

***Lyons Bancorp, Inc.***

Consolidated Financial Report

December 31, 2018



## MANAGEMENT'S REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING

February 21, 2019

This management report is intended to meet the management reporting requirements under Part 363.2(b) of the FDIC Rules and Regulations, and should not be used for any other purpose.

### ***Statement of Management's Responsibilities***

The management of Lyons Bancorp, Inc. (the "Institution") is responsible for preparing the Institution's annual financial statements in accordance with generally accepted accounting principles; for establishing and maintaining an adequate internal control structure and procedures for financial reporting, including controls over the preparation of regulatory financial statements in accordance with the instructions for the Consolidated Reports of Condition and Income for a Bank with Domestic Offices Only - FFIEC 041 ("FDIC Call Report"); and for complying with the Federal laws and regulations pertaining to insider loans and the Federal and, if applicable, State laws and regulations pertaining to dividend restrictions.

### ***Management's Assessment of Compliance With Designated Laws and Regulations***

The management of the Institution has assessed the Institution's compliance with the Federal laws and regulations pertaining to insider loans and the Federal and, if applicable, State laws and regulations pertaining to dividend restrictions during the year that ended on December 31, 2018. Based upon its assessment, management has concluded that the Institution complied with the Federal laws and regulations pertaining to insider loans and the Federal and, if applicable, State laws and regulations pertaining to dividend restrictions during the fiscal year that ended on December 31, 2018.

### ***Management's Assessment of Internal Control Over Financial Reporting***

The Institution's internal control over financial reporting is a process effected by those charged with governance, management, and other personnel, designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of reliable financial statements in accordance with accounting principles generally accepted in the United States of America and financial statements for regulatory reporting purposes, *i.e.*, FDIC Call Report. The Institution's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the Institution; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with accounting principles generally accepted in the United States of America and financial statements for regulatory reporting purposes, and that receipts and expenditures of the Institution are being made only in accordance with authorizations of management and directors of the Institution; and (3) provide reasonable assurance regarding

prevention, or timely detection and correction of unauthorized acquisition, use, or disposition of the Institution's assets that could have a material effect on the financial statements.

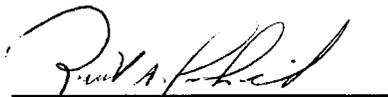
Because of its inherent limitations, internal control over financial reporting may not prevent, or detect and correct misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies and procedures may deteriorate.

Management assessed the effectiveness of the Institution's internal control over financial reporting, including controls over the preparation of regulatory financial statements in accordance with the instructions for the FDIC Call Report, as of December 31, 2018, based on the framework set forth by the Committee of Sponsoring Organizations of the Treadway Commission ("COSO") in *Internal Control- Integrated Framework (2013)*.

Based upon its assessment, management has concluded that, as of December 31, 2018, the Institution's internal control over financial reporting, including controls over the preparation of regulatory financial statements in accordance with the instructions for the FDIC Call Report, is effective based on the criteria established in *Internal Control-Integrated Framework (2013)* set forth by COSO.

Management's assessment of the effectiveness of internal control over financial reporting, including controls over the preparation of regulatory financial statements in accordance with the instructions for the FDIC Call Report, as of December 31, 2018, has been audited by Bonadio & Co., LLP, an independent public accounting firm, as stated in their report dated February 21, 2019.

**Lyons Bancorp, Inc.**



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**Robert A. Schick**  
**Chief Executive Officer**



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**Chad Proper**  
**Chief Financial Officer**

## REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

February 21, 2019

To the Stockholders and the  
Board of Directors of Lyons Bancorp Inc.:

### Opinion on the Financial Statements

We have audited the accompanying consolidated balance sheets of Lyons Bancorp Inc. and subsidiary as of December 31, 2018 and 2017, and the related consolidated statements of income, comprehensive income, stockholders' equity, and cash flows for the years then ended, and the related notes (collectively referred to as the "consolidated financial statements"). In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of Lyons Bancorp Inc. and subsidiary as of December 31, 2018 and 2017, and the results of their operations and their cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States) (PCAOB), the Company's internal control over financial reporting as of December 31, 2018, based on criteria established in *Internal Control—Integrated Framework (2013)* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO), and our report dated February 21, 2019, expressed an unqualified opinion.

### Basis for Opinion

These consolidated financial statements are the responsibility of Lyons Bancorp Inc. and subsidiary's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We are a public accounting firm registered with the Public Company Accounting Oversight Board (United States) ("PCAOB") and are required to be independent with respect to Lyons Bancorp Inc. and subsidiary in accordance with the relevant ethical requirements relating to our audit, and the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audits in accordance with the standards of the PCAOB and in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement, whether due to error or fraud. Our audits included performing procedures to assess the risks of material misstatement of the consolidated financial statements, whether due to error or fraud, and performing procedures that respond to those risks. Such procedures included examining, on a test basis, evidence regarding the amounts and disclosures in the consolidated financial statements. Our audits also included evaluating the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements. We believe that our audits provide a reasonable basis for our opinion.

We have served as Lyons Bancorp Inc. and subsidiary's auditor since 2011.

**REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

February 21, 2019

To the Board of Directors and  
Stockholders of Lyons Bancorp Inc.:

**Opinion on Internal Control over Financial Reporting**

We have audited Lyons Bancorp Inc.'s (the Company's) internal control over financial reporting as of December 31, 2018, based on criteria established in *Internal Control—Integrated Framework (2013)* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). In our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2018, based on criteria established in *Internal Control—Integrated Framework (2013)* issued by COSO.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States) (PCAOB) and in accordance with auditing standards generally accepted in the United States of America, the consolidated balance sheets and the related consolidated statements of income, comprehensive income, stockholders' equity, and cash flows of the Company, and our report dated February 21, 2019, expressed an unqualified opinion.

**Basis for Opinion**

The Company's management is responsible for maintaining effective internal control over financial reporting, and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Management's Report on Internal Control Over Financial Reporting. Our responsibility is to express an opinion on the Company's internal control over financial reporting based on our audit. We are a public accounting firm registered with the PCAOB and are required to be independent with respect to the Company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audit in accordance with the standards of the PCAOB and in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit of internal control over financial reporting included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audit also included performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

**Definition and Limitations of Internal Control over Financial Reporting**

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the

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**Definition and Limitations of Internal Control over Financial Reporting (Continued)**

maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the consolidated financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. 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.

Syracuse, New York

## Table of Contents December 31, 2018 and 2017

	<u>Page</u>
Consolidated Balance Sheets	2
Consolidated Statements of Income	3
Consolidated Statements of Comprehensive Income	4
Consolidated Statements of Stockholders' Equity	5
Consolidated Statements of Cash Flows	6
Notes to Consolidated Financial Statements	7

# Lyons Bancorp, Inc.

## Consolidated Balance Sheets

December 31, 2018 and 2017

	2018	2017
Assets	(In thousands)	
Cash and due from banks	\$ 18,696	\$ 13,638
Interest-bearing deposits in banks	17,437	19,596
Cash and Cash Equivalents	36,133	33,234
Investment securities:		
Available for sale	184,665	206,342
Restricted equity securities	7,254	7,340
Total Investment Securities	191,919	213,682
Loans	810,136	741,860
Less allowance for loan losses	(10,035)	(8,629)
Net Loans	800,101	733,231
Land, premises and equipment, net	24,136	23,279
Bank owned life insurance	16,377	16,000
Accrued interest receivable and other assets	13,031	12,418
<b>Total Assets</b>	<b>\$ 1,081,697</b>	<b>\$ 1,031,844</b>
<b>Liabilities and Equity</b>		
<b>Liabilities</b>		
Deposits:		
Interest-bearing	\$ 711,993	\$ 679,748
Non-interest-bearing	233,844	213,508
Total Deposits	945,837	893,256
Borrowings from Federal Home Loan Bank	42,000	50,000
Junior subordinated debentures	6,190	6,190
Accrued interest payable and other liabilities	9,661	8,554
<b>Total Liabilities</b>	<b>1,003,688</b>	<b>958,000</b>
<b>Equity</b>		
Lyons Bancorp, Inc. stockholders' equity:		
Preferred stock	3	3
Common stock	1,599	1,599
Paid-in capital	19,342	19,317
Retained earnings	63,949	57,693
Accumulated other comprehensive loss	(6,404)	(4,527)
Treasury stock, at cost	(536)	(297)
<b>Total Lyons Bancorp, Inc. Stockholders' Equity</b>	<b>77,953</b>	<b>73,788</b>
Noncontrolling interest	56	56
<b>Total Equity</b>	<b>78,009</b>	<b>73,844</b>
<b>Total Liabilities and Equity</b>	<b>\$ 1,081,697</b>	<b>\$ 1,031,844</b>

See notes to consolidated financial statements.

# Lyons Bancorp, Inc.

## Consolidated Statements of Income Years Ended December 31, 2018 and 2017

	2018	2017
	(In thousands, except per share data)	
<b>Interest Income</b>		
Loans	\$ 35,596	\$ 30,607
Investment securities:		
Taxable	3,605	3,591
Non-taxable	1,388	1,502
<b>Total Interest Income</b>	<b>40,589</b>	<b>35,700</b>
<b>Interest Expense</b>		
Deposits	5,125	3,410
Borrowings	837	571
<b>Total Interest Expense</b>	<b>5,962</b>	<b>3,981</b>
<b>Net Interest Income</b>	<b>34,627</b>	<b>31,719</b>
<b>Provision for Loan Losses</b>	<b>2,133</b>	<b>1,500</b>
<b>Net Interest Income after Provision for Loan Losses</b>	<b>32,494</b>	<b>30,219</b>
<b>Noninterest Income</b>		
Service charges on deposit accounts	3,243	3,036
Cardholder fees	2,695	2,223
Loan servicing fees	1,819	1,540
Realized gains on loans sold	1,386	1,180
Financial services fees	1,165	1,022
Earnings on investment in bank owned life insurance	377	389
Net realized losses from sales of securities	(35)	(17)
Other	557	467
<b>Total Noninterest Income</b>	<b>11,207</b>	<b>9,840</b>
<b>Noninterest Expense</b>		
Salaries and wages	13,132	11,757
Pensions and benefits	3,336	3,806
Occupancy	3,122	2,620
Professional fees	2,095	1,825
Data processing	1,817	1,867
Cardholder expense	1,193	1,106
Advertising	1,071	942
FDIC and OCC assessments	783	733
Office supplies	325	274
Other	4,052	3,019
<b>Total Noninterest Expense</b>	<b>30,926</b>	<b>27,949</b>
<b>Income before Income Taxes</b>	<b>12,775</b>	<b>12,110</b>
<b>Income Tax Expense</b>	<b>2,778</b>	<b>4,096</b>
<b>Net income attributable to noncontrolling interest and Lyons Bancorp, Inc.</b>	<b>9,997</b>	<b>8,014</b>
<b>Net income attributable to noncontrolling interest</b>	<b>5</b>	<b>5</b>
<b>Net income attributable to Lyons Bancorp, Inc.</b>	<b>9,992</b>	<b>8,009</b>
<b>Preferred stock dividends</b>	<b>250</b>	<b>250</b>
<b>Net Income available to common shareholders</b>	<b>\$ 9,742</b>	<b>\$ 7,759</b>
<b>Earnings Per Share – basic</b>	<b>\$ 3.06</b>	<b>\$ 2.43</b>
<b>Earnings Per Share – diluted</b>	<b>\$ 3.03</b>	<b>\$ 2.42</b>

See notes to consolidated financial statements.

# Lyons Bancorp, Inc.

## Consolidated Statements of Comprehensive Income Years Ended December 31, 2018 and 2017

	<u>2018</u>	<u>2017</u>
	(In thousands)	
Net income	\$9,992	\$ 8,009
Other comprehensive income (loss) :		
Securities available for sale:		
Net unrealized losses during the year	(2,170)	(219)
Reclassification adjustment for transfer from held to maturity	-	(165)
Reclassification adjustment for losses included in income	35	17
Securities held to maturity:		
Reclassification adjustment for amortization of unrealized losses included in income	-	136
Changes in unrealized gains during the year of restricted equity securities	-	42
Pension and postretirement benefits:		
Amortization of prior service credit	(3)	(3)
Amortization of net loss	92	233
Net actuarial gain (loss)	(519)	761
Cash flow hedge:		
Gains on the effective portion of cash flow hedge	6	10
Reclassification adjustment for losses included in income	127	151
	<u>(2,432)</u>	<u>963</u>
Tax benefit (expense)	<u>685</u>	<u>(385)</u>
Other comprehensive (loss) income	<u>(1,747)</u>	<u>578</u>
Comprehensive income	<u>\$ 8,245</u>	<u>\$ 8,587</u>

*See notes to consolidated financial statements.*

# Lyons Bancorp, Inc.

## Consolidated Statements of Stockholders' Equity Years Ended December 31, 2018 and 2017

(In thousands, except per share data)

	Preferred Stock	Common Stock	Paid-In Capital	Retained Earnings	Accumulated Other Comprehensive Loss	Treasury Stock	Noncontrolling Interest	Total
<b>Balance - January 1, 2017</b>	3	\$1,599	\$19,294	\$52,449	\$(4,270)	\$(277)	\$56	\$ 68,854
Net income attributable to noncontrolling interests and Lyons Bancorp, Inc.	-	-	-	8,009	-	-	5	8,014
Total other comprehensive loss, net	-	-	-	-	578	-	-	578
Reclassification of stranded tax effect <sup>(1)</sup>	-	-	-	835	(835)	-	-	-
Purchase of treasury stock	-	-	-	-	-	(183)	-	(183)
Deferred compensation shares awarded	-	-	23	-	-	163	-	186
Dividends to noncontrolling interests	-	-	-	-	-	-	(5)	(5)
Preferred cash dividends declared, \$50.00 per share	-	-	-	(250)	-	-	-	(250)
Cash dividends declared, \$1.05 per share	-	-	-	(3,350)	-	-	-	(3,350)
<b>Balance – December 31, 2017</b>	3	1,599	19,317	57,693	(4,527)	(297)	56	\$ 73,844
Net income attributable to noncontrolling interests and Lyons Bancorp, Inc.	-	-	-	9,992	-	-	5	9,997
Total other comprehensive income, net	-	-	-	-	(1,747)	-	-	(1,747)
Cumulative effect of change in measurement of equity securities <sup>(2)</sup>	-	-	-	130	(130)	-	-	-
Purchase of treasury stock	-	-	-	-	-	(582)	-	(582)
Deferred compensation shares awarded	-	-	25	-	-	343	-	368
Dividends to noncontrolling interests	-	-	-	-	-	-	(5)	(5)
Preferred cash dividends declared, \$50.00 per share	-	-	-	(250)	-	-	-	(250)
Cash dividends declared, \$1.14 per share	-	-	-	(3,616)	-	-	-	(3,616)
<b>Balance – December 31, 2018</b>	<u>\$ 3</u>	<u>\$ 1,599</u>	<u>\$ 19,342</u>	<u>\$ 63,949</u>	<u>\$ (6,404)</u>	<u>\$ (536)</u>	<u>\$ 56</u>	<u>\$ 78,009</u>

- (1) Reclassification adjustment from accumulated other comprehensive loss to retained earnings for stranded tax effects resulting from the newly enacted Federal corporate income tax rate of 21% in accordance with the early adoption of ASU 2018-02.
- (2) Cumulative effect of unrealized gain on marketable equity securities based on the adoption of ASU 2016-01 Financial Instruments overall (subtopic 825-10) Recognition and measurement of financial assets and liabilities.

See notes to consolidated financial statements.

# Lyons Bancorp, Inc.

## Consolidated Statements of Cash Flows

Years Ended December 31, 2018 and 2017

	2018	2017
	(In thousands)	
<b>Cash Flows from Operating Activities</b>		
Net income	\$ 9,992	\$ 8,009
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for loan losses	2,133	1,500
Earnings on investment in bank owned life insurance	(376)	(390)
Net realized loss from sales of securities	35	17
Realized gain on loans sold	(1,386)	(1,180)
Deferred compensation expense	297	27
Net amortization on securities	424	419
Depreciation and amortization	1,218	1,099
Deferred income tax expense (benefit)	(2,043)	2,763
Contribution to defined benefit pension plan	-	(2,400)
Decrease (increase) in accrued interest receivable and other assets	466	(1,868)
Increase in accrued interest payable and other liabilities	2,483	6,986
Loans originated for sale	(82,347)	(66,357)
Proceeds from sales of loans	84,550	63,487
<b>Net Cash Provided by Operating Activities</b>	<b>15,446</b>	<b>12,112</b>
<b>Cash Flows from Investing Activities</b>		
Purchases of securities available for sale	(6,027)	(108,858)
Proceeds from sales of securities available for sale	4,263	-
Proceeds from maturities and calls of securities available for sale	20,804	92,413
Purchases of held to maturity securities	-	(850)
Proceeds from maturities/sales of securities held to maturity	-	10,107
Net (increase) decrease in restricted equity securities	86	(1,506)
Net increase in portfolio loans	(69,819)	(59,779)
Premises and equipment purchases, net	(2,076)	(4,280)
<b>Net Cash Used in Investing Activities</b>	<b>(52,769)</b>	<b>(72,753)</b>
<b>Cash Flows from Financing Activities</b>		
Net increase in demand and savings deposits	7,303	10,214
Net increase in time deposits	45,278	22,969
Net increase in overnight borrowings from Federal Home Loan Bank	(8,000)	32,000
Preferred stock dividend	(250)	(250)
Purchase of treasury stock	(582)	(183)
Dividends paid	(3,527)	(3,285)
<b>Net Cash Provided by Financing Activities</b>	<b>40,222</b>	<b>61,465</b>
	2,899	824
<b>Cash and Cash Equivalents – Beginning</b>	<b>33,234</b>	<b>32,410</b>
<b>Cash and Cash Equivalents – Ending</b>	<b>\$ 36,133</b>	<b>\$ 33,234</b>
<b>Supplementary Cash Flow Information</b>		
Interest paid	\$ 5,516	\$ 3,970
Income taxes paid, net of refund received	\$ 4,446	\$ 1,474

See notes to consolidated financial statements.

