT 32.1 Section 1350 Certification of the Chief Executive Officer and Chief Financial Officer

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

Thomas W. Schneider, President and Chief Executive Officer, and James A. Dowd, Senior Vice President and Chief Financial Officer of Pathfinder Bancorp, Inc. (the "Company"), each certify in his capacity as an officer of the Company that he has reviewed the Quarterly Report of the Company on Form 10-Q for the quarter ended March 31, 2013 and that to the best of his knowledge:

1. The report fully complies with the requirements of Sections 13(a) of the Securities Exchange Act of 1934; and
2. The information contained in the report fairly presents, in all material respects, the financial condition and results of operations of the Company.

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

May 14, 2013

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

May 14, 2013

/s/ James A. Dowd  
James A. Dowd  
Senior Vice President and Chief Financial Officer