STEWARDSHIP FINANCIAL CORP
Form 10-K
March 24, 2016

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-K

x **ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the fiscal year ended December 31, 2015

OR

o **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 1-33377

Stewardship Financial Corporation

(Exact name of registrant as specified in its charter)

New Jersey	**22-3351447**
(State of other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
630 Godwin Avenue, Midland Park, NJ	**07432**
(Address of principal executive offices)	(Zip Code)

Registrant's telephone number, including area code: (201) 444-7100

Securities registered pursuant to Section 12(b) of the Act: Common Stock, no par value

Securities registered under Section 12(g) of the Act: None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.

Yes o No **x**

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act.

Yes o No **x**

Note – Checking the box above will not relieve any registrant required to file reports pursuant to Section 13 or 15(d) of the Exchange Act from their obligations under those Sections.

Indicate by check mark whether the registrant: (1) has filed 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 **x** No o

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 (§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 **x** No o

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. o

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 the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer	o	Accelerated filer	o
Non-accelerated filer	o	Smaller reporting company	**x**

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act).

Yes o No **x**

The aggregate market value of the voting and non-voting common equity held by non-affiliates of the registrant, as of June 30, 2015 was $30,974,000. As of March 23, 2016, 6,113,213 shares of the registrant's common stock, net of treasury stock, were outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

Part III incorporates certain information by reference from the registrant's definitive proxy statement for the registrant's 2016 Annual Meeting of Shareholders.

FORM 10-K

STEWARDSHIP FINANCIAL CORPORATION

For the Year Ended December 31, 2015

Table of Contents

Table of Contents

Cautionary Note Regarding Forward-Looking Statements

This Annual Report on Form 10-K may contain certain "forward-looking statements" within the meaning of the Private Securities Litigation Reform Act of 1995 with respect to the financial condition, results of operations and business of Stewardship Financial Corporation (the "Corporation"). Such statements are not historical facts and may involve risks and uncertainties. Such statements include expressions about the Corporation's confidence, strategies and expectations about earnings, new and existing programs and products, relationships, opportunities, technology and market conditions and are based on current beliefs and are inherently subject to significant business, economic and competitive uncertainties and contingencies, many of which are beyond our control. In addition, these forward-looking statements are subject to assumptions with respect to future business strategies and decisions that are subject to change. These statements may be identified by forward-looking terminology such as "expect," "believe," or "anticipate," "should", "plan", "estimate" and "potential" or expressions of confidence like "strong," or "on-going," or similar statements or variations of such terms. Factors that may cause actual results to differ materially from those contemplated by such forward-looking statements include, among others, the following possibilities:

§ impairment charges with respect to securities,
§ unanticipated costs in connection with new branch openings,
§ further deterioration of the economy and level of unemployment,
§ acts of war, acts of terrorism, cyber-attacks and natural disasters,
§ declines in commercial and residential real estate values,
§ unexpected changes in interest rates,
§ inability to manage growth in commercial loans,
§ unexpected loan prepayment volume,
§ unanticipated exposure to credit risks,
§ insufficient allowance for loan losses,
§ competition from other financial institutions,
§ adverse effects of government regulation or different than anticipated effects from existing regulations,
§ passage by Congress of a law which unilaterally amends the terms of the Treasury's investment in us in a way that adversely affects us,
§ a decline in the levels of loan quality and origination volume, and
§ a decline in deposits.

The Corporation undertakes no obligation to update or revise any forward-looking statements in the future based upon future events or circumstances, new information or otherwise.

Table of Contents

Part I

Item 1. Business

General

Stewardship Financial Corporation (the “Corporation” or the “Registrant”) is a one-bank holding company, which was incorporated under the laws of the State of New Jersey in January 1995 to serve as a holding company for Atlantic Stewardship Bank (the “Bank”). The Corporation was organized at the direction of the Board of Directors of the Bank for the purpose of acquiring all of the capital stock of the Bank (the “Acquisition”). Pursuant to the New Jersey Banking Act of 1948, as amended (the “New Jersey Banking Act”), and pursuant to approval of the shareholders of the Bank, the Corporation acquired the Bank and became its holding company on November 22, 1996. As part of the Acquisition, shareholders of the Bank received one share of common stock, no par value of the Corporation (“Common Stock”), for each outstanding share of the common stock of the Bank held. The only significant activity of the Corporation is ownership and supervision of the Bank.

The Bank is a commercial bank formed under the laws of the State of New Jersey on April 26, 1984. Throughout 2015 the Bank operated from its main office at 630 Godwin Avenue, Midland Park, New Jersey, and its current eleven branches located in the State of New Jersey.

The Corporation is subject to the supervision and regulation of the Board of Governors of the Federal Reserve System (the “FRB”). The Bank’s deposits are insured by the Federal Deposit Insurance Corporation, an agency of the federal government (the “FDIC”), up to applicable limits. The operations of the Corporation and the Bank are subject to the supervision and regulation of the FRB, the FDIC and the New Jersey Department of Banking and Insurance (the “Department”).

Stewardship Investment Corp. is a wholly-owned, non-bank subsidiary of the Bank, whose primary business is to own and manage an investment portfolio. Stewardship Realty, LLC is a wholly-owned, non-bank subsidiary of the Bank, whose primary business is to own and manage property at 612 Godwin Avenue, Midland Park, New Jersey. Atlantic Stewardship Insurance Company, LLC is a wholly-owned, non-bank subsidiary of the Bank, whose primary business is insurance. The Bank also has several other wholly-owned, non-bank subsidiaries formed to hold title to properties acquired through foreclosure or deed in lieu of foreclosure. In addition to the Bank, in 2003, the Corporation formed, Stewardship Statutory Trust I, a wholly-owned, non-bank subsidiary for the purpose of issuing trust preferred securities.

The principal executive offices of the Corporation are located at 630 Godwin Avenue, Midland Park, New Jersey 07432. Our telephone number is (201) 444-7100 and our website address is http://www.asbnow.com.

Business of the Corporation

The Corporation's primary business is the ownership and supervision of the Bank. The Corporation, through the Bank, conducts a traditional commercial banking business, and offers deposit services including personal and business checking accounts and time deposits, money market accounts and regular savings accounts. The Corporation structures the Bank's specific products and services in a manner designed to attract the business of the small and medium-sized business and professional community as well as that of individuals residing, working and shopping in Bergen, Morris and Passaic counties, New Jersey. The Corporation engages in a wide range of lending activities and offers commercial, consumer, residential real estate, home equity and personal loans.

In forming the Bank, the members of the Board of Directors envisioned a community-based institution which would serve the local communities surrounding its branches, while also providing a return to its shareholders. This vision has been reflected in the Bank's tithing policy, under which the Bank tithes 10% of its pre-tax profits to worthy Christian and civic organizations in the communities where the Bank maintains branches.

Service Area

The Bank's service area primarily consists of Bergen, Morris and Passaic Counties in New Jersey, although the Corporation makes loans throughout New Jersey. Throughout 2015, the Bank operated from its main office in Midland Park, New Jersey and eleven existing branch offices in Hawthorne (2), Ridgewood, Montville, North Haledon, Pequannock, Waldwick, Wayne (2), Westwood and Wyckoff, New Jersey.

Table of Contents

Competition

The market for banking services remains highly competitive. The Bank competes for deposits and loans with commercial banks, thrifts and other financial institutions, many of which have greater financial resources than the Bank. Many large financial institutions in New York City and other parts of New Jersey compete for the business of New Jersey residents and companies located in the Bank's service area. Certain of these institutions have significantly higher lending limits and expend greater resources on marketing and advertising than the Bank and provide services to their customers that the Bank does not offer.

Management believes the Bank is able to compete on a substantially equal basis with its competitors because it provides responsive, personalized services through management's knowledge and awareness of the Bank's service area, customers and business.

Employees

At December 31, 2015, the Corporation employed 121 full-time employees and 29 part-time employees. None of these employees are covered by a collective bargaining agreement and the Corporation believes that its employee relations are good.

Supervision and Regulation

General

Bank holding companies and banks are extensively regulated under both federal and state law. These laws and regulations are intended to protect depositors, not shareholders. To the extent that the following information describes statutory and regulatory provisions, it is qualified in its entirety by reference to the particular statutory and regulatory provisions and is not intended to be an exhaustive description of the statutes or regulations applicable to the Corporation's business. Any change in the applicable law or regulation may have a material effect on the business and prospects of the Corporation and the Bank.

Dodd-Frank Act

On July 21, 2010, financial regulatory reform legislation entitled The Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (the “Dodd-Frank Act”) was signed into law. The Dodd-Frank Act imposed extensive changes across the financial regulatory landscape, including provisions that, among other things, have:

- centralized responsibility for consumer financial protection by creating a new agency, the Consumer Financial Protection Bureau (the “CFPB”), responsible for implementing, examining, and enforcing compliance with federal consumer financial laws;
- applied to most bank holding companies, the same leverage and risk-based capital requirements applicable to insured depository institutions. The Corporation’s existing trust preferred securities continue to be treated as Tier 1 capital;
- changed the assessment base for federal deposit insurance from the amount of insured deposits to consolidated assets less tangible equity, eliminated the ceiling on the size of the Deposit Insurance Fund (“DIF”) and increased the floor on the size of the DIF, which generally requires an increase in the level of assessments for institutions with assets in excess of $10 billion;
- implemented corporate governance revisions, including with regard to executive compensation and proxy access by shareholders, that apply to all public companies, not just financial institutions;
- made permanent the $250,000 limit for federal deposit insurance;
- repealed the federal prohibitions on the payment of interest on demand deposits, thereby permitting depository institutions to pay interest on business transactions and other accounts; and
- restricted the interchange fees payable on debit card transactions for issuers with $10 billion in assets or greater.

In December 2013, regulatory agencies adopted a rule on the treatment of certain collateralized debt obligations backed by trust preferred securities to implement sections of the Dodd-Frank Wall Street Reform and Consumer Protection Act, known as the Volcker Rule. In January 2014, the regulatory agencies approved an interim final rule to permit banking entities to retain interests in certain collateralized debt obligations backed primarily by trust preferred securities from the investment prohibitions of the Volcker rule. Under the interim final rule, the regulatory agencies

Table of Contents

permit the retention of an interest in or sponsorship of covered funds by banking entities if certain qualifications are met. Based upon management's review of the securities portfolio, management believes that there are no securities in our portfolio that are impacted by the Volcker Rule.

Provisions in the Dodd-Frank Act and related rules that affect deposit insurance assessments, payment of interest on demand deposits, and interchange fees could increase the costs associated with deposits as well as place limitations on certain revenues that those deposits may generate.

Certain aspects of the Dodd-Frank Act remain subject to implementation through rulemaking that will continue for several years, making it difficult to anticipate the overall financial impact of the legislation on the Corporation, the Bank and its customers as well as the financial industry in general.

Bank Holding Company Act

As a bank holding company registered under the Bank Holding Company Act of 1956, as amended (the "BHCA"), the Corporation is subject to the regulation, supervision examination and inspection of the Board of Governors of the FRB. The Corporation is required to file with the FRB annual reports and other information showing that its business operations and those of its subsidiaries are limited to banking, managing or controlling banks, furnishing services to or performing services for its subsidiaries or engaging in any other activity which the FRB determines to be so closely related to banking or managing or controlling banks as to be properly incident thereto. The FRB may also make examinations of the Corporation and its subsidiaries.

The BHCA requires, among other things, the prior approval of the FRB in any case where a bank holding company proposes to (i) acquire all or substantially all of the assets of any other bank, (ii) acquire direct or indirect ownership or control of more than 5% of the outstanding voting stock of any bank (unless it owns a majority of such bank's voting shares), or (iii) merge or consolidate with any other bank holding company. The FRB will not approve any merger, acquisition, or consolidation that would have a substantially anti-competitive effect, unless the anti-competitive impact of the proposed transaction is clearly outweighed by a greater public interest in meeting the convenience and needs of the community to be served. The FRB also considers capital adequacy and other financial and managerial resources and future prospects of the companies and the banks concerned, together with the convenience and needs of the community to be served.

Additionally, the BHCA prohibits, with certain limited exceptions, a bank holding company from (i) acquiring or retaining direct or indirect ownership or control of more than 5% of the outstanding voting stock of any company which is not a bank or bank holding company, or (ii) engaging directly or indirectly in activities other than those of banking, managing or controlling banks, or performing services for its subsidiaries; unless such non-banking business is determined by the FRB to be so closely related to banking or managing or controlling banks as to be properly incident thereto. In making such determinations, the FRB is required to weigh the expected benefits to the public, such as greater convenience, increased competition or gains in efficiency, against the possible adverse effects, such as undue concentration of resources, decreased or unfair competition, conflicts of interest, or unsound banking practices.

The BHCA prohibits depository institutions whose deposits are insured by the FDIC and bank holding companies, among others, from transferring and sponsoring and investing in private equity funds and hedge funds.

There are a number of obligations and restrictions imposed on bank holding companies and their depository institution subsidiaries by law and regulatory policy that are designed to minimize potential loss to the depositors of such depository institutions and the FDIC insurance funds in the event the depository institution becomes in danger of default. Under a policy of the FRB with respect to bank holding company operations, a bank holding company is required to commit resources to support such institutions in circumstances where it might not do so absent such a policy. The FRB also has the authority under the BHCA to require a bank holding company to terminate any activity or to relinquish control of a non-bank subsidiary upon the FRB’s determination that such activity or control constitutes a serious risk to the financial soundness and stability of any bank subsidiary of the bank holding company.

Capital Adequacy Guidelines for Banks and Bank Holding Companies

The Corporation is subject to capital adequacy guidelines promulgated by the Board of Governors of the FRB (the “FRB Board”). The Bank is subject to somewhat comparable but different capital adequacy requirements imposed by the FDIC. The federal banking agencies have adopted risk-based capital guidelines for banks and bank holding companies. The risk-based capital guidelines are designed to make regulatory capital requirements more sensitive to

Table of Contents

differences in risk profiles among banks and bank holding companies, to account for off-balance sheet exposure, and to minimize disincentives for holding liquid assets. Under these guidelines, assets and off-balance sheet items are assigned to broad risk categories, each with appropriate weights. The resulting capital ratios represent capital as a percentage of total risk-weighted assets and off-balance sheet items.

Federal banking regulators have also adopted leverage capital guidelines to supplement the risk-based measures. Leverage capital to average total assets is determined by dividing Tier 1 Capital as defined under the risk-based capital guidelines by average total assets (non-risk adjusted).

Guidelines for Banks

In December 2010 and January 2011, the Basel Committee on Banking Supervision (the “Basel Committee”) published the final texts of reforms on capital and liquidity, which are generally referred to as “Basel III”. The Basel Committee is a committee of central banks and bank supervisors and regulators from the major industrialized countries that develops broad policy guidelines for the regulation of banks and bank holding companies. In July 2013, the FDIC and the other federal bank regulatory agencies adopted final rules (the “Basel Rules”) to implement certain provisions of Basel III and the Dodd-Frank Act. The Basel Rules revise the leverage and risk-based capital requirements and the methods for calculating risk-weighted assets. The Basel Rules apply to all depository institutions, top-tier bank holding companies with total consolidated assets of $1 billion or more and top-tier savings and loan holding companies.

Among other things, the Basel Rules (a) establish a new common equity Tier 1 Capital (“CET1”) to risk-weighted assets ratio minimum of 4.5% of risk-weighted assets, (b) raise the minimum Tier 1 Capital to risk-based assets requirement (“Tier 1 Capital Ratio) from 4% to 6% of risk-weighted assets and (c) assign a higher risk weight of 150% to exposures that are more than 90 days past due or are on nonaccrual status and to certain commercial real estate facilities. The minimum ratio of Total Capital to risk-weighted assets (including certain off-balance sheet activities, such as standby letters of credit) is 8%. At least 6% of the Total Capital is required to be “Tier 1 Capital”, which consists of common shareholders’ equity and certain preferred stock, less certain items and other intangible assets. The remainder, “Tier 2 Capital,” may consist of (a) the allowance for loan losses of up to 1.25% of risk-weighted assets, (b) excess of qualifying preferred stock, (c) hybrid capital instruments, (d) debt, (e) mandatory convertible securities and (f) qualifying subordinated debt. “Total Capital” is the sum of Tier 1 Capital and Tier 2 Capital less reciprocal holdings of other banking organizations’ capital instruments, investments in unconsolidated subsidiaries and any other deductions as determined by the federal banking regulatory agencies on a case-by-case basis or as a matter of policy after formal rule-making. A small bank holding company that has the highest regulatory examination rating and is not contemplating significant growth or expansion must maintain a minimum level of Tier 1 Capital to average total consolidated assets leverage ratio of at least 3%. All other bank holding companies are expected to maintain a leverage ratio of at least 100 to 200 basis points above the stated minimum.

The Basel Rules also require unrealized gains and losses on certain available-for-sale securities to be included for purposes of calculating regulatory capital unless a one-time opt-out is exercised. Additional constraints are also imposed on the inclusion in regulatory capital of mortgage-servicing assets and deferred tax assets. The Basel Rules limit a banking organization's capital distributions and certain discretionary bonus payments if the banking organization does not hold a "capital conservation buffer" consisting of 2.5% of CET1 to risk-weighted assets in addition to the amount necessary to meet its minimum risk-based capital requirements. The purpose of the capital conservation buffer is to ensure that banking organizations conserve capital when it is needed most, allowing them to weather periods of economic stress. Banking institutions with a CET1 Ratio, Tier 1 Capital Ratio and Total Capital Ratio above the minimum capital ratios but below the minimum capital ratios plus the capital conservation buffer will face constraints on their ability to pay dividends, repurchase equity and pay discretionary bonuses to executive officers based on the amount of the shortfall. The Basel Rules became effective for the Bank on January 1, 2015. The capital conservation buffer requirement will be phased in beginning January 1, 2016 and ending January 1, 2019, when the full capital conservation buffer requirement will be effective.

Bank assets are given risk-weights of 0%, 20%, 50%, 100%, and 150%. In addition, certain off-balance sheet items are given similar credit conversion factors to convert them to asset equivalent amounts to which an appropriate risk-weight will apply. These computations result in the total risk-weighted assets. Most loans are assigned to the 100% risk category, except for performing first mortgage loans fully secured by residential property which carry a 50% risk-weighting. Loan exposures past due 90 days or more or on nonaccrual are assigned a risk-weighting of at least 100%. Most investment securities (including, primarily, general obligation claims of states or other political subdivisions of the United States) are assigned to the 20% category, except for municipal or state revenue bonds, which have a 50% risk-weight, and direct obligations of the U.S. Treasury or obligations backed by the full faith and credit of the U.S.

Table of Contents

government, which have a 0% risk-weight. In converting off-balance sheet items, direct credit substitutes, including general guarantees and standby letters of credit backing nonfinancial obligations, and undrawn commitments (including commercial credit lines with an initial maturity of more than one year) have a 50% risk-weighting. Short-term undrawn commitments and commercial letters of credit with an initial maturity of under one year have a 20% risk-weighting and certain short-term unconditionally cancelable commitments are not risk-weighted.

Guidelines for Small Bank Holding Companies

In April 2015, the FRB Board updated and amended its Small Bank Holding Company Policy Statement. Under the revised Small Bank Holding Company Policy Statement, Basel III capital rules and reporting requirements do not apply to small bank holding companies ("SBHC"), such as the Corporation, that have total consolidated assets of less than $1 billion. The minimum risk-based capital requirements for a SBHC to be considered adequately capitalized are 4% for Tier 1 Capital and 8% for Total Capital to risk-weighted assets.

The regulations for SBHCs classify risk-based capital into two categories: "Tier 1 Capital" which consists of common and qualifying perpetual preferred shareholders' equity less goodwill and other intangibles and "Tier 2 Capital" which consists of (a) the allowance for loan losses of up to 1.25% of risk-weighted assets, (b) the excess of qualifying preferred stock, (c) hybrid capital instruments, (d) debt, (e) mandatory convertible securities and (f) qualifying subordinated debt. Total qualifying capital consists of Tier 1 Capital and Tier 2 Capital less reciprocal holdings of other banking organizations' capital instruments, investments in unconsolidated subsidiaries and any other deductions as determined by the FRB on a case-by-case basis or as a matter of policy after formal rule-making. However, the amount of Tier 2 Capital may not exceed the amount of Tier 1 Capital. The Corporation must maintain a minimum level of Tier 1 Capital to average total consolidated assets leverage ratio of 3%, which is the leverage ratio reserved for top-tier bank holding companies having the highest regulatory examination rating and not contemplating significant growth or expansion.

Bank holding company assets are given risk-weights of 0%, 20%, 50%, and 100%. In addition, certain off-balance sheet items are given similar credit conversion factors to convert them to asset equivalent amounts to which an appropriate risk-weight will apply. These computations result in the total risk-weighted assets.

As of December 31, 2015, the Corporation and the Bank exceeded all regulatory capital requirements.

Regulation of the Bank by the FDIC and the New Jersey Department of Banking and Insurance

As a New Jersey-chartered commercial bank, the Bank is subject to the regulation, supervision, and control of the Department. As an FDIC-insured institution, the Bank is also subject to regulation, supervision and control by the

FDIC. The regulations of the FDIC and the Department impact virtually all activities of the Bank, including the minimum level of capital the Bank must maintain, the ability of the Bank to pay dividends, the ability of the Bank to expand through new branches or acquisitions, and various other matters.

Insurance of Deposits

Substantially all of the deposits of the Bank are insured up to applicable limits by the DIF of the FDIC and are subject to deposit insurance assessments to maintain the DIF. The Dodd-Frank Act permanently raised the standard maximum deposit insurance amount to $250,000.

The FDIC redefined its deposit insurance premium assessment base to be an institution's average consolidated total assets minus average tangible equity as required by the Dodd-Frank Act and revised deposit insurance assessment rate schedules in light of the changes to the assessment base. The rate schedule and other revisions to the assessment rules, which were adopted by the FDIC Board of Directors on February 7, 2011, became effective April 1, 2011 and were first used to calculate the June 30, 2011 assessment. The assessment rules were further modified in November, 2014; the revisions became effective on January 1, 2015. As of December 31, 2015, the Bank's assessment rate averaged $0.06 per $100 in assessable assets minus average tangible equity.

In addition to the assessment for deposit insurance, institutions are required to make payments on bonds issued in the late 1980s by the Financing Corporation ("FICO") in connection with the failure of certain savings and loan associations. This payment obligation is established quarterly and averaged 0.59% and 0.62% of the assessment base for the years ended December 31, 2015 and 2014, respectively. The Corporation paid $37,000 and $38,000

Table of Contents

under this assessment for the years ended December 31, 2015 and 2014, respectively. These assessments will continue until the FICO bonds mature in 2017.

FDIC's Capital Adequacy Guidelines for Banks

Similar to the FRB, the FDIC has promulgated risk-based capital guidelines for banks that are designed to make regulatory capital requirements more sensitive to differences in risk profile among banks, to account for off-balance sheet exposure, and to minimize disincentives for holding liquid assets. These guidelines are substantially the same as those put in place by the FRB for bank holding companies.

Dividend Rights

Under the New Jersey Banking Act, a bank may declare and pay dividends only if, after payment of the dividend, the capital stock of the bank will be unimpaired and either the bank will have a surplus of not less than 50% of its capital stock or the payment of the dividend will not reduce the bank's surplus.

USA Patriot Act of 2001

On October 26, 2001, the USA Patriot Act of 2001 (the "Patriot Act") was signed into law. Enacted in response to the terrorist attacks in New York, Pennsylvania, and Washington, D.C. on September 11, 2001, the Patriot Act is intended to strengthen the ability of U.S. law enforcement and the intelligence community to work cohesively to combat terrorism on a variety of fronts. The Patriot Act contains sweeping anti-money laundering and financial transparency laws and requires various regulations, including, but not limited to: (a) due diligence requirements for financial institutions that administer, maintain, or manage private bank accounts or correspondent accounts for non-U.S. persons; (b) standards for verifying customer identification at account opening; (c) rules to promote cooperation among financial institutions, regulators and law enforcement entities in identifying parties that may be involved in terrorism or money laundering; (d) reports of nonfinancial trades and business filed with the Treasury Department's Financial Crimes Enforcement Network for transactions exceeding $10,000; and (e) filing of suspicious activities reports by brokers and dealers if they believe a customer may be violating U.S. laws and regulations.

Regulations promulgated under the Patriot Act impose obligations on financial institutions to maintain appropriate policies, procedures and controls to detect, prevent and report money laundering and terrorist financing. Failure of the Corporation or the Bank to comply with the Patriot Act's requirements could have serious legal consequences for the institution and adversely affect our reputation.

Item 1A. Risk Factors

Investments in the Common Stock of the Corporation involve risk. The following discussion highlights the risks management believes are material for our Corporation, but does not necessarily include all risks that we may face.

Our operations are subject to interest rate risk and changes in interest rates may negatively affect financial performance.

Our earnings and cash flows are largely dependent upon our net interest income. Net interest income is the difference between interest income earned on interest-earning assets, such as loans and securities, and interest expense paid on interest-bearing liabilities, such as deposits and borrowed money. To be profitable we must earn more interest from our interest-earning assets than we pay on our interest-bearing liabilities. Changes in the general level of interest rates may have an adverse effect on our business, financial condition and results of operations. Interest rates are highly sensitive to many factors that are beyond our control, including general economic conditions and the policies of governmental and regulatory agencies such as the Federal Reserve Bank. Changes in monetary policy and interest rates can also adversely affect our ability to originate loans and deposits, the fair value of financial assets and liabilities and the average duration of our assets and liabilities.

Our allowance for loan losses may be insufficient.

There are risks inherent in our lending activities, including dealing with individual borrowers, nonpayment, uncertainties as to the future value of collateral and changes in economic and industry conditions. We attempt to mitigate and manage credit risk through prudent loan underwriting and approval procedures, monitoring of loan concentrations and

Table of Contents

periodic independent review of outstanding loans. We cannot be assured that these procedures will reduce credit risk inherent in the business.

We make various assumptions and judgments about the collectability of our loan portfolio, including the creditworthiness of our borrowers and the value of the real estate and assets serving as collateral for loan repayments. In determining the size of our allowance for loan loss, we rely on our experience and our evaluation of economic conditions. If our assumptions prove to be incorrect, our current allowance may not be sufficient to cover probable incurred loan losses and adjustments may be necessary to allow for different economic conditions or adverse developments in our portfolio. Significant additions to our allowance for loan losses would materially decrease our net income. Various regulatory agencies, as an integral part of their examination process, periodically review the Corporation's allowance for loan losses. Such agencies may require the Corporation to make additional provisions for loan losses based upon information available to them at the time of their examination.

An improving but a prolonged weak economy has adversely affected the financial services industry and, because of our geographic concentration in northern New Jersey, we could be impacted by adverse changes in local economic conditions.

Our success depends on the general economic conditions of the nation, the State of New Jersey, and the northern New Jersey area. The nation's improving but prolonged weak economic environment has severely adversely affected the banking industry and may adversely affect our business, financial condition, results of operations and stock price. We believe recovery will continue to be slow and believe the reversal of the impact of the prolonged difficult economic conditions are likely to take time to show improvement. Unlike larger banks that are more geographically diversified, we provide financial services to customers primarily in the market areas in which we operate. The local economic conditions of these areas have a significant impact on our commercial, real estate and construction loans, the ability of our borrowers to repay these loans and the value of the collateral securing these loans. While we did not and do not have a sub-prime lending program, any significant decline in the real estate market in our primary market area would hurt our business and mean that collateral for our loans would have less value. As a consequence, our ability to recover on defaulted loans by selling the real estate securing the loan would be diminished and we would be more likely to suffer losses on defaulted loans. Any of the foregoing events and conditions could have a material adverse effect on our business, results of operations and financial condition.

Competition within the financial services industry could adversely affect our profitability.

We face strong competition from banks, other financial institutions, money market mutual funds and brokerage firms within the New York metropolitan area. A number of these entities have substantially greater marketing and advertising resources and lending limits, larger branch systems and a wider array of banking services. Competition among depository institutions for customer deposits has increased significantly and will likely continue in the current economic environment. If we are unsuccessful in competing effectively, we will lose market share and may suffer a reduction in our margins and adverse consequences to our business, results of operations and financial condition.

Federal and State regulations could restrict our business and increase our costs and non-compliance would result in penalties, litigation and damage to our reputation.

We operate in a highly regulated environment and are subject to extensive regulation, supervision, and examination by the FDIC, the FRB and the State of New Jersey. The significant federal and state banking regulations that we are subject to are described herein under “Item 1. Business.” The regulation and supervision of the activities in which bank and bank holding companies may engage is primarily intended for the protection of the depositors and the federal deposit insurance funds. These regulations affect our lending practices, capital structure, investment practices, dividend policy and overall operations. These statutes, regulations, regulatory policies, and interpretations of policies and regulations are constantly evolving and may change significantly over time. Any such changes could subject the Corporation to additional costs, limit the types of financial services and products the Bank may offer and/or increase the ability of non-banks to offer competing financial services and products, among other things. Due to our nation’s current economic environment and a lower level of confidence in the financial markets, new federal and/or state laws and regulations of lending and funding practices and liquidity standards continue to be implemented. Bank regulatory agencies are being very aggressive in responding to concerns and trends identified in bank examinations with respect to bank capital requirements. Any increased government oversight, including the full implementation of the Dodd-Frank Act, may increase our costs and limit our business opportunities. Our failure to comply with laws, regulations or policies applicable to our business could result in sanctions against us by regulatory agencies, civil money penalties and/or reputation damage, which could have a material adverse effect on our business, financial condition and results of

Table of Contents

operations. While we have policies and procedures designed to prevent any such violations, there can be no assurances that such violations will not occur.

The Dodd-Frank Act requires lenders to make a reasonable, good faith determination of a borrower's ability to repay a mortgage. The CFPB has promulgated a safe harbor rule for any loan that constitutes a "qualified mortgage." Loans that meet this "qualified mortgage" definition will be presumed to have complied with the new ability-to-repay standard. Under the CFPB's rule, a "qualified mortgage" loan must not contain certain specified features, including: excessive upfront points and fees (those exceeding 3% of the total loan amount, less "bona fide discount points" for prime loans); interest-only payments; negative-amortization; and terms longer than 30 years. Also, to qualify as a "qualified mortgage," a borrower's total debt-to-income ratio may not exceed 43%. Lenders must also verify and document the income and financial resources relied upon to qualify the borrower for the loan and underwrite the loan based on a fully amortizing payment schedule and maximum interest rate during the first five years, taking into account all applicable taxes, insurance and assessments. The CFPB's rule on qualified mortgages could limit our ability or desire to make certain types of loans or loans to certain borrowers, or could make it more expensive/and or time-consuming to make these loans, all of which could limit our growth or profitability.