# ***Lyons Bancorp, Inc.***

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## Notes to Consolidated Financial Statements

December 31, 2018 and 2017

### **Note 1 - Summary of Significant Accounting Policies**

#### **Nature of Operations**

Lyons Bancorp, Inc. (the Company) provides a full range of commercial and retail banking services to individual and small business customers through its wholly-owned subsidiary, The Lyons National Bank (the Bank). The Bank's operations are conducted in fifteen branches located in Wayne, Onondaga, Yates, Ontario, Monroe, Seneca and Cayuga Counties, New York. The Company and the Bank are subject to the regulations of certain federal agencies and undergo periodic examinations by those regulatory authorities.

The Company owns all of the voting common shares of Lyons Capital Statutory Trust I (Trust I), Lyons Capital Statutory Trust II (Trust II), and Lyons Statutory Trust IV (Trust IV). Trust I was formed in 2003, Trust II was formed in 2004, and Trust IV was formed in 2016. The Trusts were each formed for the purpose of securitizing trust preferred securities, the proceeds of which were advanced to the Company and contributed to the Bank as additional capital.

The Bank owns all of the voting stock of Lyons Realty Associates Corp. (LRAC). LRAC is a real estate investment trust which holds a portfolio of real estate mortgages. In order to maintain its status as a real estate investment trust, LRAC holds the real estate mortgages until they are paid. The real estate mortgages held by LRAC are included in loans on the consolidated balance sheet.

#### **Basis of Presentation**

The consolidated financial information included herein combines the results of operations, the assets, liabilities, and shareholders' equity (including comprehensive income or loss) of the Company and all entities in which the Company has a controlling financial interest. All significant intercompany balances and transactions are eliminated in consolidation.

Variable interest entities (VIEs) are required to be consolidated if it is determined the company is the primary beneficiary of a VIE. The primary beneficiary of a VIE is the enterprise that has both the power and ability to direct the activities of the VIE that most significantly impact the VIE's economic performance and an obligation to absorb losses or the right to receive benefits that could potentially be significant to the VIE. The Company's wholly owned subsidiaries, Trust I, Trust II, and Trust IV are VIE's for which the Company is not the primary beneficiary. Accordingly, the accounts of these entities are not included in the Company's consolidated financial statements, as discussed in Note 8.

#### **Reclassification**

Amounts in the prior years' consolidated financial statements are reclassified when necessary to conform to the current year's presentation.

**Note 1 - Summary of Significant Accounting Policies (Continued)**

**Use of Estimates**

The preparation of consolidated financial statements in conformity with accounting principles generally accepted in the United States of America (GAAP) requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. Material estimates that are particularly susceptible to significant change in the near future relate to the determination of the allowance and provision for loan losses, actuarial assumptions associated with the Company's benefit plans and deferred tax assets and liabilities.

**Investment Securities**

Securities are classified as held to maturity and carried at amortized cost when management has the positive intent and ability to hold them until maturity. Securities to be held for indefinite periods of time are classified as available for sale and carried at fair value, with the unrealized holding gains and losses reported as a component of other comprehensive income, net of tax. Securities held for resale for liquidity purposes are classified as trading and are carried at fair value, with changes in unrealized holding gains and losses included in income. Management determines the appropriate classification of securities at the time of purchase. Restricted equity securities consist primarily of Federal Reserve Bank and the Federal Home Loan Bank stock.

Purchase premiums and discounts are recognized in interest income using the interest method or methods that approximate the interest method over the terms of the securities. Interest and dividends on securities are recognized in interest income using the interest method over the terms of the securities. Gains and losses on the sale of securities are determined using the specific identification method.

On a quarterly basis, the Company performs an assessment to determine whether there have been any events or economic circumstances indicating that a security with an unrealized loss has suffered other-than-temporary impairment. A security is considered impaired if the fair value is less than its amortized cost basis at the reporting date. If impaired, the Company then assesses whether the unrealized loss is other-than-temporary. The assessment considers (i) whether the Company intends to sell the security prior to recovery and/or maturity, (ii) whether it is more likely than not that the Company will have to sell the security prior to recovery and/or maturity and (iii) if the present value of the expected cash flows is not sufficient to recover the entire amortized cost basis. If a debt security is deemed to be other-than-temporarily impaired, the credit loss component of an other-than-temporary impairment write-down is recorded in earnings while the remaining portion of the impairment loss is recognized, net of tax, in other comprehensive income provided that the Company does not intend to sell the underlying security and it is more-likely-than not that the Company would not have to sell the security prior to recovery.

**Note 1 - Summary of Significant Accounting Policies (Continued)**  
**Investment Securities – (Continued)**

The Company considers the following factors in determining whether a credit loss exists and the period over which the security is expected to recover:

- The length of time and the extent to which the fair value has been less than the amortized cost basis;
- The level of credit enhancement provided by the structure which includes, but is not limited to, credit subordination positions, excess spreads, overcollateralization, protective triggers;
- Changes in the near term prospects of the issuer or underlying collateral of a security, such as changes in default rates, loss severities given default and significant changes in prepayment assumptions;
- The level of excess cash flow generated from the underlying collateral supporting the principal and interest payments of the debt securities; and
- Any adverse change to the credit conditions of the issuer of the security such as credit downgrades by the rating agencies.

**Loans**

The Bank grants real estate, commercial and consumer loans to its customers. A substantial portion of the loan portfolio is represented by real estate loans in Wayne, Ontario, Monroe, Yates, Onondaga, Seneca and Cayuga Counties. The Company's loan portfolio includes residential real estate, commercial real estate, agricultural real estate, commercial and agricultural loans, and consumer installment classes. Residential real estate loans include classes for 1-4 family and home equity loans. Consumer installment loans include classes for direct and indirect loans.

Loans that management has the intent and ability to hold for the foreseeable future or until maturity or payoff are stated at their outstanding unpaid principal balances, net of an allowance for loan losses and any deferred fees or costs. Interest income is accrued on the unpaid principal balance. Loan origination fees, net of certain direct origination costs, are deferred and recognized as an adjustment of the yield (interest income) of the related loans. The Bank is generally amortizing these amounts over the contractual life of the loan. Premiums and discounts on purchased loans are amortized as adjustments to interest income using the effective yield method.

Interest income is accrued on the unpaid principal balance. The accrual of interest on loans is discontinued at the time the loan is 90 days past due unless the credit is well-secured and in process of collection. Credit card loans and other personal loans are typically charged off no later than 180 days past due. Past due status is based on contractual terms of the loan. In all cases, loans are placed on nonaccrual or charged-off at an earlier date if collection of principal or interest is considered doubtful. All interest accrued but not collected for loans that are placed on nonaccrual or charged off is reversed

**Note 1 - Summary of Significant Accounting Policies (Continued)**

**Loans – (Continued)**

against interest income or the allowance for loan losses if the interest income was earned in a prior period. The interest on these loans is accounted for on the cash-basis or cost-recovery method, until qualifying for return to accrual. Loans are returned to accrual status when all the principal and interest amounts contractually due are brought current and future payments are reasonably assured.

Management, considering current information and events regarding the borrowers' ability to repay their obligations, considers a loan to be impaired when it is probable that the Company will be unable to collect all amounts due according to the contractual terms of the loan agreement. When a loan is considered to be impaired, the amount of the impairment is measured based on the present value of expected future cash flows discounted at the loan's effective interest rate, or at the loan's observable fair value or the fair value of underlying collateral if the loan is collateral-dependent. Impairment losses are included in the allowance for loan losses through a charge to the provision for loan losses. Cash receipts on impaired loans are generally applied to reduce the principal balance outstanding. In considering loans for evaluation of impairment, management generally excludes smaller balance, homogeneous loans: residential mortgage loans, home equity loans, and all consumer loans, unless subject to a troubled debt restructuring. These loans are collectively evaluated for risk of loss.

**Loans Held for Sale**

Generally, loans held for sale consist of residential mortgage loans that are originated and are intended to be sold through agreements the Bank has with the Federal Home Loan Bank (FHLB) and the Federal Home Loan Mortgage Corporation (Freddie Mac). Realized gains and losses on sales are computed using the specific identification method. These loans are carried on the consolidated balance sheet at the lower of cost or estimated fair value determined in the aggregate. Residential loans held for sale totaled \$4.5 million and \$5.3 million at December 31, 2018 and 2017, respectively, and are included in loans on the consolidated balance sheets.

During 2018 and 2017, the Company sold residential mortgage loans totaling \$84.5 million and \$63.5 million, respectively, and realized gains on these sales were \$1.4 million and \$1.2 million, respectively. These residential real estate loans are generally sold without recourse in accordance with standard secondary market loan sale agreements. When residential mortgage loans are sold, the Company typically retains all servicing rights, which provides the Company with a source of fee income. In connection with the sales in 2018 and 2017, the Company recorded mortgage-servicing assets of \$759,000 and \$586,000, respectively. Amortization of mortgage-servicing assets amounted to \$273,000 in 2018 and \$246,000 in 2017. Net mortgage-servicing assets included in the consolidated balance sheets totaled \$2.1 million and \$1.6 million, net of amortization, as of December 31, 2018 and 2017, respectively.

Government-guaranteed loans which may be sold after origination are not classified as held for sale in as much as sale of such loans is largely dependent upon the extent to which gains may be realized.

During 2018 and 2017, the Company sold no commercial loans. There were no commercial loans held for sale at December 31, 2018 or 2017.

**Note 1 - Summary of Significant Accounting Policies (Continued)**

**Loans Held for Sale – (Continued)**

Total loans serviced for others amounted to \$353.3 million and \$302.9 million at December 31, 2018 and 2017, respectively.

**Allowance for Loan Losses**

The allowance for loan losses (allowance) is established as losses are estimated to have occurred in the loan portfolio. The allowance is recorded through a provision for loan losses charged to earnings. Loan losses are charged against the allowance when management believes the uncollectibility of a loan balance is confirmed. Subsequent recoveries, if any, are credited to the allowance.

The allowance is evaluated on a regular basis by management and is based upon management's periodic review of the collectability of the loans in light of historical experience, the nature and volume of the loan portfolio, adverse situations that may affect the borrower's ability to repay, estimated value of any underlying collateral and prevailing economic conditions. This evaluation is inherently subjective as it requires estimates that are susceptible to significant revision as more information becomes available.

The allowance consists of general, specific and unallocated components as further described below.

General Component

The general component of the allowance is based on historical loss experience adjusted for qualitative factors stratified by the following loan classes: residential real estate, commercial real estate, agricultural real estate, commercial and agricultural loans, and consumer installment segments. Management uses a rolling average of historical losses based on a time frame appropriate to capture relevant loss data for each loan class. The historical loss factor is adjusted for the following qualitative factors: levels and trends in delinquencies; trends in volume and terms of loans; effects of changes in risk selection and underwriting standards and other changes in lending policies, procedures and practices; experience/ability/depth of lending management and staff; and national and local economic trends and conditions. There were no changes in the Company's policies or its methodology pertaining to the general component of the allowance during 2018 or 2017.

The qualitative factors are determined based on the various risk characteristics of each loan type. Risk characteristics relevant to each loan type are as follows:

Residential real estate - The Company generally does not originate loans with a loan-to-value ratio greater than 80 percent and does not grant subprime loans. The majority of loans in this segment are collateralized by owner-occupied residential real estate and repayment is dependent on the credit quality of the individual borrower. The overall health of the economy, including unemployment rates and housing prices, will have an effect on the credit quality in this class.

Commercial real estate - Loans in this class represent both extensions of credit for owner-occupied real estate and income-producing properties throughout the local region. The underlying cash flows of the operating commercial businesses (owner-occupied) and income properties (non-owner occupied) can be adversely impacted by a downturn in the economy as evidenced by increased vacancy rates,

**Note 1 - Summary of Significant Accounting Policies (Continued)**

**Allowance for Loan Losses – (Continued)**

which in turn, will have an effect on the credit quality in this class. In a majority of cases, the Company obtains rent rolls annually and continually monitors the cash flows of non-owner occupied loans commensurate with sound lending practices.

Agricultural real estate – Loans in this class represent extensions of credit for owner-occupied agricultural real estate throughout the local region. The underlying cash flows generated by the agribusinesses can be adversely impacted by adverse climate and a weakened economy, which in turn, will have an effect on the credit quality in this class. Management obtains annual tax returns and continually monitors the cash flows of these loans commensurate with sound lending practices.

Commercial and Agricultural loans – Loans in these classes are made to businesses and generally secured by the assets of the business. Repayment is expected from the cash flows of the business. A weakened economy, and resultant decreased consumer spending, will have an effect on the credit quality in this class.

Consumer installment loans – Loans in this segment may be secured or unsecured and repayment is dependent on the credit quality of the individual borrower. Unemployment rates will have an effect on the credit quality in this class.

Specific Component

The specific component relates to loans that are classified as impaired. Impairment is measured on a loan by loan basis for commercial and agricultural loans, commercial real estate and agricultural real estate by either the present value of expected future cash flows discounted at the loan's effective interest rate or the fair value of the collateral, less costs to sell, if determined to be more appropriate. An allowance is established when the discounted cash flow or collateral value of the impaired loan is lower than the carrying value of that loan. Large groups of smaller balance homogeneous loans are collectively evaluated for impairment. Accordingly, the Company does not separately identify individual consumer or residential real estate loans for impairment disclosures, unless such loans are subject to a troubled debt restructuring agreement.

A loan is considered impaired when, based on current information and events, it is probable that the Company will be unable to collect the scheduled payments of principal or interest when due according to the contractual terms of the loan agreement. Factors considered by management in determining impairment include payment status, collateral value, and the probability of collecting scheduled principal and interest payments when due.

All impaired loans require appraisals and/or chattel evaluations within 180 days of impairment, unless existing evaluation is less than 24 months old and no market or physical deterioration is noted. Re-appraisals and/or re-evaluations are conducted whenever deemed appropriate, but typically performed on a 24-month cycle if repayment is predicated upon liquidation of collateral and evidence suggests collateral values may have deteriorated.

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

**Note 1 - Summary of Significant Accounting Policies (Continued)**

**Allowance for Loan Losses – (Continued)**

borrower, including the length of the delay, the reason for the delay, the borrower's prior payment record, and the amount of the shortfall in relation to the principal and interest owed.

Unallocated Component

An unallocated component is maintained to cover uncertainties that could affect management's estimate of probable losses. The unallocated component of the allowance reflects the margin of imprecision inherent in the underlying assumptions used in the methodologies for estimating allocated and general reserves in the portfolio.

**Troubled Debt Restructurings**

A modification of a loan constitutes a troubled debt restructuring ("TDR") when a borrower is experiencing financial difficulty and the modification constitutes a concession. Loans modified in a TDR often involve temporary interest-only payments, term extensions, reducing the interest rate for the remaining term of the loan, extending the maturity date at an interest rate lower than the current market rate for new debt with similar risk, requesting additional collateral, releasing collateral for consideration, or substituting or adding a new borrower or guarantor.

Nonaccrual loans that are restructured remain on nonaccrual status, but may move to accrual status after they have performed according to the restructured terms for a period of time of at least six months.

**Land, Premises and Equipment**

Land is stated at cost. Premises and equipment are recorded at cost and are generally depreciated by the straight-line method over the estimated useful lives of the assets. Buildings are generally depreciated over a useful life of thirty-nine and one half years, furniture and equipment over a useful life of three to seven years, and leasehold improvements over the lesser of the asset's useful life or the term of the lease.

**Bank Owned Life Insurance**

Bank owned life insurance (BOLI) was purchased by the Bank as a financing tool for employee benefits and to fund discriminatory retirement benefits for the Board of Directors and executive management. The value of life insurance financing is the tax preferred status of increases in life insurance cash values and death benefits and the cash flow generated at the death of the insured. The proceeds or increases in cash surrender value of the life insurance policy results in tax-exempt income to the Company. The largest risk to the BOLI program is credit risk of the insurance carriers. To mitigate this risk, annual financial condition reviews are completed on all carriers. BOLI is stated on the Company's consolidated balance sheets at its current cash surrender value. Increases in BOLI's cash surrender value are reported as noninterest income in the Company's consolidated statements of income.

**Note 1 - Summary of Significant Accounting Policies (Continued)**  
**Foreclosed Real Estate**

Included in other assets are real estate properties acquired through, or in lieu of, loan foreclosure. These properties are initially recorded at fair value less estimated selling costs at the date of foreclosure. Any write-downs based on the asset's fair value at date of foreclosure are charged to the allowance for loan losses. After foreclosure, property held for sale is carried at the lower of the new basis or fair value less any costs to sell. Costs of significant property improvements are capitalized, whereas costs relating to holding property are expensed. Valuations are periodically performed by management, and any subsequent write-downs are recorded as a charge to operations, if necessary, to reduce the carrying value of the property to the lower of its cost or fair value less cost to sell. The recorded investment in residential real estate in process of foreclosure at December 31, 2018 and 2017 was approximately \$541,000 and \$211,000, respectively. There was no foreclosed real estate at December 31, 2018 or 2017.

**Treasury Stock**

Treasury stock is recorded at cost. Shares are reissued on the average cost method on a first in, first out basis, except for issuance of deferred compensation shares, which are discussed in Note 11.

**Interest Rate Swap Agreements**

The Company utilizes interest rate swap agreements as part of its management of interest rate risk to modify the repricing characteristics of its floating-rate junior subordinate debentures and to hedge fixed rate assets on the balance sheet that are funded by short-term and variable liabilities. For these swap agreements, amounts receivable or payable are recognized as accrued under the terms of the agreement, and the net differential is recorded as an adjustment to interest expense of the related hedged item. The interest rate swap agreements are designated as a cash flow hedge. Therefore, the effective portion of the swap's unrealized gain or loss was initially recorded as a component of other comprehensive income, net of tax. The ineffective portion of the unrealized gain or loss, if any, is immediately reported in other operating income. The Company considers its interest rate swap agreement to be fully effective and accordingly it has not recorded any gains or losses in earnings during 2018 or 2017.

**Advertising Costs**

Advertising costs are expensed as incurred.

**Noncontrolling Interest**

Noncontrolling interest represents the portion of ownership and interest expense that is attributable to the minority owners of LRAC. The minority ownership is in the form of 8.50% cumulative preferred stock, and the dividends paid are included in noncontrolling interest as a charge against income.