A breach of our information systems through a system failure, cyber-security breach, computer virus or disruption or interruption of service or a compliance breach by one of our vendors could negatively affect our reputation, our business and our earnings.

Information technology systems are critical to our business. The financial services industry has experienced an increase in both the number and severity of reported cyber-attacks aimed at gaining unauthorized access to bank systems for purposes of misappropriating assets or sensitive information, corrupting data, or causing operational disruption. We rely heavily upon a variety of computing platforms and networks over the Internet for the purpose of data processing, communication and information exchange and to conduct and manage various aspects of our business and provide our customers with the ability to bank online. We have business continuity and data security systems, policies and procedures designed to prevent or limit the effect of the failure, interruption or security breach of our information systems and controls in place to monitor vendor risks. Despite the safeguards instituted by management, our systems may be vulnerable to a breach of security through unauthorized access, phishing schemes, computer viruses and other security problems, as well as failures and disruptions of services resulting from power outages and other circumstances.

The Corporation maintains policies and procedures to prevent or limit the impact of system failures, interruptions and security breaches (including privacy breaches), but such events may still occur or may not be adequately addressed if they do occur. In addition, any compromise of our systems could deter customers from using our products and services. Although we rely on security systems to provide security and authentication necessary to effect the secure transmission of data, these precautions may not fully protect our systems from compromises or breaches of security.

Our information technology environment/network, including disaster recovery and business continuity planning, are outsourced to a third party hosted environment. In addition, we rely on the service of a variety of third-party vendors to meet our data processing needs. If any of these third-party providers encounters a system failure, cyber-security breach or other difficulties, or if we have difficulty communicating with any of these third-party providers, our ability to adequately process and account for transactions could be affected, and our business operations could be adversely affected. Threats to information security also exist in the processing of customer information through various other vendors and their personnel.

The occurrence of any system failures, interruption or breach of security involving us or our vendors could result in the compromise of our confidential information and the confidential information of our customers, employees and others. In such event, we could be exposed to claims, litigation, financial losses, costs and damages. Such damages could materially affect our earnings. In addition, any failure, interruption or breach in security could also result in failures or disruptions in our general ledger, deposit, loan and other systems and could subject us to additional regulatory scrutiny. In addition, the negative affect on our reputation could affect our ability to deliver products and services successfully to existing customers and to attract new customers. Any of the foregoing events and conditions could have a material adverse effect on our business, results of operations and financial condition.

The trading volume of our Common Stock remains low which could impact Common Stock prices.

Table of Contents

The trading history of our Common Stock, which trades on the Nasdaq Capital Market, has been characterized by relatively low trading volume. The value of a shareholder's investment may be subject to decreases due to the volatility of the price of our Common Stock.

Volatility in the market price of our Common Stock may occur in response to numerous factors, including, but not limited to, the factors discussed in the other risk factors and the following:

- actual or anticipated fluctuation in our operating results;
- press releases, publicity, or announcements concerning us, our competitors or the banking industry;
- changes in expectation of our future financial performance;
- future sales of our Common Stock; and
- other developments affecting us or our competitors.

These factors may adversely affect the trading price of our Common Stock, regardless of our actual operating performance, and could prevent a shareholder from selling Common Stock at or above the current market price.

The Corporation's principal source of cash flow is dividends and distributions from the Bank; however, we cannot be assured that the Bank will, in any circumstances, pay dividends to us. If the Bank fails to make dividend payments to us, and sufficient cash is not otherwise available, we may not be able to make interest and principal payments on the Subordinated Notes. Various federal and state statutes, regulations and rules limit, directly or indirectly, the amount of dividends that the Bank may pay to us without regulatory approval. There can be no assurances that we would receive such approval if required.

We may be unable to generate sufficient cash to service our Subordinated Notes and other debt obligations.

Our ability to make payments on and to refinance our indebtedness, including the Subordinated Notes, will depend on our financial and operating performance. We may be unable to maintain a level of cash flows from operating activities sufficient to permit us to pay the principal, premium, if any, and interest on our indebtedness, including the Subordinated Notes. If our cash flows and capital resources, and the dividends we receive from the Bank, are insufficient to fund our debt service obligations, we may be unable to provide new loans, other products or to fund our obligations to existing customers and otherwise implement our business plans. As a result, we may be unable to meet our scheduled debt service obligations. In the absence of sufficient operating results and resources, we could face substantial liquidity issues and we might be required to dispose of material assets or operations to meet our debt service and other obligations, or seek to restructure our indebtedness, including the notes. In such event, there could be no assurance that we would be able to consummate these transactions, and proceeds of such transactions might not be adequate to meet our debt service obligations then due.

If we fail to make interest and principal payments on the Subordinated Notes, the terms of the Subordinated Notes will restrict us from paying dividends to our common shareholders and this may adversely affect the market price of our Common Stock.

If we fail to make payments of principal or interest on the Subordinated Notes or a default occurs under the Subordinated Notes, the Corporation is not permitted to pay or declare dividends or distributions on or redeem, purchase, acquire or make a liquidation payments with respect to our Common Stock.

Further, our ability to pay dividends to our shareholders is always subject to legal and regulatory restrictions. Any payment of dividends in the future will depend, in large part, on the Corporation's earnings, capital requirements, financial condition and other factors considered relevant by the Corporation's Board of Directors. Although we have historically paid cash dividends on our Common Stock, we are not required to do so and our Board of Directors could reduce or eliminate our Common Stock dividend in the future. Our shareholders bear the risk that no dividends will be paid on our Common Stock in future periods or that, if paid, such dividends will be reduced, which may negatively impact the market price of our Common Stock.

External factors, many of which we cannot control, may result in liquidity concerns for us.

Liquidity risk is the potential that the Corporation will be unable to: meet its obligations as they come due; capitalize on growth opportunities as they arise; or pay regular dividends, because of the Corporation's inability to liquidate assets or obtain adequate funding on a timely basis, at a reasonable cost and within acceptable risk tolerances.

Table of Contents

Liquidity is required to fund various obligations, including credit commitments to borrowers, loan originations, withdrawals by depositors, repayment of borrowings, operating expenses, capital expenditures and dividends to shareholders.

Liquidity is derived primarily from deposit growth and retention; principal and interest payments on loans; principal and interest payments on investment securities; sale, maturity and prepayment of investment securities; borrowing capacity; net cash provided from operations and access to other funding sources.

Our access to funding sources in amounts adequate to finance our activities could be impaired by factors that affect us specifically or the financial services industry in general. Factors that could detrimentally impact our access to liquidity sources include a decrease in the level of our business activity due to a prolonged economic downturn or adverse regulatory action against us. Our ability to borrow could also be impaired by factors that are not specific to us, such as a severe disruption of the financial markets or negative views and expectations about the prospects for the financial services industry as a whole.

Item 1B. Unresolved Staff Comments

None.

Table of Contents

Item 2. Properties

The Corporation conducts its business through its main office located at 630 Godwin Avenue, Midland Park, New Jersey and its current eleven branch offices. The property located at 612 Godwin Avenue is used for administrative offices, primarily for commercial lending functions. The following table sets forth certain information regarding the Corporation's properties as of December 31, 2015.

Location	Leased or Owned	Date of Lease Expiration
612 Godwin Avenue Midland Park, NJ	Owned	---
630 Godwin Avenue Midland Park, NJ	Owned	---
386 Lafayette Avenue Hawthorne, NJ	Owned	---
87 Berdan Avenue Wayne, NJ	Leased	06/30/19
64 Franklin Turnpike Waldwick, NJ	Owned	---
190 Franklin Avenue Ridgewood, NJ	Leased	09/30/17
311 Valley Road Wayne, NJ	Leased	11/30/18
249 Newark Pompton Turnpike Pequannock, NJ	Owned	---
1111 Goffle Road Hawthorne, NJ	Leased	05/31/16
2 Changebridge Road Montville, NJ	Leased	07/31/20
378 Franklin Avenue Wyckoff, NJ	Leased	05/31/26

200 Kinderkamack Road Westwood, NJ	Leased	05/30/26
33 Sicomac Avenue North Haledon, NJ	Leased	10/31/20

We believe that our properties are in good condition, well maintained and adequate for the present and anticipated needs of our business.

Item 3. Legal Proceedings

The Corporation and the Bank are parties to or otherwise involved in legal proceedings arising in the normal course of business from time to time, such as claims to enforce liens, claims involving the making and servicing of real property loans, and other issues incident to the Bank's business. Management does not believe that there is any pending or

Table of Contents

threatened proceeding against the Corporation or the Bank which, if determined adversely, would have a material effect on the business or financial position of the Corporation or the Bank.

Item 4. Mine Safety Disclosures

Not applicable.

Part II

Item 5. Market for the Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities

The Corporation's Common Stock trades on the Nasdaq Capital Market under the symbol "SSFN". As of March 18, 2016, there were approximately 1,000 shareholders of record of the Common Stock.

The following table sets forth the quarterly high and low sale prices of the Common Stock as reported on the Nasdaq Capital Market for the quarterly periods presented and cash dividends declared and paid in the quarterly periods presented. The prices below reflect inter-dealer prices, without retail markup, markdown or commissions, and may not represent actual transactions.

	Sales Price		Cash
	High	Low	Dividend
Year Ended December 31, 2015			
Fourth Quarter	$6.48	$5.41	$ 0.02
Third Quarter	6.35	5.48	0.02
Second Quarter	6.50	5.53	0.02
First Quarter	5.96	4.50	0.02
Year Ended December 31, 2014			
Fourth Quarter	$5.20	$4.09	$ 0.02
Third Quarter	4.90	4.29	0.01
Second Quarter	5.07	3.71	0.01
First Quarter	5.25	4.63	0.01

The Corporation may pay dividends as declared from time to time by the Corporation’s Board of Directors out of funds legally available therefor, subject to certain restrictions. Since dividends paid by the Bank to the Corporation are a major source of income for the Corporation, any restriction on the Bank’s ability to pay dividends to the Corporation will act as a restriction on the Corporation’s ability to pay dividends to its shareholders. Under the New Jersey Banking Act, the Bank may not pay a cash dividend unless, following the payment of such dividend, the capital stock of the Bank will be unimpaired and (i) the Bank will have a surplus of no less than 50% of its capital stock or (ii) the payment of such dividend will not reduce the surplus of the Bank. In addition, the Bank cannot pay dividends if doing so would reduce its capital below the regulatory imposed minimums.

During fiscal 2015, the Corporation paid quarterly cash dividends totaling $0.08 per share compared to quarterly cash dividends totaling $0.05 per share during fiscal 2014. We did not repurchase any shares of our Common Stock during the years ended December 31, 2015 and 2014.

Table of Contents

Item 6. Selected Financial Data

The following selected consolidated financial data of the Corporation is qualified in its entirety by, and should be read in conjunction with, the consolidated financial statements, including notes, thereto, included elsewhere in this document.

STEWARDSHIP FINANCIAL CORPORATION AND SUBSIDIARY CONSOLIDATED

FINANCIAL SUMMARY OF SELECTED FINANCIAL DATA

	December 31,				
	2015	2014	2013	2012	2011
	(Dollars in thousands, except per share amounts)				
Earnings Summary:					
Net interest income	$21,783	$21,727	$22,758	$23,532	$24,610
Provision for loan losses	(1,375)	(50)	3,775	9,995	10,845
Net interest income after provision for loan losses	23,158	21,777	18,983	13,537	13,765
Noninterest income	3,493	2,960	3,965	6,389	5,170
Noninterest expense	20,179	20,233	19,838	19,653	18,666
Income before income tax expense (benefit)	6,472	4,504	3,110	273	269
Income tax expense (benefit)	2,272	1,419	640	(247)	(415)
Net income	4,200	3,085	2,470	520	684
Dividends on preferred stock and accretion	456	683	633	352	558
Net income available to common shareholders	$3,744	$2,402	$1,837	$168	$126
Common Share Data:					
Basic net income	$0.62	$0.40	$0.31	$0.03	$0.02
Diluted net income	0.62	0.40	0.31	0.03	0.02
Cash dividends declared	0.08	0.05	0.04	0.15	0.20
Book value at year end	7.82	7.29	6.53	6.98	7.28
Average shares outstanding, net of treasury stock	6,078	6,004	5,937	5,909	5,861
Shares outstanding at year end	6,086	6,035	5,944	5,925	5,883
Selected Consolidated Ratios:					
Return on average assets	0.60%	0.46%	0.36%	0.07%	0.10%
Return on average common shareholders' equity	8.14%	5.77%	4.54%	0.39%	0.29%
Average shareholders' equity as a percentage of average total assets	7.98%	8.42%	8.06%	8.33%	7.92%
Leverage (Tier 1) capital (1)	7.67%	9.45%	9.04%	9.09%	8.86%

Tier 1 risk based capital (2)	10.16%	13.04%	13.52%	13.63%	12.65%
Total risk based capital (2)	14.34%	14.30%	14.78%	14.89%	13.91%
Allowance for loan loss to total loans	1.68%	2.01%	2.28%	2.42%	2.54%
Nonperforming loans to total loans	0.36%	0.76%	2.34%	4.14%	6.08%
Selected Year-end Balances					
Total assets	$717,888	$693,551	$673,508	$688,388	$708,818
Total loans, net of allowance for loan loss	517,556	467,699	424,262	429,832	444,803
Total deposits	604,753	556,476	577,591	590,254	593,552
Shareholders' equity	47,573	58,969	53,779	56,346	57,792

(1) As a percentage of average quarterly assets.

(2) As a percentage of total risk-weighted assets.

Table of Contents

Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations

This section provides an analysis of the Corporation's consolidated financial condition and results of operations for the years ended December 31, 2015 and 2014. The analysis should be read in conjunction with the related audited consolidated financial statements and the accompanying notes presented elsewhere herein.

As used in this annual report, "we", "us" and "our" refer to Stewardship Financial Corporation and its consolidated subsidiary, Atlantic Stewardship Bank, depending on the context.

Introduction

The Corporation's primary business is the ownership and supervision of the Bank and, through the Bank, the Corporation has been, and intends to continue to be, a community-oriented financial institution offering a variety of financial services to meet the needs of the communities it serves. As of December 31, 2015, the Corporation had 12 full service branch offices located in Bergen, Passaic and Morris Counties in New Jersey. The Corporation conducts a general commercial and retail banking business encompassing a wide range of traditional deposit and lending functions along with other customary banking services. The Corporation earns income and generates cash primarily through the deposit gathering activities of the branch network. These deposits gathered from the general public are then utilized to fund the Corporation's lending and investing activities.

The Corporation has developed a strong deposit base with good franchise value. A mix of a variety of different deposit products and electronic services, along with a strong focus on customer service, is used to attract customers and build depositor relationships. Challenges facing the Corporation include our ability to continue to grow the branch deposit levels, provide adequate technology enhancements to achieve efficiencies, offer a competitive product line, and provide the highest level of customer service.

The Corporation is affected by the overall economic conditions in northern New Jersey, the interest rate and yield curve environment, and the overall national economy. Each of these factors has an impact on our ability to attract specific deposit products, our ability to invest in loan and investment products, and our ability to earn acceptable profits without incurring increased risks.

When evaluating the financial condition and operating performance of the Corporation, management reviews historical trends, peer comparisons, asset and deposit concentrations, interest margin analysis, adequacy of loan loss reserve and loan quality performance, adequacy of capital under current positions as well as to support future expansion, adequacy of liquidity, and overall quality of earnings performance.

The branch network coupled with our online services provides for solid coverage in both existing and new markets in key towns in the three counties in which we operate. The Corporation continually evaluates the need to further develop the infrastructure, including electronic products and services, to enable it to continue to build franchise value and expand its existing and future customer base.

During 2015 and 2014, the Corporation, like all financial institutions, continued to experience a difficult and complicated economic and operating environment. Although substantial improvement in asset quality was achieved in 2015, the Corporation’s results have been affected by the prolonged challenging economic environment. The managing of credit risk has stabilized for the Bank as reflected in the improvement in asset quality measurements. Nevertheless, competition in the northern New Jersey market remains intense and the challenges of operating throughout these years in a flat interest rate market has continued to make it somewhat difficult to attract deposits when interest rate levels are so low. Competition for low cost, core deposits remains strong. The level of consumers and businesses looking to borrow improved in 2015. In addition, all new lending opportunities continue to be appropriately evaluated. The Corporation has not engaged in subprime lending.

In an effort to address the strong competition in attracting deposit balances, the Corporation continues to evaluate product and services offerings. Improvements and upgrades of our electronic / online banking products and services continue to be a priority. Management believes that the Corporation offers the majority of the services that our competitors offer and what today’s customers require. Electronic products and services now available to our customers include: online banking / cash management, including remote deposit capture services for businesses, mobile deposit capabilities (depositing checks remotely by taking pictures of checks and transmitting them electronically) and applications for smartphones and tablets. These electronic banking products and services continue to provide our customers with additional means to access their accounts conveniently. Our security for online banking

Table of Contents

customers includes a multi-factor authentication sign-on. In addition, the Corporation has the technology and procedures to enable instant debit card issuance for new customers and existing customers.

Expense control is an ongoing focus. The Corporation continues to balance the need to control expenses with its focus on quality loan growth and an awareness of the customers' desire for convenient banking – all being addressed while continuing to be compliant with regulations and remaining up-to-date on all levels of security.

The Corporation will continue to concentrate its efforts on the origination of loans funded with appropriate deposit growth. In addition, monitoring asset quality, capitalizing on technology and improving efficiencies will remain a focus during 2016.

Subordinated Notes / Small Business Lending Fund Program

On August 28, 2015, the Corporation completed a private placement of $16.6 million in aggregate principal amount of fixed rate subordinated notes (the "Subordinated Notes") to certain institutional accredited investors pursuant to a Subordinated Note Purchase Agreement dated August 28, 2015 between the Corporation and such investors. The Subordinated Notes have a maturity date of August 28, 2025 and bear interest at the rate of 6.75% per annum, payable semi-annually, in arrears, on March 1 and September 1 of each year during the time that the Subordinated Notes remain outstanding. The Subordinated Notes include a right of prepayment, without penalty, on or after August 28, 2020 and, in certain limited circumstances, before that date. The indebtedness evidenced by the Subordinated Notes, including principal and interest, is unsecured. In addition, the Subordinated Notes are subordinate and junior in right to the Company's payments to general and secured creditors and depositors of the Bank. The Subordinated Notes have been structured to qualify as Tier 2 capital for regulatory purposes. The Subordinated Notes totaled $16.0 million at December 31, 2015, which includes $641,000 of remaining unamortized debt issuance costs. The debt issuance costs are being amortized over the expected life of the Subordinated Notes.

Using the net proceeds of the Subordinated Notes issuance, on September 1, 2015, the Corporation repurchased from the U.S. Department of the Treasury ("Treasury") all 15,000 shares of the Corporation's Senior Non-Cumulative Perpetual Preferred Stock, Series B (the "Series B Preferred Shares"), having a liquidation preference of $1,000 per share, for an aggregate purchase price of $15 million, in cash, plus approximately $114,000 of accrued dividends. The Series B Preferred Shares were issued to Treasury on September 1, 2011 pursuant to a Securities Purchase Agreement between the Corporation and the Secretary of the Treasury in connection with the Corporation's participation in Treasury's Small Business Lending Fund program ("SBLF"), a $30 billion fund established under the Small Business Jobs Act of 2010 to encourage small business lending by providing capital to qualified community banks with assets of less than $10 billion.

The dividend rate of the Series B Preferred Shares was subject to fluctuation on a quarterly basis during the first ten quarters during which the Series B Preferred Shares were outstanding, based upon changes in the level of Qualified

Small Business Lending ("QSBL" as defined in the Securities Purchase Agreement) from 1% to 5% per annum and, since then, for the eleventh dividend period through that portion of the nineteenth dividend period prior to the four and one-half year anniversary of the date of issuance of the Series B Preferred Shares (i.e., through February 29, 2016), the dividend rate became fixed at 4.56%. In general, the dividend rate decreased as the level of the Bank's QSBL increased. Beginning on March 1, 2016 and for all dividend periods thereafter, the dividend rate of the Series B Preferred Shares would have increased and become fixed at 9%.

Recent Accounting Pronouncements

A discussion of recent accounting pronouncements and their effect on the Corporation's Audited Consolidated Financial Statements can be found in Note 1 of the Corporation's Audited Consolidated Financial Statements contained elsewhere in this Annual Report on Form 10-K.

Critical Accounting Policies and Estimates

"Management's Discussion and Analysis of Financial Condition and Results of Operations," as well as disclosures found elsewhere in this Annual Report on Form 10-K, are based upon the Corporation's audited consolidated financial statements, which have been prepared in conformity of U.S. generally accepted accounting principles ("GAAP"). The preparation of these financial statements requires the Corporation to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses. Note 1 to the Corporation's Audited Consolidated Financial Statements for the year ended December 31, 2015 contains a summary of the Corporation's significant accounting policies. Management believes the Corporation's policies with respect to the methodology for the

Table of Contents
determination of the allowance for loan losses and the evaluation of deferred income taxes involves a higher degree of complexity and requires management to make difficult and subjective judgments, which often require assumptions or estimates about highly uncertain matters. Changes in these judgments, assumptions or estimates could materially impact results of operations. These critical policies and their application are periodically reviewed with the Audit Committee and the Board of Directors.

Allowance for Loan Losses. The allowance for loan losses is based upon management’s evaluation of the adequacy of the allowance, including an assessment of known and inherent risks in the loan portfolio, giving consideration to the size and composition of the loan portfolio, actual loan loss experience, level of delinquencies, detailed analysis of individual loans for which full collectability may not be assured, the existence and estimated net realizable value of any underlying collateral and guarantees securing the loans, and current economic and market conditions. Although management uses the best information available, the level of the allowance for loan losses remains an estimate, which is subject to significant judgment and short-term change. Various regulatory agencies, as an integral part of their examination process, periodically review the Corporation’s allowance for loan losses. Such agencies may require the Corporation to make additional provisions for loan losses based upon information available to them at the time of their examination. Furthermore, the majority of the Corporation’s loans are secured by real estate in the State of New Jersey. Accordingly, the collectability of a substantial portion of the carrying value of the Corporation’s loan portfolio is susceptible to changes in local market conditions and may be adversely affected should real estate values decline or the northern New Jersey area experience adverse economic changes. Future adjustments to the allowance for loan losses may be necessary due to economic, operating, regulatory and other conditions beyond the Corporation’s control.

Deferred Income Taxes. The Corporation records income taxes in accordance with ASC 740, “Income Taxes,” as amended, using the asset and liability method. Accordingly, deferred tax assets and liabilities: (i) are recognized for the expected future tax consequences of events that have been recognized in the financial statements or tax returns; (ii) are attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases; and (iii) are measured using enacted tax rates expected to apply in the years when those temporary differences are expected to be recovered or settled. Where applicable, deferred tax assets are reduced by a valuation allowance for any portions determined not likely to be realized. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income tax expense in the period of enactment. The valuation allowance is adjusted, by a charge or credit to income tax expense, as changes in facts and circumstances warrant.

Earnings Summary

The Corporation reported net income of $4.2 million for the year ended December 31, 2015, compared to $3.1 million for 2014. After dividends on preferred stock and accretion, net income available to common shareholders was $3.7 million for 2015, or $0.62 per diluted common share, compared to $2.4 million, or $0.40 per diluted common share for the year ended December 31, 2014.

The return on average assets was 0.60% in 2015 compared to 0.46% in 2014. The return on average common equity was 8.14% for 2015 as compared to 5.77% in 2014.

Results of Operations

Net Interest Income

The Corporation's principal source of revenue is the net interest income derived from the Bank, which represents the difference between the interest earned on assets and interest paid on funds acquired to support those assets. Net interest income is affected by the balances and mix of interest-earning assets and interest-bearing liabilities, changes in their corresponding yields and costs, and by the volume of interest-earning assets funded by noninterest-bearing deposits. The Corporation's principal interest-earning assets are loans made to businesses and individuals and investment securities.

For the year ended December 31, 2015, net interest income, on a tax equivalent basis, was relatively unchanged from the year ended December 31, 2014. The net interest rate spread and net yield on interest-earning assets for the year ended December 31, 2015 were 3.10% and 3.30%, respectively, compared to 3.28% and 3.46% for the year ended December 31, 2014. The declines in both the net interest rate spread and net yield on interest-earning assets reflect the impact of the new $16.6 million of Subordinated Notes issued on August 28, 2015. While the cost of the Subordinated Notes reduces net interest income, the increased interest expense for the year, on an after tax basis, is approximately offset by the dividends that would have accrued at a rate of 4.56% on the Series B Preferred Shares for the full year resulting in an overall neutral effect on net income available to common shareholders for the year.

Table of Contents

Furthermore, beginning on March 1, 2016, and for all dividend periods thereafter, the dividend rate would have increased and become fixed at 9% per annum, making the issuance of the Subordinated Notes a positive impact to net income available to common shareholders in the future.

In addition, in general, the net interest rate spread and net yield on interest-earning assets for the current year also reflects a decline in loan interest rates. The reduced loan yields primarily reflect the historically low market rates in the current environment.

For the year ended December 31, 2015, total interest income, on a tax equivalent basis, was $25.9 million compared to $25.3 million for the prior year. The increase was due to an increase in the average balance of interest-earning assets partially offset by a decrease in yields on interest-earning assets. Average interest-earning assets increased $30.4 million in 2015 over the 2014 amount. The change in average interest-earning assets primarily reflects an increase from the comparable prior year in average loans offset by a decrease in securities reflective of the sale of available-for-sale securities with high price volatility and use of those proceeds to fund loan growth. Average loans increased $66.7 million while average investment securities decreased $41.6 million. The average rate earned on interest-earning assets decreased 9 basis points from 3.96% for the year ended December 31, 2014 to 3.87% in the 2015 fiscal year. The decline in the asset yield reflects the effect of a prolonged low interest rate environment.

Interest expense increased $619,000, or 19.3%, during the year ended December 31, 2015 to $3.8 million. The issuance of the Subordinated Notes on August 28, 2015 had the effect of increasing average interest-bearing liabilities and added approximately $405,000 to interest expense for the current year. An increase in the other components of average interest-bearing liabilities also contributed to the increase in interest expense for the year ended December 31, 2015. The average balance of interest-bearing deposits, repurchase agreements and FHLB-NY borrowings increased $22.9 million for the year ended December 31, 2015 from the comparable prior year. Interest-bearing deposits accounted for $7.3 million and repurchase agreements and FHLB-NY borrowings accounted for $10.1 million of the increase in average interest-bearing liabilities. For the year ended December 31, 2015, the total cost for interest-bearing liabilities was 0.77% compared to 0.68% for the prior year periods. As noted previously, the issuance of the Subordinated Notes contributed to the overall increase of interest-bearing liabilities in the current year. Excluding the Subordinated Debentures and the Subordinated Notes, the cost for interest-bearing deposits, repurchase agreements and FHLB-NY borrowings was 0.60% compared to 0.58% for the prior year, reflecting a slight increase in the cost for interest-bearing deposits and FHLB-NY borrowings. The Corporation continues to supplement its branch deposit network with a mix of wholesale repurchase agreements and Federal Home Loan Bank borrowings. The Federal Home Loan Bank borrowings in particular provide an alternative funding source that helps provide for better management of interest rate risk. At December 31, 2015 and 2014 brokered deposits totaled $7.8 million and $10.5 million, respectively.

Table of Contents

The following table reflects the components of the Corporation's net interest income for the years ended December 31, 2015, 2014 and 2013 including: (1) average assets, liabilities and shareholders' equity based on average daily balances, (2) interest income earned on interest-earning assets and interest expense paid on interest-bearing liabilities, (3) average yields earned on interest-earning assets and average rates paid on interest-bearing liabilities, and (4) net yield on interest-earning assets. Nontaxable income from investment securities and loans is presented on a tax-equivalent basis assuming a statutory tax rate of 34% for the years presented. This was accomplished by adjusting non-taxable income upward to make it equivalent to the level of taxable income required to earn the same amount after taxes.

	2015			2014			2013	
	Average Balance	Interest Income/ Expense	Average Rates Earned/ Paid	Average Balance	Interest Income/ Expense	Average Rates Earned/ Paid	Average Balance	Interest Income/ Expense
	(Dollars in thousands)							
Assets								
Interest-earning assets:								
Loans (1)	$502,981	$22,684	4.51%	$436,321	$21,160	4.85%	$441,670	$22,693
Taxable investment securities	139,587	2,430	1.74%	175,487	3,118	1.78%	173,739	2,864
Tax-exempt investment securities (2)	13,959	741	5.31%	19,698	1,008	5.12%	34,042	1,532
Other interest-earning assets	12,775	40	0.31%	7,369	25	0.34%	8,881	29
Total interest-earning assets	669,302	25,895	3.87%	638,875	25,311	3.96%	658,332	27,118
Non-interest-earning assets:								
Allowance for loan losses	(9,551)			(10,058)			(11,337)	
Other assets	41,774			43,095			41,310	
Total assets	$701,525			$671,912			$688,305	
Liabilities and Shareholders' Equity								
Interest-bearing liabilities:								
Interest-bearing demand deposits	$214,318	$568	0.27%	$219,142	$629	0.29%	$232,422	$739
Savings deposits	79,276	84	0.11%	78,559	84	0.11%	73,814	79
Time deposits	141,071	1,416	1.00%	129,685	1,094	0.84%	143,365	1,518
Repurchase agreements	—	—	0.00%	5,255	254	4.83%	7,501	367
FHLB-NY borrowings	47,837	850	1.78%	32,503	642	1.98%	26,737	606
Subordinated Debentures and Subordinated Notes	12,736	908	7.13%	7,217	504	6.98%	7,217	504
Total interest-bearing liabilities	495,238	3,826	0.77%	472,361	3,207	0.68%	491,056	3,813
Non-interest bearing liabilities:								
Demand deposits	147,756			140,384			138,886	
Other liabilities	2,554			2,591			2,908	
Shareholders' equity	55,977			56,576			55,455	
Total liabilities and Shareholders' equity	$701,525			$671,912			$688,305	
Net interest income (taxable equivalent basis)		22,069			22,104			23,305
Tax equivalent adjustment		(286)			(377)			(547)

Net interest income	$21,783	$21,727	$22,758
Net interest spread (taxable equivalent basis)	3.10%	3.28%	
Net yield on interest-earning assets (taxable equivalent basis) (3)	3.30%	3.46%	

(1) For purpose of these calculations, nonaccruing loans are included in the average balance. Fees are included in loan interest.

(2) The tax equivalent adjustments are based on a marginal tax rate of 34%. Loans and total interest-earning assets are net of unearned income. Securities are included at amortized cost.

(3) Net interest income (taxable equivalent basis) divided by average interest-earning assets.

Table of Contents

The following table compares net interest income for the years ended December 31, 2015 and 2014 over the respective prior years in terms of changes from the prior year in the volume of interest-earning assets and interest-bearing liabilities and changes in yields earned and rates paid on such assets and liabilities on a tax-equivalent basis. The table reflects the extent to which changes in the Corporation's interest income and interest expense are attributable to changes in volume (changes in volume multiplied by prior year rate) and changes in rate (changes in rate multiplied by prior year volume). Changes attributable to the combined impact of volume and rate have been allocated proportionately to changes due to volume and changes due to rate.

	2015 Versus 2014 (In thousands)			2014 Versus 2013 (In thousands)		
	Increase (Decrease) Due to Change in			Increase (Decrease) Due to Change in		
	Volume	Rate	Net	Volume	Rate	Net
Interest income:						
Loans	$3,077	$(1,553)	$1,524	$(272)	$(1,261)	$(1,533)
Taxable investment securities	(626)	(62)	(688)	29	225	254
Tax-exempt investment securities	(304)	37	(267)	(711)	187	(524)
Other interest-earning assets	17	(2)	15	(5)	1	(4)
Total interest-earning assets	2,164	(1,580)	584	(959)	(848)	(1,807)
Interest expense:						
Interest-bearing demand deposits	(14)	(47)	(61)	(40)	(70)	(110)
Savings deposits	1	(1)	—	5	—	5
Time deposits	102	220	322	(135)	(289)	(424)
Repurchase agreements	(127)	(127)	(254)	(109)	(4)	(113)
FHLB borrowings	278	(70)	208	120	(84)	36
Subordinated Debentures and Subordinated Notes	393	11	404	—	—	—
Total interest-bearing liabilities	633	(14)	619	(159)	(447)	(606)
Net change in net interest income	$1,531	$(1,566)	$(35)	$(800)	$(401)	$(1,201)

Table of Contents

Provision for Loan Losses

The Corporation maintains an allowance for loan losses at a level considered by management to be adequate to cover the probable incurred losses associated with its loan portfolio. On an ongoing basis, management analyzes the adequacy of this allowance by considering the nature and volume of the Corporation's loan activity, financial condition of the borrower, fair value of underlying collateral, and changes in general market conditions. Additions to the allowance for loan losses are charged to operations in the appropriate period. Actual loan losses, net of recoveries, reduce the allowance. The appropriate level of the allowance for loan losses is based on estimates, and ultimate losses may vary from current estimates.

For the year ended December 31, 2015, the Corporation recorded a $1.4 million negative loan loss provision compared to a $50,000 negative loan loss provision recorded for the year ended December 31, 2014. The negative provision reflects the continued improvement in the credit quality of the portfolio as well as the recording of net recoveries of previously charged-off loan balances. The allowance for loan loss was $8.8 million, or 1.68% of total loans as of December 31, 2015 compared to $9.6 million, or 2.01% of total loans a year earlier.

The loan loss provision takes into account any growth or contraction in the loan portfolio and any changes in nonperforming loans as well as the impact of net charge-offs. In determining the level of the allowance for loan loss, the Corporation also considered the types of loans as well as the overall seasoning of new loans to determine the risk that was inherent in the portfolio.

Nonperforming loans decreased from $3.6 million, or 0.76% of total loans, at December 31, 2014 to $1.9 million, or 0.36% of total loans, at December 31, 2015. During the year ended December 31, 2015, the Corporation charged-off $602,000 of loan balances and recovered $1.2 million in previously charged-off loans compared to $1.4 million and $1.1 million, respectively, in the prior year. The allowance for loan losses related to the impaired loans decreased from $920,000 at December 31, 2014 to $719,000 at December 31, 2015.

In addition to these factors, the Corporation evaluated the economic conditions and overall real estate climate in the primary business markets in which it operates when considering the overall risk of the lending portfolio. Recent years showed improvement in the economy and the real estate market which is reflected in a reduced level of charge-offs and loan delinquencies. The Corporation monitors its loan portfolio and intends to continue to provide for loan loss reserves based on its ongoing periodic review of the loan portfolio and general market conditions.

See "Asset Quality" section below for further information concerning the allowance for loan losses and nonperforming assets.

Noninterest Income

Noninterest income consists of all income other than interest income and is principally derived from service charges on deposits, income derived from bank-owned life insurance, gains from calls and sales of securities, gains and losses on sales of loans and income derived from debit cards and ATM usage. In addition, gains on sales of other real estate owned ("OREO") are reflected as noninterest income.

Noninterest income was $3.5 million for the year ended December 31, 2015 as compared to $3.0 million for the prior year. Noninterest income for the year ended December 31, 2015 included a year over year increase of $132,000 in fees and service charges as a result of changes to the standard amounts assessed on deposit accounts. In addition, gains on sales of mortgage loans reflected an increase of $69,000 for the year ended December 31, 2015, as the Corporation returned to selling the majority of mortgage originations due to current market conditions and commercial loan demand. Noninterest income for the year ended December 31, 2015 included $169,000 of gains on calls and sales of securities as compared to $165,000 for the year ended December 31, 2014. The prior year ended December 31, 2014 included a $241,000 loss from the sale of nonperforming loans. For the year ended December 31, 2015, gains on sales of OREO were $83,000 compared to $63,000 for prior year OREO activity.

Noninterest Expense

For the years ended December 31, 2015 and 2014, total noninterest expense was relatively unchanged at $20.2 million each year. Increases in various expenses were offset by decreases in other expenses. The most significant

Table of Contents

increase in salaries and employee benefits was in costs for medical benefits as well as 401(k) and profit sharing contributions. A decrease in occupancy expense includes the impact of the closure of a remote drive-up location. An increase in data processing expense is reflective of costs associated with electronic product offerings and maintaining appropriate security.

Income Taxes

Income tax expense totaled $2.3 million and $1.4 million for the years ended December 31, 2015 and 2014, respectively, representing effective tax rates of 35.1% and 31.5%. For the year ended December 31, 2014, tax expense reflects a lower overall projected effective tax rate as a result of our tax exempt income representing a larger percentage of pretax income.

Financial Condition

Total assets at December 31, 2015 were $717.9 million, an increase of $24.3 million, or 3.5%, over the $693.6 million at December 31, 2014. Securities available-for-sale decreased $31.6 million to $93.4 million while securities held to maturity increased $5.6 million to $60.7 million. In order to manage the growth in assets while still assisting in the funding of the loan growth, in early 2015, the Corporation identified and sold approximately $27.8 million of available-for-sale securities with high price volatility. Net loans increased $49.9 million to $517.6 million at December 31, 2015 compared to $467.7 million at December 31, 2014, reflecting improved loan demand. Loans held for sale totaled $1.5 million at December 31, 2015 compared to no loans held for sale at December 31, 2014. Other real estate owned (OREO) decreased $428,000 to $880,000 at December 31, 2015 compared to $1.3 million at December 31, 2014 reflecting the sale of several properties partially offset by one additional foreclosure.

Loan Portfolio

The Corporation’s loan portfolio at December 31, 2015, net of allowance for loan losses, totaled $517.6 million, an increase of $49.9 million, or a 10.7% increase over the $467.7 million at December 31, 2014. Residential real estate mortgages increased $5.1 million. Although the Corporation continued its policy of selling the majority of its residential real estate loans in the secondary market, certain residential real estate loans were placed into the portfolio to partially compensate for payoffs and normal amortization. Of the loans sold, all have been sold with servicing of the loan transferring to the purchaser. Commercial real estate mortgage loans consisting of $348.7 million, or 66.2% of the total portfolio, represent the largest portion of the loan portfolio. These loans reflected an increase of $53.4 million from $295.3 million, or 61.9% of the total loan portfolio at December 31, 2014. Commercial loans decreased $11.0 million to $64.9 million, representing 12.3% of the total loan portfolio. Consumer installment loans and home equity loans increased $1.6 million, partially attributable to borrowers protecting a low interest rate on their first lien and taking advantage of low interest rates by using the equity in the home to borrow against.

The Corporation’s lending activities are concentrated in loans secured by real estate located in northern New Jersey. Accordingly, the collectability of a substantial portion of the Corporation’s loan portfolio is susceptible to changes in real estate market conditions in northern New Jersey. The Corporation has not made loans to borrowers outside the United States.

At December 31, 2015, aside from the real estate concentration described above, there were no concentrations of loans exceeding 10% of total loans outstanding. Loan concentrations are considered to exist when there are amounts loaned to a multiple number of borrowers engaged in similar activities which would cause them to be similarly impacted by economic or other related conditions.

Table of Contents

The following table sets forth the classification of the Corporation's loans by major category at the end of each of the last five years:

	December 31, 2015	2014	2013	2012	2011
	(In thousands)				
Real estate mortgage:					
Residential (1)	$82,955	$77,836	$77,540	$67,200	$54,946
Commercial (1)	348,724	295,278	256,480	252,087	259,462
Commercial loans	64,860	75,852	73,890	89,414	102,500
Consumer loans:					
Installment (2)	10,262	12,174	13,327	16,544	21,310
Home equity	19,425	15,950	12,538	14,912	17,889
Other	251	230	234	266	306
Total gross loans	526,477	477,320	434,009	440,423	456,413
Less: Allowance for loan losses	8,823	9,602	9,915	10,641	11,604
Deferred loan (fees) costs	98	19	(168)	(50)	6
Net loans	$517,556	$467,699	$424,262	$429,832	$444,803

(1) Includes construction loans

(2) Includes automobile, home improvement, second mortgages, and unsecured loans.

The following table sets forth certain categories of gross loans as of December 31, 2015 by contractual maturity. Borrowers may have the right to prepay obligations with or without prepayment penalties. This might cause actual maturities to differ from the contractual maturities summarized below.

	Within 1 Year	After 1 Year But Within 5 Years	After 5 Years	Total
	(In thousands)			
Real estate mortgage	$5,036	$ 26,708	$399,935	$431,679
Commercial	27,595	17,214	20,051	64,860
Consumer	160	3,015	26,763	29,938
Total gross loans	$32,791	$ 46,937	$446,749	$526,477

The following table sets forth the dollar amount of all gross loans due one year or more after December 31, 2015, which have predetermined interest rates or floating or adjustable interest rates:

	Predetermined Rates	Adjustable Rates	Total
	(In thousands)		
Real estate mortgage	$90,552	$336,091	$426,643
Commercial	15,393	21,872	37,265
Consumer	10,600	19,178	29,778
Total gross loans	$116,545	$377,141	$493,686

22

Table of Contents

Asset Quality

The Corporation's principal earning asset is its loan portfolio. Inherent in the lending function is the risk of deterioration in a borrower's ability to repay loans under existing loan agreements. The Corporation manages this risk by maintaining reserves to absorb probable incurred loan losses. In determining the adequacy of the allowance for loan losses, management considers the risks inherent in its loan portfolio and changes in the nature and volume of its loan activities, along with general economic and real estate market conditions. Although management endeavors to establish a reserve sufficient to offset probable incurred losses in the portfolio, changes in economic conditions, regulatory policies and borrower's performance could require future changes to the allowance.

In establishing the allowance for loan losses, the Corporation utilizes a two-tiered approach by (1) identifying problem loans and allocating specific loss allowances to such loans and (2) establishing a general loan loss allowance on the remainder of its loan portfolio. The Corporation maintains a loan review system that allows for a periodic review of its loan portfolio and the early identification of potential problem loans. Such a system takes into consideration, among other things, delinquency status, size of loans, type of collateral and financial condition of the borrowers.

Allocations of specific loan loss allowances are established for identified loans based on a review of various information including appraisals of underlying collateral. Appraisals are performed by independent licensed appraisers to determine the value of impaired, collateral-dependent loans. Appraisals are periodically updated to ascertain any further decline in value. General loan loss allowances are based upon a combination of factors including, but not limited to, actual loss experience, composition of the loan portfolio, current economic conditions and management's judgment.

Management continually reviews and makes enhancements, as appropriate, to its process over measuring the general portion of the allowance for loan losses. In connection with its periodic risk assessment and monitoring process, the Corporation re-evaluated a number of assumptions supporting the methodology, including the look-back period used to evaluate the historical loss factors for its portfolios, as well as performing a study of its loss emergence period ("LEP") data. As a result of this review, management updated a number of assumptions, including lengthening the look back period for all loan portfolios as well as the LEP for certain portfolios. Given these changes to the quantitative methodology, management reassessed its qualitative and environmental factors to align with the revised model assumptions. These changes had no material impact on the overall allowance.

The Corporation's accounting policies are set forth in Note 1 to the Corporation's Audited Consolidated Financial Statements. The application of some of these policies requires significant management judgment and the utilization of estimates. Actual results could differ from these judgments and estimates resulting in a significant impact on the financial statements. A critical accounting policy for the Corporation is the policy utilized in determining the adequacy of the allowance for loan losses. Although management uses the best information available, the level of the allowance for loan losses remains an estimate which is subject to significant judgment and short-term change. Various regulatory agencies, as an integral part of their examination process, periodically review the Corporation's allowance for loan losses. Such agencies may require the Corporation to make additional provisions for loan losses based upon information available to them at the time of their examination. Furthermore, the Corporation's lending activities are concentrated in loans secured by real estate located in northern New Jersey. Accordingly, the collectability of a substantial portion of the Corporation's loan portfolio is susceptible to changes in real estate market conditions in northern New Jersey. Future adjustments to the allowance may be necessary due to economic, operating, regulatory, and other conditions beyond the Corporation's control. In management's opinion, the allowance for loan losses totaling $8.8 million is adequate to cover probable incurred losses inherent in the portfolio at December 31, 2015.

Nonperforming Assets

Risk elements include nonaccrual loans, past due and restructured loans, potential problem loans, loan concentrations and other real estate owned (i.e., property acquired through foreclosure or deed in lieu of foreclosure). The Corporation's loans are generally placed on a nonaccrual status when they become past due in excess of 90 days as to payment of principal and interest or earlier if collection of principal or interest is considered doubtful. Interest previously accrued on these loans and not yet paid is charged against income during the current period. Interest earned thereafter may only be included in income to the extent that it is received in cash. Loans past due 90 days or more and accruing represent those loans which are in the process of collection, adequately collateralized and management believes all interest and principal owed will be collected. Restructured loans are loans that have been renegotiated to permit a borrower, who has incurred adverse financial circumstances, to continue to perform.

Table of Contents

Management can make concessions to the terms of the loan or reduce the contractual interest rates to below market rates in order for the borrower to continue to make payments.

The following table sets forth certain information regarding the Corporation's nonperforming assets as of December 31 of each of the preceding five years:

	December 31,				
	2015	2014	2013	2012	2011
	(Dollars in thousands)				
Nonaccrual loans (1):					
Construction	$—	$—	$—	$3,080	$8,092
Residential real estate	—	96	755	413	779
Commercial real estate	484	1,284	6,592	10,083	9,302
Commercial	1,314	1,923	2,255	3,635	8,672
Consumer	84	325	617	800	891
Total nonaccrual loans	1,882	3,628	10,219	18,011	27,736
Loans past due ninety days or more and accruing: (2)					
Commercial	—	—	—	237	—
Total loans past due ninety days or more and accruing	—	—	—	237	—
Total nonperforming loans	1,882	3,628	10,219	18,248	27,736
Other real estate owned	880	1,308	451	1,058	5,288
Total nonperforming assets	$2,762	$4,936	$10,670	$19,306	$33,024
Allowance for loan losses	$8,823	$9,602	$9,915	$10,641	$11,604
Nonaccrual loans to total gross loans (3)	0.36%	0.76%	2.34%	4.09%	6.08%
Nonperforming loans to total gross loans (3)	0.36%	0.76%	2.34%	4.14%	6.08%
Nonperforming assets to total assets	0.38%	0.71%	1.58%	2.80%	4.66%
Allowance for loan losses to nonperforming loans	468.81%	264.66%	97.03%	58.31%	41.84%

(1) Restructured loans classified in the nonaccrual category totaled $552,000, $824,000, $1.4 million, $1.3 million, and $9.1 million, for the years ended December 31, 2015, 2014, 2013, 2012, and 2011, respectively.
(2) There were no restructured loans classified in the past due 90 days or more and accruing for any years presented.
(3) Gross loans includes $2.8 million of loans held for sale at December 31, 2014.

A loan is generally placed on nonaccrual when, based on current information and events, it is probable that the Corporation will be unable to collect the scheduled payments of principal or interest when due according to the contractual terms of the loan agreement. The identification of nonaccrual loans reflects careful monitoring of the loan portfolio. The Corporation is focused on resolving nonperforming loans and mitigating future losses in the portfolio. All delinquent loans continue to be reviewed by management.

At December 31, 2015, the nonaccrual loans were comprised of 11 loans, primarily commercial real estate loans and commercial loans. While the Corporation maintains strong underwriting requirements, the number and amount of nonaccrual loans is a reflection of the prolonged weakened economic conditions and the corresponding effects it has had on our commercial borrowers and the current real estate environment. Certain loans, including restructured loans, are current, but in accordance with applicable guidance and other weakness concerns, management has continued to keep these loans on nonaccrual status.

As of December 31, 2015, nonaccrual loans have decreased over 48% since December 31, 2014 to $1.9 million. The decrease reflects payments received, payoffs, charge-offs and loans returned to an accrual status, partially offset by a small number of new nonaccrual loans. The ratio of allowance for loan losses to nonperforming loans increased to 468.81% at December 31, 2015 from 264.66% at December 31, 2014. The ratio of allowance for loan losses to

Table of Contents

nonperforming loans is reflective of a detailed analysis and the probable losses to be incurred that the Corporation has identified with these nonperforming loans. This metric reflects the effect of the decrease in nonaccrual loans partially offset by a decline in the allowance for loan losses.

Evaluation of all nonperforming loans includes the updating of appraisals and specific evaluation of such loans to determine estimated cash flows from business and/or collateral. We have assessed these loans for collectability and considered, among other things, the borrower's ability to repay, the value of the underlying collateral, and other market conditions to ensure the allowance for loan losses is adequate to absorb probable losses to be incurred. The majority of our nonperforming loans are secured by real estate collateral. While we have continued to record appropriate charge-offs, the existing underlying collateral coverage for a considerable portion of the nonperforming loans currently supports the collection of our remaining principal.

For loans not included in nonperforming loans, at December 31, 2015, the level of loans past due 30-89 days was $1.0 million, a decrease of $100,000 from $1.1 million at December 31, 2014. We will continue to monitor delinquencies for early identification of new problem loans.

The Corporation maintains an allowance for loan losses at a level considered by management to be adequate to cover the probable losses to be incurred associated with its loan portfolio. The Corporation's policy with respect to the methodology for the determination of the allowance for loan losses involves a high degree of complexity and requires management to make difficult and subjective judgments.

The adequacy of the allowance for loan losses is based upon management's evaluation of the known and inherent risks in the portfolio, consideration of the size and composition of the loan portfolio, actual loan loss experience, the level of delinquencies, detailed analysis of individual loans for which full collectability may not be assured, the existence and estimated net realizable value of any underlying collateral and guarantees securing the loans, and current economic and market conditions.

The allowance for loan losses contains an unallocated reserve amount to cover inherent imprecision of the overall loss estimation process for items that may not be fully captured in the Corporation's loss history or the qualitative factors. Due to the complexity in determining the estimated amount of allowance for loan losses, these unallocated reserves reflect management's attempt to ensure that the overall allowance reflects an appropriate level of reserves. The Corporation continues to refine and enhance, as appropriate, its assessment of the adequacy of the allowance by reviewing the look-back periods, updating the loss emergence periods, and enhancing the analysis of qualitative factors. These refinements have increased the level of precision in the allowance and the unallocated portion has declined. During the year ended December 31, 2015, the Corporation decreased its unallocated allowance for loan losses by $277,000. Management believes that the reduction in unallocated reserves at December 31, 2015 is appropriate as, in addition to the above discussion, the Corporation has demonstrated a sustained level of performance in the loan portfolio.

For the year ended December 31, 2015, a negative provision for loan loss was recorded in the amount of $1.4 million. For the year ended December 31, 2014, a negative provision for loan loss was recorded in the amount of $50,000. The recording of a negative provision for the current year is reflective of both the recording of recoveries of past chargeoffs and a reduction in the level of nonaccrual loans. The total allowance for loan losses of $8.8 million represented 1.68% of total gross loans at December 31, 2015 compared to $9.6 million or a ratio of 2.01% at December 31, 2014.

At December 31, 2015 and 2014, the Corporation had $10.2 million and $12.9 million, respectively, of loans whose terms have been modified in troubled debt restructurings. Of these loans, $9.7 million and $12.0 million were performing in accordance with their new terms at December 31, 2015 and 2014, respectively, and not included in the table above. The remaining troubled debt restructures are reported as nonaccrual loans. Specific reserves of $708,000 and $868,000 have been allocated for the troubled debt restructurings at December 31, 2015 and 2014, respectively. As of December 31, 2015, the Corporation had committed $138,000 of additional funds to a single customer with an outstanding construction loan that is classified as a troubled debt restructuring. There were no committed funds at December 31, 2014.

The balance in performing restructured loans also includes loans that are current under their restructured terms, but because of the below market rate of interest and other forbearance agreements, continue to be reflected as restructured loans and impaired loans in accordance with accounting practices. These loans included two loan

Table of Contents

relationships at December 31, 2015 totaling $5.2 million and two loan relationships at December 31, 2014 totaling $5.3 million.

For the year ended December 31, 2015, gross interest income which would have been recorded had the restructured and non-accruing loans been current in accordance with their original terms amounted to $721,000, of which $535,000 was included in interest income for the year ended December 31, 2015.

When management expects that some portion or all of a loan balance will not be collected, that amount is charged-off as a loss against the allowance for loan losses. For the year ended December 31, 2015, net recoveries were $596,000 compared to net charge-offs of $263,000 for the year ended December 31, 2014. The net charge-offs reflect partial writedowns or full charge-offs on nonaccrual loans due to the initial and ongoing evaluations of market values of the underlying real estate collateral in accordance with Accounting Standards Codification ("ASC") 310-40. While regular monthly payments continue to be made on many of the nonaccrual loans, certain charge-offs result, nevertheless, from the borrowers' inability to provide adequate documentation evidencing their ability to continue to service their debt. Management believes the charge-off of these loan balances against reserves provides a clearer indication of the value of nonaccrual loans. Regardless of our actions of recording partial and full charge-offs on loans, we continue to aggressively pursue collection, including legal action.

As of December 31, 2015, there were $6.5 million of other loans not included in the preceding table, compared to $11.3 million at December 31, 2014, where credit conditions of borrowers, including real estate tax delinquencies, caused management to have concerns about the possibility of the borrowers not complying with the present terms and conditions of repayment and which may result in disclosure of such loans as nonperforming loans at a future date. These loans have been considered by management in conjunction with the analysis of the adequacy of the allowance for loan losses.

The following table sets forth, for each of the preceding five years, the historical relationships among the amount of loans outstanding, the allowance for loan losses, the provision for loan losses, the amount of loans charged-off and the amount of loan recoveries:

Table of Contents

	December 31,				
	2015	2014	2013	2012	2011
	(Dollars in thousands)				
Allowance for loan losses:					
Balance at beginning of period	$9,602	$9,915	$10,641	$11,604	$8,490
Loans charged-off:					
Construction	—	—	23	394	839
Residential real estate	—	7	83	21	112
Commercial real estate	—	1,110	3,786	3,577	1,911
Commercial	600	262	984	7,144	4,603
Consumer	2	6	145	74	304
Total loans charged-off	602	1,385	5,021	11,210	7,769
Recoveries of loans previously charged-off:					
Construction	552	48	26	6	3
Residential real estate	26	—	—	—	—
Commercial real estate	151	858	112	—	—
Commercial	465	216	355	240	29
Consumer	4	—	27	6	6
Total recoveries of loans previously charged-off	1,198	1,122	520	252	38
Net loans charged-off	(596)	263	4,501	10,958	7,731
Provisions charged to operations	(1,375)	(50)	3,775	9,995	10,845
Balance at end of period	$8,823	$9,602	$9,915	$10,641	$11,604
Net charge-offs during the period to average loans outstanding during the period	-0.12%	0.06%	1.02%	2.44%	1.67%
Balance of allowance for loan losses at the end of year to gross year end loans	1.68%	2.01%	2.28%	2.42%	2.54%

Table of Contents

The following table sets forth the allocation of the allowance for loan losses, for each of the preceding five years, as indicated by loan categories:

	2015		2014		2013		2012		2011	
	Amount	Percent to Total (1)	Amount	Percent to Total (1)	Amount	Percent to Total (1)	Amount	Percent to Total (1)	Amount	Percent to Total (1)
	(Dollars in thousands)									
Real estate - residential	$109	15.8%	$142	16.3%	$460	17.9%	$308	15.3%	$303	12.0%
Real estate - commercial	4,774	66.2%	5,017	61.9%	5,782	59.1%	5,105	57.2%	5,423	56.8%
Commercial	3,698	12.3%	3,854	15.9%	3,373	17.0%	4,832	20.3%	5,368	22.5%
Consumer	121	5.7%	191	5.9%	291	6.0%	355	7.2%	500	8.7%
Unallocated	121	—%	398	—%	9	—%	41	—%	10	—%
Total allowance for loan losses	$8,823	100.0%	$9,602	100.0%	$9,915	100.0%	$10,641	100.0%	$11,604	100.0%

(1) Represents percentage of loan balance in category to total gross loans.

Investment Portfolio

The Corporation maintains an investment portfolio to enhance its yields and to provide a secondary source of liquidity. The portfolio is currently comprised of U.S. Treasury, U.S. government and agency obligations, state and political subdivision obligations, mortgage-backed securities, asset-backed securities, corporate debt securities and other equity investments, and has been classified as held to maturity or available-for-sale. Investments in debt securities that the Corporation has the intention and the ability to hold to maturity are classified as held to maturity securities and reported at amortized cost. All other securities are classified as available-for-sale securities and reported at fair value, with unrealized gains or losses reported in a separate component of shareholders' equity. Securities in the available-for-sale category may be held for indefinite periods of time and include securities that management intends to use as part of its Asset/Liability strategy or that may be sold in response to changes in interest rates, changes in prepayment risks, the need to provide liquidity, the need to increase regulatory capital or similar factors. Securities available-for-sale decreased to $93.4 million at December 31, 2015, from $124.9 million at December 31, 2014, a decrease of $31.6 million, or 25.3%. Securities held to maturity increased $5.6 million, or 10.2%, to $60.7 million at December 31, 2015 from $55.1 million at December 31, 2014.

The change in securities available-for-sale for the year ended December 31, 2015 includes the sale of $26.7 million of U.S. government and agency obligations and mortgage-backed securities transacted to provide funding for a growing loan portfolio.

The changes in available-for-sale and held to maturity securities for the year ended December 31, 2014 is primarily attributed to a $24.0 million transfer of previously-designated available-for-sale securities to a held to maturity designation at fair value. In accordance with Accounting Standards Codification 320, *Investment – Debt and Equity Securities,* the Corporation is required at each balance sheet due date to reassess the classification of each security held. The reclassification which occurred during the three months ended June 30, 2014 is permitted as the Corporation has appropriately determined the ability and intent to now hold these securities as an investment, until maturity or call. The securities were transferred at fair value to the held to maturity portfolio to protect our tangible common equity against rising interest rates and to appropriately align the mix of securities within held to maturity and available-for-sale. The securities transferred had a net loss of $742,000 that is reflected in accumulated other comprehensive loss on the consolidated statement of financial condition, net of subsequent amortization, which is being recognized over the life of the securities.

Table of Contents

The following table sets forth the classification of the Corporation's investment securities by major category at the end of the last three years:

	December 31, 2015 Carrying Value	Percent	2014 Carrying Value	Percent	2013 Carrying Value	Percent
	(Dollars in thousands)					
Securities available-for-sale:						
U.S. government-sponsored agencies	$30,954	33.2%	$30,274	24.2%	$38,692	23.0%
Obligation of state and political subdivisions	1,410	1.5%	1,400	1.1%	1,358	0.8%
Mortgage-backed securities-residential	45,237	48.4%	76,743	61.5%	112,235	66.7%
Asset-backed securities (a)	9,701	10.4%	9,915	7.9%	9,836	5.8%
Corporate debt	2,419	2.6%	2,997	2.4%	2,885	1.7%
Other equity investments	3,633	3.9%	3,589	2.9%	3,405	2.0%
Total	$93,354	100.0%	$124,918	100.0%	$168,411	100.0%
Securities held to maturity:						
U.S. Treasury	$999	1.6%	$—	0.0%	$—	0.0%
U.S. government-sponsored agencies	15,109	24.9%	11,962	21.7%	258	1.0%
Obligations of state and political subdivisions	11,219	18.5%	15,636	28.4%	20,642	79.5%
Mortgage-backed securities-residential	33,411	55.0%	27,499	49.9%	5,064	19.5%
Total	$60,738	100.0%	$55,097	100.0%	$25,964	100.0%

(a) Collateralized by student loans

Table of Contents

The following table sets forth the maturity distribution and weighted average yields (calculated on the basis of stated yields to maturity, considering applicable premium or discount) of the Corporation's debt securities available-for-sale as of December 31, 2015. Issuers may have the right to call or prepay obligations with or without call or prepayment penalties. This might cause actual maturities to differ from contractual maturities.