**Income Taxes**

Income taxes are provided for the tax effects of certain transactions reported in the consolidated financial statements. Income taxes consist of taxes currently due plus deferred taxes related primarily

**Note 1 - Summary of Significant Accounting Policies (Continued)**  
**Income Taxes – (Continued)**

to temporary differences between the financial reporting and income tax basis of available for sale securities, the allowance for loan losses, premises and equipment, and prepaid and accrued employee benefits. The deferred tax assets and liabilities represent the future tax return consequences of the temporary differences, which will either be taxable or deductible when the assets and liabilities are recovered or settled. Deferred tax assets and liabilities are reflected at income tax rates applicable to the period in which the deferred tax assets and liabilities are expected to be realized or settled. As changes in tax laws or rates are enacted, deferred tax assets and liabilities are adjusted through the provision for income taxes. The Company recognizes interest and penalties accrued on any unrecognized tax benefits as a component of income tax expense.

**Transfers of Financial Assets**

Transfers of financial assets are accounted for as sales when control over the assets has been surrendered. Control over transferred assets is deemed to be surrendered when (1) the assets have been isolated from the Company, (2) 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 (3) the Company does not maintain effective control over the transferred assets through an agreement to repurchase them before their maturity.

**Earnings Per Share**

Basic earnings per share represents income available to common shareholders divided by the weighted-average number of common shares outstanding during the period. Diluted earnings per share reflects additional common shares that would have been outstanding if dilutive potential common shares had been issued. Treasury shares are not deemed outstanding for earnings per share calculations. See Note 12 for earnings per share calculations.

**Comprehensive Income**

Accounting principles generally require that recognized revenue, expenses, gains and losses be included in net income. Although certain changes in assets and liabilities are reported as a separate component of the equity section of the balance sheet, such items, along with net income, are components of comprehensive income.

**Statements of Cash Flows**

For the purpose of presentation in the consolidated statements of cash flows, cash and cash equivalents are defined as the sum of cash and due from banks, federal funds sold, and interest-bearing deposits in banks with an original maturity of less than three months.

**Off-Balance-Sheet Financial Instruments**

In the ordinary course of business, the Bank has entered into off-balance-sheet financial instruments consisting of commitments to extend credit and standby letters of credit. Such financial instruments are recorded in the consolidated financial statements when they are funded or related fees are incurred or received.

**Note 1 - Summary of Significant Accounting Policies (Continued)**

**Segment Reporting**

The Company has evaluated the activities relating to its strategic business units, and determined that these strategic business units are similar in nature, and managed accordingly. The strategic business units are not reviewed separately to make operating decisions or assess performance. Therefore, the Company has determined it has no reportable segments.

**Recently Issued Accounting Pronouncements**

On January 1, 2018, Lyons Bancorp, Inc. adopted Accounting Standard Update (“ASU”) 2014-09 amending guidance on “Revenue from Contracts with Customers (Topic 606)”. The objective of the ASU is to align the recognition of revenue with the transfer of promised goods or services provided to customers in an amount that reflects the consideration which the entity expects to be entitled in exchange for those goods or services. This ASU replaces most existing revenue recognition guidance under GAAP. A significant amount of the Company’s revenues are derived from net interest income on financial assets and liabilities, which are excluded from the scope of the amended guidance. With respect to noninterest income, the Company has identified revenue streams within the scope of the guidance, which include service charges on deposits, cardholder fees, financial services fees and loan servicing fees and realized gain on sale of loans. Further details regarding the revenue recognition of these revenue streams is provided in Note 18 to these Consolidated Financial Statements.

On January 1, 2018, Lyons Bancorp, Inc. adopted ASU 2016-01 amending guidance on “Financial Instruments (Subtopic 825-10)”. This amendment addresses certain aspects of recognition, measurement, presentation, and disclosure of financial instruments. These amendments require equity securities to be measured at fair value with changes in the fair value to be recognized through net income. The amendments also simplify the impairment assessment of equity investments without readily determinable fair values by requiring assessment for impairment qualitatively at each reporting period. As of December 31, 2017, the Company had a small equity investment with a fair value of \$157,000. In 2018, the Company recorded a cumulative-effect adjustment to increase retained earnings in the amount of \$130,000 representing the unrealized gain, net of tax, on these equity securities. Changes in fair value during the year ended December 31, 2018 have been recognized in net income. ASU 2016-01 also emphasized the existing requirement to use exit prices to measure fair value for disclosure purposes and clarifies that entities not make use of a practicability exception in determining the fair value of loans. Accordingly, we refined the calculation used to determine the disclosed fair value of our loans as part of adopting this standard. See Note 17 Fair Value Measurements and Fair Value of Financial Instruments for further information.

On January 1, 2018, Lyons Bancorp, Inc. adopted ASU 2017-07 amending guidance on “Compensation - Retirement Benefits (Topic 715)” to improve the presentation of net periodic pension cost and net periodic postretirement benefit cost. ASU 2017-07 requires that an employer report the service cost component in the same line item or items as other compensation costs arising from services rendered by the pertinent employees during the period. The other components of net benefit cost are required to be presented in the income statement separately from the service cost component and outside a subtotal of income from operations, if one is presented. If a separate line item or items are used to present the other components of net benefit cost, that line item or items must be appropriately described. If a separate line item or items are not used, the line item or items used in the income statement to present

**Note 1 - Summary of Significant Accounting Policies (Continued)**  
**Recently Issued Accounting Pronouncements – (Continued)**

the other components of net benefit cost must be disclosed. Prior to adoption of this update, the Company presented all components of net periodic pension cost in “pension and benefits expense” on its income statement. The Company is continuing to present all components of net period pension cost in “pension and benefits expense” for the year ended December 31, 2018 and 2017. Further details regarding the Company’s net periodic pension cost are provided in Note 11 to these Unaudited Consolidated Financial Statements.

On January 1, 2018, Lyons Bancorp, Inc. adopted Accounting Standard Update ASU 2014-14, a guidance on “Receivables – Troubled Debt Restructurings by Creditors (Subtopic 310-40)”. The objective of the ASU is to reduce the diversity in how creditors classify government-guaranteed mortgage loans, including FHA or VA guaranteed loans, upon foreclosure, to provide more decision-useful information about a creditor’s foreclosed mortgage loans that are expected to be recovered, at least in part, through government guarantees. The adoption of this guidance had no impact on our consolidated results of operations or financial position.

On January 1, 2018, Lyons Bancorp, Inc. adopted Accounting Standard Update ASU 2016-15 which clarifies how certain cash receipts and cash payments are presented and classified in the statement of cash flows. The amendments are intended to reduce diversity in practice. The amendment covers the following cash flows: Cash payments for debt prepayment or extinguishment costs will be classified in financing activities. Upon settlement of zero-coupon bonds and bonds with insignificant cash coupons, the portion of the payment attributable to imputed interest will be classified as an operating activity, while the portion of the payment attributable to principal will be classified as a financing activity. Cash paid by an acquirer that isn’t soon after a business combination for the settlement of a contingent consideration liability will be separated between financing activities and operating activities. Cash payments up to the amount of the contingent consideration liability recognized at the acquisition date will be classified in financing activities; any excess will be classified in operating activities. Cash paid soon after the business combination will be classified in investing activities. Cash proceeds received from the settlement of insurance claims will be classified on the basis of the related insurance coverage (that is, the nature of the loss). Cash proceeds from lump-sum settlements will be classified based on the nature of each loss included in the settlement. Cash proceeds received from the settlement of corporate-owned life insurance (COLI) and bank-owned life insurance (BOLI) policies will be classified as cash inflows from investing activities. Cash payments for premiums on COLI and BOLI may be classified as cash outflows for investing, operating, or a combination of both. A transferor’s beneficial interest obtained in a securitization of financial assets will be disclosed as a noncash activity, and cash received from beneficial interests will be classified in investing activities. Distributions received from equity method investees will be classified using either a cumulative earnings approach or a look-through approach as an accounting policy election. The ASU contains additional guidance clarifying when an entity should separate cash receipts and cash payments and classify them into more than one class of cash flows (including when reasonable judgment is required to estimate and allocate cash flows) versus when an entity should classify the aggregate amount into one class of cash flows on the basis of predominance. The adoption of this guidance had no impact on our consolidated results of operations or financial position.

On January 1, 2018, Lyons Bancorp, Inc. adopted Accounting Standard Update ASU 2016-18, a guidance on “Statement of Cash Flows (Topic 230) Restricted Cash” addresses diversity in practice

**Note 1 - Summary of Significant Accounting Policies (Continued)**  
**Recently Issued Accounting Pronouncements – (Continued)**

from entities classifying and presenting transfers between cash and restricted cash as operating, investing or financing activities or as a combination of those activities in the statement of cash flows. The ASU requires entities to show the changes in the total cash, cash equivalents, restricted cash and restricted cash equivalents in the Statement of Cash Flows. As a result, transfers between such categories will no longer be presented in the Statement of Cash Flows. The adoption of this guidance had no impact on our consolidated results of operations or financial position.

On January 1, 2018, Lyons Bancorp, Inc. adopted Accounting Standard Update (ASU 2017-09) a guidance on “Compensation - Stock Compensation (Topic 718)” such that an entity must apply modification accounting to changes in the terms or conditions of a share-based payment award unless all of the following criteria are met: (1) The fair value of the modified award is the same as the fair value of the original award immediately before the modification. The standard indicates that if the modification does not affect any of the inputs to the valuation technique used to value the award, the entity is not required to estimate the value immediately before and after the modification. (2) The vesting conditions of the modified award are the same as the vesting conditions of the original award immediately before the modification. (3) The classification of the modified award as an equity instrument or a liability instrument is the same as the classification of the original award immediately before the modification. The adoption of this guidance had no impact on our consolidated results of operations or financial position.

In February 2016, the FASB issued an Update (ASU 2016-02) to its guidance on “Leases (Topic 842)”. The new leases standard applies a right-of-use (ROU) model that requires a lessee to record, for all leases with a lease term of more than 12 months, an asset representing its right to use the underlying asset and a liability to make lease payments. For leases with a term of 12 months or less, a practical expedient is available whereby a lessee may elect, by class of underlying asset, not to recognize an ROU asset or lease liability. The new leases standard requires a lessor to classify leases as either sales-type, direct financing or operating, similar to existing U.S. GAAP. Classification depends on the same five criteria used by lessees plus certain additional factors. The subsequent accounting treatment for all three lease types is substantially equivalent to existing U.S. GAAP for sales-type leases, direct financing leases, and operating leases. However, the new standard updates certain aspects of the lessor accounting model to align it with the new lessee accounting model, as well as with the new revenue standard under Topic 606. Lessees and lessors are required to provide certain qualitative and quantitative disclosures to enable users of financial statements to assess the amount, timing, and uncertainty of cash flows arising from leases. The amendments are effective for public business entities for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. Early adoption is permitted. The adoption of this ASU will result in a gross up of the Consolidated Balance Sheets for right-of-use assets and associated lease liabilities for operating leases in which the Company is the lessee. In July 2018, the FASB issued ASU No. 2018-10, Codification Improvements to Topic 842 - Leases to address certain narrow aspects of the guidance issued in ASU No. 2016-02.

In July 2018, the FASB issued ASU No. 2018-11, Leases (Topic 842): Targeted Improvements, which amends FASB (ASC), Topic 842, to (1) add an optional transition method that would permit entities to apply the new requirements by recognizing a cumulative-effect adjustment to the opening balance of retained earnings in the year of adoption, and (2) provide a practical expedient for lessors regarding the

**Note 1 - Summary of Significant Accounting Policies (Continued)**  
**Recently Issued Accounting Pronouncements – (Continued)**

separation of the lease and non-lease components of a contract. In December 2018, the FASB issued ASU No. 2018-20, Narrow-Scope Improvements for Lessors, which addresses issues related to (1) sales tax and similar taxes collected from lessees, (2) certain lessor costs, and (3) recognition of variable payments for contracts with lease and non-lease components. The Company is evaluating the significance and other effects of adoption on the consolidated financial statements and related disclosures. The adoption of this guidance is not expected to have a material impact on our consolidated results of operations. Branch building leases have been reviewed and are considered immaterial to the consolidated financial statements; there are no equipment leases to consider.

In June 2016, the FASB issued an Update (ASU 2016-13) to its guidance on “Financial Instruments – Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments”. ASU 2016-13 requires credit losses on most financial assets measured at amortized cost and certain other instruments to be measured using an expected credit loss model (referred to as the current expected credit loss (CECL) model). Under this model, entities will estimate credit losses over the entire contractual term of the instrument (considering estimated prepayments, but not expected extensions or modifications unless reasonable expectation of a troubled debt restructuring exists) from the date of initial recognition of that instrument. The ASU also replaces the current accounting model for purchased credit impaired loans and debt securities. The allowance for credit losses for purchased financial assets with a more-than insignificant amount of credit deterioration since origination (“PCD assets”), should be determined in a similar manner to other financial assets measured on an amortized cost basis. However, upon initial recognition, the allowance for credit losses is added to the purchase price (“gross up approach”) to determine the initial amortized cost basis. The subsequent accounting for PCD financial assets is the same expected loss model described above. Further, the ASU made certain targeted amendments to the existing impairment model for available-for-sale (AFS) debt securities. For an AFS debt security for which there is neither the intent nor a more-likely-than-not requirement to sell, an entity will record credit losses as an allowance rather than a write-down of the amortized cost basis. For public business entities that are U.S. Securities and Exchange Commission (SEC) filers, the amendments in this Update are effective for fiscal years beginning after December 15, 2019, including interim periods within those fiscal years. All entities may adopt the amendments in this Update earlier as of the fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. An entity will apply the amendments in this Update through a cumulative-effect adjustment to retained earnings as of the beginning of the first reporting period in which the guidance is effective (that is, a modified-retrospective approach). In November 2018, the FASB issued ASU 2018-19, Codification Improvements to Topic 326, Financial Instruments-Credit Losses, which aligns the implementation date for nonpublic entities’ annual financial statements with the implementation date for their interim financial statements and clarifies the scope of the guidance in the amendments in ASU 2016-13. The Company is currently evaluating the potential impact on our consolidated results of operations or financial position. The initial adjustment will not be reported in earnings and therefore will not have any material impact on our consolidated results of operations, but it is expected that it will have an impact on our consolidated financial position at the date of adoption of this Update. At this time, we have not calculated the estimated impact that this Update will have on our Allowance for Loan Losses, however, we anticipate it will have a minimal impact on the methodology process we utilize to calculate the allowance. A vendor has been selected and alternative methodologies are currently being considered. Data requirements and integrity are being reviewed and enhancements incorporated into

**Note 1 - Summary of Significant Accounting Policies (Continued)**

**Recently Issued Accounting Pronouncements – (Continued)**

standard processes. The Company is in the early stages of evaluation and implementation of the guidance.

In March 2017, the FASB issued an Update (ASU 2017-08) to its guidance on “Receivables – Nonrefundable Fees and Other Costs (Subtopic 310-20) related to premium amortization on purchased callable debt securities. The amendments in this Update shorten the amortization period for certain callable debt securities held at a premium. Specifically, the amendments require the premium to be amortized to the earliest call date. The amendments do not require an accounting change for securities held at a discount; the discount continues to be amortized to maturity. For public business entities, the amendments in this Update are effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2018. Early adoption is permitted, including adoption in an interim period. If an entity early adopts the amendments in an interim period, any adjustments should be reflected as of the beginning of the fiscal year that includes that interim period. An entity should apply the amendments in this Update on a modified retrospective basis through a cumulative-effect adjustment directly to retained earnings as of the beginning of the period of adoption. Additionally, in the period of adoption, an entity should provide disclosure about a change in accounting principle. The adoption of this guidance is not expected to have a material impact on our consolidated results of operations or financial position.

In August 2018, the FASB issued an Update (ASU 2018-13) to its guidance on “Fair Value Measurement (Topic 820)”. This update modifies the disclosure requirements on fair value measurements. The following disclosure requirements were removed from Topic 820: (1) the amount of and reasons for transfers between Level 1 and Level 2 of the fair value hierarchy; (2) the policy for timing of transfers between levels; (3) the valuation processes for Level 3 fair value measurements; and (4) for nonpublic entities, the changes in unrealized gains and losses for the period included in earnings for recurring Level 3 fair value measurements held at the end of the reporting period. The following disclosure requirements were modified in Topic 820: (1) in lieu of a rollforward for Level 3 fair value measurements, a nonpublic entity is required to disclose transfers into and out of Level 3 of the fair value hierarchy and purchases and issues of Level 3 assets and liabilities; (2) for investments in certain entities that calculate net asset value, an entity is required to disclose the timing of liquidation of an investee’s assets and the date when restrictions from redemption might lapse only if the investee has communicated the timing to the entity or announced the timing publicly; and (3) the amendments clarify that the measurement uncertainty disclosure is to communicate information about the uncertainty in measurement as of the reporting date. The following disclosure requirements were added to Topic 820; however, the disclosures are not required for nonpublic entities: (1) the changes in unrealized gains and losses for the period included in other comprehensive income for recurring Level 3 fair value measurements held at the end of the reporting period; and (2) the range and weighted average of significant unobservable inputs used to develop Level 3 fair value measurements. For certain unobservable inputs, an entity may disclose other quantitative information (such as the median or arithmetic average) in lieu of the weighted average if the entity determines that other quantitative information would be a more reasonable and rational method to reflect the distribution of unobservable inputs used to develop Level 3 fair value measurements. In addition, the amendments eliminate at a minimum from the phrase “an entity shall disclose at a minimum” to promote the appropriate exercise of discretion by entities when considering fair value measurement disclosures and to clarify that materiality is an appropriate consideration of entities and their auditors when evaluating disclosure

**Note 1 - Summary of Significant Accounting Policies (Continued)**  
**Recently Issued Accounting Pronouncements – (Continued)**

requirements. The amendments in ASU No. 2018-13 are effective for all entities for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2019. The amendments on changes in unrealized gains and losses, the range and weighted average of significant unobservable inputs used to develop Level 3 fair value measurements, and the narrative description of measurement uncertainty should be applied prospectively for only the most recent interim or annual period presented in the initial fiscal year of adoption. All other amendments should be applied retrospectively to all periods presented upon their effective date. Early adoption is permitted. An entity is permitted to early adopt any removed or modified disclosures upon issuance of ASU No. 2018-13 and delay adoption of the additional disclosures until their effective date. The adoption of this guidance is not expected to have a material impact on our consolidated results of operations or financial position.