	Within 1 Year	After 1 Year Through 5 Years	After 5 Years Through 10 Years	After 10 Years	Total
	(Dollars in thousands)				
U.S. government-sponsored agencies:					
Carrying value	$—	$ 10,982	$ 13,159	$ 6,813	$ 30,954
Yield	0.00%	1.41%	2.01%	1.82%	1.76%
Obligations of state and political subdivisions:					
Carrying value	—	403	1,007	—	1,410
Yield	0.00%	1.35%	1.79%	0.00%	1.66%
Corporate debt:					
Carrying value	—	1,487	932	—	2,419
Yield	0.00%	1.32%	1.07%	0.00%	1.22%
Total carrying value	$—	$ 12,872	$ 15,098	$ 6,813	$ 34,783
Weighted average yield	0.00%	1.40%	1.94%	1.82%	1.72%

The following table sets forth the maturity distribution and weighted average yields (calculated on the basis of stated yields to maturity, considering applicable premium or discount) of the Corporation's debt securities held to maturity as of December 31, 2015. Issuers may have the right to call or prepay obligations with or without call or prepayment penalties. This might cause actual maturities to differ from contractual maturities.

	Within 1 Year	After 1 Year Through 5 Years	After 5 Years Through 10 Years	After 10 Years	Total
	(Dollars in thousands)				
U.S. Treasury:					
Carrying value	$—	$ 999	$ —	$ —	$ 999
Yield	0.00%	1.41%	0.00%	0.00%	1.41%
U.S. government-sponsored agencies:					
Carrying value	—	3,262	10,900	947	15,109
Yield	0.00%	2.28%	2.41%	3.35%	2.44%
Obligations of state and political subdivisions:					
Carrying value	2,655	7,356	1,208	—	11,219
Yield	3.75%	3.73%	4.00%	0.00%	3.76%

Total carrying value	$2,655	$ 11,617	$12,108	$947	$27,327
Weighted average yield	3.75%	3.12%	2.57%	3.35%	2.94%

Deposits

The Corporation had deposits at December 31, 2015 totaling $604.8 million, an increase of $48.3 million, or 8.7%, over the comparable period of 2014, when deposits totaled $556.5 million. The Corporation relied on its branch network and current competitive products and services to grow deposits during 2015. Included in deposit balances were $7.8 million of brokered certificates of deposit at December 31, 2015 compared to $10.5 million at December 31, 2014.

The following table sets forth the classification of the Corporation's deposits by major category as of December 31 of each of the three preceding years:

30

	December 31,					
	2015		2014		2013	
	Amount	Percent	Amount	Percent	Amount	Percent
	(Dollars in thousands)					
Non-interest bearing demand	$147,828	24.5%	$136,721	24.6%	$133,565	23.1%
Interest-bearing demand	228,737	37.8%	210,225	37.8%	227,258	39.4%
Savings deposits	81,836	13.5%	76,422	13.7%	80,280	13.9%
Certificates of deposit	146,352	24.2%	133,108	23.9%	136,488	23.6%
Total	$604,753	100.0%	$556,476	100.0%	$577,591	100.0%

As of December 31, 2015, the aggregate amount of outstanding time deposits issued in amounts of $100,000 or more, broken down by time remaining to maturity, was as follows (in thousands):

Three months or less	$10,067
Four months through six months	13,882
Seven months through twelve months	12,837
Over twelve months	50,046
Total	$86,832

Borrowings

Although deposits with the Bank are the Corporation's primary source of funds, the Corporation's policy has been to utilize borrowings to the extent that they are a less costly source of funds, when the Corporation desires additional capacity to fund loan demand, or to extend the life of its liabilities as a means of managing exposure to interest rate risk. The Corporation's borrowings are a combination of advances from the Federal Home Loan Bank of New York ("FHLB-NY"), including overnight repricing lines of credit, and, to a lesser extent, securities sold under agreements to repurchase.

Interest Rate Sensitivity

Interest rate movements have made managing the Corporation's interest rate sensitivity increasingly important. The Corporation attempts to maintain stable net interest margins by generally matching the volume of interest-earning assets and interest-bearing liabilities maturing, or subject to repricing, by adjusting interest rates to market conditions, and by developing new products. One method of measuring the Corporation's exposure to changes in interest rates is the maturity and repricing gap analysis. The difference or mismatch between the amount of assets and liabilities that mature or reprice in a given period is defined as the interest rate sensitivity gap. A "negative" gap results when the amount of interest-bearing liabilities maturing or repricing within a specified time period exceeds the amount of interest-earning assets maturing or repricing within the same period of time. Conversely, a "positive" gap results when the amount of interest-earning assets maturing or repricing exceed the amount of interest-bearing liabilities maturing or repricing in the same given time frame. The smaller the gap, the less the effect of the market volatility on net interest income. During a period of rising interest rates, an institution with a negative gap position would not be in as favorable a position, as compared to an institution with a positive gap, to invest in higher yielding assets. This may result in yields on its assets increasing at a slower rate than the increase in its costs of interest-bearing liabilities than if it had a positive gap. During a period of falling interest rates, an institution with a negative gap would experience a repricing of its assets at a slower rate than its interest-bearing liabilities, which consequently may result in its net interest income growing at a faster rate than an institution with a positive gap position.

The following table sets forth estimated maturity/repricing structure of the Corporation’s interest-earning assets and interest-bearing liabilities as of December 31, 2015. The amounts of assets or liabilities shown which reprice or mature during a particular period were determined in accordance with the contractual terms of each asset or liability and adjusted for prepayment assumptions where applicable. The table does not necessarily indicate the impact of general interest rate movements on the Corporation’s net interest income because the repricing of certain categories of assets and liabilities, for example, prepayments of loans and withdrawal of deposits, is beyond the Corporation’s control. As a result, certain assets and liabilities indicated as repricing within a period may in fact reprice at different times and at different rate levels.

Table of Contents

	Three Months or Less	More than Three Months Through One Year	After One Year	Noninterest Sensitive	Total
	(Dollars in thousands)				
Assets:					
Loans:					
Real estate Mortgage	$45,820	$50,161	$335,698	$—	$431,679
Commercial	30,208	9,635	25,017	—	64,860
Consumer	14,844	6,646	8,448	—	29,938
Mortgages held for sale	1,522	—	—	—	1,522
Investment securities (1)	30,197	26,306	100,197	—	156,700
Other assets	179	—	—	33,010	33,189
Total assets	$122,770	$92,748	$469,360	$33,010	$717,888
Source of funds:					
Interest-bearing demand	$228,737	$—	$—	$—	$228,737
Savings	81,836	—	—	—	81,836
Certificates of deposit	16,103	45,220	85,029	—	146,352
FHLB of NYC advances	—	10,000	30,000	—	40,000
Subordinated Debentures	—	—	23,186	—	23,186
Other liabilities	—	—	—	150,204	150,204
Shareholders' equity	—	—	—	47,573	47,573
Total source of funds	$326,676	$55,220	$138,215	$197,777	$717,888
Interest rate sensitivity gap	$(203,906)	$37,528	$331,145	$(164,767)	
Cumulative interest rate sensitivity gap	$(203,906)	$(166,378)	$164,767	$—	

(1) Includes securities held to maturity, securities available-for sale and FHLB-NY Stock.

The Corporation also uses a simulation model to analyze the sensitivity of net interest income to movements in interest rates. The simulation model projects net interest income, net income, net interest margin, and capital to asset ratios based on various interest rate scenarios over a twelve-month period. The model is based on the actual maturity and repricing characteristics of all rate sensitive assets and liabilities. Management incorporates into the model certain assumptions regarding prepayments of certain assets and liabilities. Assumptions have been built into the model for prepayments for assets and decay rates for nonmaturity deposits such as savings and interest bearing demand. The model assumes an immediate rate shock to interest rates without management’s ability to proactively change the mix of assets or liabilities. Based on the reports generated for December 31, 2015, an immediate interest rate increase of 200 basis points would have resulted in a decrease in net interest income of 1.9%, or $466,000, and an immediate interest rate decrease of 200 basis points would have resulted in a decrease in net interest income of 7.8% or $1.9 million. Management cannot provide any assurance about the actual effect of changes in interest rates on the Corporation’s net interest income.

Liquidity

The Corporation's primary sources of funds are deposits, amortization and prepayments of loans and mortgage-backed securities, maturities of investment securities and funds provided by operations. While scheduled loan and mortgage-backed securities amortization and maturities of investment securities are a relatively predictable source of funds, deposit flow and prepayments on loans and mortgage-backed securities are greatly influenced by market interest rates, economic conditions, and competition.

The Corporation's liquidity, represented by cash and cash equivalents, is a product of its operating, investing and financing activities. These activities are summarized below:

Table of Contents

	Years Ended December 31, 2015	2014
	(In thousands)	
Cash and cash equivalents - beginning	$ 10,086	$ 17,405
Operating activities:		
Net income	4,200	3,085
Adjustments to reconcile net income to net cash provided by operating activities	(2,999)	6,304
Net cash provided by operating activities	1,201	9,389
Net cash used in investing activities	(22,102)	(29,196)
Net cash provided by financing activities	21,725	12,488
Net increase (decrease) in cash and cash equivalents	824	(7,319)
Cash and cash equivalents - ending	$ 10,910	$ 10,086

Cash was generated by operating activities in each of the above periods. The primary source of cash from operating activities during each period was operating income.

Liquidity management is both a daily and long-term function of business management. Excess liquidity is generally invested in short-term investments, such as federal funds sold.

The Corporation enters into commitments to extend credit, such as letters of credit, which are not reflected in the Corporation's Audited Consolidated Financial Statements.

The Corporation has various contractual obligations that may require future cash payments. The following table summarizes the Corporation's contractual obligations at December 31, 2015 and the effect such obligations are expected to have on our liquidity and cash flows in future periods.

		Payment Due By Period			
	Total	Less than 1 Year	1 - 3 Years	3 - 5 Years	After 5 Years
	(In thousands)				
Contractual obligations					
Operating lease obligations	$4,182	$677	$1,232	$931	$1,342
Total contracted cost obligations	$4,182	$677	$1,232	$931	$1,342
Other long-term liabilities/long-term debt					
Time deposits	$146,352	$61,178	$60,810	$24,364	$—
Federal Home Loan Bank advances	40,000	10,000	30,000	—	—

Subordinated Debentures	7,217	7,217	—	—	—
Subordinated Notes	15,969	—	—	—	15,969
Total other long-term liabilities/long-term debt	$209,538	$78,395	$90,810	$24,364	$15,969
Other commitments - off balance sheet					
Letters of credit	$485	$433	$—	$—	$52
Commitments to extend credit	8,915	8,915	—	—	—
Unused lines of credit	74,562	74,562	—	—	—
Total off balance sheet arrangements and contractual obligations	$83,962	$83,910	$—	$—	$52

Management believes that a significant portion of the time deposits will remain with the Corporation. In addition, management does not believe that all of the unused lines of credit will be exercised. We anticipate that the Corporation will have sufficient funds available to meet its current contractual commitments. Should we need temporary funding, the Corporation has the ability to borrow overnight with the FHLB-NY. The overall borrowing capacity is contingent on available collateral to secure borrowings and the ability to purchase additional activity-based capital stock of the FHLB-NY. The Corporation may also borrow from the Discount Window of the Federal Reserve Bank of New York based on the market value of collateral pledged. At December 31, 2015 and 2014, the borrowing

Table of Contents

capacity at the Discount Window was $5.0 million. In addition, the Corporation had available overnight variable repricing lines of credit with other correspondent banks totaling $38 million on an unsecured basis. There were no borrowings under these lines of credit at December 31, 2015 and 2014.

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

Of the $485,000 in commitments under standby and commercial letters of credit, approximately $433,000 expire within one year. Should any letter of credit be drawn on, the interest rate charged on the resulting note would fluctuate with the Corporation's base rate. Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. Since many of the commitments may expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. The Corporation evaluates each customer's creditworthiness on a case-by-case basis. The amount of collateral obtained, if deemed necessary by the Corporation upon extension of credit, is based on management's credit evaluation of the counter-party. Collateral held varies, but may include accounts receivable, inventory, property, plant and equipment, and income-producing commercial properties.

Standby and commercial letters of credit are conditional commitments issued by the Corporation to guarantee payment or performance of a customer to a third party. Those guarantees are primarily issued to support public and private borrowing arrangements, including commercial paper, bond financing and similar transactions. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loan facilities to customers. The Corporation obtains collateral supporting those commitments for which collateral is deemed necessary.

At December 31, 2015, the Corporation had residential mortgage commitments to extend credit aggregating approximately $1.4 million at fixed rates averaging 3.20%. Approximately $276,000 of these loan commitments will be sold to investors upon closing. Commercial, construction, and home equity loan commitments of approximately $7.0 million were extended with variable rates averaging 3.74% and approximately $469,000 extended at fixed rates averaging 4.15%. Generally, commitments were due to expire within approximately 30 days.

The unused lines of credit consist of $21.1 million relating to a home equity line of credit program and an unsecured line of credit program (cash reserve), $4.3 million relating to an unsecured overdraft protection program, and $49.2 million relating to commercial and construction lines of credit. Amounts drawn on the unused lines of credit are predominantly assessed interest at rates which fluctuate with the base rate.

Capital

Capital Adequacy

The Corporation is subject to capital adequacy guidelines promulgated by the Board of Governors of the Federal Reserve System ("FRB Board"). The Bank is subject to somewhat comparable but different capital adequacy requirements imposed by the Federal Deposit Insurance Corporation (the "FDIC"). The federal banking agencies have adopted risk-based capital guidelines for banks and bank holding companies. The risk-based capital guidelines are designed to make regulatory capital requirements more sensitive to differences in risk profiles among banks and bank holding companies, to account for off-balance sheet exposure, and to minimize disincentives for holding liquid assets. Under these guidelines, assets and off-balance sheet items are assigned to broad risk categories, each with appropriate weights. The resulting capital ratios represent capital as a percentage of total risk-weighted assets and off-balance sheet items.

Federal banking regulators have also adopted leverage capital guidelines to supplement the risk-based measures. Leverage capital to average total assets is determined by dividing Tier 1 Capital as defined under the risk-based capital guidelines by average total assets (non-risk adjusted).

Guidelines for Banks

In December 2010 and January 2011, the Basel Committee on Banking Supervision (the "Basel Committee") published the final texts of reforms on capital and liquidity, which are generally referred to as "Basel III". The Basel

Table of Contents

Committee is a committee of central banks and bank supervisors and regulators from the major industrialized countries that develops broad policy guidelines for the regulation of banks and bank holding companies. In July 2013, the FDIC and the other federal bank regulatory agencies adopted final rules (the “Basel Rules”) to implement certain provisions of Basel III and the Dodd-Frank Wall Street Reform and Consumer Protection Act. The Basel Rules revise the leverage and risk-based capital requirements and the methods for calculating risk-weighted assets. The Basel Rules apply to all depository institutions, top-tier bank holding companies with total consolidated assets of $1 billion or more and top-tier savings and loan holding companies.

Among other things, the Basel Rules (a) establish a new common equity Tier 1 Capital (“CET1”) to risk-weighted assets ratio minimum of 4.5% of risk-weighted assets, (b) raise the minimum Tier 1 Capital to risk-based assets requirement (“Tier 1 Capital Ratio) from 4% to 6% of risk-weighted assets and (c) assign a higher risk weight of 150% to exposures that are more than 90 days past due or are on nonaccrual status and to certain commercial real estate facilities. The minimum ratio of Total Capital to risk-weighted assets (including certain off-balance sheet activities, such as standby letters of credit) is 8%. At least 6% of the Total Capital is required to be “Tier 1 Capital”, which consists of common shareholders’ equity and certain preferred stock, less certain items and other intangible assets. The remainder, “Tier 2 Capital,” may consist of (a) the allowance for loan losses of up to 1.25% of risk-weighted assets, (b) excess of qualifying preferred stock, (c) hybrid capital instruments, (d) debt, (e) mandatory convertible securities and (f) qualifying subordinated debt. “Total Capital” is the sum of Tier 1 Capital and Tier 2 Capital less reciprocal holdings of other banking organizations’ capital instruments, investments in unconsolidated subsidiaries and any other deductions as determined by the federal banking regulatory agencies on a case-by-case basis or as a matter of policy after formal rule-making. A small bank holding company that has the highest regulatory examination rating and is not contemplating significant growth or expansion must maintain a minimum level of Tier 1 Capital to average total consolidated assets leverage ratio of at least 3%. All other bank holding companies are expected to maintain a leverage ratio of at least 100 to 200 basis points above the stated minimum.

The Basel Rules also require unrealized gains and losses on certain available-for-sale securities to be included for purposes of calculating regulatory capital unless a one-time opt-out is exercised. Additional constraints are also imposed on the inclusion in regulatory capital of mortgage-servicing assets and deferred tax assets. The Basel Rules limit a banking organization’s capital distributions and certain discretionary bonus payments if the banking organization does not hold a “capital conservation buffer” consisting of 2.5% of CET1 to risk-weighted assets in addition to the amount necessary to meet its minimum risk-based capital requirements. The purpose of the capital conservation buffer is to ensure that banking organizations conserve capital when it is needed most, allowing them to weather periods of economic stress. Banking institutions with a CET1 Ratio, Tier 1 Capital Ratio and Total Capital Ratio above the minimum capital ratios but below the minimum capital ratios plus the capital conservation buffer will face constraints on their ability to pay dividends, repurchase equity and pay discretionary bonuses to executive officers based on the amount of the shortfall. The Basel Rules became effective for the Bank on January 1, 2015. The capital conservation buffer requirement will be phased in beginning January 1, 2016 and ending January 1, 2019, when the full capital conservation buffer requirement will be effective.

Bank assets are given risk-weights of 0%, 20%, 50%, 100%, and 150%. In addition, certain off-balance sheet items are given similar credit conversion factors to convert them to asset equivalent amounts to which an appropriate risk-weight will apply. These computations result in the total risk-weighted assets. Most loans are assigned to the 100% risk category, except for performing first mortgage loans fully secured by residential property which carry a 50% risk-weighting. Loan exposures past due 90 days or more or on nonaccrual are assigned a risk-weighting of at least 100%. Most investment securities (including, primarily, general obligation claims of states or other political subdivisions of the United States) are assigned to the 20% category, except for municipal or state revenue bonds, which have a 50% risk-weight, and direct obligations of the U.S. Treasury or obligations backed by the full faith and credit of the U.S. government, which have a 0% risk-weight. In converting off-balance sheet items, direct credit substitutes, including general guarantees and standby letters of credit backing nonfinancial obligations, and undrawn commitments (including commercial credit lines with an initial maturity of more than one year) have a 50% risk-weighting. Short-term undrawn commitments and commercial letters of credit with an initial maturity of under one year have a 20% risk-weighting and certain short-term unconditionally cancelable commitments are not risk-weighted.

Guidelines for Small Bank Holding Companies

In April 2015, the FRB Board updated and amended its Small Bank Holding Company Policy Statement. Under the revised Small Bank Holding Company Policy Statement, Basel III capital rules and reporting requirements will not apply to small bank holding companies (“SBHC”), such as the Corporation, that have total consolidated assets of less

Table of Contents

than $1 billion. The minimum risk-based capital requirements for a SBHC to be considered adequately capitalized are 4% for Tier 1 Capital and 8% for Total Capital to risk-weighted assets.

The regulations for SBHCs classify risk-based capital into two categories: "Tier 1 Capital" which consists of common and qualifying perpetual preferred shareholders' equity less goodwill and other intangibles and "Tier 2 Capital" which consists of (a) the allowance for loan losses of up to 1.25% of risk-weighted assets, (b) the excess of qualifying preferred stock, (c) hybrid capital instruments, (d) debt, (e) mandatory convertible securities and (f) qualifying subordinated debt. Total qualifying capital consists of Tier 1 Capital and Tier 2 Capital less reciprocal holdings of other banking organizations' capital instruments, investments in unconsolidated subsidiaries and any other deductions as determined by the FRB on a case-by-case basis or as a matter of policy after formal rule-making. However, the amount of Tier 2 Capital may not exceed the amount of Tier 1 Capital. The Corporation must maintain a minimum level of Tier 1 Capital to average total consolidated assets leverage ratio of 3%, which is the leverage ratio reserved for top-tier bank holding companies having the highest regulatory examination rating and not contemplating significant growth or expansion.

Bank holding company assets are given risk-weights of 0%, 20%, 50%, and 100%. In addition, certain off-balance sheet items are given similar credit conversion factors to convert them to asset equivalent amounts to which an appropriate risk-weight will apply. These computations result in the total risk-weighted assets.

The following table summarizes the capital ratios for the Corporation and the Bank at December 31, 2015.

	Actual	Required for Capital Adequacy Purposes	To Be Well Capitalized Under Prompt Corrective Action Regulations
Tier 1 Leverage ratio			
Corporation	7.67%	4.00%	N/A
Bank	9.47%	4.00%	5.00%
Risk-based capital:			
Common Equity Tier 1			
Corporation	N/A	N/A	N/A
Bank	12.41%	4.50%	6.50%
Tier 1			
Corporation	10.16%	4.00%	N/A
Bank	12.41%	6.00%	8.00%
Total			
Corporation	14.34%	8.00%	N/A

Bank	13.67%	8.00%	10.00%

As discussed previously and in Note 8 to the unaudited consolidated financial statements, on August 28, 2015, the Corporation completed a private placement of Subordinated Notes. The Subordinated Notes have a maturity date of August 28, 2025 and bear interest at the rate of 6.75% per annum, payable semiannually, over their term. The Subordinated Notes have been structured to qualify as Tier 2 capital for regulatory purposes.

Using the net proceeds of the Subordinated Notes issued by the Corporation on August 28, 2015 to certain institutional accredited investors, on September 1, 2015, the Corporation repurchased from the U.S. Department of the Treasury ("Treasury") all 15,000 shares of the Corporation's Senior Non-Cumulative Perpetual Preferred Stock, Series B (the "Series B Preferred Shares"), having a liquidation preference of $1,000 per share, for an aggregate purchase price of $15 million, in cash, plus approximately $114,000 of accrued dividends. The Series B Preferred Shares were issued to Treasury on September 1, 2011 pursuant to a Securities Purchase Agreement between the Corporation and the Secretary of the Treasury in connection with the Corporation's participation in Treasury's Small Business Lending Fund program ("SBLF"), a $30 billion fund established under the Small Business Jobs Act of 2010 to encourage small

Table of Contents

business lending by providing capital to qualified community banks with assets of less than $10 billion. The Series B Preferred Shares qualified as Tier 1 for regulatory purposes.

The dividend rate of the Series B Preferred Shares was subject to fluctuation on a quarterly basis during the first ten quarters during which the Series B Preferred Shares were outstanding, based upon changes in the level of Qualified Small Business Lending ("QSBL" as defined in the Securities Purchase Agreement) from 1% to 5% per annum and, since then, for the eleventh dividend period through that portion of the nineteenth dividend period prior to the four and one-half year anniversary of the date of issuance of the Series B Preferred Shares (i.e., through February 29, 2016), the dividend rate became fixed at 4.56%. In general, the dividend rate decreased as the level of the Bank's QSBL increased. Beginning on March 1, 2016 and for all dividend periods thereafter, the dividend rate of the Series B Preferred Shares would have increased and become fixed at 9%.

As a result of the issuance of the Subordinated Notes and the subsequent repurchase of the Series B Preferred Shares, the Corporation's Tier 1 capital was reduced, thereby decreasing the Corporation's Tier 1 Leverage, the Common Equity Tier 1 and the Tier 1 ratios in the above table. Nevertheless, the Bank and the Corporation exceed all capital adequacy requirements to which they are subject.

Item 7A. Quantitative and Qualitative Disclosures About Market Risk

Not applicable to smaller reporting companies.

Item 8. Financial Statements and Supplementary Data

Table of Contents

Report of Independent Registered Public Accounting Firm

The Board of Directors and Shareholders

Stewardship Financial Corporation and Subsidiary:

We have audited the accompanying consolidated statements of financial condition of Stewardship Financial Corporation and Subsidiary (the Corporation) as of December 31, 2015 and 2014, and the related consolidated statements of income, comprehensive income, changes in shareholders' equity, and cash flows for the years then ended. These consolidated financial statements are the responsibility of the Corporation's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Stewardship Financial Corporation and Subsidiary as of December 31, 2015 and 2014, and the results of their operations and their cash flows for the years then ended, in conformity with U.S. generally accepted accounting principles.

/s/ KPMG LLP

Short Hills, New Jersey

March 24, 2016

Table of Contents

Stewardship Financial Corporation and Subsidiary

Consolidated Statements of Financial Condition

	December 31, 2015	2014
Assets		
Cash and due from banks	$10,731,000	$9,849,000
Other interest-earning assets	179,000	237,000
Cash and cash equivalents	10,910,000	10,086,000
Securities available-for-sale	93,354,000	124,918,000
Securities held to maturity; estimated fair value of $61,281,000 (2015) and $56,223,000 (2014)	60,738,000	55,097,000
Federal Home Loan Bank of New York stock, at cost	2,608,000	3,777,000
Loans held for sale	1,522,000	—
Loans, net of allowance for loan losses of $8,823,000 (2015) and $9,602,000 (2014)	517,556,000	467,699,000
Premises and equipment, net	6,799,000	6,577,000
Accrued interest receivable	1,967,000	1,994,000
Other real estate owned, net	880,000	1,308,000
Bank owned life insurance	14,111,000	13,708,000
Other assets	7,443,000	8,387,000
Total assets	$717,888,000	$693,551,000
Liabilities and Shareholders' equity		
Liabilities		
Deposits:		
Noninterest-bearing	$147,828,000	$136,721,000
Interest-bearing	456,925,000	419,755,000
Total deposits	604,753,000	556,476,000
Federal Home Loan Bank of New York advances	40,000,000	66,700,000
Subordinated Debentures and Subordinated Notes	23,186,000	7,217,000
Accrued interest payable	791,000	308,000
Accrued expenses and other liabilities	1,585,000	3,881,000
Total liabilities	670,315,000	634,582,000
Shareholders' equity		
Preferred stock, no par value; 2,500,000 shares authorized; 15,000 and outstanding at December 31, 2014 Liquidation preference of $15,000,000	—	14,984,000
Common stock, no par value; 10,000,000 shares authorized;		

6,085,528 and 6,034,933 shares issued and outstanding		
at December 31, 2015, and 2014, respectively	41,410,000	41,125,000
Retained earnings	7,008,000	3,817,000
Accumulated other comprehensive (loss), net	(845,000)	(957,000)
Total Shareholders' equity	47,573,000	58,969,000
Total liabilities and Shareholders' equity	$717,888,000	$693,551,000

See accompanying notes to consolidated financial statements.

Table of Contents

Stewardship Financial Corporation and Subsidiary

Consolidated Statements of Income

	Years Ended December 31,	
	2015	2014
Interest income:		
Loans	$22,644,000	$21,119,000
Securities held to maturity:		
Taxable	933,000	580,000
Nontaxable	471,000	648,000
Securities available-for-sale:		
Taxable	1,374,000	2,444,000
Nontaxable	24,000	24,000
FHLB dividends	123,000	94,000
Other interest-earning assets	40,000	25,000
Total interest income	25,609,000	24,934,000
Interest expense:		
Deposits	2,068,000	1,807,000
Repurchase agreements	—	254,000
FHLB-NY borrowings	850,000	642,000
Subordinated Debentures and Subordinated Notes	908,000	504,000
Total interest expense	3,826,000	3,207,000
Net interest income before provision for loan losses	21,783,000	21,727,000
Provision for loan losses	(1,375,000)	(50,000)
Net interest income after provision for loan losses	23,158,000	21,777,000
Noninterest income:		
Fees and service charges	2,135,000	2,003,000
Bank owned life insurance	403,000	405,000
Gain on calls and sales of securities, net	169,000	165,000
Gain on sales of mortgage loans	141,000	72,000
Loss on sale of loans	—	(241,000)
Gain on sale of other real estate owned	83,000	63,000
Miscellaneous	562,000	493,000
Total noninterest income	3,493,000	2,960,000
Noninterest expenses:		
Salaries and employee benefits	10,900,000	10,597,000
Occupancy, net	1,739,000	1,934,000
Equipment	655,000	687,000
Data processing	1,847,000	1,702,000
Advertising	839,000	820,000
FDIC insurance premium	423,000	580,000
Charitable contributions	290,000	180,000
Stationery and supplies	155,000	212,000

Legal	320,000	430,000
Bank-card related services	528,000	517,000
Other real estate owned	298,000	430,000
Miscellaneous	2,185,000	2,144,000
Total noninterest expenses	20,179,000	20,233,000
Income before income tax expense	6,472,000	4,504,000
Income tax expense	2,272,000	1,419,000
Net income	4,200,000	3,085,000
Dividends on preferred stock	456,000	683,000
Net income available to common shareholders	$3,744,000	$2,402,000
Basic and diluted earnings per common share	$0.62	$0.40
Weighted average number of basic and diluted common shares outstanding	6,077,657	6,003,814

See accompanying notes to consolidated financial statements.

Table of Contents

Stewardship Financial Corporation and Subsidiary

Consolidated Statements of Comprehensive Income

	Years Ended December 31, 2015	2014
Net income	$ 4,200,000	$ 3,085,000
Other comprehensive income (loss), net of tax:		
Change in unrealized holding gains (losses) on securities available-for-sale arising during the period	(116,000)	3,162,000
Reclassification adjustment for gains in net income	(102,000)	(99,000)
Unrealized loss on securities reclassifed from available-for-sale to held to maturity	—	(457,000)
Accretion of unrealized loss on securities reclassified to held to maturity	179,000	80,000
Change in fair value of interest rate swap in a cash flow hedging relationship	151,000	147,000
Total other comprehensive income	112,000	2,833,000
Total comprehensive income	$ 4,312,000	$ 5,918,000

See accompanying notes to consolidated financial statements.