In August 2018, the FASB has issued an Update (ASU No. 2018-14), “Compensation—Retirement Benefits—Defined Benefit Plans—General (Subtopic 715-20): Disclosure Framework—Changes to the Disclosure Requirements for Defined Benefit Plans”, that applies to all employers that sponsor defined benefit pension or other postretirement plans. The amendments modify the disclosure requirements for employers that sponsor defined benefit pension or other postretirement plans. The following disclosure requirements were removed from Subtopic 715-20: (1) the amounts in accumulated other comprehensive income expected to be recognized as components of net periodic benefit cost over the next fiscal year; (2) the amount and timing of plan assets expected to be returned to the employer; (3) the disclosures related to the June 2001 amendments to the Japanese Welfare Pension Insurance Law; related party disclosures about the amount of future annual benefits covered by insurance and annuity contracts and significant transactions between the employer or related parties and the plan; (4) for nonpublic entities, the reconciliation of the opening balances to the closing balances of plan assets measured on a recurring basis in Level 3 of the fair value hierarchy. However, nonpublic entities will be required to disclose separately the amounts of transfers into and out of Level 3 of the fair value hierarchy and purchases of Level 3 plan assets; and (5) for public entities, the effects of a one-percentage-point change in assumed health care cost trend rates on the (a) aggregate of the service and interest cost components of net periodic benefit costs and (b) benefit obligation for postretirement health care benefits. The following disclosure requirements were added to Subtopic 715-20: (1) the weighted-average interest crediting rates for cash balance plans and other plans with promised interest crediting rates; and (2) an explanation of the reasons for significant gains and losses related to changes in the benefit obligation for the period. The amendments also clarify the disclosure requirements in paragraph 715-20-50-3, which state that the following information for defined benefit pension plans should be disclosed: (1) the projected benefit obligation (PBO) and fair value of plan assets for plans with PBOs in excess of plan assets; and (2) the accumulated benefit obligation (ABO) and fair value of plan assets for plans with ABOs in excess of plan assets. ASU No. 2018-14 is effective for fiscal years ending after December 15, 2020, for public business entities and for fiscal years ending after December 15, 2021, for all other entities. Early adoption is permitted for all entities. The adoption of this guidance is not expected to have a material impact on our consolidated results of operations or financial position.

# Lyons Bancorp, Inc.

## Notes to Consolidated Financial Statements

December 31, 2018 and 2017

### Note 2 - Restrictions on Cash and Due from Banks

The Bank is required to maintain reserve funds in cash and/or on deposit with the Federal Reserve Bank. The required reserve at December 31, 2018 and 2017 was \$18.9 million and \$18.5 million, respectively.

### Note 3 - Investments

The amortized cost and fair value of investment securities, with gross unrealized gains and losses, are as follows at December 31, 2018 and 2017:

(In thousands)	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
<b>December 31, 2018:</b>				
<b>Available for Sale:</b>				
United States agencies	\$ 43,413	\$ 5	\$ (1,432)	\$ 41,986
State and local governments	68,713	161	(388)	68,486
Corporate	2,000	-	-	2,000
Mortgage-backed securities	75,923	10	(3,740)	72,193
Total Available for Sale	<u>\$ 190,049</u>	<u>\$ 176</u>	<u>\$ (5,560)</u>	<u>\$ 184,665</u>
<b>Restricted Equity Securities</b>	<u>\$ 7,254</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 7,254</u>
<b>December 31, 2017:</b>				
<b>Available for Sale:</b>				
United States agencies	\$ 43,473	\$ 20	\$ (1,201)	\$ 42,292
State and local governments	76,527	390	(253)	76,664
Corporate	2,000	-	-	2,000
Mortgage-backed securities	87,545	88	(2,247)	85,386
Total Available for Sale	<u>\$ 209,545</u>	<u>\$ 498</u>	<u>\$ (3,701)</u>	<u>\$ 206,342</u>
<b>Restricted Equity Securities</b>	<u>\$ 7,223</u>	<u>\$ 117</u>	<u>\$ -</u>	<u>\$ 7,340</u>

All of the above mortgage-backed securities are residential direct pass through securities or collateralized mortgage obligations issued or backed by U.S. government sponsored enterprises (GSEs). Restricted equity securities primarily include non-marketable Federal Home Loan Bank New York (FHLB NY) stock and non-marketable Federal Reserve Bank (FRB) stock, both of which are required to be held for regulatory purposes and for borrowing availability. The required investment in FHLB NY stock is tied to both the Company's borrowing levels with the FHLB and commitments to sell residential mortgage loans to the FHLB. Holdings of FHLB NY stock and FRB stock totaled \$6.1 million and \$648,000 at December 31, 2018, respectively, and \$6.2 million and \$648,000 at December 31, 2017, respectively. These securities are carried at par, which is also cost. The Company has an investment in Federal Agricultural Mortgage Corp (Farmer Mac) class A stock totaling \$121,000 and \$157,000 at December 31, 2018 and 2017, respectively,

# Lyons Bancorp, Inc.

## Notes to Consolidated Financial Statements

December 31, 2018 and 2017

### Note 3 – Investments (Continued)

in order to participate in certain lending activities with Farmer Mac. The stock is actively traded on the NYSE, pays a dividend, and is reflective of current market value. Restricted equity securities also include miscellaneous investments carried at par, which is also cost.

Restricted equity securities are held as a long-term investment and value is determined based on the ultimate recoverability of the par value. Impairment of these investments is evaluated quarterly and is a matter of judgment that reflects management's view of the issuer's long-term performance, which includes factors such as the following: its operating performance; the severity and duration of declines in the fair value of its net assets related to its capital stock amount; its commitment to make payments required by law or regulation and the level of such payments in relation to its operating performance; and its liquidity and funding position. After evaluating these considerations, the Company concluded that the par value of these investments will be recovered and, as such, has not recognized any impairment on its holdings of restricted equity securities during the current year.

The following table sets forth the Company's investment in securities with unrealized losses of less than twelve months and unrealized losses of twelve months or more at December 31:

	Less than 12 Months		12 Months or More		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
(In thousands)						
<b>December 31, 2018:</b>						
United States agencies	\$ -	\$ -	\$ 41,514	\$ (1,432)	\$ 41,514	\$ (1,432)
State and local governments	17,771	(63)	18,329	(325)	36,100	(388)
Mortgage-backed securities	2,331	(30)	64,180	(3,710)	66,511	(3,740)
	<u>\$ 20,102</u>	<u>\$ (93)</u>	<u>\$ 124,023</u>	<u>\$ ( 5,467)</u>	<u>\$ 144,125</u>	<u>\$ ( 5,560)</u>

	Less than 12 Months		12 Months or More		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
(In thousands)						
<b>December 31, 2017:</b>						
United States agencies	\$ 15,746	\$ (242)	\$ 28,539	\$ (959)	\$ 44,285	\$ (1,201)
State and local governments	26,431	(139)	4,370	(114)	30,801	(253)
Mortgage-backed securities	28,280	(772)	44,486	(1,475)	72,766	(2,247)
	<u>\$ 70,457</u>	<u>\$ (1,153)</u>	<u>\$ 77,395</u>	<u>\$ ( 2,548)</u>	<u>\$ 147,852</u>	<u>\$ ( 3,701)</u>

On a quarterly basis, the Company performs an assessment to determine whether there have been any events or economic circumstances indicating that a security with an unrealized loss has suffered other-than-temporary impairment. Consideration is given to (1) the length of time and the extent to which the fair value has been less than the amortized cost basis, (2) the financial condition of the issuer (and guarantor, if

# Lyons Bancorp, Inc.

## Notes to Consolidated Financial Statements

December 31, 2018 and 2017

### Note 3 – Investments (Continued)

any) and adverse conditions specifically related to the security, industry or geographic area, (3) failure of the issuer of the security to make scheduled interest or principal payments, (4) any changes to the rating of a security by a rating agency, (5) the presence of credit enhancements, if any, including the guarantee of the federal government or any of its agencies, (6) whether the Company intends to sell or more likely than not be required to sell the debt security, and (7) if the present value of the expected cash flow is not sufficient to recover the entire amortized cost.

There were one hundred sixty-five securities with unrealized losses at December 31, 2018, 64 securities with a value of \$20 million were less than 12 months and 101 securities with a value of \$129 million were greater than 12 months. On December 31, 2017 there were one hundred thirty-nine securities with unrealized losses. Substantially all of the unrealized losses on the Company's securities were caused by market interest rate changes from those in effect when the securities were purchased by the Company. The contractual terms of these securities do not permit the issuer to settle the securities at a price less than par value. Except for certain state and local government obligations, all securities rated by an independent rating agency carry an investment grade rating. Financial information relating to unrated state and government obligations is reviewed for indications of adverse conditions that may indicate other-than-temporary impairment. The Company did not consider these investment securities to be other than temporarily impaired at December 31, 2018 and 2017.

The amortized cost and fair value of debt securities at December 31, 2018, by contractual maturity, are shown below. Expected maturities may differ from contractual maturities because borrowers may have the right to call or prepay obligations without call or prepayment penalties.

(In thousands)

	Available for Sale	
	Amortized Cost	Fair Value
Due in one year or less	\$ 27,353	\$ 27,223
Due after one year through five years	52,975	52,510
Due after five years through ten years	29,714	28,511
Due after ten years	3,772	3,761
Securities not due at a single maturity date	76,235	72,660
	<u>\$ 190,049</u>	<u>\$ 184,665</u>

During 2018, the Company sold \$4.3 million available for sale, while in 2017 the Company sold \$3.5 million of held to maturity securities. Gross loss on the sale of investments in 2018 was \$35,000. Gross loss on the sale of investment securities in 2017 was \$17,000. Investment securities with carrying amounts of \$106.9 million and \$141.8 million at December 31, 2018 and 2017, respectively, were pledged to secure deposits as required or permitted by law.

# Lyons Bancorp, Inc.

## Notes to Consolidated Financial Statements

December 31, 2018 and 2017

### Note 4 – Loans

Loans consist of the following at December 31, 2018 and 2017:

	<u>2018</u>	<u>2017</u>
	(In thousands)	
Real estate:		
Residential:		
1-4 family	\$ 211,499	\$ 202,150
Home equity	122,267	115,791
Commercial	203,890	172,381
Agriculture	<u>66,715</u>	<u>54,792</u>
Total mortgage loans on real estate	<u>604,371</u>	545,114
Commercial loans	127,471	120,637
Agriculture loans	46,245	44,824
Consumer installment loans:		
Direct	21,756	21,490
Indirect	<u>10,293</u>	<u>9,795</u>
Total consumer installment loans	<u>32,049</u>	<u>31,285</u>
Total loans	<u>\$ 810,136</u>	<u>\$ 741,860</u>

Net unamortized loan origination costs totaled \$2.0 million and \$1.9 million at December 31, 2018 and 2017, respectively and are included with their related loan class.

The Company has transferred a portion of its originated commercial, commercial real estate, agriculture and agriculture real estate loans to participating lenders. The amounts transferred have been accounted for as sales and are therefore not included in the Company's accompanying consolidated balance sheets. The Company and participating lenders share ratably in cash flows and any gains or losses that may result from a borrower's lack of compliance with contractual terms of the loan. The Company continues to service the loans on behalf of the participating lenders and, as such, collects cash payments from the borrowers, remits payments (net of servicing fees) to participating lenders and disburses required escrow funds to relevant parties. At December 31, 2018 and 2017, the Company was servicing loans for participants aggregating \$14.7 million and \$16.0 million, respectively.

Loans are considered past due if the required principal and interest payments have not been received as of the date such payments are due. Generally, loans are placed on nonaccrual status if principal or interest payments become 90 days or more past due and/or management deems the collectability of the principal and/or interest to be in question, as well as when required by regulatory requirements.

# Lyons Bancorp, Inc.

## Notes to Consolidated Financial Statements

December 31, 2018 and 2017

### Note 4 – Loans (Continued)

The following table presents past due loans by classes of the loan portfolio at December 31, 2018 and 2017:

(In thousands)	<u>Current</u>	<u>30-89 Days Past Due</u>	<u>90 Days and Greater</u>	<u>Total Loans</u>	<u>Loans on Nonaccrual</u>
<b>December 31, 2018:</b>					
Commercial loans	\$ 126,423	\$ 345	\$ 703	\$ 127,471	\$ 879
Commercial real estate	203,335	398	157	203,890	73
Agriculture loans	45,113	520	612	46,245	1,132
Agriculture real estate	66,278	-	437	66,715	437
Residential real estate:					
1-4 family	209,911	964	624	211,499	624
Home equity	122,177	90	-	122,267	-
Consumer installment loans:					
Direct	21,720	34	2	21,756	17
Indirect	10,113	180	-	10,293	89
<b>Total</b>	<b>\$ 805,070</b>	<b>\$ 2,531</b>	<b>\$ 2,535</b>	<b>\$ 810,136</b>	<b>\$ 3,251</b>

(In thousands)	<u>Current</u>	<u>30-89 Days Past Due</u>	<u>90 Days and Greater</u>	<u>Total Loans</u>	<u>Loans on Nonaccrual</u>
<b>December 31, 2017:</b>					
Commercial loans	\$ 118,772	\$ 185	\$ 1,680	\$ 120,637	\$ 1,242
Commercial real estate	171,949	45	387	172,381	368
Agriculture loans	44,590	234	-	44,824	-
Agriculture real estate	54,348	444	-	54,792	-
Residential real estate:					
1-4 family	201,922	177	51	202,150	202
Home equity	115,712	79	-	115,791	85
Consumer installment loans:					
Direct	21,357	133	-	21,490	-
Indirect	9,668	127	-	9,795	21
<b>Total</b>	<b>\$ 738,318</b>	<b>\$ 1,424</b>	<b>\$ 2,118</b>	<b>\$ 741,860</b>	<b>\$ 1,918</b>

At December 31, 2018 and 2017, there were no loans that were over 90 days' delinquent and still accruing interest.

# Lyons Bancorp, Inc.

## Notes to Consolidated Financial Statements

December 31, 2018 and 2017

### Note 4 – Loans (Continued)

Activity in the allowance for loan losses for the years ended December 31, 2018 and 2017 follows:

(In thousands)

	Commercial	Commercial Real Estate	Agriculture	Agriculture Real Estate	Residential Real Estate	Consumer	Unallocated	Total
<b>2018</b>								
Beginning balance	\$ 2,875	\$ 1,659	\$ 496	\$ 508	\$ 1,944	\$ 470	\$ 677	\$ 8,629
Provisions for loan losses	486	850	219	91	126	73	288	2,133
Recoveries of loans previously charged off	11	9	-	-	3	56	-	79
Loans charged off	(342)	(244)	-	-	(15)	(205)	-	(806)
Ending balance	<u>\$ 3,030</u>	<u>\$ 2,274</u>	<u>\$ 715</u>	<u>\$ 599</u>	<u>\$ 2,058</u>	<u>\$ 394</u>	<u>\$ 965</u>	<u>\$ 10,035</u>
<b>2017</b>								
Beginning balance	\$ 2,167	\$ 1,762	\$ 465	\$ 464	\$ 1,782	\$ 363	\$ 793	\$ 7,796
Provisions for loan losses	1,152	(25)	31	44	188	226	(116)	1,500
Recoveries of loans previously charged off	17	9	-	-	-	68	-	94
Loans charged off	(461)	(87)	-	-	(26)	(187)	-	(761)
Ending balance	<u>\$ 2,875</u>	<u>\$ 1,659</u>	<u>\$ 496</u>	<u>\$ 508</u>	<u>\$ 1,944</u>	<u>\$ 470</u>	<u>\$ 677</u>	<u>\$ 8,629</u>

The allocation of the allowance for loan losses by loan class is as follows at December 31, 2018 and 2017:

(In thousands)

<b>December 31, 2018</b>	Commercial	Commercial Real Estate	Agriculture	Agriculture Real Estate	Residential Real Estate	Consumer	Unallocated	Total
Amount of allowance for loan losses on loans individually evaluated for impairment	\$ 1,078	\$ 30	\$ 225	\$ -	\$ -	\$ -	\$ -	\$ 1,333
Amount of allowance for loan losses on loans collectively evaluated for impairment	<u>1,952</u>	<u>2,244</u>	<u>490</u>	<u>599</u>	<u>2,058</u>	<u>394</u>	<u>965</u>	<u>8,702</u>
Total allowance for loan losses	<u>\$ 3,030</u>	<u>\$ 2,274</u>	<u>\$ 715</u>	<u>\$ 599</u>	<u>\$ 2,058</u>	<u>\$ 394</u>	<u>\$ 965</u>	<u>\$10,035</u>
Loans individually evaluated for impairment	\$ 3,236	\$ 73	\$ 1,148	\$ 437	\$ -	\$ -	\$ -	\$ 4,894
Loans collectively evaluated for impairment	<u>124,235</u>	<u>203,817</u>	<u>45,097</u>	<u>66,278</u>	<u>333,766</u>	<u>32,049</u>	<u>-</u>	<u>805,242</u>
Total Loans	<u>\$ 127,471</u>	<u>\$ 203,890</u>	<u>\$ 46,245</u>	<u>\$ 66,715</u>	<u>\$333,766</u>	<u>\$ 32,049</u>	<u>\$ -</u>	<u>\$810,136</u>

# Lyons Bancorp, Inc.

## Notes to Consolidated Financial Statements

December 31, 2018 and 2017

### Note 4 – Loans (Continued)

December 31, 2017	Commercial	Commercial Real Estate	Agriculture	Agriculture Real Estate	Residential Real Estate	Consumer	Unallocated	Total
Amount of allowance for loan losses on loans individually evaluated for impairment	\$ 1,056	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 1,056
Amount of allowance for loan losses on loans collectively evaluated for impairment	1,819	1,659	496	508	1,944	470	677	7,573
Total allowance for loan losses	\$ 2,875	\$ 1,659	\$ 496	\$ 508	\$ 1,944	\$ 470	\$ 677	\$ 8,629
Loans individually evaluated for impairment	\$ 1,242	\$ 368	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 1,610
Loans collectively evaluated for impairment	119,395	172,013	44,824	54,792	317,941	31,285	-	740,250
Total Loans	\$ 120,637	\$ 172,381	\$ 44,824	\$ 54,792	\$ 317,941	\$ 31,285	\$ -	\$ 741,860

Management is committed to early recognition of loan problems and to maintaining an adequate allowance. At least quarterly, management reviews all commercial and commercial real estate loans and leases and agriculturally related loans with an outstanding principal balance of over \$100,000 that are internally risk rated substandard or worse, giving consideration to payment history, debt service payment capacity, collateral support, strength of guarantors, local market trends, industry trends, and other factors relevant to the particular borrowing relationship. Through this process, management identifies impaired loans. For loans considered impaired, estimated exposure amounts are based upon collateral values or present value of expected future cash flows discounted at the original effective interest rate of each loan. For commercial loans, commercial mortgage loans, agricultural mortgages and agricultural loans not specifically reviewed, and for homogenous loan portfolios such as residential mortgage loans and consumer loans, estimated exposure amounts are assigned based upon historical net loss experience and current charge-off trends, past due status, and management's judgment of the effects of current economic conditions on portfolio performance. In determining and assigning historical loss factors to the various homogeneous portfolios, the Company calculates average net losses over a period of time and compares this average to current levels and trends to ensure that the calculated average loss factor is reasonable.