Table of Contents

Stewardship Financial Corporation and Subsidiary

Consolidated Statements of Changes in Shareholders' Equity

Years Ended December 31, 2015 and 2014

	Preferred Stock	Common Stock Shares	Common Stock Amount	Retained Earnings	Accumulated Other Compre-hensive Income (Loss), Net	Total
Balance – January 1, 2014	$14,974,000	5,943,767	$40,690,000	$1,905,000	$(3,790,000)	$53,779,000
Cash dividends declared ($0.05 per share)	—	—	—	(300,000)	—	(300,000)
Payment of discount on dividend reinvestment plan	—	—	(2,000)	—	—	(2,000)
Cash dividends declared on preferred stock	—	—	—	(683,000)	—	(683,000)
Common stock issued under dividend reinvestment plan	—	8,589	37,000	—	—	37,000
Common stock issued under stock plans	—	32,916	151,000	—	—	151,000
Issuance of restricted stock	—	49,661	249,000	(249,000)	—	—
Amortization of restricted stock	—	—	—	69,000	—	69,000
Amortization of issuance costs	10,000	—	—	(10,000)	—	—
Net income	—	—	—	3,085,000	—	3,085,000
Other comprehensive loss	—	—	—	—	2,833,000	2,833,000
Balance -- December 31, 2014	14,984,000	6,034,933	41,125,000	3,817,000	(957,000)	58,969,000
Cash dividends declared ($0.08 per share)	—	—	—	(486,000)	—	(486,000)
Payment of discount on dividend reinvestment plan	—	—	(3,000)	—	—	(3,000)
Cash dividends declared on preferred stock	—	—	—	(456,000)	—	(456,000)
Common stock issued under dividend reinvestment plan	—	10,821	59,000	—	—	59,000
Common stock issued under stock plans	—	14,483	83,000	—	—	83,000
Issuance of restricted stock	—	50,974	279,000	(279,000)	—	—
Amortization of restricted stock	—	—	—	127,000	—	127,000
Tax benefit from restricted stock vesting	—	—	3,000	—	—	3,000
Restricted stock forfeited	—	(25,683)	(136,000)	101,000	—	(35,000)
Amortization of issuance costs	16,000	—	—	(16,000)	—	—
Repurchase of SBLF preferred stock	(15,000,000)	—	—	—	—	(15,000,000)
Net income	—	—	—	4,200,000	—	4,200,000

Other comprehensive income	—	—	—	—	112,000	112,000
Balance -- December 31, 2015	$—	6,085,528	$41,410,000	$7,008,000	$(845,000)	$47,573,000

See accompanying notes to consolidated financial statements.

42

Table of Contents

Stewardship Financial Corporation and Subsidiary

Consolidated Statements of Cash Flows

	Years Ended December 31, 2015	2014
Cash flows from operating activities:		
Net income	$4,200,000	$3,085,000
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization of premises and equipment	392,000	420,000
Amortization of premiums and accretion of discounts, net	670,000	943,000
Amortization of restricted stock, net of forfeitures	92,000	69,000
Amortization of Subordinated Notes issuance cost	21,000	—
Accretion of deferred loan fees	102,000	42,000
Provision for loan losses	(1,375,000)	(50,000)
Originations of mortgage loans held for sale	(10,764,000)	(4,608,000)
Proceeds from sale of mortgage loans	9,383,000	4,680,000
Proceeds from sale of loans	—	2,559,000
Gain on sales of mortgage loans	(141,000)	(72,000)
Loss on sale of loans	—	241,000
Gain on sales and calls of securities	(169,000)	(165,000)
Gain on sale of other real estate owned	(83,000)	(63,000)
Deferred income tax expense	517,000	626,000
Decrease in accrued interest receivable	27,000	72,000
Increase (decrease) in accrued interest payable	483,000	(93,000)
Earnings on bank owned life insurance	(403,000)	(405,000)
Decrease in other assets	395,000	300,000
Increase (decrease) in other liabilities	(2,146,000)	1,808,000
Net cash provided by operating activities	1,201,000	9,389,000
Cash flows from investing activities:		
Purchase of securities available-for-sale	(13,404,000)	(6,319,000)
Proceeds from maturities and principal repayments on securities available-for-sale	12,458,000	18,247,000
Proceeds from sales and calls on securities available-for-sale	31,845,000	11,155,000
Purchase of securities held to maturity	(22,944,000)	(12,940,000)
Proceeds from maturities and principal repayments on securities held to maturity	9,144,000	7,824,000
Proceeds from calls on securities held to maturity	8,250,000	—
(Purchase) Sale of FHLB-NY stock	1,169,000	(1,644,000)
Net increase in loans	(49,464,000)	(45,869,000)
Proceeds from sale of other real estate owned	1,458,000	1,608,000
Additions to premises and equipment	(614,000)	(1,258,000)
Net cash used in investing activities	(22,102,000)	(29,196,000)
Cash flows from financing activities:		
Net increase in noninterest-bearing deposits	11,107,000	3,156,000

Net increase (decrease) in interest-bearing deposits	37,170,000	(24,271,000)
Net increase in long term borrowings	—	15,000,000
Net decrease in securities sold under agreements to repurchase	—	(7,300,000)
Net increase (decrease) in short term borrowings	(26,700,000)	26,700,000
Cash dividends paid on common stock	(486,000)	(300,000)
Cash dividends paid on preferred stock	(456,000)	(683,000)
Redemption of SBLF	(15,000,000)	—
Payment of discount on dividend reinvestment plan	(3,000)	(2,000)
Proceeds from issuance of Subordinated Notes	15,948,000	—
Issuance of common stock	142,000	188,000
Tax benefit from restricted stock vesting	3,000	—
Net cash provided by financing activities	21,725,000	12,488,000
Net increase (decrease) in cash and cash equivalents	824,000	(7,319,000)
Cash and cash equivalents - beginning	10,086,000	17,405,000
Cash and cash equivalents - ending	$10,910,000	$10,086,000

43

Table of Contents

Stewardship Financial Corporation and Subsidiary

Consolidated Statements of Cash Flows, continued

	Years Ended December 31,	
	2015	2014
Supplemental disclosures of cash flow information:		
Cash paid during the year for interest	$ 3,342,000	$ 3,300,000
Cash paid during the year for income taxes	$ 2,301,000	$ 358,000
Reclassification of securities available-for-sale to held-to-maturity	$ —	$ 24,022,000
Transfers from loans to other real estate owned	$ 880,000	$ 2,440,000

See accompanying notes to consolidated financial statements.

Table of Contents

Stewardship Financial Corporation and Subsidiary

Notes to Consolidated Financial Statements

Note 1. SIGNIFICANT ACCOUNTING POLICIES

Nature of operations and principles of consolidation

The consolidated financial statements include the accounts of Stewardship Financial Corporation and its wholly owned subsidiary, Atlantic Stewardship Bank ("the Bank"), together referred to as "the Corporation". The Bank includes its wholly-owned subsidiaries, Stewardship Investment Corporation (whose primary business is to own and manage an investment portfolio), Stewardship Realty LLC (whose primary business is to own and manage property at 612 Godwin Avenue, Midland Park, New Jersey), Atlantic Stewardship Insurance Company, LLC (whose primary business is insurance) and several other subsidiaries formed to hold title to properties acquired through foreclosure or deed in lieu of foreclosure. The Bank's subsidiaries have an insignificant impact on the daily operations. All intercompany accounts and transactions are eliminated in the consolidated financial statements.

The Corporation provides financial services through the Bank's offices in Bergen, Passaic, and Morris Counties, New Jersey. Its primary deposit products are checking, savings, and term certificate accounts, and its primary lending products are commercial, residential mortgage and installment loans. Substantially all loans are secured by specific items of collateral including business assets, consumer assets, and commercial and residential real estate. Commercial loans are expected to be repaid from cash flow generated from the operations of businesses. There are no significant concentrations of loans to any one industry or customer. The Corporation's lending activities are concentrated in loans secured by real estate located in northern New Jersey and, therefore, collectability of the loan portfolio is susceptible to changes in real estate market conditions in the northern New Jersey market. The Corporation has not made loans to borrowers outside the United States.

Basis of consolidated financial statements presentation

The consolidated financial statements of the Corporation have been prepared in conformity with U.S. generally accepted accounting principles ("GAAP"). In preparing the financial statements, management is required to make estimates and assumptions, based on available information, that affect the amounts reported in the financial statements and the disclosures provided. The estimate of the allowance for loan losses and the valuation of deferred tax assets are particularly critical because they involve a higher degree of complexity and subjectivity and require estimates and assumptions about highly uncertain matters. Actual results may differ from those estimates and assumptions. The current economic environment has increased the degree of uncertainty inherent in these material estimates.

Cash flows

Cash and cash equivalents include cash and deposits with other financial institutions under 90 days and interest-bearing deposits in other banks with original maturities under 90 days. Net cash flows are reported for customer loan and deposit transactions, and short term borrowings and securities sold under agreement to repurchase.

Securities available-for-sale and held to maturity

The Corporation classifies its securities as held to maturity or available-for-sale. Investments in debt securities that the Corporation has the positive intent and ability to hold to maturity are classified as securities held to maturity and are carried at amortized cost. All other securities are classified as securities available-for-sale. Securities available-for-sale may be sold prior to maturity in response to changes in interest rates or prepayment risk, for asset/liability management purposes, or other similar factors. These securities are carried at fair value with unrealized holding gains or losses reported in a separate component of shareholders' equity, net of the related tax effects.

Interest income includes amortization of purchase premium or discount. Premiums and discounts on securities are amortized on the level-yield method without anticipating prepayments except for mortgage-backed securities where prepayments are anticipated. Gains and losses on sales are recorded on the trade date and determined using the specific identification method.

Table of Contents

Management evaluates securities for other-than-temporary impairment ("OTTI") on at least a quarterly basis, and more frequently when economic or market conditions warrant such an evaluation. For securities in an unrealized loss position, management considers the extent and duration of the unrealized loss, and the financial condition and near-term prospects of the issuer. Management also assesses whether it intends to sell, or it is more likely than not that it will be required to sell, a security in an unrealized loss position before recovery of its amortized cost basis. If either of the criteria regarding intent or requirement to sell is met, the entire difference between amortized cost and fair value is recognized as impairment through earnings. For debt securities that do not meet the aforementioned criteria, the amount of impairment is split into two components as follows: (1) OTTI related to credit loss, which must be recognized in the income statement and (2) OTTI related to other factors, which is recognized in other comprehensive income. The credit loss is defined as the difference between the present value of the cash flows expected to be collected and the amortized cost basis. For equity securities, the entire amount of impairment is recognized through earnings.

Federal Home Loan Bank ("FHLB") Stock

The Bank is a member of the FHLB system. Members are required to own a certain amount of FHLB stock based on the level of borrowings and other factors. FHLB stock is carried at cost, classified as a restricted security, and periodically evaluated for impairment based on the ultimate recovery of par value. Cash dividends are reported as income.

Loans held for sale

Loans held for sale generally represent mortgage loans originated and intended for sale in the secondary market, which are carried at the lower of cost or fair value on an aggregate basis. Mortgage loans held for sale are carried net of deferred fees, which are recognized as income at the time the loans are sold to permanent investors. Gains or losses on the sale of mortgage loans held for sale are recognized at the settlement date and are determined by the difference between the net proceeds and the amortized cost. All loans are sold with loan servicing rights released to the buyer.

Loans

Loans that management has the intent and ability to hold for the foreseeable future or until maturity or payoff are reported at the principal amount outstanding, net of deferred loan fees and costs and an allowance for loan losses. Interest income is accrued on the unpaid principal balance. Loan origination fees, net of certain direct origination costs, are deferred and recognized in interest income using the level-yield method without anticipating prepayments. The recorded investment in loans represents the outstanding principal balance after charge-offs and does not include accrued interest receivable as the inclusion is not significant to the reported amounts.

Interest income on loans is discontinued at the time the loan is 90 days delinquent unless the loan is well secured and in process of collection. Past due status is based on the contractual terms of the loan. In all cases, loans are placed on nonaccrual or are charged-off at an earlier date if collection of principal or interest is considered doubtful. Nonaccrual loans and loans past due 90 days still on accrual include both smaller balance homogeneous loans that are collectively evaluated for impairment and individually classified impaired loans.

All interest accrued but not received for loans placed on nonaccrual is reversed against interest income. Interest received on such loans is accounted for on the cash-basis or cost-recovery method, until qualifying for return to accrual. Loans are returned to an accrual status when all the principal and interest amounts contractually due are brought current and future payments are reasonably assured.

Allowance for loan losses

The allowance for loan losses is a valuation allowance for probable incurred credit losses. Loan losses are charged against the allowance when management believes the collectability of the full loan balance is in doubt. Subsequent recoveries, if any, are credited to the allowance. Management estimates the allowance balance required using past loan loss experience, the nature and volume of the portfolio, information about specific borrower situations and estimated collateral values, economic conditions and other factors. Allocations of the allowance may be made for specific loans, but the entire allowance is available for any loan that, in management’s judgment, should be charged-off.

Table of Contents

The allowance consists of specific and general components. The specific component relates to loans that are individually classified as impaired.

A loan is considered impaired when, based on current information and events, it is probable that the Corporation will be unable to collect the scheduled payments of principal or interest when due according to the contractual terms of the loan agreement. Loans for which the terms have been modified and for which the borrower is experiencing financial difficulties are considered troubled debt restructuring and classified as impaired. Factors considered by management in determining impairment include payment status, collateral value, and the probability of collecting scheduled principal and interest payments when due. Loans that experience insignificant payment delays and payment shortfalls generally are not classified as impaired. Management determines the significance of payment delays and payment shortfalls on a case-by-case basis, taking into consideration all of the circumstances surrounding the loan and the borrower, including the length of the delay, the reasons for the delay, the borrower's prior payment record, and the amount of the shortfall in relation to the principal and interest owed. Impairment is measured on a loan by loan basis by either the present value of expected future cash flows discounted at the loan's effective interest rate, the fair value of the note, or the fair value of the collateral if the loan is collateral-dependent. Large groups of smaller balance homogeneous loans, such as consumer and residential real estate loans are collectively evaluated for impairment and, accordingly, they are not separately identified for impairment disclosures. Troubled debt restructurings are separately identified for impairment disclosures and are measured at the present value of estimated future cash flows using the loan's effective rate at inception. If a troubled debt restructuring is considered to be a collateral dependent loan, the loan is reported, net, at the fair value of the collateral. For troubled debt restructurings that subsequently default, the Corporation determines the amount of reserve in accordance with the accounting policy for the allowance for loan losses.

The general component of the allowance is based on historical loss experience, including an appropriate loss emergence period, adjusted for qualitative factors. The historical loss experience is determined for each portfolio segment and class, and is based on the actual loss history experienced by the Corporation over the most recent 5 years. For each portfolio segment the Bank prepares an analysis which examines the historical loss experience as well as the loss emergence period. The analysis is updated quarterly for the purpose of determining the assigned allocation factors which are essential components of the allowance for loan losses calculation. This actual loss experience is supplemented with other qualitative factors based on the risks present for each portfolio segment or class. These qualitative factors include consideration of the following: levels of and trends in charge-offs; levels of and trends in delinquencies and impaired loans; levels and trends in loan size; levels of real estate concentrations; national and local economic trends and conditions; the depth and experience of lending management and staff; and other changes in lending policies, procedures, and practices.

For purposes of determining the allowance for loan losses, loans in the portfolio are segregated by type into the following segments: commercial, commercial real estate, construction, residential real estate, consumer and other. The Corporation also sub-divides these segments into classes based on the associated risks within those segments. Commercial loans are divided into the following two classes: secured by real estate and other. Construction loans are divided into the following two classes: commercial and residential. Consumer loans are divided into two classes: secured by real estate and other. The models and assumptions used to determine the allowance require management's judgment. Assumptions, data and computations are appropriately reviewed and properly documented.

The risk characteristics of each of the identified portfolio segments are as follows:

Commercial – Commercial loans are generally of higher risk and typically are made on the basis of the borrower's ability to make repayment from the cash flow of the borrower's business. As a result, the availability of funds for the repayment of commercial loans may depend substantially on the success of the business itself. Furthermore, any collateral securing such loans may depreciate over time, may be difficult to appraise and may fluctuate in value.

Commercial Real Estate – Commercial real estate loans are secured by multi-family and nonresidential real estate and generally have larger balances and generally are considered to involve a greater degree of risk than residential real estate loans. Commercial real estate loans depend on the global cash flow analysis of the borrower and the net operating income of the property, the borrower's expertise, credit history and profitability, and the value of the underlying property. Of primary concern in commercial real estate lending is the borrower's creditworthiness and the cash flow from the property. Payments on loans secured by income producing properties often depend on successful operation and management of the properties. As a result, repayment of such loans may be subject, to a greater extent than residential real estate loans, to adverse conditions in the real estate market or the economy. Commercial real

Table of Contents

estate is also subject to adverse market conditions that cause a decrease in market value or lease rates, obsolescence in location or function and market conditions associated with over supply of units in a specific region.

Construction – Construction financing is generally considered to involve a higher degree of risk of loss than long-term financing on improved, occupied real estate. Risk of loss on a construction loan depends largely upon the accuracy of the initial estimate of the property's value at completion of construction and the estimated cost of construction. During the construction phase, a number of factors could result in delays and cost overruns. If the estimate of construction costs proves to be inaccurate, additional funds may be required to be advanced in excess of the amount originally committed to permit completion of the building. If the estimate of value proves to be inaccurate, the value of the building may be insufficient to assure full repayment if liquidation is required. If foreclosure is required on a building before or at completion due to a default, there can be no assurance that all of the unpaid balance of, and accrued interest on, the loan as well as related foreclosure and holding costs will be recovered.

Residential Real Estate – Residential real estate loans are generally made on the basis of the borrower's ability to make repayment from his or her employment income or other income, and which are secured by real property whose value tends to be more easily ascertainable. Repayment of residential real estate loans is subject to adverse employment conditions in the local economy leading to increased default rate and decreased market values from oversupply in a geographic area. In general, residential real estate loans depend on the borrower's continuing financial stability and, therefore, are likely to be adversely affected by various factors, including job loss, divorce, illness or personal bankruptcy. Furthermore, the application of various federal and state laws, including federal and state bankruptcy and insolvency laws, may limit the amount that can be recovered on such loans.

Consumer loans – Consumer loans secured by real estate may entail greater risk than residential mortgage loans due to a lower lien position. In addition, other consumer loans, particularly loans secured by assets that depreciate rapidly, such as motor vehicles, are subject to greater risk. In all cases, collateral for a defaulted consumer loan may not provide an adequate source of repayment for the outstanding loan and a small remaining deficiency often does not warrant further substantial collection efforts against the borrower. Consumer loan collections depend on the borrower's continuing financial stability and, therefore, are likely to be adversely affected by various factors, including job loss, divorce, illness or personal bankruptcy. Furthermore, the application of various federal and state laws, including federal and state bankruptcy and insolvency laws, may limit the amount that can be recovered on such loans.

Generally, when it is probable that some portion or all of a loan balance will not be collected, regardless of portfolio segment, that amount is charged-off as a loss against the allowance for loan losses. On loans secured by real estate, the charge-offs reflect partial writedowns due to the initial valuation of market values of the underlying real estate collateral in accordance with Financial Accounting Standards Board ("FASB") Accounting Standards Codification ("ASC") 310-40. Consumer loans are generally charged-off in full when they reach 90 – 120 days past due.

Transfers of Financial Assets

Transfers of financial assets are accounted for as sales, when control over the assets has been relinquished. Control over transferred assets is deemed to be surrendered when the assets have been isolated from the Corporation, the transferee obtains the right (free of conditions that constrain it from taking advantage of that right) to pledge or exchange the transferred assets, and the Corporation does not maintain effective control over the transferred assets through an agreement to repurchase them before their maturity.

Premises and equipment

Land is stated at cost. Buildings and improvements and furniture, fixtures and equipment are stated at cost, less accumulated depreciation computed on the straight-line method over the estimated lives of each type of asset. Estimated useful lives are three to forty years for buildings and improvements and three to twenty-five years for furniture, fixtures and equipment. Leasehold improvements are stated at cost less accumulated amortization computed on the straight-line method over the shorter of the term of the lease or useful life.

Long-Term Assets

Premises and equipment and other long-term assets are reviewed for impairment when events indicate their carrying amount may not be recovered from future undiscounted cash flows. If impaired, the assets are recorded at fair value.

Table of Contents

Other Real Estate Owned

Other real estate owned (OREO) consists of property acquired through foreclosure or deed in lieu of foreclosure and property that is in-substance foreclosed. OREO is initially recorded at fair value less estimated selling costs. When a property is acquired, the excess of the carrying amount over fair value, if any, is charged to the allowance for loan losses. Subsequent adjustments to the carrying value are recorded in an allowance for OREO and charged to OREO expense.

Bank owned life insurance

The Corporation has purchased life insurance policies on certain key officers. Bank owned life insurance is recorded at the amount that can be realized under the insurance contract at the balance sheet date, which is the cash surrender value adjusted for other charges or other amounts due that are probable at settlement.

Dividend Reinvestment Plan

The Corporation offers shareholders the opportunity to participate in a dividend reinvestment plan. Plan participants may reinvest cash dividends to purchase new shares of stock at 95% of the market value, based on the most recent trades. Cash dividends due to the plan participants are utilized to acquire shares from either, or a combination of, the issuance of authorized shares or purchases of shares in the open market through an approved broker. The Corporation reimburses the broker for the 5% discount when the purchase of the Corporation’s stock is completed. The plan is considered to be non-compensatory.

Stock-based compensation

Stock-based compensation cost is based on the fair value of the awards at the date of grant. The fair value of restricted stock awards is based upon the average of the high and low sale price reported for the Corporation’s common stock on the date of grant. Compensation cost is recognized for restricted stock over the required service period, generally defined as the vesting period.

Income taxes

The Corporation records income taxes in accordance with ASC 740, Income Taxes, as amended, using the asset and liability method. Accordingly, deferred tax assets and liabilities: (i) are recognized for the expected future tax consequences of events that have been recognized in the financial statements or tax returns; (ii) are attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases; and (iii) are measured using enacted tax rates expected to apply in the years when those temporary differences are expected to be recovered or settled. Where applicable, deferred tax assets are reduced by a valuation allowance for any portions determined not likely to be realized. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income tax expense in the period of enactment. The valuation allowance is adjusted, by a charge or credit to income tax expense, as changes in facts and circumstances warrant.

A tax position is recognized as a benefit only if it is “more likely than not” that the tax position would be sustained in a tax examination, with a tax examination being presumed to occur. The amount recognized is the largest amount of tax benefit that is greater than 50% likely of being realized on examination. For tax positions not meeting the “more likely than not” test, no tax benefit is recorded. The Corporation recognizes interest and/or penalties related to income tax matters in income tax expense.

Comprehensive income

Comprehensive income consists of net income and other comprehensive income (loss). Other comprehensive income includes unrealized gains and losses on securities available-for-sale, accretion of losses related to securities transferred from available-for-sale to held to maturity, and unrealized gains or losses on cash flow hedges, net of tax, which are also recognized as separate components of equity.

Table of Contents

Earnings per common share

Basic earnings per common share is calculated by dividing net income available to common shareholders by the weighted average number of common shares outstanding during the period. Common stock equivalents are not included in the calculation.

Diluted earnings per share is computed similar to that of the basic earnings per share except that the denominator is increased to include the number of additional common shares that would have been outstanding if all potential dilutive common shares were issued.

Loan Commitments and Related Financial Instruments

Financial instruments include off-balance sheet credit instruments, such as commitments to make loans and commercial letters of credit, issued to meet customer financing needs. The face amount for these items represents the exposure to loss, before considering customer collateral or ability to repay. Such financial instruments are recorded when they are funded.

Loss contingencies

Loss contingencies, including claims and legal actions arising in the ordinary course of business, are recorded as liabilities when the likelihood of loss is probable and an amount or range of loss can be reasonably estimated. Management does not believe there are such matters that will have a material effect on the financial statements.

Dividend restriction

Banking regulations require maintaining certain capital levels and may limit the dividends paid by the Bank to the Corporation or by the Corporation to its shareholders. The Corporation's ability to pay cash dividends is based, among other things, on its ability to receive cash from the Bank. Banking regulations limit the amount of dividends that may be paid without prior approval of regulatory agencies. Under these regulations, the amount of dividends that may be paid in any calendar year is limited to the current year's profits, combined with the retained net profits of the preceding two years. At December 31, 2015 the Bank could have paid dividends totaling approximately $6.8 million. At December 31, 2015, this restriction did not result in any effective limitation in the manner in which the Corporation is currently operating.

Derivatives

Derivative financial instruments are recognized as assets or liabilities at fair value. The Corporation's only free standing derivative consists of an interest rate swap agreement, which is used as part of its asset liability management strategy to help manage interest rate risk related to its Subordinated Debentures. The Corporation does not use derivatives for trading purposes.

The Corporation designated the interest rate swap as a cash flow hedge, which is a hedge of a forecasted transaction or the variability of cash flows to be received or paid related to a recognized asset or liability. For a cash flow hedge, the change in the fair value on the derivative is reported in other comprehensive income and is reclassified into earnings in the same periods during which the hedged transaction affects earnings. Net cash settlements on this interest rate swap that qualify for hedge accounting are recorded in interest expense. Changes in the fair value of derivatives that are not highly effective in hedging the changes in fair value or expected cash flows of the hedged item are recognized immediately in current earnings.

The Corporation formally documented the risk-management objective and the strategy for undertaking the hedge transaction at the inception of the hedging relationship. This documentation includes linking the fair value of the cash flow hedge to the Subordinated Debentures on the balance sheet. The Corporation formally assessed, both at the hedge's inception and on an ongoing basis, whether the derivative instrument used is highly effective in offsetting changes in cash flows of the Subordinated Debentures.

When a cash flow hedge is discontinued but the hedged cash flows or forecasted transactions are still expected to occur, gains or losses that would be accumulated in other comprehensive income are amortized into earnings over the same periods which the hedged transactions will affect earnings.

Table of Contents

Fair value of financial instruments

Fair values of financial instruments are estimated using relevant market information and other assumptions, as more fully disclosed in a separate note. Fair value estimates involve uncertainties and matters of significant judgment regarding interest rates, credit risk, prepayments, and other factors, especially in the absence of broad markets for particular items. Changes in assumptions or in market conditions could significantly affect the estimates.

Adoption of New Accounting Standards

In January 2014, the Financial Accounting Standards Board (the "FASB") issued Accounting Standards Update ("ASU") 2014-04, "Receivables – Troubled Debt Restructurings by Creditors (Subtopic 310-40) Reclassification of Residential Real Estate Collateralized Consumer Mortgage Loans upon Foreclosure." This ASU applies to all creditors who obtain physical possession of residential real estate property collateralizing a consumer mortgage loan in satisfaction of a receivable. The amendments in this update clarify when an in substance repossession or foreclosure occurs and requires disclosure of both (1) the amount of foreclosed residential real estate property held by a creditor and (2) the recorded investment in consumer mortgage loans collateralized by residential real estate property that are in the process of foreclosure according to local requirements of the applicable jurisdiction. The amendments in ASU 2014-04 are effective for fiscal years, including interim periods, beginning after December 15, 2014. The adoption of the amendments in this standard did not have a material impact on the Corporation's consolidated financial statements.

In April 2015, the FASB issued ASU 2015-03, "Interest – Imputation of Interest (Subtopic 835-30) – Simplifying the Presentation of Debt Issuance Costs." This ASU is part of the FASB's initiative to reduce complexity in accounting standards. To simplify presentation of debt issuance costs, the amendments in this ASU require that debt issuance costs related to a recognized debt liability be presented in the balance sheet as a direct deduction from the carrying amount of that debt liability, consistent with debt discounts. The recognition and measurement guidance for debt issuance costs are not affected by the amendments in this ASU. The amendments in ASU 2015-03 are effective for fiscal years, including interim periods, beginning after December 15, 2015. Early adoption of ASU 2015-03 is permitted for financial statements that have not been previously issued. The adoption of the amendments in this standard are not expected to have a material impact on the Corporation's consolidated financial statements.

In January 2016, the FASB issued ASU No. 2016-01, "Financial Instruments - Overall: Recognition and Measurement of Financial Assets and Liabilities." This ASU addresses certain aspects of recognition, measurement, presentation, and disclosure of financial instruments. This amendment supersedes the guidance to classify equity securities with readily determinable fair values into different categories, requires equity securities to be measured at fair value with changes in the fair value recognized through net income, and simplifies the impairment assessment of equity investments without readily determinable fair values. The amendment requires public business entities that are required to disclose the fair value of financial instruments measured at amortized cost on the balance sheet to measure that fair value using the exit price notion. The amendment requires an entity to present separately in other comprehensive income the portion of the total change in the fair value of a liability resulting from a change in the instrument-specific credit risk when the entity has elected to measure the liability at fair value in accordance with the fair value option. The amendment requires separate presentation of financial assets and financial liabilities by measurement category and form of financial asset on the balance sheet or in the accompanying notes to the financial statements. The amendment reduces diversity in current practice by clarifying that an entity should evaluate the need for a valuation allowance on a deferred tax asset related to available for sale securities in combination with the entity’s other deferred tax assets. This amendment is effective for fiscal years, including interim periods, beginning after December 15, 2017. Entities should apply the amendment by means of a cumulative-effect adjustment as of the beginning of the fiscal year of adoption, with the exception of the amendment related to equity securities without readily determinable fair values, which should be applied prospectively to equity investments that exist as of the date of adoption. The Corporation intends to adopt the accounting standard during the first quarter of 2018, and is currently evaluating the impact that the adoption of the guidance will have on the Corporation's consolidated financial statements.

In February 2016, the FASB issued ASU 2016-02, “Leases (Subtopic 842).” This ASU requires all lessees to recognize a lease liability and a right-of-use asset, measured at the present value of the future minimum lease payments, at the lease commencement date. Lessor accounting remains largely unchanged under the new guidance. The amendments in ASU 2016-02 are effective for fiscal years, including interim periods, beginning after December 15, 2018. Early adoption of ASU 2015-03 is permitted. The Corporation is currently assessing the impact that the adoption of the guidance will have on the Corporation's consolidated financial statements.

Table of Contents

Note 2. SECURITIES - AVAILABLE-FOR-SALE AND HELD TO MATURITY

The fair value of the available-for-sale securities and the related gross unrealized gains and losses recognized in accumulated other comprehensive income were as follows:

	December 31, 2015			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
U.S. government-sponsored agencies	$31,266,000	$81,000	$393,000	$30,954,000
Obligations of state and political subdivisions	1,409,000	2,000	1,000	1,410,000
Mortgage-backed securities-residential	45,520,000	213,000	496,000	45,237,000
Asset-backed securities (a)	9,877,000	—	176,000	9,701,000
Corporate debt	2,500,000	—	81,000	2,419,000
Total debt securities	90,572,000	296,000	1,147,000	89,721,000
Other equity investments	3,778,000	—	145,000	3,633,000
	$94,350,000	$296,000	$1,292,000	$93,354,000

	December 31, 2014			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
U.S. government-sponsored agencies	$30,701,000	$94,000	$521,000	$30,274,000
Obligations of state and political subdivisions	1,420,000	2,000	22,000	1,400,000
Mortgage-backed securities-residential	76,894,000	521,000	672,000	76,743,000
Asset-backed securities (a)	9,874,000	57,000	16,000	9,915,000
Corporate debt	2,998,000	6,000	7,000	2,997,000
Total debt securities	121,887,000	680,000	1,238,000	121,329,000
Other equity investments	3,664,000	—	75,000	3,589,000
	$125,551,000	$680,000	$1,313,000	$124,918,000

(a) Collateralized by student loans

Cash proceeds realized from sales and calls of securities available-for-sale for the years ended December 31, 2015 and 2014 were $31,845,000 and $11,155,000, respectively. There were gross gains totaling $213,000 and gross losses totaling $61,000 realized on sales or calls during the year ended December 31, 2015. There were gross gains totaling $165,000 and no gross losses realized on sales or calls during the year ended December 31, 2014.

The fair value of available-for-sale securities pledged to secure public deposits for the years ended December 31, 2015 and 2014 was $1,012,000 and $670,000, respectively. See also Note 7 to the consolidated financial statements regarding securities pledged as collateral for Federal Home Loan Bank of New York advances and securities sold under agreements to repurchase.

Table of Contents

The following is a summary of the held to maturity securities and related gross unrealized gains and losses:

	December 31, 2015			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
U.S. Treasury	$999,000	$—	$11,000	$988,000
U.S. government-sponsored agencies	15,109,000	132,000	24,000	15,217,000
Obligations of state and political subdivisions	11,219,000	268,000	—	11,487,000
Mortgage-backed securities-residential	33,411,000	295,000	117,000	33,589,000
	$60,738,000	$695,000	$152,000	$61,281,000

	December 31, 2014			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
U.S. Treasury	$—	$—	$—	$—
U.S. government-sponsored agencies	11,962,000	177,000	—	12,139,000
Obligations of state and political subdivisions	15,636,000	514,000	—	16,150,000
Mortgage-backed securities-residential	27,499,000	511,000	66,000	27,944,000
	$55,097,000	$1,202,000	$66,000	$56,233,000

Cash proceeds realized from calls of securities held to maturity for the year ended December 31, 2015 were $8,250,000. There were no cash proceeds realized from calls of securities held to maturity for the year ended December 31, 2014. There were gross gains totaling $17,000 and no gross losses realized from calls during the year ended December 31, 2015. There were no gross gains and no gross losses realized from calls for the year ended December 31, 2014.

The fair value of held to maturity securities pledged to secure public deposits for the years ended December 31, 2015 and 2014 was $581,000 and $751,000, respectively. See also Note 7 to the consolidated financial statements regarding securities pledged as collateral for Federal Home Loan Bank of New York advances and securities sold under agreements to repurchase.

Issuers may have the right to call or prepay obligations with or without call or prepayment penalties. This might cause actual maturities to differ from the contractual maturities.

Mortgage-backed securities are a type of asset-backed security secured by a mortgage or collection of mortgages, purchased by government agencies such as the Government National Mortgage Association and government sponsored agencies such as the Federal National Mortgage Association ("FNMA") and the Federal Home Loan Mortgage Corporation, which then issue securities that represent claims on the principal and interest payments made by borrowers on the loans in the pool. At year end 2015 and 2014, there were no holdings of securities of any one issuer other than the U.S. government and its agencies in an amount greater than 10% of shareholders' equity.

Table of Contents

The following table presents the amortized cost and fair value of the debt securities portfolio by contractual maturity. As issuers may have the right to call or prepay obligations with or without call or prepayment premiums, the actual maturities may differ from contractual maturities. Securities not due at a single maturity date, such as mortgage-backed securities and asset-backed securities, are shown separately.

	December 31, 2015	
	Amortized Cost	Fair Value
Available-for-sale		
Within one year	$—	$—
After one year, but within five years	12,986,000	12,872,000
After five years, but within ten years	15,183,000	15,098,000
After ten years	7,006,000	6,813,000
Mortgage-backed securities - residential	45,520,000	45,237,000
Asset-backed securities	9,877,000	9,701,000
Total	$90,572,000	$89,721,000
Held to maturity		
Within one year	$2,655,000	$2,698,000
After one year, but within five years	11,617,000	11,845,000
After five years, but within ten years	12,108,000	12,180,000
After ten years	947,000	969,000
Mortgage-backed securities - residential	33,411,000	33,589,000
Total	$60,738,000	$61,281,000

The following tables summarize the fair value and unrealized losses of those investment securities which reported an unrealized loss at December 31, 2015 and 2014, and if the unrealized loss position was continuous for the twelve months prior to December 31, 2015 and 2014.

Table of Contents

Available-for-Sale

December 31, 2015	Less than 12 Months		12 Months or Longer		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
U.S. government-sponsored agencies	$18,396,000	$(183,000)	$7,296,000	$(210,000)	$25,692,000	$(393,000)
Obligations of state and political subdivisions	984,000	(1,000)	—	—	984,000	(1,000)
Mortgage-backed securities - residential	8,599,000	(69,000)	16,278,000	(427,000)	24,877,000	(496,000)
Asset-backed securities	6,791,000	(56,000)	2,910,000	(120,000)	9,701,000	(176,000)
Corporate debt	—	—	1,419,000	(81,000)	1,419,000	(81,000)
Other equity investments	—	—	3,573,000	(145,000)	3,573,000	(145,000)
Total temporarily impaired securities	$34,770,000	$(309,000)	$31,476,000	$(983,000)	$66,246,000	$(1,292,000)

December 31, 2014	Less than 12 Months		12 Months or Longer		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
U.S. government-sponsored agencies	$—	$—	$23,750,000	$(521,000)	$23,750,000	$(521,000)
Obligations of state and political subdivisions	—	—	992,000	(22,000)	992,000	(22,000)
Mortgage-backed securities - residential	5,985,000	(22,000)	30,445,000	(650,000)	36,430,000	(672,000)
Asset-backed securities	3,022,000	(16,000)	—	—	3,022,000	(16,000)
Corporate debt	—	—	1,494,000	(7,000)	1,494,000	(7,000)
Other equity investments	—	—	3,529,000	(75,000)	3,529,000	(75,000)
Total temporarily impaired securities	$9,007,000	$(38,000)	$60,210,000	$(1,275,000)	$69,217,000	$(1,313,000)

Held to Maturity

December 31, 2015	Less than 12 Months		12 Months or Longer		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
U.S. Treasury	$988,000	$(11,000)	$—	$—	$988,000	$(11,000)
U.S. government-sponsored agencies	4,955,000	(24,000)	—	—	4,955,000	(24,000)
Mortgage-backed securities - residential	15,183,000	(90,000)	1,066,000	(27,000)	16,249,000	(117,000)
Total temporarily impaired securities	$21,126,000	$(125,000)	$1,066,000	$(27,000)	$22,192,000	$(152,000)

December 31, 2014	Less than 12 Months		12 Months or Longer		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
U.S. Treasury	$—	$—	$—	$ —	$—	$—
U.S. government-sponsored agencies	—	—	—	—	—	—
Mortgage-backed securities - residential	8,788,000	(66,000)	—	—	8,788,000	(66,000)
Total temporarily impaired securities	$8,788,000	$(66,000)	$—	$ —	$8,788,000	$(66,000)

55

Table of Contents

Other-Than-Temporary-Impairment

At December 31, 2015, there were available-for-sale investments comprising five U.S. government-sponsored agency securities, seventeen mortgage-backed securities, one asset-backed security, two corporate debt securities, and an other equity investments security in a continuous loss position for twelve months or longer. There were held to maturity investments consisting of two mortgage-backed securities in a continuous loss position for twelve months or longer at December 31, 2015. Management has assessed the securities that were in an unrealized loss position at December 31, 2015 and 2014 and determined that any decline in fair value below amortized cost primarily relate to changes in interest rates and market spreads and was temporary.

In making this determination management considered the following factors: the period of time the securities were in an unrealized loss position; the percentage decline in comparison to the securities' amortized cost; any adverse conditions specifically related to the security, an industry or a geographic area; the rating or changes to the rating by a credit rating agency; the financial condition of the issuer and guarantor and any recoveries or additional declines in fair value subsequent to the balance sheet date.

Management does not intend to sell securities in an unrealized loss position and it is not more likely than not that the Corporation will be required to sell these securities before the recovery of their amortized cost bases, which may be at maturity.

Note 3. LOANS AND ALLOWANCE FOR LOAN LOSSES

At December 31, 2015 and 2014, respectively, the loan portfolio consisted of the following:

	December 31,	
	2015	2014
Commercial:		
Secured by real estate	$37,993,000	$46,545,000
Other	26,867,000	29,307,000
Commercial real estate	334,489,000	286,063,000
Commercial construction	4,609,000	4,215,000
Residential real estate	82,955,000	77,836,000
Consumer:		
Secured by real estate	29,224,000	27,319,000

Other	580,000	939,000
Government Guaranteed Loans - guaranteed portion	9,626,000	5,000,000
Other	134,000	96,000
Total gross loans	526,477,000	477,320,000
Less: Deferred loan costs (fees), net	98,000	19,000
Allowance for loan losses	8,823,000	9,602,000
	8,921,000	9,621,000
Loans, net	$517,556,000	$467,699,000

During the years ended December 31, 2015 and 2014, the Corporation purchased the guaranteed portion of several Government Guaranteed loans. Due to the guarantee of the principal amount of these loans, no allowance for loan losses is established for these SBA loans.

At December 31, 2015 and 2014, loan participations sold by the Corporation to other lending institutions totaled approximately $8,527,000 and $12,948,000, respectively. These amounts are not included in the totals presented above.

The Corporation has entered into lending transactions with directors, executive officers and principal shareholders of the Corporation and their affiliates. At December 31, 2015 and 2014, these loans aggregated approximately $2,458,000 and $2,533,000, respectively. During the year ended December 31, 2015, new loans totaling $1,019,000

Table of Contents

were granted and repayments totaled approximately $1,094,000. The loans, at December 31, 2015, were current as to principal and interest payments.

Activity in the allowance for loan losses is summarized as follows:

	Year Ended December 31, 2015				
	Balance beginning of period	Provision charged to operations	Loans charged-off	Recoveries of loans charged-off	Balance end of period
Commercial	$3,704,000	$129,000	$(600,000)	$465,000	$3,698,000
Commercial real estate	5,017,000	(508,000)	—	151,000	4,660,000
Commercial construction	150,000	(588,000)	—	552,000	114,000
Residential real estate	142,000	(59,000)	—	26,000	109,000
Consumer	189,000	(75,000)	—	4,000	118,000
Other	2,000	3,000	(2,000)	—	3,000
Unallocated	398,000	(277,000)	—	—	121,000
Balance, ending	$9,602,000	$(1,375,000)	$(602,000)	$1,198,000	$8,823,000

	Year Ended December 31, 2014				
	Balance beginning of period	Provision charged to operations	Loans charged-off	Recoveries of loans charged-off	Balance end of period
Commercial	$3,373,000	$377,000	$(262,000)	$216,000	$3,704,000
Commercial real estate	5,665,000	(396,000)	(1,110,000)	858,000	5,017,000
Commercial construction	117,000	(15,000)	—	48,000	150,000
Residential real estate	460,000	(311,000)	(7,000)	—	142,000
Consumer	288,000	(93,000)	(6,000)	—	189,000
Other	3,000	—	(1,000)	—	2,000
Unallocated	9,000	388,000	1,000	—	398,000
Balance, ending	$9,915,000	$(50,000)	$(1,385,000)	$1,122,000	$9,602,000

Table of Contents

The following table presents the balance in the allowance for loan losses and the recorded investment in loans by portfolio segment and based on the impairment method as of December 31, 2015 and 2014:

	December 31, 2015								
	Commercial	Commercial Real Estate	Commercial Construction	Residential Real Estate	Consumer	Gov't Guarnatee	Other Loans	Unallocated	T
Allowance for loan losses:									
Ending Allowance balance attributable to loans									
Individually evaluated for impairment	$81,000	$638,000	$—	$—	$—	$—	$—	$—	$
Collectively evaluated for impairment	3,617,000	4,022,000	114,000	109,000	118,000	—	3,000	121,000	
Total ending allowance balance	$3,698,000	$4,660,000	$114,000	$109,000	$118,000	$—	$3,000	$121,000	$
Loans:									
Loans individually evaluated for impairment	$3,348,000	$8,113,000	$—	$—	$84,000	$—	$—	$—	$
Loans collectively evaluated for impairment	61,512,000	326,376,000	4,609,000	82,955,000	29,720,000	9,626,000	134,000	—	
Total ending Loan balance	$64,860,000	$334,489,000	$4,609,000	$82,955,000	$29,804,000	$9,626,000	$134,000	$—	$

58

Table of Contents

	December 31, 2014								
	Commercial	Commercial Real Estate	Commercial Construction	Residential Real Estate	Consumer	Government Guaranteed	Other Loans	Unallocated	To
Allowance for loan losses:									
Ending Allowance balance attributable to loans									
Individually evaluated for impairment	$223,000	$697,000	$—	$—	$—	$—	$—	$—	$9
Collectively evaluated for impairment	3,481,000	4,320,000	150,000	142,000	189,000	—	2,000	398,000	8
Total ending allowance balance	$3,704,000	$5,017,000	$150,000	$142,000	$189,000	$—	$2,000	$398,000	$9
Loans:									
Loans individually evaluated for impairment	$6,042,000	$8,913,000	$288,000	$96,000	$326,000	$—	$—	$—	$1
Loans collectively evaluated for impairment	69,810,000	277,150,000	3,927,000	77,740,000	27,932,000	5,000,000	96,000	—	4
Total ending Loan balance	$75,852,000	$286,063,000	$4,215,000	$77,836,000	$28,258,000	$5,000,000	$96,000	$—	$4

Table of Contents

The following table presents the recorded investment in nonaccrual loans at the dates indicated:

	December 31, 2015	2014
Commercial:		
Secured by real estate	$1,300,000	$1,923,000
Other	14,000	—
Commercial real estate	484,000	1,284,000
Residential real estate	—	96,000
Consumer:		
Secured by real estate	84,000	325,000
Total nonaccrual loans	$1,882,000	$3,628,000

At December 31, 2015 and 2014 there were no loans that were past due 90 days and still accruing.

The following table presents loans individually evaluated for impairment by class of loans at and for the periods indicated:

	At And For The Year Ended December 31, 2015				
	Unpaid Principal Balance	Recorded Investment	Allowance for Loan Losses Allocated	Average Recorded Investment	Interest Income Recognized
With no related allowance recorded:					
Commercial:					
Secured by real estate	$3,244,000	$2,729,000		$3,683,000	$ 156,000
Other	137,000	137,000		61,000	2,000
Commercial real estate	3,245,000	2,885,000		2,890,000	121,000
Commercial construction	—	—		215,000	—
Residential real estate	—	—		74,000	—
Consumer:					
Secured by real estate	84,000	84,000		226,000	—
With an allowance recorded:					
Commercial:					
Secured by real estate	390,000	308,000	$ 80,000	405,000	14,000
Other	174,000	174,000	1,000	463,000	31,000
Commercial real estate	5,228,000	5,228,000	638,000	5,534,000	211,000

Total impaired loans	$12,502,000	$11,545,000	$719,000	$13,551,000	$535,000

During the year ended December 31, 2015, no interest income was recognized on a cash basis.

60

Table of Contents

	At And For The Year Ended December 31, 2014				
	Unpaid Principal Balance	Recorded Investment	Allowance for Loan Losses Allocated	Average Recorded Investment	Interest Income Recognized
With no related allowance recorded:					
Commercial:					
Secured by real estate	$5,997,000	$4,838,000		$5,443,000	$ 225,000
Other	66,000	58,000		65,000	3,000
Commercial real estate	4,609,000	3,279,000		6,755,000	155,000
Commercial construction	652,000	288,000		517,000	71,000
Residential real estate	132,000	96,000		526,000	—
Consumer:					
Secured by real estate	333,000	326,000		506,000	—
With an allowance recorded:					
Commercial:					
Secured by real estate	458,000	436,000	$ 213,000	437,000	16,000
Other	713,000	710,000	10,000	750,000	44,000
Commercial real estate	5,643,000	5,634,000	697,000	3,922,000	233,000
Commercial construction	—	—	—	420,000	—
Total impaired loans	$18,603,000	$15,665,000	$ 920,000	$19,341,000	$ 747,000

During the year ended December 31, 2014, no interest income was recognized on a cash basis.

Table of Contents

The following table presents the aging of the recorded investment in past due loans by class of loans as of December 31, 2015 and 2014. Nonaccrual loans are included in the disclosure by payment status:

	December 31, 2015					
	30-59 Days Past Due	60-89 Days Past Due	Greater than 90 Days Past Due	Total Past Due	Loans Not Past Due	Total
Commercial:						
Secured by real estate	$—	$ —	$1,011,000	$1,011,000	$36,982,000	$37,993,000
Other	—	—	—	—	26,867,000	26,867,000
Commercial real estate	271,000	—	—	271,000	334,218,000	334,489,000
Commercial construction	—	—	—	—	4,609,000	4,609,000
Residential real estate	—	—	—	—	82,955,000	82,955,000
Consumer:						
Secured by real estate	112,000	—	41,000	153,000	29,071,000	29,224,000
Other	—	—	—	—	580,000	580,000
Government guarantee	—	—	—	—	9,626,000	9,626,000
Other	—	—	—	—	134,000	134,000
Total	$383,000	$ —	$1,052,000	$1,435,000	$525,042,000	$526,477,000

	December 31, 2014					
	30-59 Days Past Due	60-89 Days Past Due	Greater than 90 Days Past Due	Total Past Due	Loans Not Past Due	Total
Commercial:						
Secured by real estate	$546,000	$ —	$1,508,000	$2,054,000	$44,491,000	$46,545,000
Other	225,000	—	—	225,000	29,082,000	29,307,000
Commercial real estate	—	330,000	836,000	1,166,000	284,897,000	286,063,000
Commercial construction	—	—	—	—	4,215,000	4,215,000
Residential real estate	—	—	—	—	77,836,000	77,836,000
Consumer:						
Secured by real estate	—	—	249,000	249,000	27,070,000	27,319,000
Other	—	—	—	—	939,000	939,000

SBA	—	—	—	—	5,000,000	5,000,000
Other	—	—	—	—	96,000	96,000
Total	$771,000	$ 330,000	$ 2,593,000	$ 3,694,000	$ 473,626,000	$ 477,320,000

Troubled Debt Restructurings

In order to determine whether a borrower is experiencing financial difficulty necessitating a restructuring, an evaluation is performed of the probability that the borrower will be in payment default on any of its debt in the foreseeable future without the modification. This evaluation is performed in accordance with the Corporation's internal underwriting policy. A loan is considered to be in payment default once it is contractually 90 days past due under the modified terms.

At December 31, 2015 and 2014, the Corporation had $10.2 million and $12.9 million, respectively, of loans whose terms have been modified in troubled debt restructurings. Of these loans, $9.7 million and $12.0 million were performing in accordance with their new terms at December 31, 2015 and 2014, respectively. The remaining troubled debt restructurings are reported as nonaccrual loans. Specific reserves of $708,000 and $868,000 have been allocated for the troubled debt restructurings at December 31, 2015 and 2014, respectively. As of December 31, 2015,

Table of Contents

the Corporation had committed $138,000 of additional funds to a single customer with an outstanding commercial line that is classified as a troubled debt restructuring. There were no committed amounts at December 31, 2014.

There were no new loans classified as troubled debt restructuring during the year ended December 31, 2015. The following table presents loans by class that were modified as troubled debt restructurings that occurred during the year ended December 31, 2014:

	December 31, 2014		
	Number of Loans	Pre-Modification Recorded Investment	Post-Modification Recorded Investment
Commercial:			
Secured by real estate	2	$ 252,000	$ 252,000
Commercial real estate	1	111,000	111,000
Total	3	$ 363,000	$ 363,000

During the year ended December, 2014, three loans were modified as troubled debt restructurings. The modification of the terms of the two commercial – secured by real estate loans represented a term out of the remaining balances on these matured loans as well as an interest rate reduction. The modification of the terms of the commercial real estate loan involved an extension of the loan with an additional borrower added.

For the year ended December 31, 2015, there was a net decrease in the allowance for loan losses of $161,000 related to troubled debt restructurings. For the year ended December 31, 2014, the troubled debt restructurings described above resulted in a net increase in the allowance for loan losses of $587,000. There were no charge-offs in 2015 or 2014 related to these troubled debt restructurings.

Credit Quality Indicators

The Corporation categorizes loans into risk categories based on relevant information about the ability of the borrowers to service their debt such as: current financial information, historical payment experience, credit documentation, public information, and current economic trends, among other factors. The Corporation analyzes loans individually by classifying the loans as to credit risk. This analysis includes non-homogeneous loans, such as commercial, commercial real estate and commercial construction loans. This analysis is performed at the time the loan is originated and annually thereafter. The Corporation uses the following definitions for risk ratings.

Special Mention – A Special Mention asset has potential weaknesses that deserve management’s close attention, which, if left uncorrected, may result in deterioration of the repayment prospects for the asset or the Bank’s credit position at some future date. Special Mention assets are not adversely classified and do not expose the Bank to sufficient risk to warrant adverse classification.

Substandard – Substandard loans are inadequately protected by the current net worth and paying capacity of the borrower or by the collateral pledged, if any. Loans so classified must have a well-defined weakness or weaknesses that jeopardize the repayment and liquidation of the debt. These loans are characterized by the distinct possibility that the Bank will sustain some loss if the deficiencies are not corrected.

Doubtful – A Doubtful loan has all of the weaknesses inherent in those classified as Substandard with the added characteristic that the weaknesses make collection or liquidation in full, on the basis of currently known facts, conditions, and values, highly questionable or improbable. The likelihood of loss is extremely high, but because of certain important and reasonably specific factors, an estimated loss is deferred until a more exact status can be determined.

Loss – A loan classified Loss is considered uncollectible and of such little value that its continuance as an asset is not warranted. This classification does not necessarily mean that an asset has absolutely no recovery or salvage value, but rather it is not practical or desirable to defer writing off a basically worthless asset even though partial recovery may be affected in the future.

Table of Contents

Loans not meeting the criteria above that are analyzed individually as part of the above described process are considered to be pass rated loans. As of December 31, 2015 and 2014, and based on the most recent analysis performed at those times, the risk category of loans by class is as follows:

	December 31, 2015					
	Pass	Special Mention	Substandard	Doubtful	Loss	Total
Commercial:						
Secured by real estate	$35,263,000	$1,431,000	$1,299,000	$ —	$ —	$37,993,000
Other	25,725,000	745,000	397,000	—	—	26,867,000
Commercial real estate	326,737,000	4,034,000	3,718,000	—	—	334,489,000
Commercial construction	4,609,000	—	—	—	—	4,609,000
Total	$392,334,000	$6,210,000	$5,414,000	$ —	$ —	$403,958,000

	December 31, 2014					
	Pass	Special Mention	Substandard	Doubtful	Loss	Total
Commercial:						
Secured by real estate	$41,091,000	$3,531,000	$1,923,000	$ —	$ —	$46,545,000
Other	27,903,000	616,000	788,000	—	—	29,307,000
Commercial real estate	274,788,000	5,521,000	5,754,000	—	—	286,063,000
Commercial construction	2,709,000	1,506,000	—	—	—	4,215,000
Total	$346,491,000	$11,174,000	$8,465,000	$ —	$ —	$366,130,000

The Corporation considers the historical and projected performance of the loan portfolio and its impact on the allowance for loan losses. For residential real estate and consumer loan segments, the Corporation evaluates credit quality primarily based on payment activity and historical loss data. The following table presents the recorded investment in residential real estate and consumer loans based on payment activity as of December 31, 2015 and 2014.

	December 31, 2015		
	Current	Past Due and Nonaccrual	Total
Residential real estate	$82,415,000	$ 540,000	$82,955,000
Consumer:			
Secured by real estate	27,730,000	1,494,000	29,224,000
Other	578,000	2,000	580,000
Total	$110,723,000	$ 2,036,000	$112,759,000

	December 31, 2014		
	Current	Past Due and Nonaccrual	Total
Residential real estate	$77,740,000	$ 96,000	$77,836,000
Consumer:			
Secured by real estate	25,867,000	1,452,000	27,319,000
Other	930,000	9,000	939,000
Total	$104,537,000	$ 1,557,000	$106,094,000

64

Table of Contents

Note 4. PREMISES AND EQUIPMENT, NET

The balance of premises and equipment consists of the following at December 31, 2015 and 2014:

	Years Ended December 31, 2015	2014
Land	$3,240,000	$3,219,000
Buildings and improvements	4,498,000	4,082,000
Leasehold improvements	2,077,000	2,246,000
Furniture, fixtures, and equipment	1,078,000	2,401,000
	10,893,000	11,948,000
Less: accumulated depreciation and amortization	4,094,000	5,371,000
Total premises & equipment, net	$6,799,000	$6,577,000

Amounts charged to net occupancy expense for depreciation and amortization of banking premises and equipment amounted to $392,000 and $420,000 in 2015 and 2014, respectively.

Note 5. OTHER REAL ESTATE OWNED

The balance of other real estate owned consists of the following at December 31, 2015 and 2014:

	Years Ended December 31, 2015	2014
Aquired by foreclosure or deed in lieu of foreclosure	$ 880,000	$ 1,375,000
Allowance for losses on other real estate owned	—	(67,000)
Other real estate, net	$ 880,000	$ 1,308,000

Activity in the allowance for losses on other real estate owned was as follows:

Years Ended December 31, 2015	2014

Beginning of year	$ 67,000	$ 29,000
Additions charged to expense	218,000	235,000
Reductions from sales of other real estate owned	(285,000)	(197,000)
End of year	$ —	$ 67,000

Net gain on sale of other real estate owned totaled $83,000 and $63,000 for the years ended December 31, 2015 and 2014, respectively.

Expenses related to other real estate owned include:

	Years Ended December 31,	
	2015	2014
Provision for unrealized losses	$ 218,000	$ 235,000
Operating expenses, net of rental income	80,000	195,000
End of year	$ 298,000	$ 430,000

Table of Contents

Note 6. DEPOSITS

	December 31, 2015	2014
Noninterest-bearing demand	$147,828,000	$136,721,000
Interest-bearing checking accounts	182,310,000	168,319,000
Money market accounts	46,427,000	41,906,000
Total interest-bearing demand	228,737,000	210,225,000
Statement savings and clubs	74,384,000	71,202,000
Business savings	7,452,000	5,220,000
Total savings	81,836,000	76,422,000
IRA investment and variable rate savings	28,731,000	28,765,000
Brokered certificates	7,779,000	10,496,000
Money market certificates	109,842,000	93,847,000
Total certificates of deposit	146,352,000	133,108,000
Total interest-bearing deposits	456,925,000	419,755,000
Total deposits	$604,753,000	$556,476,000

Certificates of deposit with balances of $100,000 or more at December 31, 2015 and 2014, totaled $86,832,000 and $75,859,000, respectively.

The scheduled maturities of certificates of deposit were as follows:

	December 31,
2016	61,178,000
2017	41,882,000
2018	18,928,000
2019	14,648,000
2020	9,716,000
	$146,352,000

Note 7. BORROWINGS

Federal Home Loan Bank of New York Advances

The following table presents Federal Home Loan Bank of New York ("FHLB-NY") advances by maturity date:

	December 31, 2015		December 31, 2014	
Advances maturing	Amount	Weighted Average Rate	Amount	Weighted Average Rate
Within one year	$10,000,000	1.64%	$26,700,000	2.10%
After one year, but within two years	15,000,000	3.74%	10,000,000	1.64%
After two years, but within three years	15,000,000	3.35%	15,000,000	3.74%
After three years, but within four years	—	—%	15,000,000	3.35%
After four years, but within five years	—	—%	—	—%
	$40,000,000	3.07%	$66,700,000	2.68%

During 2015 and 2014, the maximum amount of FHLB-NY advances outstanding at any month end was $55.0 million and $66.7 million, respectively. The average amount of advances outstanding during the year ended December 31, 2015 and 2014 was $47.8 million and $32.5 million, respectively.

Table of Contents

At December 31, 2015, FHLB advances totaling $10.0 million had a quarterly call feature which has reached its first call date.

Advances from the FHLB-NY are all fixed rate borrowings and are secured by a blanket assignment of the Corporation's unpledged, qualifying mortgage loans and by mortgage-backed securities or investment securities. The loans remain under the control of the Corporation. Securities are maintained in safekeeping with the FHLB-NY. As of December 31, 2015 and 2014, the advances were collateralized by $68.3 million and $63.2 million, respectively of first mortgage loans under the blanket lien arrangement. Additionally, the advances were collateralized by $15.8 million and $21.5 million of investment securities as of December 31, 2015 and 2014, respectively. Based on the collateral the Corporation was eligible to borrow up to a total of $84.1 million at December 31, 2015 and $84.7 million at December 31, 2014.

The Corporation has the ability to borrow overnight with the FHLB-NY. There were no overnight borrowings with the FHLB-NY at December 31, 2015. As of December 31, 2014 overnight borrowings with the FHLB-NY were $6.7 million. The overall borrowing capacity is contingent on available collateral to secure borrowings and the ability to purchase additional activity-based capital stock of the FHLB-NY.

The Corporation may also borrow from the Discount Window of the Federal Reserve Bank of New York based on the market value of collateral pledged. At December 31, 2015 and 2014, the Corporation’s borrowing capacity at the Discount Window was $7.8 million and $5.1 million, respectively. In addition, at December 31, 2015 and 2014 the Corporation had available overnight variable repricing lines of credit with other correspondent banks totaling $38 million and $35 million, respectively, on an unsecured basis. There were no borrowings under these lines of credit at December 31, 2015 and 2014.