Significant factors that could give rise to changes in these estimates may include, but are not limited to, changes in economic conditions in the local area, concentration of risk, changes in interest rates, and declines in local property values. While management uses available information to recognize losses on loans, future additions to the allowance may be necessary. In addition, various regulatory agencies, as an integral part of their examination process, periodically review the Company's allowance for loan losses. Such agencies may require the Company to recognize additions to the allowance based on their judgments about information available to them at the time of their examination.

# Lyons Bancorp, Inc.

## Notes to Consolidated Financial Statements

December 31, 2018 and 2017

### Note 4 – Loans (Continued)

The above allocation is neither indicative of the specific amounts or the loan categories in which future charge-offs may occur, nor is it an indicator of future loss trends. The allocation of the allowance to each category does not restrict the use of the allowance to absorb losses in any category.

The following table summarizes information regarding impaired loans by loan portfolio class as of December 31, 2018 and 2017:

(In thousands)	<u>Recorded Investment</u>	<u>Unpaid Principal Balance</u>	<u>Related Allowance</u>	<u>Average Recorded Investment</u>	<u>Interest Income Recognized</u>
<b>December 31, 2018</b>					
With no related allowance recorded:					
Commercial loans	\$ -	\$ -	\$ -	\$ -	\$ -
Commercial real estate	-	-	-	-	-
Agricultural loans	-	-	-	-	-
Agricultural real estate	437	437	-	87	-
With an allowance recorded:					
Commercial loans	3,236	3,672	1,078	1,571	-
Commercial real estate	73	74	30	135	-
Agricultural loans	1,148	1,137	225	375	-
Agricultural real estate	-	-	-	-	-
Total	<u>\$ 4,457</u>	<u>\$ 4,883</u>	<u>\$ 1,333</u>	<u>\$ 2,081</u>	<u>\$ -</u>
Summary:					
Commercial	\$ 3,236	\$ 3,672	\$ 1,078	\$ 1,571	\$ -
Commercial real estate	73	74	30	135	-
Agricultural loans	1,148	1,137	225	375	-
Agricultural real estate	437	437	-	87	-
Total	<u>\$ 4,894</u>	<u>\$ 5,320</u>	<u>\$ 1,333</u>	<u>\$ 2,168</u>	<u>\$ -</u>
<b>December 31, 2017</b>					
With no related allowance recorded:					
Commercial loans	\$ -	\$ -	\$ -	\$ -	\$ -
Commercial real estate	368	368	-	27	-
With an allowance recorded:					
Commercial loans	1,242	2,059	1,056	1,197	-
Commercial real estate	-	-	-	-	-
Total	<u>\$ 1,610</u>	<u>\$ 2,427</u>	<u>\$ 1,056</u>	<u>\$ 1,224</u>	<u>\$ -</u>
Summary:					
Commercial	\$ 1,242	\$ 2,059	\$ 1,056	\$ 1,197	\$ -
Commercial real estate	368	368	-	27	-
Total	<u>\$ 1,610</u>	<u>\$ 2,427</u>	<u>\$ 1,056</u>	<u>\$ 1,224</u>	<u>\$ -</u>

# ***Lyons Bancorp, Inc.***

## Notes to Consolidated Financial Statements

December 31, 2018 and 2017

### **Note 4 – Loans (Continued)**

There were no troubled debt restructurings for the years ended December 31, 2018 or 2017.

There were no troubled debt restructurings that defaulted in the first twelve months after restructuring was granted.

#### **Credit Quality**

The Company utilizes a ten grade internal loan rating system for commercial, commercial real estate, agriculture and agriculture real estate loans. Loans that are rated “1” through “6” are considered “pass” rated loans with low to average risk.

Loans rated a “7” are considered “special mention”. These loans have potential weaknesses that deserve management’s close attention. These weaknesses may, if not checked or corrected, weaken the asset or inadequately protect the Company’s position at some future date. Borrowers may be experiencing adverse operating trends, or an ill-proportioned balance sheet. Adverse economic or market conditions may also support a special mention rating. These assets pose elevated risks, but their weakness does not yet justify a substandard classification.

Loans rated an “8” are considered “substandard”. Generally, a loan is considered substandard if it is inadequately protected by the current net worth and paying capacity of the obligors and/or the collateral pledged. Substandard loans have a high probability of payment default or they have other well-defined weaknesses. They require more intensive supervision by Company management. Substandard loans are generally characterized by current or unexpected unprofitable operations, inadequate debt service coverage, inadequate liquidity, or marginal capitalization.

Loans rated a “9” are considered “doubtful”. Loans classified as doubtful have all 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 existing facts, highly questionable and improbable. There were no doubtful loans at December 31, 2018 or 2017.

Loans rated a “10” are considered uncollectible (“loss”) and of such little value that their continuance as loans is not warranted. This classification does not mean that the loan has absolutely no recovery or salvage value, but rather that it is not practical or desirable to defer writing off this basically worthless loan even though partial recovery may be affected in the future. There were no loss loans at December 31, 2018 or 2017.

On an annual basis, or more often if needed, the Company formally reviews the ratings on all commercial, commercial real estate, agriculture and agriculture real estate loans. The Company also annually engages an independent third party to review a significant portion of loans within these classes. Management uses the results of these reviews as part of its annual review process.

The following table presents the classes of the commercial and agriculture loan portfolios summarized by the aggregate pass rating and the criticized and classified ratings of special mention and substandard within the Company’s internal risk rating system as of December 31, 2018 and 2017:

# Lyons Bancorp, Inc.

## Notes to Consolidated Financial Statements

December 31, 2018 and 2017

### Note 4 – Loans (Continued) Credit Quality – continued

(In thousands)

	<u>Commercial</u>	<u>Commercial Real Estate</u>	<u>Agriculture</u>	<u>Agriculture Real Estate</u>	<u>Total</u>
<b>December 31, 2018</b>					
Grade:					
Pass	\$ 122,425	\$ 201,576	\$ 43,763	\$ 62,580	\$ 430,344
Special Mention	1,533	1,581	1,334	3,662	8,110
Substandard	<u>3,513</u>	<u>733</u>	<u>1,148</u>	<u>473</u>	<u>5,867</u>
Total	<u>\$ 127,471</u>	<u>\$ 203,890</u>	<u>\$ 46,245</u>	<u>\$ 66,715</u>	<u>\$ 444,321</u>
<b>December 31, 2017</b>					
Grade:					
Pass	\$ 116,179	\$ 168,682	\$ 43,145	\$ 53,453	\$ 381,459
Special Mention	2,709	2,729	1,631	1,124	8,193
Substandard	<u>1,749</u>	<u>970</u>	<u>48</u>	<u>215</u>	<u>2,982</u>
Total	<u>\$ 120,637</u>	<u>\$ 172,381</u>	<u>\$ 44,824</u>	<u>\$ 54,792</u>	<u>\$ 392,634</u>

Loans within the residential real estate and consumer portfolios do not have an internal loan rating system. Instead, they are monitored for past due status. If a residential real estate or consumer loan becomes 90 days past due, it is placed into nonaccrual status and the accrual of interest is discontinued.

Past due status is based on contractual terms of the loan. In all cases, loans are placed on nonaccrual if collection of principal or interest is considered doubtful.

The following table presents the classes of the residential real estate and consumer loan portfolios summarized by performing or nonaccrual as of December 31, 2018 and 2017:

(In thousands)

	<u>1-4 Family</u>	<u>Home Equity</u>	<u>Consumer - Direct</u>	<u>Consumer - Indirect</u>	<u>Total</u>
<b>December 31, 2018</b>					
Performing	\$ 210,875	\$ 122,267	\$ 21,739	\$ 10,204	\$ 365,085
Nonaccrual	<u>624</u>	<u>-</u>	<u>17</u>	<u>89</u>	<u>730</u>
Total	<u>\$211,499</u>	<u>\$ 122,267</u>	<u>\$ 21,756</u>	<u>\$ 10,293</u>	<u>\$ 365,815</u>

# Lyons Bancorp, Inc.

## Notes to Consolidated Financial Statements

December 31, 2018 and 2017

### Note 4 – Loans (Continued) Credit Quality – continued

#### December 31, 2017

Performing	\$ 201,948	\$ 115,706	\$ 21,490	\$ 9,774	\$ 348,918
Nonaccrual	<u>202</u>	<u>85</u>	<u>-</u>	<u>21</u>	<u>308</u>
Total	<u>\$202,150</u>	<u>\$ 115,791</u>	<u>\$ 21,490</u>	<u>\$ 9,795</u>	<u>\$ 349,226</u>

### Note 5 - Land, Premises and Equipment

Land, premises and equipment, net consist of the following at December 31, 2018 and 2017:

	<u>2018</u>	<u>2017</u>
	(In thousands)	
Land	\$ 5,230	\$ 5,230
Buildings	18,932	15,109
Furniture and equipment	7,840	6,763
Leasehold improvements	3,055	3,055
Construction in progress	<u>-</u>	<u>2,825</u>
	35,057	32,982
Less: Accumulated depreciation	<u>(10,921)</u>	<u>(9,703)</u>
	<u>\$ 24,136</u>	<u>\$ 23,279</u>

Depreciation and amortization expense in 2018 and 2017 are included in noninterest expense as follows:

	<u>2018</u>	<u>2017</u>
	(In thousands)	
Buildings	\$ 465	\$ 388
Furniture and equipment	605	568
Leasehold improvements	<u>148</u>	<u>143</u>
	<u>\$ 1,218</u>	<u>\$ 1,099</u>

# ***Lyons Bancorp, Inc.***

## Notes to Consolidated Financial Statements

December 31, 2018 and 2017

### **Note 5 - Land, Premises and Equipment (Continued)**

At December 31, 2018, the Bank leased five of its branch facilities, as well as its operations facility under non-cancelable operating leases. Future minimum rental payments under these leases are as follows:

Years Ending December 31,	(In thousands)
2019	\$ 333
2020	244
2021	182
2022	162
2023	152
Thereafter	1,016
	<u>\$ 2,089</u>

Rent expense under the operating leases totaled \$344,000 and \$332,000 in 2018 and 2017, respectively.

At December 31, 2018, the Bank leased out space under non-cancelable operating leases. Future minimum rental payments to be received by the Company under these leases are as follows:

Years Ending December 31,	(In thousands)
2019	\$ 77
2020	79
2021	81
2022	14
2023	-
Thereafter	-
	<u>\$ 251</u>

Rent income under the operating leases totaled \$90,000 and \$89,000 in 2018 and 2017, respectively.

# Lyons Bancorp, Inc.

## Notes to Consolidated Financial Statements

December 31, 2018 and 2017

### Note 6 - Deposits

Certificates of deposit in denominations of \$250,000 and over were \$70.2 million and \$63.3 million at December 31, 2018 and 2017, respectively.

At December 31, 2018, scheduled maturities of time deposits are as follows:

Years Ending December 31,	(In thousands)
2019	\$ 166,532
2020	52,495
2021	2,951
2022	914
2023	1,801
	<u>\$ 224,693</u>

Included within certificates of deposits in December 31, 2018 and 2017 were \$11.1 million and \$9.6 million in brokered certificates of deposits.

### Note 7 - Borrowings

Borrowings consist of overnight advances and amortizing borrowings. At December 31, 2018 and 2017, there were \$42 million and \$50 million in overnight advances outstanding, respectively. The table below details additional information related to overnight advances for the years ended December 31, 2018 and 2017:

	<u>2018</u>	<u>2017</u>
	(Dollars in thousands)	
Average outstanding balance	\$ 17,661	\$ 13,966
Interest expense	\$ 377	\$ 186
Weighted average interest rate during the year	2.14%	1.34%
Weighted average interest rate at end of year	2.60%	1.53%

There was not any long term debt at December 31, 2018 and 2017.

As a member of the FHLB, the Bank can use certain unencumbered mortgage-related assets to secure borrowings from the FHLB. At December 31, 2018, total unencumbered mortgage-related loans were \$91.2 million. Additional assets may also qualify as collateral for FHLB advances.

The Company, through the Bank, can use certain unencumbered collateral to secure borrowings at the Federal Reserve Bank. At December 31, 2018, total unencumbered collateral in the form of home equity loans and other consumer loans was \$38.9 million.

**Note 7 – Borrowings (Continued)**

The Company, through the Bank, had available unsecured line of credit agreements with correspondent banks permitting borrowings to a maximum of \$30.0 million at December 31, 2018 and \$17.0 million at December 31, 2017. There were no outstanding advances against those lines at December 31, 2018 or 2017.

From time to time, the Bank enters into interest rate swap contracts with counterparties for the purpose of limiting the interest rate risk related to variable rate funding costs for overnight advances used to fund long-term fixed rate assets, including loans made to certain of the Bank's customers.

In May 2018, the Bank entered into an interest rate swap agreement with a counterparty under which the Bank pays a fixed rate of 2.765% and receives a variable rate (which resets quarterly) equal to 3-month LIBOR Flat. The derivative and hedging accounting guidance requires the Bank recognize all derivative instruments as either assets or liabilities at fair value in the consolidated balance sheets. In accordance with this guidance, the Bank designates this interest rate swap as a cash flow hedge. If certain hedging criteria specified in derivatives and hedge accounting guidance are met, including testing for hedge effectiveness, hedge accounting may be applied. The hedge effectiveness assessment methodologies for similar hedges are performed in a similar manner and are used consistently throughout the hedging relationships. The Bank determined that the entire amount of the interest rate swap contract described above was an effective cash flow hedging instrument.

The agreement has a notional amount of \$10,000,000. This interest rate swap is scheduled to mature on May 14, 2020. The fair value of the interest rate swap contract at December 31, 2018 was not material and therefore no asset or liability is recorded in the consolidated balance sheet at December 31, 2018.

**Note 8 - Junior Subordinated Debentures**

On June 27, 2003, the Company issued \$1.035 million in junior subordinated debentures due June 27, 2033, to Trust I. The Company owns all of the \$35,000 in common equity of Trust I and the debentures are the sole asset of Trust I. Trust I issued \$1.0 million of floating-rate trust capital securities in a non-public offering. The floating-rate capital securities provide for quarterly distributions at a variable annual coupon rate, reset quarterly, based on three-month LIBOR plus 2.75%. The coupon rate was 5.56% at December 31, 2018 and 4.44% at December 31, 2017. The securities are callable by the Company, subject to any required regulatory approval, at par, after June 2008.

The Company unconditionally guarantees the Trust I capital securities. The terms of the junior subordinated debentures and the common equity of Trust I mirror the terms of the trust capital securities issued by Trust I. The Company used the net proceeds from this offering to fund an additional \$1.0 million capital investment in the Bank to fund its operations and future growth.

On August 23, 2004, the Company issued \$5.155 million in junior subordinated debentures due August 23, 2034, to Trust II. The Company owns all of the \$155,000 in common equity of Trust II and the debentures are the sole asset of Trust II. Trust II issued \$5.0 million of floating-rate trust capital securities in a non-public offering. The floating-rate capital securities provide for quarterly distributions at a variable annual coupon rate, reset quarterly, based on three-month LIBOR plus 2.65%. The coupon rate was 5.30% at December 31, 2018 and 4.10% at December 31, 2017. The securities are callable by the Company subject to any required regulatory approval, at par, after August 2009.

**Note 8 - Junior Subordinated Debentures (Continued)**

The Company unconditionally guarantees the Trust II capital securities. The terms of the junior subordinated debentures and the common equity of Trust II mirror the terms of the trust capital securities issued by Trust II. The Company used the net proceeds from this offering to fund an additional \$5.0 million capital investment in the Bank to fund its operations and future growth.

In December 2009, the Company entered into an interest rate swap agreement (swap) with an effective date of February 23, 2011. The Company designated the swap as a cash flow hedge and it is intended to protect against the variability of cash flows associated with Trust II. The swap modifies the pricing characteristic of Trust II, wherein the Company receives interest at three-month LIBOR plus 2.65% from a counterparty and pays a fixed rate of interest of 6.80% to the same counterparty calculated on a notional amount of \$5.0 million. This agreement will expire on November 23, 2019. The swap agreement was entered into with a counterparty that met the Company's credit standards, and the agreement contains collateral provisions protecting the at-risk party. The Company believes that the credit risk inherent in this contract is not significant. At December 31, 2018, the Company pledged \$220,000 cash collateral to the counterparty.

At December 31, 2018 and 2017, the fair value of the swap agreement was a loss of \$72,000 and \$216,000, respectively, and was the amount the Company would have expected to pay to terminate the agreement. The fair value of the swap is included in other liabilities in the accompanying consolidated balance sheets.

The net effect of the swap decreased interest expense to \$127,000 and \$151,000 in 2018 and 2017, respectively.

On February 12, 2010, the Company issued \$3.027 million in junior subordinated debentures due February 12, 2040, to Trust III. The Company owned all of the \$95,000 in common equity of Trust III and the debentures were the sole asset of Trust III. Trust III issued \$2.932 million of fixed rate convertible trust capital securities in a non-public offering. These capital securities provided for quarterly distributions at a fixed annual coupon rate of 6.00%. The securities were callable by the Company, subject to any required regulatory approval, at par, after February 2015. Holders of the trust securities were able to convert the securities, at any time, into shares of the Company's common stock at a conversion price of \$13.89 per share, subject to adjustments for splits, stock dividends, recapitalization and the like and issuances on a pro rata basis below the current market value, in-kind dividends and tender offers above market value.