Securities Sold Under Agreements to Repurchase

Securities sold under agreements to repurchase represent financing arrangements.

During 2014, the balance of securities sold under agreements to repurchase which included a wholesale repurchase agreement with a broker was repaid in full. After a fixed rate period, the borrowing converted to a floating rate at 9.00% minus 3-month London Interbank Offered Rate (LIBOR) measured on a quarterly basis with a 5.15% cap and a 0.0% floor. This repurchase agreement was collateralized by agency securities maintained in safekeeping with the broker.

During 2014, there were also securities sold to Bank customers at a fixed rate with maturities varying from 6 months to one year. These securities were maintained in a separate safekeeping account within the Corporation's control.

At December 31, 2015 and 2014, there were no securities sold under agreements to repurchase.

Information concerning securities sold under agreements to repurchase is summarized as follows:

	December 31,	
	2015	2014
Balance	$—	$—
Weighted average interest rate at year end	0.00%	0.00%
Maximum amount outstanding at any month end during the year	$—	$7,601,000
Average amount outstanding during the year	$—	$5,255,000
Average interest rate during the year	0.00%	4.83%

Table of Contents

Note 8. SUBORDINATED DEBENTURES AND SUBORDINATED NOTES

			Carrying Amount December 31,	
Issue	Maturity	Rate	2015	2014
9/17/2003	9/17/2033	Fixed / Floating Rate Junior Subordinated Debentures	$7,217,000	$7,217,000
8/28/2015	8/25/2025	Fixed Rate Subordinated Notes	15,969,000	—
			$23,186,000	$7,217,000

In 2003, the Corporation formed Stewardship Statutory Trust I (the "Trust"), a statutory business trust, which on September 17, 2003 issued $7.0 million Fixed/Floating Rate Capital Securities ("Capital Securities"). The Trust used the proceeds to purchase from the Corporation, $7,217,000 of Fixed/Floating Rate Junior Subordinated Deferrable Interest Debentures (the "Subordinated Debentures") maturing September 17, 2033. The Trust is obligated to distribute all proceeds of a redemption whether voluntary or upon maturity, to holders of the Capital Securities. The Corporation's obligation with respect to the Capital Securities, and the Subordinated Debentures, when taken together, provide a full and unconditional guarantee on a subordinated basis by the Corporation of the Trust's obligations to pay amounts when due on the Capital Securities. The Corporation is not considered the primary beneficiary of this Trust (variable interest entity); therefore, the Trust is not consolidated in the Corporation's consolidated financial statements, but rather the Subordinated Debentures are shown as a liability. Prior to September 17, 2008, the Capital Securities and the Subordinated Debentures both had a fixed interest rate of 6.75%. Beginning September 17, 2008, the rate floats quarterly at a rate of three month LIBOR plus 2.95%. At December 31, 2015 and December 31, 2014, the rate on both the Capital Securities and the Subordinated Debentures was 3.48% and 3.19%, respectively. The Corporation has the right to defer payments of interest on the Subordinated Debentures by extending the interest payment period for up to 20 consecutive quarterly periods. The Subordinated Debentures may be included in Tier 1 capital (with certain limitations applicable) under current regulatory guidelines and interpretations.

On August 28, 2015, the Corporation completed a private placement of $16.6 million in aggregate principal amount of fixed rate subordinated notes (the "Subordinated Notes") to certain institutional accredited investors pursuant to a Subordinated Note Purchase Agreement dated August 28, 2015 between the Corporation and such investors. The Subordinated Notes have a maturity date of August 28, 2025 and bear interest at the rate of 6.75% per annum, payable semi-annually, in arrears, on March 1 and September 1 of each year during the time that the Subordinated Notes remain outstanding. The Subordinated Notes include a right of prepayment, without penalty, on or after August 28, 2020 and, in certain limited circumstances, before that date. The indebtedness evidenced by the Subordinated Notes, including principal and interest, is unsecured and subordinate and junior in right of the Company's payment to general and secured creditors and depositors of the Bank. The Subordinated Notes have been structured to qualify as Tier 2 capital for regulatory purposes. The Subordinated Notes totaled $16.0 million at December 31, 2015, which includes $631,000 of remaining unamortized debt issuance costs. The debt issuance costs are being amortized over the expected life of the issue. The net cash proceeds of the Subordinated Notes were used to redeem the Series B Preferred Shares as discussed in Note 9.

68

Table of Contents

Note 9. PREFERRED STOCK

Using the net proceeds of the Subordinated Notes issuance discussed in Note 8, on September 1, 2015, the Corporation repurchased from the U.S. Department of the Treasury (“Treasury”) all 15,000 shares of the Corporation’s Senior Non-Cumulative Perpetual Preferred Stock, Series B (the “Series B Preferred Shares”), having a liquidation preference of $1,000 per share, for an aggregate purchase price of $15 million, in cash, plus approximately $114,000 of accrued dividends. The Series B Preferred Shares were issued to Treasury on September 1, 2011 pursuant to a Securities Purchase Agreement between the Corporation and the Secretary of the Treasury in connection with the Corporation’s participation in Treasury’s Small Business Lending Fund program (“SBLF”), a $30 billion fund established under the Small Business Jobs Act of 2010 to encourage small business lending by providing capital to qualified community banks with assets of less than $10 billion.

The dividend rate of the Series B Preferred Shares was subject to fluctuation on a quarterly basis during the first ten quarters during which the Series B Preferred Shares were outstanding, based upon changes in the level of Qualified Small Business Lending (“QSBL” as defined in the Securities Purchase Agreement) from 1% to 5% per annum and, since then, for the eleventh dividend period through that portion of the nineteenth dividend period prior to the four and one-half year anniversary of the date of issuance of the Series B Preferred Shares (i.e., through February 29, 2016), the dividend rate became fixed at 4.56%. In general, the dividend rate decreased as the level of the Bank’s QSBL increased. Beginning on March 1, 2016 and for all dividend periods thereafter, the dividend rate of the Series B Preferred Shares would have increased and become fixed at 9%.

Note 10. REGULATORY CAPITAL REQUIREMENTS

The Corporation is subject to capital adequacy guidelines promulgated by the Board of Governors of the Federal Reserve System (“FRB Board”). The Bank is subject to somewhat comparable but different capital adequacy requirements imposed by the Federal Deposit Insurance Corporation (the “FDIC”). The federal banking agencies have adopted risk-based capital guidelines for banks and bank holding companies. The risk-based capital guidelines are designed to make regulatory capital requirements more sensitive to differences in risk profiles among banks and bank holding companies, to account for off-balance sheet exposure, and to minimize disincentives for holding liquid assets. Under these guidelines, assets and off-balance sheet items are assigned to broad risk categories, each with appropriate weights. The resulting capital ratios represent capital as a percentage of total risk-weighted assets and off-balance sheet items.

Federal banking regulators have also adopted leverage capital guidelines to supplement the risk-based measures. Leverage capital to average total assets is determined by dividing Tier 1 Capital as defined under the risk-based capital guidelines by average total assets (non-risk adjusted).

Guidelines for Banks

In December 2010 and January 2011, the Basel Committee on Banking Supervision (the “Basel Committee”) published the final texts of reforms on capital and liquidity, which are generally referred to as “Basel III”. The Basel Committee is a committee of central banks and bank supervisors and regulators from the major industrialized countries that develops broad policy guidelines for the regulation of banks and bank holding companies. In July 2013, the FDIC and the other federal bank regulatory agencies adopted final rules (the “Basel Rules”) to implement certain provisions of Basel III and the Dodd-Frank Wall Street Reform and Consumer Protection Act. The Basel Rules revise the leverage and risk-based capital requirements and the methods for calculating risk-weighted assets. The Basel Rules apply to all depository institutions, top-tier bank holding companies with total consolidated assets of $1 billion or more and top-tier savings and loan holding companies.

Among other things, the Basel Rules (a) establish a new common equity Tier 1 Capital (“CET1”) to risk-weighted assets ratio minimum of 4.5% of risk-weighted assets, (b) raise the minimum Tier 1 Capital to risk-based assets requirement (“Tier 1 Capital Ratio) from 4% to 6% of risk-weighted assets and (c) assign a higher risk weight of 150% to exposures that are more than 90 days past due or are on nonaccrual status and to certain commercial real estate facilities. The minimum ratio of Total Capital to risk-weighted assets (including certain off-balance sheet activities, such as standby letters of credit) is 8%. At least 6% of the Total Capital is required to be “Tier 1 Capital”, which consists of common shareholders’ equity and certain preferred stock, less certain items and other intangible assets. The remainder, “Tier 2 Capital,” may consist of (a) the allowance for loan losses of up to 1.25% of risk-weighted assets, (b) excess of qualifying preferred stock, (c) hybrid capital instruments, (d) debt, (e) mandatory convertible

Table of Contents

securities and (f) qualifying subordinated debt. "Total Capital" is the sum of Tier 1 Capital and Tier 2 Capital less reciprocal holdings of other banking organizations' capital instruments, investments in unconsolidated subsidiaries and any other deductions as determined by the federal banking regulatory agencies on a case-by-case basis or as a matter of policy after formal rule-making. A small bank holding company that has the highest regulatory examination rating and is not contemplating significant growth or expansion must maintain a minimum level of Tier 1 Capital to average total consolidated assets leverage ratio of at least 3%. All other bank holding companies are expected to maintain a leverage ratio of at least 100 to 200 basis points above the stated minimum.

The Basel Rules also require unrealized gains and losses on certain available-for-sale securities to be included for purposes of calculating regulatory capital unless a one-time opt-out is exercised. Additional constraints are also imposed on the inclusion in regulatory capital of mortgage-servicing assets and deferred tax assets. The Basel Rules limit a banking organization's capital distributions and certain discretionary bonus payments if the banking organization does not hold a "capital conservation buffer" consisting of 2.5% of CET1 to risk-weighted assets in addition to the amount necessary to meet its minimum risk-based capital requirements. The purpose of the capital conservation buffer is to ensure that banking organizations conserve capital when it is needed most, allowing them to weather periods of economic stress. Banking institutions with a CET1 Ratio, Tier 1 Capital Ratio and Total Capital Ratio above the minimum capital ratios but below the minimum capital ratios plus the capital conservation buffer will face constraints on their ability to pay dividends, repurchase equity and pay discretionary bonuses to executive officers based on the amount of the shortfall. The Basel Rules became effective for the Bank on January 1, 2015. The capital conservation buffer requirement will be phased in beginning January 1, 2016 and ending January 1, 2019, when the full capital conservation buffer requirement will be effective.

Bank assets are given risk-weights of 0%, 20%, 50%, 100%, and 150%. In addition, certain off-balance sheet items are given similar credit conversion factors to convert them to asset equivalent amounts to which an appropriate risk-weight will apply. These computations result in the total risk-weighted assets. Most loans are assigned to the 100% risk category, except for performing first mortgage loans fully secured by residential property which carry a 50% risk-weighting. Loan exposures past due 90 days or more or on nonaccrual are assigned a risk-weighting of at least 100%. Most investment securities (including, primarily, general obligation claims of states or other political subdivisions of the United States) are assigned to the 20% category, except for municipal or state revenue bonds, which have a 50% risk-weight, and direct obligations of the U.S. Treasury or obligations backed by the full faith and credit of the U.S. government, which have a 0% risk-weight. In converting off-balance sheet items, direct credit substitutes, including general guarantees and standby letters of credit backing nonfinancial obligations, and undrawn commitments (including commercial credit lines with an initial maturity of more than one year) have a 50% risk-weighting. Short-term undrawn commitments and commercial letters of credit with an initial maturity of under one year have a 20% risk-weighting and certain short-term unconditionally cancelable commitments are not risk-weighted.

Guidelines for Small Bank Holding Companies

In April 2015, the FRB Board updated and amended its Small Bank Holding Company Policy Statement. Under the revised Small Bank Holding Company Policy Statement, Basel III capital rules and reporting requirements will not apply to small bank holding companies ("SBHC"), such as the Corporation, that have total consolidated assets of less than $1 billion. The minimum risk-based capital requirements for a SBHC to be considered adequately capitalized are 4% for Tier 1 Capital and 8% for Total Capital to risk-weighted assets.

The regulations for SBHCs classify risk-based capital into two categories: “Tier 1 Capital” which consists of common and qualifying perpetual preferred shareholders’ equity less goodwill and other intangibles and “Tier 2 Capital” which consists of (a) the allowance for loan losses of up to 1.25% of risk-weighted assets, (b) the excess of qualifying preferred stock, (c) hybrid capital instruments, (d) debt, (e) mandatory convertible securities and (f) qualifying subordinated debt. Total qualifying capital consists of Tier 1 Capital and Tier 2 Capital less reciprocal holdings of other banking organizations’ capital instruments, investments in unconsolidated subsidiaries and any other deductions as determined by the FRB on a case-by-case basis or as a matter of policy after formal rule-making. However, the amount of Tier 2 Capital may not exceed the amount of Tier 1 Capital. The Corporation must maintain a minimum level of Tier 1 Capital to average total consolidated assets leverage ratio of 3%, which is the leverage ratio reserved for top-tier bank holding companies having the highest regulatory examination rating and not contemplating significant growth or expansion.

Bank holding company assets are given risk-weights of 0%, 20%, 50%, and 100%. In addition, certain off-balance sheet items are given similar credit conversion factors to convert them to asset equivalent amounts to which an appropriate risk-weight will apply. These computations result in the total risk-weighted assets.

Table of Contents

	Actual Amount	Ratio	Required for Capital Adequacy Purposes Amount	Ratio	To Be Well Capitalized Under Prompt Corrective Action Regulations Amount	Ratio
December 31, 2015						
Tier 1 Leverage ratio						
Consolidated	$55,331,000	7.67 %	$28,842,000	4.00 %	N/A	N/A
Bank	68,118,000	9.47 %	28,762,000	4.00 %	$ 35,953,000	5.00 %
Risk-based capital:						
Common Equity Tier 1						
Consolidated	N/A	N/A	N/A	N/A	N/A	N/A
Bank	68,118,000	12.41 %	24,698,000	4.50 %	35,675,000	6.50 %
Tier 1						
Consolidated	55,331,000	10.16 %	21,791,000	4.00 %	N/A	N/A
Bank	68,118,000	12.41 %	32,930,000	6.00 %	43,907,000	8.00 %
Total						
Consolidated	78,135,000	14.34 %	43,583,000	8.00 %	N/A	N/A
Bank	75,006,000	13.67 %	43,907,000	8.00 %	54,884,000	10.00 %
December 31, 2014						
Tier 1 Leverage ratio						
Consolidated	$64,399,000	9.45 %	$27,265,000	4.00 %	N/A	N/A
Bank	62,622,000	9.20 %	27,214,000	4.00 %	$ 34,018,000	5.00 %
Risk-based capital:						
Tier 1						
Consolidated	64,399,000	13.04 %	19,751,000	4.00 %	N/A	N/A
Bank	62,622,000	12.69 %	19,740,000	4.00 %	29,609,000	6.00 %
Total						
Consolidated	70,614,000	14.30 %	39,502,000	8.00 %	N/A	N/A
Bank	68,833,000	13.95 %	39,479,000	8.00 %	49,349,000	10.00 %

As presented above, at December 31, 2015 and 2014, the Bank’s regulatory capital ratios exceeded the established minimum capital requirements.

The Subordinated Notes have been structured to qualify as Tier 2 capital for regulatory purposes.

The Series B Preferred Shares qualified as Tier 1 for regulatory purposes.

As a result of the issuance of the Subordinated Notes and the subsequent repurchase of the Series B Preferred Shares, the Corporation's Tier 1 capital was reduced, thereby decreasing the Corporation's Tier 1 Leverage and the Tier 1 ratios in the above table. Nevertheless, the Bank and the Corporation exceed all capital adequacy requirements to which they are subject.

Note 11. BENEFIT PLANS

The Corporation has a noncontributory profit sharing plan covering all eligible employees. Contributions are determined by the Corporation's Board of Directors on an annual basis. Total profit sharing expense for the years ended December 31, 2015 and 2014 was $248,000 and $170,000, respectively.

The Corporation also has a 401(k) plan which covers all eligible employees. Participants may elect to contribute up to 100% of their salaries, not to exceed the applicable limitations as per the Internal Revenue Code. The Corporation, on

Table of Contents

an annual basis, may elect to match 50% of the participant's first 5% contribution. Total 401(k) expense for the years ended December 31, 2015 and 2014 amounted to approximately $164,000 and $141,000, respectively.

The Corporation offers an Employee Stock Purchase Plan which allows all eligible employees to authorize a specific payroll deduction from his or her base compensation for the purchase of the Corporation's Common Stock. Total stock purchases amounted to 4,671 and 6,560 shares during 2015 and 2014, respectively. At December 31, 2015, the Corporation had 174,752 shares reserved for issuance under this plan.

Note 12. STOCK-BASED COMPENSATION

At December 31, 2015, the Corporation had various types of the following stock award programs.

Director Stock Plan

The Director Stock Plan permits members of the Board of Directors of the Bank to receive any monthly Board of Directors' fees in shares of the Corporation's Common Stock, rather than in cash. Shares are purchased for directors in the open market and resulted in purchases of 4,058 and 5,060 shares for the years ended 2015 and 2014, respectively. At December 31, 2015, the Corporation had 524,036 shares authorized but unissued for this plan.

Stock Incentive Plan

The 2010 Stock Incentive Plan covers both employees and directors. The purpose of the plan is to promote the long-term growth and profitability of the Corporation by (i) providing key people with incentives to improve shareholder value and to contribute to the growth and financial success of the Corporation, and (ii) enabling the Corporation to attract, retain and reward the best available persons. The Plan permits the granting of stock (including incentive stock options qualifying under Internal Revenue Code section 422 and nonqualified options), stock appreciation rights restricted or unrestricted stock awards, phantom stock, performance awards or other stock-based awards.

Restricted shares granted under the plan generally vest over a three year service period with compensation expenses recognized on a straight-line basis. The value of restricted shares is based upon an average of the high and low closing price of the common stock on the date of grant.

Changes in nonvested restricted shares were as follows:

	2015		2014	
	Number of Shares	Weighted Average Grant Date Fair Value	Number of Shares	Weighted Average Grant Date Fair Value
Balance January 1	49,661	$ 5.01	—	$ —
Granted	50,974	5.47	49,661	5.01
Vested	(16,065)	5.01	—	—
Forfeited	(19,600)	5.26	—	—
Balance December 31	64,970	$ 5.29	49,661	$ 5.01

Stock based compensation expense related to stock grants to associates was $91,000 and $69,000 for the years ended December 31, 2015 and December 31, 2014, respectively.

In addition, there were 8,250 unrestricted stock awards granted to the Board of Directors during the year ended December 31, 2015. There were no unrestricted stock awards granted during the year ended December 31, 2014. Expense related to stock grants to the Board of Directors was $50,000 for the year ended December 31, 2015.

At December 31, 2015 the Corporation had 109,153 shares authorized but unissued for this plan.

Note 13. EARNINGS PER COMMON SHARE

The following reconciles the income available to common shareholders (numerator) and the weighted average common stock outstanding (denominator) for both basic and diluted earnings per share:

Table of Contents

	Years Ended December 31,	
	2015	2014
Net Income	$ 4,200,000	$ 3,085,000
Dividends on preferred stock and accretion	456,000	683,000
Net income available to common shareholders	$ 3,744,000	$ 2,402,000
Weighted-average common shares outstanding - basic	6,077,657	6,003,814
Effect of dilutive securities - stock options	N/A	N/A
Weighted average common shares outstanding - diluted	6,077,657	6,003,814
Basic earnings per common share	$ 0.62	$ 0.40
Diluted earnings per common share	$ 0.62	$ 0.40

There were no stock options to purchase shares of common stock for the years ended December 31, 2015 or 2014.

Table of Contents

Note 14. INCOME TAXES

The components of income tax benefit are summarized as follows:

	Years Ended December 31, 2015	2014
Current tax expense (benefit)		
Federal	$ 1,278,000	$ 634,000
State	477,000	159,000
	1,755,000	793,000
Deferred tax expense (benefit)		
Federal	459,000	392,000
State	134,000	273,000
Valuation allowance	(76,000)	(39,000)
	517,000	626,000
	$ 2,272,000	$ 1,419,000

The following table presents a reconciliation between the reported income taxes and the income taxes which would be computed by applying the normal federal income tax rate (34%) to income before income taxes:

	Years Ended December 31, 2015	2014
Federal income tax	$ 2,200,000	$ 1,531,000
Add (deduct) effect of:		
State income taxes, net of federal income tax effect	443,000	246,000
Nontaxable interest income	(194,000)	(255,000)
Bank owned life insurance	(141,000)	(141,000)
Nondeductible expenses	14,000	10,000
Change in valuation reserve	(50,000)	—
Other items, net	—	28,000
Effective federal income taxes	$ 2,272,000	$ 1,419,000

Table of Contents

The tax effects of existing temporary differences that give rise to significant portions of the deferred tax assets and deferred tax liabilities are as follows:

	December 31, 2015	2014
Deferred tax assets:		
Allowance for loan losses	$3,524,000	$3,835,000
Accrued compensation	124,000	159,000
Nonaccrual loan interest	302,000	453,000
Depreciation	379,000	382,000
Contribution carry forward	105,000	146,000
Restricted stock	42,000	28,000
OREO reserve	—	27,000
Accrued contributions	82,000	21,000
State net operating loss carry forward	—	23,000
Unrealized loss on fair value of interest rate swap	25,000	125,000
Unrealized loss on securities available-for-sale	385,000	477,000
Alternate minimum tax	347,000	425,000
	5,315,000	6,101,000
Valuation reserve	(87,000)	(163,000)
	5,228,000	5,938,000
Deferred tax liabilities		
Other	4,000	4,000
	4,000	4,000
Net deferred tax assets	$5,224,000	$5,934,000

At December 31, 2015, the Corporation has provided a full valuation allowance relating to both federal and state tax benefit of all contribution carryforwards and for the parent company only state tax benefit of net operating loss carryforwards. Management has determined that it is more likely than not that it will not be able to realize the deferred tax benefits described above.

The Corporation has approximately $1.0 million of taxes paid in the carryback period that could be utilized against the deferred tax asset. The remaining $4.2 million of net deferred tax assets more likely than not will be utilized through future earnings.

The Corporation has alternate minimum tax (AMT) credit carryforwards of approximately $347,000 to reduce regular Federal income taxes in future years to the extent that the regular federal income tax exceeds AMT. The AMT credit carryforwards have no expiration date.

There were no unrecognized tax benefits during the years or at the years ended December 31, 2015 and 2014 and management does not expect a significant change in unrecognized benefits in the next twelve months. There were no tax interest and penalties recorded in the income statement for the years ended December 31, 2015 and 2014. There were no tax interest and penalties accrued for the years ended December 31, 2015 and 2014.

The Corporation and its subsidiaries are subject to U.S. federal income tax as well as income tax of the State of New Jersey.

The Corporation is no longer subject to examination by taxing authorities for years before 2012.

Note 15. COMMITMENTS AND CONTINGENCIES

Loan Commitments

The Corporation is a party to financial instruments with off-balance sheet risk in the normal course of business to meet the financing needs of its customers. These financial instruments include commitments to extend credit and standby letters of credit. Those instruments involve, to varying degrees, elements of credit and interest rate risk in excess of

Table of Contents

the amount recognized in the consolidated financial statements. The contract or notional amounts of those instruments reflect the extent of involvement the Corporation has in particular classes of financial instruments.

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

At December 31, 2015, the Corporation had residential mortgage commitments to extend credit aggregating approximately $1.4 million at fixed rates averaging 3.20% and none at variable rates. Approximately $276,000 of these loan commitments will be sold to investors upon closing. Commercial, construction, and home equity loan commitments of approximately $7.0 million were extended with variable rates averaging 3.74% and approximately $469,000 extended at fixed rates averaging 4.15% Generally, commitments were due to expire within approximately 30 days.

Additionally, at December 31, 2015, the Corporation was committed for approximately $74.6 million of unused lines of credit, consisting of $21.1 million relating to a home equity line of credit program and an unsecured line of credit program (cash reserve), $4.3 million relating to an unsecured overdraft protection program, and $49.2 million relating to commercial and construction lines of credit. Amounts drawn on the unused lines of credit are predominantly assessed interest at rates which fluctuate with the base rate.

Commitments under standby letters of credit were approximately $485,000 at December 31, 2015, of which $433,000 expires within one year. Should any letter of credit be drawn on, the interest rate charged on the resulting note would fluctuate with the Corporation's base rate. Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. Since many of the commitments may expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. The Corporation evaluates each customer's creditworthiness on a case-by-case basis. The amount of collateral obtained, if deemed necessary by the Corporation upon extension of credit, is based on management's credit evaluation of the borrower. Collateral held varies, but may include accounts receivable, inventory, property, plant and equipment, and income-producing commercial properties.

Standby letters of credit are conditional commitments issued by the Corporation to guarantee payment or performance of a customer to a third party. Those guarantees are primarily issued to support public and private borrowing arrangements, including commercial paper, bond financing and similar transactions. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loan facilities to customers. The Corporation obtains collateral supporting those commitments for which collateral is deemed necessary.

Lease Commitments

At December 31, 2015, the minimum rental commitments on the noncancellable leases with an initial term of one year and expiring thereafter are as follows:

Year Ended December 31,	Minimum Rent
2016	$677,000
2017	648,000
2018	584,000
2019	513,000
2020	418,000
Thereafter	1,342,000
	$4,182,000

Rental expense under long-term operating leases for branch offices amounted to approximately $924,000 and $1,106,000 during the years ended December 31, 2015 and 2014, respectively. Rental income was approximately $40,000 and $46,000 for the years ended December 31, 2015 and 2014.

76

Table of Contents

Contingencies

The Corporation is also subject to litigation which arises primarily in the ordinary course of business. In the opinion of management the ultimate disposition of such litigation should not have a material adverse effect on the financial position of the Corporation.

Note 16. INTEREST RATE SWAP

The Corporation utilizes interest rate swap agreements as part of its asset liability management strategy to help manage its interest rate risk position. The notional amount of the interest rate swap does not represent an amount exchanged by the parties. The amount exchanged is determined by reference to the notional amount and the other terms of the individual interest rate swap agreements.

Interest Rate Swap Designated as Cash Flow Hedge: The Corporation entered into an interest rate swap with a notional amount of $7 million. It was designated as a cash flow hedge of the Subordinated Debentures (See Note 8 of the consolidated financial statements) and was determined to be fully effective during the years ended December 31, 2015 and 2014. As such, no amount of ineffectiveness has been included in net income. Therefore, the aggregate fair value of the swap is recorded in other assets (liabilities) with changes in fair value recorded in other comprehensive income. The amount included in accumulated other comprehensive income (loss) would be reclassified to current earnings should the hedge no longer be considered effective. The Corporation expects the hedge to remain fully effective during the remaining term of the swap. As of December 31, 2015, the Corporation has secured the interest rate swap by pledging investment securities with a fair value of $997,000.

Summary information as of December 31, 2015 about the interest rate swap designated as a cash flow hedge is as follows:

Notional amount	$ 7,000,000
Pay rate	7.00%
Receive rate	3 month LIBOR plus 2.95%
Maturity	March 17, 2016
Unrealized loss	($62,000)

The net expense recorded on the swap transaction totaled $267,000 and $271,000 for the years ended December 31, 2015 and 2014, respectively, and is reported as a component of interest expense – Subordinated Debentures and Subordinated Notes.

The fair value of the interest rate swap of ($62,000) and ($314,000) at December 31, 2015 and 2014, respectively, was included in accrued expenses and other liabilities on the Consolidated Statements of Financial Condition.

Table of Contents

The following table presents the after tax net gains recorded in accumulated other comprehensive income and the Consolidated Statements of Income relating to the cash flow derivative instruments for the periods indicated.

	Year Ended December 31, 2015		
	Amount of gain recognized in OCI (Effective Portion)	Amount of gain (loss) reclassified from OCI to interest income	Amount of gain (loss) recognized in other noninterest income (Ineffective Portion)
Interest rate contract	$ 151,000	$ —	$ —

	Year Ended December 31, 2014		
	Amount of gain recognized in OCI (Effective Portion)	Amount of gain (loss) reclassified from OCI to interest income	Amount of gain (loss) recognized in other noninterest income (Ineffective Portion)
Interest rate contract	$ 147,000	$ —	$ —

Note 17. FAIR VALUE OF FINANCIAL INSTRUMENTS

Fair value is the exchange price that would be received for an asset or paid to transfer a liability (exit price) in an orderly transaction between market participants on the measurement date. There are three levels of inputs that may be used to measure fair value:

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

Level 2: Significant other observable inputs other than Level 1 prices such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data.

Level 3: Significant unobservable inputs that reflect a reporting entity's own assumptions about the assumptions that market participants would use in pricing an asset or liability.

The fair values of investment securities are determined by quoted market prices, if available (Level 1). For securities where quoted prices are not available, fair values of investment securities are determined by matrix pricing, which is a mathematical technique widely used in the industry to value debt securities without relying exclusively on quoted prices for the specific securities but rather by relying on the securities' relationship to other benchmark quoted securities (Level 2 inputs). As the Corporation is responsible for the determination of fair value, it performs quarterly analyses on the prices received from the pricing service to determine whether the prices are reasonable estimates of fair value. Specifically, the Corporation compares the prices received from the pricing service to a secondary pricing source. The Corporation's internal price verification procedures have not historically resulted in adjustment in the prices obtained from the pricing service.

The interest rate swaps are reported at fair values obtained from brokers who utilize internal models with observable market data inputs to estimate the values of these instruments (Level 2 inputs).

The Corporation measures impairment of collateralized loans and other real estate owned ("OREO") based on the estimated fair value of the collateral less estimated costs to sell the collateral, incorporating assumptions that experienced parties might use in estimating the value of such collateral (Level 3 inputs). At the time a loan or OREO is considered impaired, it is valued at the lower of cost or fair value. Generally, impaired loans carried at fair value have been partially charged-off or receive specific allocations of the allowance for loan losses. OREO is initially recorded at fair value less estimated selling costs. For collateral dependent loans and OREO, fair value is commonly based on real estate appraisals. These appraisals may utilize a single valuation approach or a combination of approaches including comparable sales and the income approach. Adjustments are routinely made in the appraisal process by the independent appraisers to adjust for differences between the comparable sales and income data available. Such adjustments typically result in a Level 3 classification of the inputs for determining fair value. Non-real estate collateral may be valued using an appraisal, the net book value recorded for the collateral on the borrower's financial

Table of Contents

statements, or aging reports. Collateral is then adjusted or discounted based on management's historical knowledge, changes in market conditions from the time of the valuation, and management's expertise and knowledge of the borrower and borrower's business, resulting in a Level 3 fair value classification. Impaired loans are evaluated on a quarterly basis for additional impairment and adjusted accordingly.

Appraisals are generally obtained to support the fair value of collateral. Appraisals for both collateral-dependent impaired loans and OREO are performed by licensed appraisers whose qualifications and licenses have been reviewed and verified by the Corporation. The Corporation utilizes a third party to order appraisals and, once received, reviews the assumptions and approaches utilized in the appraisal as well as the resulting fair value in comparison with independent data sources such as recent market data or industry-wide statistics.

Real estate appraisals typically incorporate measures such as recent sales prices for comparable properties. In addition, appraisers may make adjustments to the sales price of the comparable properties as deemed appropriate based on the age, condition or general characteristics of the subject property. Management generally applies a 12% discount to real estate appraised values to cover disposition / selling costs and to reflect the potential price reductions in the market necessary to complete an expedient transaction and to factor in the impact of the perception that a transaction being completed by a bank may result in further price reduction pressure.

Table of Contents

Assets and Liabilities Measured on a Recurring Basis

Assets and liabilities measured at fair value on a recurring basis are summarized below:

		Fair Value Measurements Using		
	Carrying Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
	December 31, 2015			
Assets:				
Available-for-sale securities				
U.S. government - sponsored agencies	$30,954,000	$—	$30,954,000	$ —
Obligations of state and political subdivisions	1,410,000	—	1,410,000	—
Mortgage-backed securities - residential	45,237,000	—	45,237,000	—
Asset-backed securities	9,701,000	—	9,701,000	—
Corporate bonds	2,419,000	—	2,419,000	—
Other equity investments	3,633,000	3,573,000	60,000	—
Total available-for-sale securities	$93,354,000	$3,573,000	$89,781,000	$ —
Liabilities:				
Interest rate swap	$62,000	$—	$62,000	$ —
	December 31, 2014			
Assets:				
Available-for-sale securities				
U.S. government - sponsored agencies	$30,274,000	$—	$30,274,000	$ —
Obligations of state and political subdivisions	1,400,000	—	1,400,000	—
Mortgage-backed securities - residential	76,743,000	—	76,743,000	—
Asset-backed securities	9,915,000	—	9,915,000	—
Corporate bonds	2,997,000	—	2,997,000	—
Other equity investments	3,589,000	3,529,000	60,000	—

Total available-for-sale securities	$124,918,000	$3,529,000	$121,389,000	$ —
Liabilities:				
Interest rate swap	$314,000	$—	$314,000	$ —

There were no transfers of assets between Level 1 and Level 2 during 2015 and 2014. There were no changes to the valuation techniques for fair value measurements as of December 31, 2015 and 2014.

Table of Contents

Assets and Liabilities Measured on a Non-Recurring Basis

Assets and liabilities measured at fair value on a non-recurring basis are summarized below:

		Fair Value Measurements Using		
	Carrying Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
	December 31, 2015			
Assets:				
Impaired loans				
Commercial:				
Secured by real estate	$367,000	$ —	$ —	$ 367,000
Consumer:				
Secured by real estate	84,000	—	—	84,000
Other real estate owned	880,000	—	—	880,000
	$1,331,000	$ —	$ —	$ 1,331,000
	December 31, 2014			
Assets:				
Impaired loans				
Commercial:				
Secured by real estate	$1,348,000	$ —	$ —	$ 1,348,000
Commercial real estate	205,000	—	—	205,000
Consumer:				
Secured by real estate	49,000	—	—	49,000
Other real estate owned	1,117,000	—	—	1,117,000
	$2,719,000	$ —	$ —	$ 2,719,000

Collateral-dependent impaired loans measured for impairment using the fair value of the collateral had a recorded investment value of $461,000, with a valuation allowance of $10,000, resulting in an increase of the allocation for loan losses of $16,000 for the year ended December 31, 2015.

Collateral-dependent impaired loans measured for impairment using the fair value of the collateral had a recorded investment value of $1,690,000, with a valuation allowance of $88,000, resulting in an increase of the allocation for loan losses of $155,000 for the year ended December 31, 2014.

OREO had a recorded investment value of $880,000 with no valuation allowance at December 31, 2015. At December 31, 2014, OREO had a recorded investment of $1,375,000 with a $67,000 valuation allowance. Additional valuation allowances of $170,000 and $235,000 were recorded for the years ended December 31, 2015 and 2014, respectively.

Table of Contents

For the Level 3 assets measured at fair value on a non-recurring basis, the significant unobservable inputs used in the fair value measurements were as follows:

December 31, 2015

Assets	**Fair Value**	**Valuation Technique**	**Unobservable Inputs**	**Range**
Impaired loans	$451,000	Comparable real estate sales and / or the income approach.	Adjustments for differences between comparable sales and income data available.	5% - 9%
			Estimated selling costs.	7%
Other real estate owned	$990,000	Comparable real estate sales and / or the income approach.	Adjustments for differences between comparable sales and income data available.	0%
			Estimated selling costs.	7%

December 31, 2014

Assets	**Fair Value**	**Valuation Technique**	**Unobservable Inputs**	**Range**
Impaired loans	$1,602,000	Comparable real estate sales and / or the income approach.	Adjustments for differences between comparable sales and income data available.	5% - 25%
			Estimated selling costs.	7%
Other real estate owned	$ 1,117,000	Comparable real estate sales and / or the income approach.	Adjustments for differences between comparable sales and income data available.	0% - 62%
			Estimated selling costs.	7%

Table of Contents

Fair value estimates for the Corporation's financial instruments are summarized below:

		Fair Value Measurements Using		
	Carrying Value	in Active Markets for Identical Assets (Level 1)	Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
	December 31, 2015			
Financial assets:				
Cash and cash equivalents	$10,910,000	$10,910,000	$—	$—
Securities available-for-sale	93,354,000	3,573,000	89,781,000	—
Securities held to maturity	60,738,000	—	61,281,000	—
FHLB-NY stock	2,608,000	N/A	N/A	N/A
Mortgage loans held for sale	1,522,000	—	—	1,522,000
Loans, net	517,556,000	—	—	527,479,000
Accrued interest receivable	1,967,000	1,000	535,000	1,432,000
Financial liabilities:				
Deposits	604,753,000	459,327,000	145,560,000	—
FHLB-NY advances	40,000,000	—	40,222,000	—
Subordinated Debentures and Subordinated Notes	23,186,000	—	—	23,206,000
Accrued interest payable	791,000	1,000	387,000	403,000
Interest rate swap	62,000	—	62,000	—

		Fair Value Measurements Using		
	Carrying Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
	December 31, 2014			
Financial assets:				
Cash and cash equivalents	$10,086,000	$10,086,000	$—	$—
Securities available-for-sale	124,918,000	3,529,000	121,389,000	—
Securities held to maturity	55,097,000	—	56,233,000	—
FHLB-NY stock	3,777,000	N/A	N/A	N/A
Loans, net	467,699,000	—	—	478,451,000
Accrued interest receivable	1,994,000	—	646,000	1,348,000
Financial liabilities:				

Deposits	556,476,000	424,117,000	132,513,000	—
FHLB-NY advances	66,700,000	—	67,087,000	—
Subordinated Debentures	7,217,000	—	—	7,203,000
Accrued interest payable	308,000	1,000	288,000	19,000
Interest rate swap	314,000	—	314,000	—

The following methods and assumptions were used to estimate the fair value of each class of financial instruments:

Cash and cash equivalents – The carrying amount approximates fair value and is classified as Level 1.

Securities available-for-sale and held to maturity – The methods for determining fair values were described previously.

Table of Contents

Mortgage loans held for sale – Loans in this category have been committed for sale to third party investors at the current carrying amount resulting in a Level 3 classification.

Loans, net – Fair values are estimated for portfolios of loans with similar financial characteristics. Loans are segregated by type such as residential and commercial mortgages, commercial and other installment loans. The fair value of loans is estimated by discounting cash flows using estimated market discount rates which reflect the credit and interest rate risk inherent in the loans resulting in a Level 3 classification. Fair values estimated in this manner do not fully incorporate an exit-price approach to fair value, but instead are based on a comparison to current market rates for comparable loans.

FHLB-NY stock – It is not practicable to determine the fair value of FHLB-NY stock due to restrictions placed on the transferability of the stock.

Accrued interest receivable – The carrying amount approximates fair value.

Deposits – The fair value of deposits, with no stated maturity, such as noninterest-bearing demand deposits, savings, NOW and money market accounts, is equal to the amount payable on demand resulting in a Level 1 classification. The fair value of certificates of deposit is based on the discounted value of cash flows resulting in a Level 2 classification. The discount rate is estimated using market discount rates which reflect interest rate risk inherent in the certificates of deposit. Fair values estimated in this manner do not fully incorporate an exit-price approach to fair value, but instead are based on a comparison to current market rates for comparable deposits.

FHLB-NY advances – With respect to FHLB-NY borrowings, the fair value is based on the discounted value of cash flows. The discount rate is estimated using market discount rates which reflect the interest rate risk and credit risk inherent in the term borrowings resulting in a Level 2 classification.

Securities sold under agreements to repurchase – The carrying value approximates fair value due to the relatively short time before maturity resulting in a Level 2 classification.

Subordinated Debentures and Subordinated Notes – The fair value of the Subordinated Debentures and the Subordinated Notes is based on the discounted value of the cash flows. The discount rate is estimated using market rates which reflect the interest rate and credit risk inherent in the Subordinated Debentures and the Subordinated Notes resulting in a Level 3 classification.

Accrued interest payable – The carrying amount approximates fair value.

Interest rate swap – The fair value of derivatives, which is included in Accrued Expenses and Other Liabilities on the Consolidated Statements of Financial Condition, are based on valuation models using observable market data as of the measurement date (Level 2).

Commitments to extend credit – The fair value of commitments is estimated using the fees currently charged to enter into similar agreements, taking into account the remaining terms of the agreements and the present credit worthiness of the counter parties. At December 31, 2015 and 2014 the fair value of such commitments were not material.

Limitations

The preceding fair value estimates were made at December 31, 2015 and 2014 based on pertinent market data and relevant information concerning the financial instruments. These estimates do not include any premiums or discounts that could result from an offer to sell at one time the Corporation's entire holdings of a particular financial instrument or category thereof. Since no market exists for a substantial portion of the Corporation's financial instruments, fair value estimates were necessarily based on judgments with respect to future expected loss experience, current economic conditions, risk assessments of various financial instruments, and other factors. Given the subjective nature of these estimates, the uncertainties surrounding them and the matters of significant judgment that must be applied, these fair value estimates cannot be calculated with precision. Modifications in such assumptions could meaningfully alter these estimates.

Since these fair value approximations were made solely for on- and off-balance sheet financial instruments at December 31, 2015 and 2014, no attempt was made to estimate the value of anticipated future business.

Table of Contents

Furthermore, certain tax implications related to the realization of unrealized gains and losses could have a substantial impact on these fair value estimates and have not been incorporated into the estimates.

Note 18. PARENT COMPANY ONLY

The Corporation was formed in January 1995 as a bank holding company to operate its wholly-owned subsidiary, Atlantic Stewardship Bank. The earnings of the Bank are recognized by the Corporation using the equity method of accounting. Accordingly, the Bank dividends paid reduce the Corporation's investment in the subsidiary. Condensed financial statements are presented below:

Condensed Statements of Financial Condition

	December 31,	
	2015	2014
Assets		
Cash and due from banks	$1,322,000	$253,000
Securities available-for-sale	997,000	989,000
Investment in subsidiary	67,830,000	64,388,000
Accrued interest receivable	2,000	2,000
Other assets	1,076,000	964,000
Total assets	$71,227,000	$66,596,000
Liabilities and Shareholders' equity		
Subordinated Debentures	$7,217,000	$7,217,000
Subordinated Notes	15,969,000	—
Other liabilities	468,000	410,000
Shareholders' equity	47,573,000	58,969,000
Total liabilities and Shareholders' equity	$71,227,000	$66,596,000

Table of Contents

Condensed Statements of Income

	Years Ended December 31,	
	2015	2014
Interest income - securities available-for-sale	$ 15,000	$ 15,000
Dividend income	1,713,000	1,610,000
Other income	7,000	7,000
Total income	1,735,000	1,632,000
Interest expense	908,000	504,000
Other expenses	318,000	306,000
Total expenses	1,226,000	810,000
Income before income tax benefit	509,000	822,000
Tax benefit	(408,000)	(266,000)
Income before equity in undistributed earnings of subsidiary	917,000	1,088,000
Equity in undistributed earnings of subsidiary	3,283,000	1,997,000
Net income	4,200,000	3,085,000
Dividends on preferred stock and accretion	456,000	683,000
Net income available to common shareholders	$ 3,744,000	$ 2,402,000

Condensed Statements of Cash Flows

	Years Ended December 31,	
	2015	2014
Cash flows from operating activities:		
Net income	$4,200,000	$3,085,000
Adjustments to reconcile net income to net cash provided by operating activities:		
Equity in undistributed earnings of subsidiary	(3,283,000)	(1,997,000)
Amortization of Subordinated Notes issuance cost	21,000	—
Increase in other assets	(114,000)	(276,000)
Increase in other liabilities	209,000	7,000
Net cash provided by operating activities	1,033,000	819,000
Cash flows from financing activities:		
Cash dividends paid on common stock	(486,000)	(300,000)
Cash dividends paid on preferred stock	(456,000)	(683,000)
Redemption of SBLF	(15,000,000)	—
Payment of discount on dividend reinvestment plan	(3,000)	(2,000)
Restricted stock-forfeited	(109,000)	—

Proceeds from issuance of Subordinated Notes	15,948,000	—
Issuance of common stock	142,000	188,000
Net cash provided by (used in) financing activities	36,000	(797,000)
Net decrease in cash and cash equivalents	1,069,000	22,000
Cash and cash equivalents - beginning	253,000	231,000
Cash and cash equivalents - ending	$1,322,000	$253,000

86

Table of Contents

Note 19. ACCUMULATED OTHER COMPREHENSIVE INCOME

The components of comprehensive income, both gross and net of tax, are presented for the periods below:

	Year Ended December 31, 2015			December 31, 2014		
	Gross	Tax Effect	Net	Gross	Tax Effect	Net
Net income	$6,472,000	$(2,272,000)	$4,200,000	$4,504,000	$(1,419,000)	$3,085,000
Other comprehensive income:						
Change in unrealized holding gains (losses) on securities available-for-sale	(194,000)	78,000	(116,000)	5,162,000	(2,000,000)	3,162,000
Reclassification adjustment for gains in net income	(169,000)	67,000	(102,000)	(165,000)	66,000	(99,000)
Loss on securities reclassifed from available-for-sale to held to maturity	—	—	—	(742,000)	285,000	(457,000)
Accretion of loss on securities reclassified to held to maturity	290,000	(111,000)	179,000	130,000	(50,000)	80,000
Change in fair value of interest rate swap	251,000	(100,000)	151,000	246,000	(99,000)	147,000
Total other comprehensive income	178,000	(66,000)	112,000	4,631,000	(1,798,000)	2,833,000
Total comprehensive income	$6,650,000	$(2,338,000)	$4,312,000	$9,135,000	$(3,217,000)	$5,918,000

The following table presents the after-tax changes in the balances of each component of accumulated other comprehensive income for the years ended December 31, 2015 and 2014.

Table of Contents

	Year Ended December 31, 2015 Components of Accumulated Other Comprehensive Income			Total
	Unrealized Gains and (Losses) on Available-for-Sale (AFS) Securities	Loss on securities reclassifed from available-for-sale to held to maturity	Unrealized Gains and (Losses) on Derivatives	Accumulated Other Comprehensive Income (Loss)
Balance at December 31, 2014	$(392,000)	$ (377,000)	$(188,000)	$ (957,000)
Other comprehensive income (loss) before reclassifications	(116,000)	179,000	151,000	214,000
Amounts reclassified from other comprehensive income	(102,000)	—	—	(102,000)
Other comprehensive income, net	(218,000)	179,000	151,000	112,000
Balance at December 31, 2015	$(610,000)	$ (198,000)	$(37,000)	$ (845,000)

	Year Ended December 31, 2014 Components of Accumulated Other Comprehensive Income			Total
	Unrealized Gains and (Losses) on Available-for-Sale (AFS) Securities	Loss on securities reclassifed from available-for-sale to held to maturity	Unrealized Gains and (Losses) on Derivatives	Accumulated Other Comprehensive Income (Loss)
Balance at December 31, 2013	$(3,455,000)	$ —	$(335,000)	$(3,790,000)
Other comprehensive income (loss) before reclassifications	3,162,000	(377,000)	147,000	2,932,000
Amounts reclassified from other comprehensive income	(99,000)	—	—	(99,000)
Other comprehensive income, net	3,063,000	(377,000)	147,000	2,833,000
Balance at December 31, 2014	$(392,000)	$ (377,000)	$(188,000)	$(957,000)

The following table presents amounts reclassified from each component of accumulated other comprehensive income on a gross and net of tax basis for the years ended December 31, 2015 and 2014.

Years Ended

Components of Accumulated Other Comprehensive Income (Loss)	December 31, 2015	2014	Income Statement Line Item
Unrealized gains on AFS securities before tax	$169,000	$165,000	Gains on securities transactions, net
Tax effect	(67,000)	(66,000)	
Total, net of tax	102,000	99,000	
Total reclassifications, net of tax	$102,000	$99,000	

Table of Contents

Note 20. QUARTERLY FINANCIAL DATA (Unaudited)

The following table contains quarterly financial data for the years ended December 31, 2015 and 2014 (dollars in thousands).

	Year Ended December 31, 2015				
	First Quarter	Second Quarter	Third Quarter	Fourth Quarter	Total
Interest income	$6,194	$6,360	$6,412	$6,643	$25,609
Interest expense	793	842	993	1,198	3,826
Net interest income before provision for loan losses	5,401	5,518	5,419	5,445	21,783
Provision for loan losses	(100)	(600)	(400)	(275)	(1,375)
Net interest income after provision for loan losses	5,501	6,118	5,819	5,720	23,158
Noninterest income	918	882	838	855	3,493
Noninterest expenses	5,049	5,105	5,125	4,900	20,179
Income before income tax expense	1,370	1,895	1,532	1,675	6,472
Income tax expense	453	673	532	614	2,272
Net income	917	1,222	1,000	1,061	4,200
Dividends on preferred stock	171	171	114	—	456
Net income available to common shareholders	$746	$1,051	$886	$1,061	$3,744
Basic and diluted earnings per share	$0.12	$0.17	$0.15	$0.17	$0.62

	Year Ended December 31, 2014				
	First Quarter	Second Quarter	Third Quarter	Fourth Quarter	Total
Interest income	$6,145	$6,186	$6,069	$6,534	$24,934
Interest expense	839	810	791	767	3,207
Net interest income before provision for loan losses	5,306	5,376	5,278	5,767	21,727
Provision for loan losses	—	—	250	(300)	(50)
Net interest income after provision for loan losses	5,306	5,376	5,028	6,067	21,777
Noninterest income	399	807	764	990	2,960
Noninterest expenses	5,094	5,106	4,989	5,044	20,233
Income before income tax expense	611	1,077	803	2,013	4,504
Income tax expense	105	351	251	712	1,419
Net income	506	726	552	1,301	3,085
Dividends on preferred stock	171	171	170	171	683
Net income available to common shareholders	$335	$555	$382	$1,130	$2,402
Basic and diluted earnings per share	$0.06	$0.09	$0.06	$0.19	$0.40

Table of Contents

Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure

None.

Item 9A. Controls and Procedures

(a) Evaluation of internal controls and procedures

Based on their evaluation as of the end of the period covered by this Annual Report on Form 10-K, our principal executive officer and principal financial officer have concluded that our internal disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934 (the "Exchange Act")) are effective to ensure that information required to be disclosed by us in reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission's rules and forms.

(b) Management's Report on Internal Control over Financial Reporting

Our management is responsible for establishing and maintaining adequate internal control over financial reporting as defined in Rule 13a-15(f) of the Exchange Act. Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements and can only provide reasonable assurance with respect to financial statement preparation. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

We assessed the effectiveness of our internal control over financial reporting as of December 31, 2015. In making this assessment, we used the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission ("COSO") in Internal Control—Integrated Framework (2013). Based on our assessment using those criteria, our management (including our principal executive officer and principal accounting officer) concluded that our internal control over financial reporting was effective as of December 31, 2015.

This Annual Report on Form 10-K does not include an attestation report of the Corporation's independent registered public accounting firm regarding internal control over financial reporting. Management's report was not subject to attestation by the Corporation's independent registered public accounting firm pursuant to rules of the Securities and Exchange Commission that permit the Corporation to provide only management's report in this Annual Report on Form 10-K.

(c) Changes in Internal Controls over Financial Reporting

There were no significant changes in our internal control over financial reporting or in other factors that could significantly affect these controls subsequent to the date of their evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses during the quarter ended December 31, 2015 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

Item 9B. Other Information

None.

Part III

Item 10. Directors, Executive Officers and Corporate Governance

Information concerning directors and executive officers contained under the captions “Election of Directors”: “Senior Executive Officers” and “Compliance with Section 16(a) of the Securities Exchange Act of 1934,” in the Proxy Statement for the Corporation’s 2016 Annual Meeting of Shareholders is incorporated herein by reference.

Table of Contents

Code of Ethics

The Corporation has adopted a Code of Ethical Conduct for Senior Financial Managers that applies to its principal executive officer, principal financial officer, principal accounting officer, controller and any other person performing similar functions. The Corporation's Code of Ethical Conduct for Senior Financial Managers is posted on our website, www.asbnow.com. The Corporation intends to satisfy the disclosure requirement under Item 5.05 of Form 8-K regarding an amendment to, or waiver from, a provision of its Code of Ethical Conduct for Senior Financial Managers by filing an 8-K and by posting such information on its website.

Audit Committee and Audit Committee Financial Expert

The members of our Audit Committee as of December 31, 2015 were Howard Yeaton (Chairman), Wayne Aoki, John L. Steen and Michael Westra. The Audit Committee determined that Howard Yeaton, Wayne Aoki and Michael Westra were "audit committee financial experts" as defined in Item 407(d)(5) of Regulation S-K as promulgated by the Securities and Exchange Commission. All members of our Audit Committee are "independent" as defined under Nasdaq listing rule 5605(a)(2).

Item 11. Executive Compensation

Information concerning executive compensation under the caption "Executive Compensation" and director compensation under the heading "Director Compensation" in the Proxy Statement for the Corporation's 2016 Annual Meeting of Shareholders is incorporated herein by reference.

Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters

The following table provides information with respect to the equity securities that are authorized for issuance under our compensation plans as of December 31, 2015:

Equity Compensation Plan Information

	Number of Securities to be Issued upon Exercise of Outstanding Options, Warrants and Rights (a)	Weighted Average Exercise Price of Outstanding Options, Warrants and Rights (b)	Number of Securities Remaining Available for Future Issuance under Equity Compensation Plans (Excluding Securities Reflected in Column (a)) (c)
Equity compensation plans approved by security holders	—	$ —	283,906
Equity compensation plans not approved by security holders	—	$ —	524,036
	—	$ —	807,942

The only equity compensation plan not approved by security holders is the Director Stock Plan. The Director Stock Plan permits members of the Board of Directors to receive any monthly Board of Directors' fees in shares of the Corporation's Common Stock, rather than in cash. The Corporation purchased 4,058 shares of the Corporation's Common Stock in the open market during 2015 for the benefit of the Director Stock Plan.

Information concerning security ownership of certain beneficial owners and management under the caption "Stock Ownership of Management and Principal Shareholders" in the Proxy Statement for the Corporation's 2016 Annual Meeting of Shareholders is incorporated herein by reference.

Table of Contents

Item 13. Certain Relationships and Related Transactions, and Director Independence

Information concerning certain relationships and related transactions under the captions "Election of Directors" and "Certain Relationships and Related Transactions," in the Proxy Statement for the Corporation's 2016 Annual Meeting of Shareholders is incorporated herein by reference.

Item 14. Principal Accountant Fees and Services

Information concerning principal accountant fees and services under the caption "Fees Billed by our Independent Registered Public Accounting Firm During Fiscal 2015 and Fiscal 2014," in the Proxy Statement for the Corporation's 2016 Annual Meeting of Shareholders is incorporated herein by reference.

Part IV

Item 15. Exhibits and Financial Statement Schedules

(a) (1) Financial Statements

The Consolidated Financial Statements of Stewardship Financial Corporation and Subsidiary included in Item 8:

(2) Financial Statement Schedules

None.

(3) Exhibits

Exhibit Number	Description of Exhibits
3(i)	Restated Certificate of Incorporation of Stewardship Financial Corporation (1)
3(i).2	Certificate of Amendment to the Certificate of Incorporation of Stewardship Financial Corporation (2)
3(ii)	Amended and Restated By-Laws of Stewardship Financial Corporation (3)
4.1	Form of 6.75% Subordinated Note dated as of August 28, 2015 issued by Stewardship Financial Corporation (4)
10.1	Stewardship Financial Corporation 1995 Employee Stock Purchase Plan (5)
10.2	Amended and Restated Director Stock Plan (6)
10.3	Stewardship Financial Corporation Dividend Reinvestment Plan, as amended and restated effective May 21, 2015 (7)
10.4	Stewardship Financial Corporation 2010 Stock Incentive Plan (8)

Table of Contents

10.5	Subordinated Note Purchase Agreement dated as of August 28, 2015 between the Corporation and the Purchasers identified therein (9)
10.6	Change in Control Severance Agreement dated November 12, 2013 between the Corporation and Paul Van Ostenbridge (10)
10.7	Change in Control Severance Agreement dated November 12, 2013 between the Corporation and Claire M. Chadwick (11)
10.8	Change in Control Severance Agreement dated March 26, 2015 between the Corporation and Peter Ameen (12)
13	Annual Report to Shareholders for the year ended December 31, 2015
21	Subsidiaries of the Registrant
23	Consent of KPMG LLP
31.1	Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2	Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
32.1	Certification of Chief Executive Officer and Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
101	The following materials from Stewardship Financial Corporation's Annual Report on Form 10-K for the year ended December 31, 2015, formatted in XBRL (Extensible Business Reporting Language): (i) Consolidated Statements of Financial Condition, (ii) Consolidated Statements of Income, (iii) Consolidated Statement of Changes in Shareholders' Equity, (iv) Consolidated Statements of Comprehensive Income, (v) Consolidated Statements of Cash Flows and (vi) Notes to Consolidated Financial Statements (13)

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(1) Incorporated by reference from Exhibit 3(i).1 to the Corporation's Quarterly Report on Form 10-Q, filed May 15, 2009.

(2) Incorporated by reference from Exhibit 3.1 to the Corporation's Current Report on Form 8-K, filed September 7, 2011.

(3) Incorporated by reference from Exhibit 3.1(i) to the Corporation's Annual Report on Form 10-K, filed March 28, 2013.

(4) Incorporated by reference to Exhibit 4.1 to the Corporation's Current Report on Form 8-K filed with the SEC on September 1, 2015.

(5) Incorporated by reference from Exhibit 4(c) to the Corporation's Registration Statement on Form S-8, Registration No. 333-20793, filed January 31, 1997.

(6) Incorporated by reference from Exhibit 10(viii) to the Corporation's Annual Report on Form 10-KSB, filed March 31, 1999.

(7) Incorporated by reference from Exhibit 4.2 to the Corporation's Registration Statement on Form S-3D, Registration No. 333-204352, filed May 21, 2015.

(8) Incorporated by reference from Exhibit 10.1 to the Corporation's Current Report on Form 8-K, filed May 19, 2010.

(9) Incorporated by reference to Exhibit 10.1 to the Corporation's Current Report on Form 8-K filed with the SEC on September 1, 2015.

(10) Incorporated by reference from Exhibit 10.1 to the Corporation's Quarterly Report on Form 10-Q, filed November 13, 2013.

(11) Incorporated by reference from Exhibit 10.2 to the Corporation's Quarterly Report on Form 10-Q, filed November 13, 2013.

(12) Incorporated by reference from Exhibit 10.3 to the Corporation's Quarterly Report on Form 10-Q, filed November 13, 2013.

(13) This exhibit shall not be deemed "filed" for purposes of Section 18 of the Securities Exchange Act of 1934, as amended, or otherwise subject to the liability of that section, nor shall it be deemed incorporated by reference into

any filing under the Securities Act of 1933, as amended, or the Securities Exchange Act of 1934, as

93

Table of Contents

amended, whether made before or after the date hereof and irrespective of any general incorporation language in any filing, except to the extent the Corporation specifically incorporates it by reference.

Table of Contents

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) 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.

STEWARDSHIP FINANCIAL CORPORATION

By: /s/ Paul Van Ostenbridge
Paul Van Ostenbridge
Chief Executive Officer and Director
Dated: March 24, 2016

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

Name	Title	Date
/s/ Paul Van Ostenbridge Paul Van Ostenbridge	Chief Executive Officer and Director (Principal Executive Officer)	March 24, 2016
/s/ Claire M. Chadwick Claire M. Chadwick	Chief Financial Officer (Principal Financial Officer and (Principal Accounting Officer)	March 24, 2016
/s/ Wayne Aoki Wayne Aoki	Director	March 24, 2016
/s/ Richard W. Culp Richard W. Culp	Chairman	March 24, 2016
/s/ William Hanse William Hanse	Director	March 24, 2016

/s/ Margo Lane Margo Lane	Director	March 24, 2016
/s/ John C. Scoccola John C. Scoccola	Director	March 24, 2016
/s/ John L. Steen John L. Steen	Director	March 24, 2016
/s/ Robert Turner Robert Turner	Secretary and Director	March 24, 2016
/s/ William J. Vander Eems William J. Vander Eems	Director	March 24, 2016
/s/ Michael Westra Michael Westra	Director	March 24, 2016
/s/ Howard Yeaton Howard Yeaton	Vice Chairman	March 24, 2016