The Company unconditionally guaranteed the Trust III capital securities. The terms of the junior subordinated debentures and the common equity of Trust III mirror the terms of the convertible trust capital securities issued by Trust III. The Company used the net proceeds from this offering to fund an additional \$2.9 million capital investment in the Bank for its operations and future growth. In 2016 the shareholders of Trust III elected to convert all remaining shares into shares of LYBC common stock and Trust III was fully dissolved. The conversion of the Trust III capital securities resulted in 186,000 shares converted to common stock increasing additional paid in capital by \$2.5 million.

The accounts of Trust I, Trust II and Trust III are not included in the consolidated financial statements of the Company. However, for regulatory purposes, the trust capital securities qualify as Tier I capital of the Company subject to a 25% of capital limitation under risk-based capital guidelines. The portion that exceeds the 25% of capital limitation qualifies as Tier II capital. At December 31, 2018 and 2017, \$6.0 million in trust capital securities qualified as Tier I capital, respectively.

# Lyons Bancorp, Inc.

## Notes to Consolidated Financial Statements

December 31, 2018 and 2017

### Note 9 - Income Taxes

The provision for income taxes consists of the following for the years ended December 31:

	<u>2018</u>	<u>2017</u>
	(In thousands)	
Current tax provision:		
Federal	\$ 4,466	\$ 1,247
State	355	86
Total current tax provision	<u>4,821</u>	<u>1,333</u>
Deferred tax expense (benefit):		
Federal	(1,910)	2,750
State	(133)	13
Total deferred tax expense (benefit)	<u>(2,043)</u>	<u>2,763</u>
	<u>\$ 2,778</u>	<u>\$ 4,096</u>

Income tax expense differed from the statutory federal income tax rate for the years ended December 31 as follows:

	<u>2018</u>	<u>2017</u>
Statutory federal tax rate	21.0%	34.0%
Increase (decrease) resulting from:		
Tax-exempt interest income	(2.5)	(4.5)
Non-taxable earnings on bank-owned life insurance	(0.6)	(1.0)
Nondeductible expenses	0.1	0.2
Disallowed interest expense	0.1	0.2
Tax rate reduction	-	5.4
State taxes	1.2	.5
Other, net	2.5	(1.0)
Effective tax rate	<u>21.8%</u>	<u>33.8%</u>

# Lyons Bancorp, Inc.

## Notes to Consolidated Financial Statements

December 31, 2018 and 2017

### Note 9 - Income Taxes (Continued)

Deferred income taxes reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for tax purposes. Components of the Company's net deferred tax assets at December 31, included in other assets in the accompanying consolidated balance sheets, are as follows:

	<u>2018</u>	<u>2017</u>
	(In thousands)	
Deferred tax assets:		
Allowance for loan losses	\$ 2,560	\$ 2,195
Compensation and benefits	1,556	1,515
Net unrealized loss on available for sale securities	1,346	815
Other	680	477
Total deferred tax assets	<u>\$ 6,142</u>	<u>\$ 5,002</u>
Deferred tax liabilities:		
Prepaid pension	\$ 15	\$ 343
Depreciation	434	402
REIT	-	1,334
Other	1,081	932
Total deferred tax liabilities	<u>\$ 1,530</u>	<u>\$ 3,011</u>
Net deferred tax assets	<u>\$ 4,612</u>	<u>\$ 1,991</u>

Management believes it is more likely than not that all of the deferred tax assets will be realized. The amount of the deferred tax asset considered realizable, however, could be reduced in the near term if estimates of future taxable income are reduced.

During 2017, the Tax Cuts and Jobs Act (the Act) was signed into law. The most significant impact of the Act is the reduction in the corporate federal income tax rate from a maximum rate of 35% to 21% beginning in 2018. As a result, in 2017 the Company revalued its deferred tax assets and liabilities at its new effective tax rate and recorded a net adjustment of \$583,776 to deferred tax expense to reduce the carrying value of the net deferred tax assets.

### Note 10 - Stockholders' Equity

**Preferred Stock** – The Company is authorized to issue 5,000 shares of preferred stock having a par value of \$0.50 per share and a stated value of \$1,000 per share. The board of directors is authorized to issue these shares of preferred stock without stockholder approval in different classes and series and, with respect to each class or series, to determine the dividend rate, the redemption provisions, conversion provisions, liquidation preference, and other rights, privileges, and restrictions.

On November 15, 2016, the Company offered a private placement of 5,000 shares, par value of \$0.50 per share, Series A Non-Cumulative Convertible Preferred Stock at \$1,000 per share. The preferred stock is convertible, at any time, into shares of common stock, par value \$0.50 per share, at the option of the holder.

# Lyons Bancorp, Inc.

## Notes to Consolidated Financial Statements

December 31, 2018 and 2017

### Note 10 - Stockholders' Equity (Continued)

Upon a deemed liquidation event of Lyons Bancorp, the holders of the preferred shares are entitled to receive a liquidation distribution of \$1,000 per share plus any declared and unpaid dividends, before any distribution of assets to holders of common stock. Dividends will be paid quarterly, if declared by the board of directors, at a rate per annum equal to 5%. As of December 31, 2018 and 2017, all 5,000 shares, par value \$0.50 per share, of the authorized preferred stock have been issued and are outstanding.

**Common Stock** – The holders of the Company's common stock are entitled to receive dividends, if any, the board of directors may declare from time to time from funds legally available therefore, subject to the preferential rights of the holders of any shares of preferred stock that the Company may issue in the future. The holders of the Company's common stock are entitled to one vote per share on any matter to be voted upon by stockholders.

The common stock and treasury stock of the Company at December 31, 2018 and 2017 are as follows:

	<u>2018</u>	<u>2017</u>
Common stock, authorized shares, \$0.50 par value	<u>7,500,000</u>	<u>5,000,000</u>
Issued shares	3,198,660	3,198,660
Less: treasury stock shares	<u>(14,782)</u>	<u>(8,788)</u>
Outstanding shares	<u>3,183,878</u>	<u>3,189,872</u>

The amounts of income tax expense (benefit) allocated to each component of other comprehensive income are as follows for the Years Ended December 31, 2018 and 2017:

	<u>2018</u>	<u>2017</u>
	(In thousands)	
Securities available for sale:		
Net unrealized (losses) during the year	\$ (624)	\$ (87)
Reclassification adjustment for transfer from held to maturity	-	(66)
Reclassification adjustment for losses included in income	9	7
Securities held to maturity:		
Reclassification adjustment for amortization of unrealized losses included in income	-	55
Changes in unrealized gains during the year of restricted equity securities	-	16
Pension and postretirement benefits:		
Amortization of prior service credit	(1)	(1)
Amortization of net loss	23	93
Net actuarial gain (loss)	(127)	304
Cash flow hedge		
Gains (losses) on the effective portion of cash flow hedge	3	4
Reclassification adjustment for losses included in income	<u>32</u>	<u>60</u>
Tax expense (benefit)	<u>\$ (685)</u>	<u>\$ 385</u>

# Lyons Bancorp, Inc.

## Notes to Consolidated Financial Statements

December 31, 2018 and 2017

### Note 10 - Stockholders' Equity (Continued)

Reclassifications out of accumulated other comprehensive (loss) income for the years ended December 31, 2018 and 2017 are as follows:

Details About Accumulated Other Comprehensive (Loss) Income Components	Amount Reclassified from Accumulated Other Comprehensive (Loss) Income		Affected Line Item In The Statement Where Net Income is Presented
	<u>2018</u>	<u>2017</u>	
	(In Thousands)		
Unrealized gains and losses on available for sale securities (before tax)	\$ (35)	\$ (17)	Net realized gains from sales/calls of available for sale securities
Tax benefit (expense)	<u>9</u>	<u>7</u>	Income tax expense
Net of tax	<u>(26)</u>	<u>(10)</u>	
Amortization of unrealized losses on securities transferred to held to maturity (before tax):	-	(136)	Interest Income – investment securities, taxable
Tax benefit	-	<u>55</u>	Income tax expense
Net of tax	<u>-</u>	<u>(81)</u>	
Amortization of pension and postretirement benefit plan items (before tax):			
Prior service credit	3	3	
Net losses	<u>(92)</u>	<u>(233)</u>	
Tax benefit	<u>22</u>	<u>92</u>	Pensions and benefits expense
Net of tax	<u>(67)</u>	<u>(138)</u>	Income tax expense
Gains and losses on cash flow hedge (before tax)	<u>(127)</u>	(151)	Interest expense - borrowings
Tax benefit	<u>32</u>	<u>60</u>	Income tax expense
Net of tax	<u>(95)</u>	<u>(91)</u>	
Total reclassification for the year, net of tax	<u>\$ (188)</u>	<u>\$ (320)</u>	

# Lyons Bancorp, Inc.

## Notes to Consolidated Financial Statements

December 31, 2018 and 2017

### Note 10 – Stockholders’ Equity (Continued)

The balances and changes in the components of accumulated other comprehensive loss, net of tax, are as follows:

(In thousands)	Unrealized gains (losses) on securities available for sale and restricted equity securities	Unrealized losses on securities transferred to held to maturity	Pension and postretirement benefits	Unrealized losses on cash flow hedge	Total
Balance – January 1, 2017	\$ (1,744)	\$ (81)	\$ (2,217)	\$ (227)	\$ (4,270)
Other comprehensive income (loss) before reclassifications	(234)	-	486	6	258
Amounts reclassified from accumulated other comprehensive income	10	81	138	91	320
Other comprehensive income (loss) for 2017	(224)	81	624	97	578
Reclassification of stranded tax effect	(420)	-	(384)	(31)	(835)
Balance – December 31, 2017	<u>\$ (2,388)</u>	<u>\$ -</u>	<u>\$ (1,978)</u>	<u>\$ (161)</u>	<u>\$ (4,527)</u>
Other comprehensive income (loss) before reclassifications	(1,546)	-	(392)	3	(1,935)
Amounts reclassified from accumulated other comprehensive income	26	-	67	95	188
Other comprehensive (loss) for 2018	(1,520)	-	(325)	98	(1,747)
Cumulative effect of change in measurement of equity securities	(130)	-	-	-	(130)
Balance – December 31, 2018	<u>\$ (4,038)</u>	<u>\$ -</u>	<u>\$ (2,303)</u>	<u>\$ (63)</u>	<u>\$ (6,404)</u>

### Note 11 - Pension and Postretirement Benefit Plans

The Company participates in the New York State Bankers Retirement System (the “System”), a non-contributory defined benefit pension plan (the “Pension Plan”) covering substantially all employees. The benefits are based on years of service and the employee’s highest average compensation during five consecutive years of employment.

The Company also maintains an unfunded postretirement health insurance plan (the “Healthcare Plan”) for certain employees meeting eligibility requirements.

The Company engages independent, external actuaries to compute the amounts of liabilities and expense relating to these plans, subject to the assumptions that the Company selects. The benefit obligation for these plans represents the liability of the Company for current and retired employees, and is affected primarily by the following: service cost (benefits attributed to employee service during the period); interest cost

# Lyons Bancorp, Inc.

## Notes to Consolidated Financial Statements

December 31, 2018 and 2017

### Note 11 - Pension and Postretirement Benefit Plans (Continued)

(interest on the liability due to the passage of time); actuarial gains/losses (experience during the year different from that assumed and changes in plan assumptions); and benefits paid to participants.

The following table provides a reconciliation of the changes in the Pension Plan's benefit obligations and fair value of assets and the accumulated benefit obligation for the Healthcare Plan for the years ending December 31, 2018 and 2017:

	Pension Plan		Healthcare Plan	
	2018	2017	2018	2017
	(In thousands)			
Change in benefit obligation:				
Benefit obligation at beginning of year	\$ 15,631	\$ 14,053	\$ 669	\$ 599
Service cost	1,262	1,186	8	6
Interest cost	607	568	24	28
Actuarial (gain) loss	(1,507)	323	35	96
Expected expenses	(149)	(119)	-	-
Benefits paid	(448)	(380)	(126)	(60)
Benefit obligation at end of year	15,396	15,631	610	669
Change in plan assets:				
Fair value of plan assets at beginning of year	16,980	12,984	-	-
Actual return on plan assets	(994)	2,104	-	-
Employer contribution	-	2,400	33	36
Actual expenses paid	(147)	(128)	-	-
Benefits paid	(443)	(380)	(33)	(36)
Fair value of plan assets at end of year	15,396	16,980	-	-
(Unfunded) Funded status recognized	\$ (9)	\$ 1,349	\$ 610	\$ 669
Accumulated benefit obligation	\$ 12,930	\$ 13,030	\$ 610	\$ 669

The underfunded status of the Pension Plan as of December 31, 2018 has been recognized in other liabilities in the consolidated balance sheets. At December 31, 2017, the funded status of the Pension Plan is recognized in other assets in the consolidated balance sheets.

The unfunded status of the Healthcare Plan has been recognized in other liabilities in the consolidated balance sheets at December 31, 2018 and 2017.

# Lyons Bancorp, Inc.

## Notes to Consolidated Financial Statements

December 31, 2018 and 2017

### Note 11 - Pension and Postretirement Benefit Plans (Continued)

The components of net periodic benefit cost and other comprehensive income are as follows:

	Pension Plan		Healthcare Plan	
	2018	2017	2018	2017
Components of net periodic benefit cost:	(In thousands)			
Service cost	\$ 1,262	\$ 1,186	\$ 8	\$ 6
Interest cost	607	568	24	28
Expected return on plan assets	(1,084)	(889)	-	-
Amortization of prior service cost (credit)	1	1	(4)	(4)
Amortization of net loss	66	214	26	19
Net periodic benefit cost	<u>\$ 852</u>	<u>\$ 1,080</u>	<u>\$ 54</u>	<u>\$ 49</u>
Other changes in plan assets and benefit obligations recognized in other comprehensive income:				
Net (gain) loss	\$ 565	\$ (883)	\$ (46)	\$ 122
Recognized actuarial loss	(66)	(214)	(26)	(19)
Recognized prior service (cost) credit	(1)	(1)	4	4
Recognized in other comprehensive income	<u>\$ 498</u>	<u>\$ (1,098)</u>	<u>\$ (68)</u>	<u>\$ 107</u>
Total recognized in net periodic benefit cost and other comprehensive income	<u>\$ 1,350</u>	<u>\$ (18)</u>	<u>\$ (14)</u>	<u>\$ 156</u>

The following table presents the components of accumulated other comprehensive loss, net of taxes, as of December 31:

	Pension Plan		Healthcare Plan	
	2018	2017	2018	2017
	(In thousands)			
Prior service cost (credit)	\$ -	\$ 1	\$ (7)	\$ (8)
Net actuarial loss	2,142	1,414	168	184
	<u>\$ 2,142</u>	<u>\$ 1,415</u>	<u>\$ 161</u>	<u>\$ 176</u>

# Lyons Bancorp, Inc.

## Notes to Consolidated Financial Statements

December 31, 2018 and 2017

### Note 11 - Pension and Postretirement Benefit Plans (Continued)

The estimated costs that will be amortized from accumulated other comprehensive loss into net periodic cost during 2018 are as follows:

	Pension Plan	Healthcare Plan	Total
		(In thousands)	
Prior service cost (credit)	\$ -	\$ (4)	\$ (4)
Net actuarial loss	133	26	159
<b>Total</b>	<b>\$ 133</b>	<b>\$ 22</b>	<b>\$ 155</b>

Weighted-average assumptions used in accounting for the plans were as follows:

	Pension Plan		Healthcare Plan	
	2018	2017	2018	2017
Discount rates:				
Benefit cost for Plan Year	3.96%	4.12%	3.51%	4.00%
Benefit obligation at end of Plan Year	4.52%	3.96%	4.14%	3.51%
Expected long-term return on plan assets	6.50%	6.50%	N/A	N/A
Rate of compensation increase:				
Benefit cost for Plan Year	3.00%	3.00%	N/A	N/A
Benefit obligation at end of Plan Year	3.00%	3.00%	N/A	N/A

The assumed health care cost trend rate used in the postretirement benefit plan at December 31, 2018 was 4.00%. Assumed health care trend rates may have a significant effect on the amounts reported for this plan. A 1% increase in the trend rate would increase the periodic benefit cost by \$5,000 and increase the accumulated postretirement benefit obligation by \$89,000.

The discount rate used for each period was based upon the rates of return on high-quality fixed income investments. The objective of using this approach is to measure the single amount that, if invested at the measurement date in a portfolio of high-quality debt instruments, would provide the necessary future cash flows to pay benefits when they became due. The discount rates are evaluated at each measurement date to give effect to changes in the general level of interest rates.

The Company utilizes the Healthy Annuitant/Employee Mortality Table (RP-2018) to measure its pension plan obligation. In 2018, the Company used RP-2018 adjusted to reflect the Mortality Improvement Scale of 2017 (MP-2017), while in 2017, the Company utilized RP-2017 adjusted to reflect the Mortality Improvement Scale of 2017 (MP-2017). The change in the mortality table projection scale from MP-2017 to MP-2018 decreased the projected benefit obligation by approximately \$0.1 million.

The Company's funding policy is to contribute, at a minimum, an actuarially determined amount that will satisfy the minimum funding requirements determined under the appropriate sections of the Internal Revenue Code. While the Company has satisfied the minimum funding requirement for 2018, it expects to contribute to the Pension Plan during 2019. However, the amount of the contribution is not known at this time.

# Lyons Bancorp, Inc.

## Notes to Consolidated Financial Statements

December 31, 2018 and 2017

### Note 11 - Pension and Postretirement Benefit Plans (Continued)

Estimated future benefit payments, which reflect expected future service, as appropriate, are as follows:

Years Ending December 31,	Pension Plan	Healthcare Plan
	(In thousands)	
2019	\$ 428	\$ 32
2020	453	32
2021	493	31
2022	537	31
2023	591	31
2024 - 2028	4,059	182
	<u>\$ 6,561</u>	<u>\$ 339</u>

The fair value of the Company's pension plan assets at December 31, 2018 and 2017 by asset category are as follows:

	Total	(Level 1)	(Level 2)	(Level 3)
		Quoted Prices in Active Markets for Identical Assets	Significant Other Observable Inputs	Significant Unobservable Inputs
(In thousands)				
<b>December 31, 2018:</b>				
Cash equivalents:				
Foreign currencies	\$ 6	\$ 6	\$ -	\$ -
Short term investment funds	-	-	-	-
Total cash equivalents	<u>6</u>	<u>6</u>	-	-
Equity securities:				
Common stock	2,443	2,443	-	-
Depository receipts	42	42	-	-
Commingled pension trust funds	-	-	-	-
Preferred stock	20	20	-	-
Total equity securities	<u>2,505</u>	<u>2,505</u>	-	-
Fixed income securities:				
Collateralized mortgage obligations	154	-	154	-
Commingled pension trust funds	-	-	-	-
Corporate bonds	599	-	599	-
Government National Mortgage Association II	29	-	29	-
Government issues	2,170	-	2,170	-
Other securities	-	-	-	-
Total fixed income securities	<u>2,952</u>	-	<u>2,952</u>	-
Other financial instruments				
Commingled pension trust funds	593	-	-	593
Total other financial instruments	<u>593</u>	-	-	<u>593</u>
Investments valued using Net Asset Value	<u>9,340</u>	-	-	-
Total	<u>\$ 15,396</u>	<u>\$ 2,511</u>	<u>\$ 2,952</u>	<u>\$ 593</u>

# Lyons Bancorp, Inc.

## Notes to Consolidated Financial Statements

December 31, 2018 and 2017

### Note 11 - Pension and Postretirement Benefit Plans (Continued)

	Total	(Level 1) Quoted Prices in Active Markets for Identical Assets	(Level 2) Significant Other Observable Inputs	(Level 3) Significant Unobservable Inputs
	(In thousands)			
<b>December 31, 2017:</b>				
Cash equivalents:				
Foreign currencies	\$ 148	\$ 148	\$ -	\$ -
Short term investment funds	41	-	41	-
Total cash equivalents	189	148	41	-
Equity securities:				
Common stock	2,959	2,959	-	-
Depository receipts	75	75	-	-
Commingled pension trust funds	4,653	-	4,653	-
Preferred stock	65	65	-	-
Total equity securities	7,752	3,099	4,653	-
Fixed income securities:				
Collateralized mortgage obligations	119	-	119	-
Commingled pension trust funds	3,689	-	3,689	-
Corporate bonds	625	-	625	-
Federal National Mortgage Corporation	34	-	34	-
Government issues	2,061	-	2,061	-
Other securities	12	-	12	-
Total fixed income securities	6,540	-	6,540	-
Other financial instruments				
Commingled pension trust funds	538	-	-	538
Total other financial instruments	538	-	-	538
Investments valued using Net Asset Value	1,961	-	-	-
Total	<u>\$ 16,980</u>	<u>\$ 3,247</u>	<u>\$ 11,234</u>	<u>\$ 538</u>

At December 31, 2018 and 2017, the portfolio was managed by two investment firms. In addition, as of December 31, 2018 and 2017, approximately \$286,000 and \$523,000, respectively, of Pension Plan monies had not yet been allocated to either investment manager. At December 31, 2018, control was split at approximately 62%, 36% and 2%. At December 31, 2017, control was split at approximately 59%, 37% and 4%.

# Lyons Bancorp, Inc.

## Notes to Consolidated Financial Statements

December 31, 2018 and 2017

### Note 11 - Pension and Postretirement Benefit Plans (Continued)

At December 31, 2018, there were the following investment concentrations:

- Three commingled pension trust funds, which were 15%, 6% and 6% of the total portfolio,

At December 31, 2017, there were the following investment concentrations:

- Two commingled pension trust funds, which were 6% and 14% of the total portfolio,
- An exchange traded fund, which was 6% of the total portfolio, and
- The short term investment fund, which was 6% of the total portfolio.

Fair value is defined as the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date.

Valuation techniques used to measure fair value under ASC 820 must maximize the use of observable inputs and minimize the use of unobservable inputs. The standard describes a fair value hierarchy based on three levels of inputs, of which the first two are considered observable and the last unobservable, that may be used to measure fair value which are the following:

- Level 1—Quoted prices in active markets for identical assets or liabilities.
- Level 2—Inputs other than Level 1 that are observable, either directly or indirectly, 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 for substantially the full term of the assets or liabilities.
- Level 3—Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities.

The System uses the Thomson Reuters Pricing Service to determine the fair value of equities excluding commingled pension trust funds, the pricing service of IDC Corporate USA to determine the fair value of fixed income securities excluding commingled pension trust funds and JP Morgan Chase Bank, N.A. and Northern Trust to determine the fair value of commingled pension trust funds.

The following is a table of the pricing methodology and unobservable inputs at December 31, 2018 and 2017 used by JPMorgan in pricing commingled pension trust funds:

Commingled Pension Trust Funds (CPTF) - Other	Principal Valuation Technique(s) Used	Unobservable Inputs
CPTF (Strategic Property) of JPMorgan Chase Bank, N.A.	Market, Income Approach, Debt Service and Sales Comparison	Credit Spreads, Discount Rate, Loan to Value Ratio, Terminal Capitalization Rate and Value per Square Foot

# Lyons Bancorp, Inc.

## Notes to Consolidated Financial Statements

December 31, 2018 and 2017

### Note 11 - Pension and Postretirement Benefit Plans (Continued)

The following table sets forth a summary of the changes in Level 3 assets for the years ended December 31, 2018 and 2017:

January 1, 2017	\$ 455
Sales	(46)
Purchases	21
Realized gains	9
Unrealized gains	99
Balances, December 31, 2017	\$ 538
Unrealized gains	55
Balances, December 31, 2018	\$ 593

There were no transfers in or out of Level 3 in the Years Ended December 31, 2018 and 2017.

The Pension Plan was established in 1938 to provide for the payment of benefits to employees of participating banks. The Pension Plan is overseen by a Board of Trustees who meet quarterly and set the investment policy guidelines.

The overall investment strategy is to achieve a mix of approximately 97% of investments for long-term growth and 3% for near-term benefit payments with a wide diversification of asset types, fund strategies, and fund managers. The target allocations for the System assets are shown in the table below. Cash equivalents consist primarily of government issues (maturing in less than three months) and short term investment funds. Equity securities primarily include investments in common stock, depository receipts, preferred stock, commingled pension trust funds, exchange traded funds and real estate investment trusts. Fixed income securities include corporate bonds, government issues, credit card receivables, mortgage backed securities, municipals, commingled pension trust funds and other asset backed securities. Other investments are real estate interests and related investments held within a commingled pension trust fund.

The weighted average expected long-term rate of return is estimated based on current trends in the System's assets as well as projected future rates of return on those assets and reasonable actuarial assumptions based on the guidance provided by Actuarial Standard of Practice ("ASOP") No. 27 "Selection of Economic Assumptions for Measuring Pension Obligations" for long term inflation, and the real and nominal rate of investment return for a specific mix of asset classes. The following assumptions were used in determining the long-term rate of return:

*Equity securities:* Dividend discount model, the smoothed earnings yield model, and the equity risk premium model

*Fixed income securities:* Current yield-to-maturity and forecasts of future yields

**Note 11 - Pension and Postretirement Benefit Plans (Continued)**

*Other financial instruments:* Comparison of the specific investment's risk to that of fixed income and equity instruments and using judgment.

The long-term rate of return considers historical returns. Adjustments were made to historical returns in order to reflect expectations of future returns. These adjustments were due to factor forecasts by economists and long-term U.S. Treasury yields to forecast long-term inflation. In addition, forecasts by economists and others for long-term GDP growth were factored into the development of assumptions for earnings growth and per capita income.

Investment managers are prohibited from purchasing any security greater than 5% of the portfolio at the time of purchase or greater than 8% at market value in any one issuer. Effective June 25, 2013, the issuer of any security purchased must be located in a country in the MSCI (Morgan Stanley Capital International) World Index. In addition, the following are prohibited:

*Equity securities:*

- Short sales,
- Unregistered securities, and
- Margin purchases.

*Fixed income securities:*

- Mortgage backed derivatives that have an inverse floating rate coupon or that are interest only securities,
- Any asset backed security that is not issued by the U.S. government or its agencies or instrumentalities,
- In general, securities of less than Baa2/BBB quality,
- Securities of less than A-quality may not in the aggregate exceed 13% of the investment manager's portfolio, and
- An investment manager's portfolio of commercial mortgage-backed securities and asset-backed securities may not exceed 10% of the portfolio at the time of purchase.

*Other financial instruments:*

- Unhedged currency exposure in countries not defined as "high income economies" by the World Bank

All other investments not prohibited by policy are permitted. At December 31, 2018 and 2017 the Pension Plan held certain investments which are no longer deemed acceptable to acquire. These positions will be liquidated when the investment managers deem that such liquidation is in the best interest of the Pension Plan.

The target allocation for 2018 and actual allocation of plan assets as of December 31, 2018 and 2017 are as follows:

# Lyons Bancorp, Inc.

## Notes to Consolidated Financial Statements

December 31, 2018 and 2017

### Note 11 - Pension and Postretirement Benefit Plans (Continued)

Asset Category	Target Allocation 2018	% of Plan Assets at December 31,	
		2018	2017
Cash equivalents	0-20%	4.2%	6.4%
Equity securities	40-60%	46.1%	50.2%
Fixed income securities	40-60%	45.8%	40.2%
Other financial instruments	0-5%	3.9%	3.2%

#### Defined Contribution Plan

The Bank has a contributory 401(k) Plan for substantially all employees. Employees are eligible to contribute a percentage of their salary up to the maximum as determined by the Internal Revenue Service. The Bank is required to match 75% of the employees' contributions up to a maximum of 6% of the employees' salaries. The Bank contributed \$472,000 and \$419,000 under these provisions during 2018 and 2017, respectively.

#### Supplemental Employee Retirement Plans

The Company maintains supplemental employee retirement plans (the "SERP") for certain executives. All benefits provided under the SERP are unfunded and, as these executives retire, the Company will make payments to plan participants. The unfunded status of the SERP at December 31, 2018 and 2017 was \$3.9 million and \$3.7 million, respectively, and is recorded in other liabilities in the consolidated balance sheets. Compensation expense related to the SERP was \$233,000 and \$220,000 for the years ended December 31, 2018 and 2017.

#### Deferred Compensation Plans

Prior to 2007, the Company had entered into employment agreements with key executives. These employment agreements established deferred compensation plans whereby Company stock was awarded and vested each year. In 2007, the Company terminated the employment agreements and related deferred compensation plans and established new deferred compensation plans for key executives. The new plans require a vesting period of three years from the original date the executive entered the plan. Awarded shares from both the prior plan and the current plan are restricted from being sold until employment is terminated.

The Company obtains shares for the new deferred compensation plan either through open market purchases or from treasury shares. The amount of awarded shares is based on the amount earned by each executive under the deferred compensation plan. The executives are awarded a number of shares based on the amount of deferred compensation earned divided by the value of the shares. The value of the shares purchased on the open market is the price paid. The value of the shares from treasury is the average daily closing price of the stock for each day within the past quarter. Total deferred compensation shares were 147,275 and 146,497 at December 31, 2018 and 2017 respectively. Total shares awarded were 13,557 and 4,881 for 2018 and 2017, respectively. Compensation expense is recognized over the vesting period, and is based upon the total amount of the value of the shares awarded to each executive. Compensation expense related to the plan was approximately \$233,000 and \$184,000 for the years ended December 31, 2018 and 2017, respectively.

# Lyons Bancorp, Inc.

## Notes to Consolidated Financial Statements

December 31, 2018 and 2017

### Note 12 - Earnings Per Share

The following table presents a reconciliation of the earnings and shares used in calculating basic and diluted EPS for each of the years ended December 31:

	<u>2018</u>	<u>2017</u>
	(in thousands, except per share data)	
Net income	\$ 9,992	\$ 8,009
Adjustment for dilutive potential common shares	-	-
Preferred stock dividends	250	250
Net income available for diluted common shares	<u>\$ 9,742</u>	<u>\$ 7,759</u>
Weighted average common shares used to calculate basic EPS	3,180,057	3,190,774
Add: effect of common stock equivalents <sup>(1)</sup>	120,000	120,000
Weighted average common shares used to calculate diluted EPS	<u>3,300,057</u>	<u>3,310,774</u>
Earnings per common share :		
Basic	<u>\$ 3.06</u>	<u>\$ 2.43</u>
Diluted	<u>\$ 3.03</u>	<u>\$ 2.42</u>

(1) 5,000 shares of convertible preferred stock are convertible into 120,000 shares of LYBC common stock.

### Note 13 - Related Party Transactions

In the ordinary course of business, the Bank has and expects to continue to have transactions, including loans and deposit accounts, with the Company's and the Bank's executive officers and directors and their affiliates. In the opinion of management, such transactions were on substantially the same terms, including interest rates and collateral, as those prevailing at the time of comparable transactions with other unrelated persons and did not involve more than a normal risk of collectability or present any other unfavorable features.

The roll-forward of loans to related parties for the years ended December 31, 2018 and December 31, 2017 is as follows:

	<u>2018</u>	<u>2017</u>
	(In thousands)	
Beginning balance, January 1, 2018	\$ 10,389	\$ 10,556
New loans	2,802	3,332
New Directors	4,252	294
Repayments	<u>(2,591)</u>	<u>(3,793)</u>
Ending balance, December 31, 2018	<u>\$ 14,852</u>	<u>\$ 10,389</u>

# Lyons Bancorp, Inc.

## Notes to Consolidated Financial Statements

December 31, 2018 and 2017

### Note 14 - Commitments and Contingent Liabilities

The Bank 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. These instruments involve, to varying degrees, elements of credit and interest rate risk in excess of the amounts recognized in the consolidated balance sheets. The Bank uses the same credit policies in making commitments and conditional obligations as it does for on-balance-sheet instruments.

The Bank'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 summarized as follows at December 31:

	<u>2018</u>	<u>2017</u>
	(In thousands)	
Commitments to extend credit:		
Commitments to grant loans	\$ 75,483	\$ 84,811
Unfunded commitments under commercial lines of credit	102,865	100,523
Unfunded commitments under consumer lines of credit	85,939	76,293
Standby letters of credit	<u>10,396</u>	<u>13,584</u>
	<u>\$274,683</u>	<u>\$ 275,211</u>

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 are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements.

The Bank evaluates each customer's credit worthiness on a case-by-case basis. The amount and type of collateral obtained, if deemed necessary by the Bank upon extension of credit, varies and is based on management's credit evaluation of the counterparty.

Standby letters of credit are conditional lending commitments issued by the Bank to guarantee the performance of a customer to a third party. These letters of credit are primarily issued to support public and private borrowing arrangements. Generally, letters of credit issued have expiration dates within one year. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loan facilities to customers. The Bank's policy for obtaining collateral, and the nature of such collateral, is essentially the same as that involved in making commitments to extend credit. The Bank generally holds collateral supporting those commitments. Such collateral amounted to \$9.1 million and \$12.4 million at December 31, 2018 and 2017, respectively. The amount of the liability related to guarantees under standby letters of credit was not material at December 31, 2018 and 2017.

**Note 14 - Commitments and Contingent Liabilities (Continued)**

In addition to other investors, the Bank sells residential mortgage loans to the FHLB. The agreement with the FHLB includes a maximum credit enhancement liability of \$4.4 million and \$3.6 million at December 31, 2018 and 2017 respectively, which the Bank may be required to pay if realized losses on any of the sold mortgages exceed the amount held in the FHLB's spread account. The FHLB is funding the spread account annually based on the outstanding balance of loans sold. The Bank's historical losses on residential mortgages have been lower than the amount being funded to the spread account. As such, the Bank does not anticipate recognizing any losses and, accordingly, has not recorded a liability for the credit enhancement.

In addition to pledging investment securities to secure deposits, the Bank has entered into an agreement with the FHLB whereby the FHLB agrees to issue letters of credit for the benefit of securing deposits. In the event the FHLB makes a payment under this agreement, such payment will constitute an advance to the Bank and shall be immediately due and payable. The Bank has pledged unencumbered mortgage-related assets to secure letters of credit from the FHLB. As of December 31, 2018 the Bank had letters of credit outstanding with FHLB of \$54.2 million and 2017 the Bank had letters of credit outstanding with the FHLB of \$33.1 million.

**Note 15 - Concentrations of Credit**

The Company's loan customers are located primarily in the New York communities served by the Bank. Investments in state and local government securities also involve governmental entities within the Company's market area. Although operating in numerous communities in New York State, the Company is still dependent on the general economic conditions of New York. The largest concentration of credit by industry is Lessor's of Nonresidential Buildings, with loans outstanding of \$59 million or 7.28% of total loans as of December 31, 2018. Risk related to this concentration is controlled through adherence to loan policy guidelines, including appropriate debt service coverage, adequate property values substantiated by current appraisals, and obtaining guarantors where appropriate. The Company, as a matter of policy, does not extend credit to any single borrower, or group of related borrowers, in excess of its legal lending limit. Further information on the Company's lending activities is provided in "Note 4 Loans" in Notes to Consolidated Financial Statements.

**Note 16 - Regulatory Matters**

The supervision and regulation of financial and bank holding companies and their subsidiaries is intended primarily for the protection of depositors, the deposit insurance funds regulated by the Federal Deposit Insurance Corporation ("FDIC") and the banking system as a whole, and not for the protection of shareholders or creditors of bank holding companies. The various bank regulatory agencies have broad enforcement power over financial holding companies and banks, including the power to impose substantial fines, operational restrictions and other penalties for violations of laws and regulations and for safety and soundness considerations.

**Note 16 - Regulatory Matters (Continued)**

**Capital**

The Company (on a consolidated basis) and the Bank are subject to various regulatory capital requirements administered by federal banking agencies. Failure to meet minimum capital requirements can initiate certain mandatory, and possibly additional discretionary, actions by regulators that, if undertaken, could have a direct material effect on the Company's and the Bank's financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, the Company and the Bank must meet specific capital guidelines that involve quantitative measures of their assets, liabilities, and certain off-balance-sheet items as calculated under regulatory accounting practices. The capital amounts and classification are also subject to qualitative judgments by the regulators about components, risk weightings, and other factors.

Quantitative measures established by regulation to ensure capital adequacy require the Company and the Bank to maintain minimum amounts and ratios (set forth in the table below) of total and Tier I capital (as defined by regulation) and of Tier I capital (as defined) to average assets (as defined). The Company's and the Bank's capital amounts and ratios are also presented in the table below.

In July 2013, the Federal Reserve approved and published the final Basel III Capital Rules establishing a new comprehensive capital framework for U.S. banking organizations. The rules implement the Basel Committee's December 2010 framework known as "Basel III" for strengthening international capital standards as well as certain provisions of the Dodd-Frank Act. The Basel III Capital Rules substantially revise the risk-based capital requirements applicable to bank holding companies and depository institutions, including the Company and the Bank, compared to the current U.S risk-based capital rules. The Basel III Capital Rules define the components of capital, and address risk weights and other issues affecting the denominator in the banking institutions' regulatory capital ratios. It also replaces the existing risk-weighting approach, with a more risk-sensitive approach based, in part, on the standardized approach in the Basel Committee's 2004 "Basel II" capital accords and implements the requirements of Section 939A of the Dodd-Frank Act to remove references to credit ratings utilized in the federal banking agencies' rules.

The Basel III Capital Rules were effective for the Company and the Bank on January 1, 2015 (subject to a phase-in period).

As required under Dodd-Frank, a new capital ratio, "common equity tier 1 capital ratio" (CET1) was established. This ratio allows only common equity to qualify as tier 1 capital. The new CET1 ratio also will include most elements of accumulated other comprehensive income, including unrealized securities gains and losses, as part of both total regulatory capital (numerator) and total assets (denominator). Community banks, however, were given the opportunity to make a one-time irrevocable election to include or not to include certain elements of other comprehensive income, most notably unrealized securities gains or losses. The Company and the Bank elected to not include the certain items of other comprehensive income in their capital calculations.

**Note 16 - Regulatory Matters (Continued)**

In addition to setting higher minimum capital ratios, the new rules, introduce a capital conservation buffer, which must be added to each of the minimum capital ratios and is designed to absorb losses during periods of economic stress. The capital conservation buffer will be phased-in over five years beginning on January 1, 2016 and will be set at 2.5% when fully phased-in. If a banking organization fails to hold capital above minimum capital ratios, including the capital conservation buffer, it will be subject to certain restrictions on capital distribution and discretionary bonus payments.

The final rules eliminated the proposed phase-out over 10 years of Trust Preferred Securities, or “TRUPs” as tier 1 capital for bank holding companies and bank, such as the Company and the Bank, that have less than \$15 billion in total assets. Under the final rule, grandfathered TRUPs would continue to qualify as tier 1 capital until they mature or are redeemed, up to a limit of 25% of tier 1 capital (for grandfathered TRUPs and other grandfathered tier 1 capital components).

# Lyons Bancorp, Inc.

## Notes to Consolidated Financial Statements

December 31, 2018 and 2017

### Note 16 - Regulatory Matters (Continued)

(Dollars in thousands)

	Actual		For Capital Adequacy Purposes		To be Well Capitalized under Prompt Corrective Action Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
<b>December 31, 2018:</b>						
Total risk-based capital						
Consolidated	\$95,854	11.7 %	\$≥65,455	≥8.0 %	\$≥81,818	≥10.0 %
Bank	\$100,841	12.3 %	\$≥65,444	≥8.0 %	\$≥81,806	≥10.0 %
Tier 1 capital						
Consolidated	\$84,412	10.3 %	\$≥49,091	≥6.0 %	\$≥65,455	≥8.0 %
Bank	\$90,806	11.1 %	\$≥49,083	≥6.0 %	\$≥65,444	≥8.0 %
Tier 1 leverage						
Consolidated	\$84,412	7.9 %	\$≥43,082	≥4.0 %	\$≥53,852	≥5.0 %
Bank	\$90,806	8.5 %	\$≥43,092	≥4.0 %	\$≥53,864	≥5.0 %
Common Equity Tier 1						
Consolidated	\$79,425	9.7 %	\$≥36,818	≥4.5 %	\$≥53,182	≥6.5 %
Bank	\$85,823	10.5 %	\$≥36,813	≥4.5 %	\$≥53,174	≥6.5 %
<b>December 31, 2017:</b>						
Total risk-based capital						
Consolidated	\$94,127	12.4 %	\$≥60,621	≥8.0 %	\$≥75,776	≥10.0 %
Bank	\$94,061	12.4 %	\$≥60,598	≥8.0 %	\$≥75,748	≥10.0 %
Tier 1 capital						
Consolidated	\$78,372	10.3 %	\$≥45,466	≥6.0 %	\$≥60,621	≥8.0 %
Bank	\$84,602	11.2 %	\$≥45,449	≥6.0 %	\$≥60,598	≥8.0 %
Tier 1 leverage						
Consolidated	\$78,372	7.7 %	\$≥41,082	≥4.0 %	\$≥51,353	≥5.0 %
Bank	\$84,602	8.3 %	\$≥41,104	≥4.0 %	\$≥51,380	≥5.0 %
Common Equity Tier 1						
Consolidated	\$73,383	9.7 %	\$≥34,099	≥4.5 %	\$≥49,255	≥6.5 %
Bank	\$79,619	10.5 %	\$≥34,087	≥4.5 %	\$≥49,236	≥6.5 %

**Note 16 - Regulatory Matters (Continued)**

Management believes, as of December 31, 2018, that the Company and the Bank meet all capital adequacy requirements to which they are subject.

As of the most recent notification from the Office of the Comptroller of the Currency, the Bank was categorized as well capitalized. There are no conditions or events since the notification that management believes have changed the institution's category

**Dividend Restrictions**

In the ordinary course of business, the Company is dependent upon dividends from the Bank to provide funds for the payment of interest expense on the junior subordinated debentures, dividends to shareholders and to provide for other cash requirements. Banking regulations may limit the amount of dividends that may be paid. Approval by regulatory authorities is required if the effect of dividends declared would cause the regulatory capital of the Bank to fall below specified minimum levels. Approval is also required if dividends declared exceed the net profits for that year combined with the retained net profits for the preceding two years.

At December 31, 2018, the Bank's retained earnings available for the payment of dividends was approximately \$14.7 million.

**Note 17 - Fair Value Measurements and Fair Values of Financial Instruments**

**Determination of Fair Value**

The Company uses fair value measurements to record fair value adjustments to certain assets and liabilities and to determine fair value disclosures. The fair value of a financial instrument is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. Fair value is best determined based upon quoted market prices. However, in many instances, there are no quoted market prices for the Company's various assets and liabilities. In cases where quoted market prices are not available, fair values are based on estimates using present value or other valuation techniques. Those techniques are significantly affected by the assumptions used, including the discount rate and estimates of future cash flows. Accordingly, the fair value estimates may not be realized in an immediate settlement of the instrument.

Fair value guidance provides a consistent definition of fair value, which focuses on exit price in an orderly transaction (that is, not a forced liquidation or distressed sale) between market participants at the measurement date under current market conditions. If there has been a significant decrease in the volume and level of activity for the asset or liability, a change in valuation technique or the use of multiple valuation techniques may be appropriate. In such instances, determining the price at which willing market participants would transact at the measurement date under current market conditions depends on the facts and circumstances and requires the use of significant judgment.

**Note 17 - Fair Value Measurements and Fair Values of Financial Instruments (Continued)**

**Fair Value Hierarchy**

The Company groups its financial assets and financial liabilities generally measured at fair value in three levels, based on the markets in which the assets and liabilities are traded and the reliability of the assumptions used to determine fair value.

*Level 1:* Valuation is based on unadjusted quoted prices in active markets for identical assets or liabilities that are accessible at the measurement date. Level 1 assets and liabilities generally include debt and equity securities that are traded in an active exchange market.

*Level 2:* Valuation is based upon inputs other than quoted prices included within level 1 that are observable either directly or indirectly. The valuation may be based on 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 for substantially the full term of the asset or liability.

*Level 3:* Valuation is based on unobservable inputs that are supported by little or no market activity and that are significant to the fair value measurement. Level 3 assets and liabilities include financial instruments whose value is determined using pricing models, discounted cash flow methodologies, or similar techniques, as well as instruments for which determination of fair value requires significant management judgment or estimation.

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

The following information should not be interpreted as an estimate of the fair value of the entire Company since a fair value calculation is only provided for a limited portion of the Company's assets and liabilities. Due to a wide range of valuation techniques and the degree of subjectivity used in making the estimates, comparisons between the Company's disclosures and those of other companies may not be meaningful. The following methods and assumptions were used to estimate the fair values of the Company's financial instruments at December 31, 2018 and 2017:

**Cash, Due From Banks, and Interest-bearing Deposits in Banks**

The carrying amounts reported in the consolidated balance sheets for these assets approximate fair values based on the short-term nature of the assets.

**Investment Securities**

The fair value of securities available for sale and held to maturity are determined by obtaining quoted market prices on nationally recognized securities exchanges (Level 1), or pricing models (Level 2), which consider standard input factors such as observable market data, benchmark yields, interest rate volatilities, broker/dealer quotes, credit spreads and new issue data. For certain securities which are not traded in active markets or are subject to transfer restrictions, valuations are adjusted to reflect

**Note 17 - Fair Value Measurements and Fair Values of Financial Instruments (Continued)**

illiquidity and/or non-transferability, and such adjustments are generally based on available market evidence (Level 3). In the absence of such evidence, management's best estimate is used.

Management's best estimate consists of external support on certain Level 3 investments. Management has determined that the fair value of local government securities in the held to maturity portfolio approximate their carrying value. Restricted equity securities have restrictions on their sale and are primarily carried at cost due to their limited marketability. The fair value of the Company's investment in Farmer Mac is determined by obtaining quoted market prices on nationally recognized securities exchanges (Level 1).

**Loans Held for Sale**

The fair value of loans held for sale is determined using quoted secondary-market prices. If no such quoted prices exist, the fair value of a loan is determined using quoted prices for a similar loan or loans, adjusted for the specific attributes of that loan, resulting in a Level 2 classification.

**Loans**

The fair values of loans held in portfolio are estimated using discounted cash flow analyses. The discount rate considers a market participant's cost of funds, liquidity premiums, capital charges, servicing charges, and expectations of future rate movements (for variable rate loans), resulting in a Level 3 classification. Projected future cash flows are calculated based upon contractual maturity or call dates, projected repayments and prepayments of principal, and adjusted for potential defaulted loans.

**Impaired Loans**

The fair value of loans considered impaired is generally determined based upon independent third party appraisals of the properties (market approach), or discounted cash flows based upon the expected proceeds. These assets are included as Level 3 fair values, based upon the lowest level of input that is significant to the fair value measurements. The fair value consists of the loan balances of \$4.9 million and \$1.6 million, net of valuation allowances of \$1.3 million and \$1.1 million as of December 31, 2018 and 2017, respectively.

**Accrued Interest Receivable and Payable**

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

**Mortgage Servicing Rights**

The carrying amount of mortgage servicing rights approximates their fair value.

**Deposits**

The fair values disclosed for demand and savings deposits are equal to carrying amounts at the reporting date. Fair values of fixed rate certificates of deposit are estimated using discounted cash flows and interest rates currently being offered in the market on similar certificates, resulting in a Level 2 classification.

**Note 17 - Fair Value Measurements and Fair Values of Financial Instruments (Continued)**

**Borrowings from the Federal Home Loan Bank**

Fair values of borrowings from the FHLB are estimated using discounted cash flow analysis, based on quoted prices for new borrowings from the FHLB with similar credit risk characteristics, terms

and remaining maturity, resulting in a Level 2 classification. These prices obtained from this active market represent a market value that is deemed to represent the transfer price if the liability were assumed by a third party.

**Junior Subordinated Debentures**

The fair values of junior subordinated debentures are estimated using discounted cash flow analysis, based on market rates currently offered on such debt with similar credit risk characteristics, terms and remaining maturity, resulting in a Level 2 classification.

**Interest Rate Swap Agreements**

The fair value of the interest rate swap derivative is calculated based on a discounted cash flow model. All future floating cash flows are projected and both floating and fixed cash flows are discounted to the valuation date. The curve utilized for discounting and projecting is built by obtaining publicly available third party market quotes for various swap maturity terms, resulting in a Level 2 classification.

**Off-Balance Sheet Financial Instruments**

Fair values for off-balance sheet financial instruments (lending commitments and letters of credit) are based on fees currently charged in the market to enter into similar agreements, taking into account, the remaining terms of the agreements and the counterparties' credit standing.

# Lyons Bancorp, Inc.

## Notes to Consolidated Financial Statements

December 31, 2018 and 2017

### Note 17 - Fair Value Measurements and Fair Values of Financial Instruments (Continued)

#### Assets and Liabilities Measured at Fair Value on a Recurring Basis

For financial assets measured at fair value on a recurring basis, the fair value measurements by level within the fair value hierarchy used at December 31, 2018 and 2017 are as follows:

<u>Carrying Value</u>	<u>(Level 1) Quoted Prices in Active Markets for Identical Assets</u>	<u>(Level 2) Significant Other Observable Inputs</u>	<u>(Level 3) Significant Unobservable Inputs</u>
(In thousands)			
<b>December 31, 2018:</b>			
Securities available for sale:			
United States agencies	\$ 41,986	\$ -	\$ 41,986
State and local governments	68,486	-	68,486
Mortgage-backed securities	72,193	-	72,193
Corporate securities	2,000	-	2,000
Total securities available for sale	<u>\$ 184,665</u>	<u>\$ -</u>	<u>\$ 184,665</u>
Restricted equity security	<u>\$ 121</u>	<u>\$ 121</u>	<u>\$ -</u>
Interest rate swap agreements	<u>\$ (72)</u>	<u>\$ -</u>	<u>\$ (72)</u>
<b>December 31, 2017:</b>			
Securities available for sale:			
United States agencies	\$ 42,292	\$ -	\$ 42,292
State and local governments	76,664	-	76,664
Mortgage-backed securities	85,386	-	85,386
Corporate securities	2,000	-	2,000
Total securities available for sale	<u>\$ 206,342</u>	<u>\$ -</u>	<u>\$ 206,342</u>
Restricted equity security	<u>\$ 157</u>	<u>\$ 157</u>	<u>\$ -</u>
Interest rate swap agreements	<u>\$ (216)</u>	<u>\$ -</u>	<u>\$ (216)</u>

# Lyons Bancorp, Inc.

## Notes to Consolidated Financial Statements

December 31, 2018 and 2017

### Note 17 - Fair Value Measurements and Fair Values of Financial Instruments (Continued)

#### Assets Measured at Fair Value on a Nonrecurring Basis

There were no assets measured at fair value on a nonrecurring basis at December 31, 2018 and 2017.

The carrying amounts and estimated fair values of the Company's financial instruments at December 31, 2018 and 2017 are as follows:

	Fair Value Hierarchy	2018		2017	
		Carrying Amount	Fair Value	Carrying Amount	Fair Value
Financial assets:					
(In thousands)					
Cash and due from banks	1	\$ 18,696	\$ 18,696	\$ 13,638	\$ 13,638
Interest-bearing deposits in banks	1	17,437	17,437	19,596	19,596
Investment securities	1 and 2	191,919	192,597	213,682	214,139
Loans, net of allowance	2 and 3	800,101	779,995	733,231	731,556
Accrued interest receivable	1	3,760	3,760	3,516	3,516
Mortgage servicing rights	2	2,111	2,111	1,625	1,625
Financial liabilities:					
Demand and savings deposits	1	\$ 721,143	\$ 721,143	\$ 713,840	\$ 713,840
Certificates of deposit	2	224,694	223,266	179,635	178,626
Borrowings from FHLB	2	42,000	42,000	50,000	50,000
Junior subordinated debentures	2	6,190	6,160	6,190	6,170
Interest rate swap agreements	2	72	72	216	216
Accrued interest payable	1	331	331	156	156

Amounts in the preceding table are included in the consolidated balance sheets under the applicable captions. The fair values of off-balance sheet financial instruments are not significant.

#### Note 18 – Revenue Recognition

The majority of the Company's revenue-generating transactions are not subject to ASC Topic 606, including revenue generated from financial instruments, such as loans and investment securities which are presented in our consolidated income statements as components of net interest income. All of the Company's revenue from contracts with customers in the scope of ASC 606 is recognized within non-interest income, with the exception of net gains and losses from sales of foreclosed real estate, which is recognized within non-interest expense. The following table presents revenues subject to ASC 606 for the years ended December 31, 2018 and 2017, respectively.

# Lyons Bancorp, Inc.

## Notes to Consolidated Financial Statements

December 31, 2018 and 2017

### Note 18 – Revenue Recognition (Continued)

<i>(In thousands)</i>	For the years ended	
	December 31, 2018	2017
<b>Service charges on deposit accounts</b>		
Insufficient funds fees	\$ 1,845	\$ 1,739
Deposit related fees	444	423
ATM/point of sale fees	954	874
	<u>3,243</u>	<u>3,036</u>
<b>Cardholder fees</b>		
Debit card interchange fees	2,324	2,047
Other cardholder fees	371	176
	<u>2,695</u>	<u>2,223</u>
<b>Loan servicing fees and realized gain on sales of loans</b>		
Loan Servicing Fees	1,819	1,540
Realized gain on sale of loans	1,386	1,180
	<u>3,205</u>	<u>2,720</u>
<b>Financial services fees</b>	1,165	1,022
<b>Other miscellaneous income</b>	899	839
	<u>11,207</u>	<u>9,840</u>

Service Charges on Deposit Accounts: The Company earns fees from its deposit customers for transaction-based, account maintenance, and overdraft services. Transaction-based fees, which included services such as ATM use fees, stop payment charges, statement rendering, and ACH fees, are recognized at the time the transaction is executed as that is the point in time the Company fulfills the customer's request. Account maintenance fees, which relate primarily to monthly maintenance, are recognized at the time the maintenance occurs. Overdraft fees are recognized at the point in time that the overdraft occurs. Service charges on deposits are withdrawn from the customer's account balance.

**Note 18 – Revenue Recognition (Continued)**

Cardholder Fees: The Company earns interchange fees from debit cardholder transactions conducted through the Fiserv payment network. Interchange fees from cardholder transactions represent a percentage of the underlying transaction value and are recognized daily, concurrently with the transaction processing services provided to cardholder.

Loan Servicing Fees and Realized Gain on sale of Loans: Revenue from mortgage fee income, commercial loan fees, and realized gain on sales of loans is earned through the origination of residential mortgages and sales of one-to-four family residential mortgages loans and is recognized as transactions occur.

Financial Services Fees: The Company earns commissions from investment brokerage services provided to its customers by a third-party service provider. The Company receives fees from the third-party service provider on a monthly basis based upon customer activity for the month. The Company (i) acts as an agent in arranging the relationship between the customer and the third-party service provider and (ii) does control the selection of services but does not control the services rendered to the customers. Investment brokerage fees are presented net of related costs.