PATHFINDER BANCORP INC
Form 10-K
March 17, 2014

UNITED STATES
SECURITIES EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-K

T ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the fiscal year ended December 31, 2013.
or
* TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from ______________ to ______________.

Commission file number: 000-23601

PATHFINDER BANCORP, INC.
(Exact name of registrant as specified in its charter)

Federal 16-1540137
(State or other jurisdiction of incorporation or organization) (I.R.S. Employer Identification No.)

214 West First Street Oswego NY 13126
(Address of principal executive offices) (Zip Code)

Registrant's telephone number, including area code: (315) 343-0057
Securities registered pursuant to Section 12(b) of the Act:

Title of each class	Name of each exchange on which registered
Common Stock, $0.01 par value	The NASDAQ Stock Market LLC

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

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. YES* NOT

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

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

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

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§229.405 of this chapter) is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.*

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

Large accelerated filer Accelerated filer Non-acceleratef filer Smaller reporting company T
(Do not check if a smaller reporting company)

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

The aggregate market value of the voting and non-voting common equity held by non-affiliates of the Registrant, computed by reference to the last sale price on June 30, 2013, as reported by the NASDAQ Capital Market, was approximately $13.6 million.

As of March 14, 2014, there were 2,618,182 shares outstanding of the Registrant's Common Stock.

DOCUMENTS INCORPORATED BY REFERENCE:

(1) Proxy Statement for the 2014 Annual Meeting of Stockholders of the Registrant (Part III).
(2) Annual Report to Stockholders (Part II and IV).

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FORM 10-K ANNUAL REPORT
FOR THE YEAR ENDED
DECEMBER 31, 2013
PATHFINDER BANCORP, INC.

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PART I

FORWARD-LOOKING STATEMENTS

When used in this Annual Report the words or phrases “will likely result”, “are expected to”, “will continue”, “is anticipated” “estimate”, ”project” or similar expression are intended to identify “forward-looking statements” within the meaning of the Private Securities Litigation Reform Act of 1995. Such statements are subject to certain risks and uncertainties. By identifying these forward-looking statements for you in this manner, the Company is alerting you to the possibility that its actual results and financial condition may differ, possibly materially, from the anticipated results and financial condition indicated in these forward-looking statements. Important factors that could cause the Company’s actual results and financial condition to differ from those indicated in the forward-looking statements include, among others:

- Credit quality and the effect of credit quality on the adequacy of our allowance for loan losses
- Deterioration in financial markets that may result in impairment charges relating to our securities portfolio
- Competition in our primary market areas
- Significant government regulations, legislation and potential changes thereto
- A reduction in our ability to generate or originate revenue-producing assets as a result of compliance with heightened capital standards
- Increased cost of operations due to greater regulatory oversight, supervision and examination of banks and bank holding companies, and higher deposit insurance premiums
- Limitations on our ability to expand consumer product and service offerings due to anticipated stricter consumer protection laws and regulations
- Other risks described herein and in the other reports and statements we file with the SEC

These risks and uncertainties should be considered in evaluating forward-looking statements and undue reliance should not be placed on such statements. The Company wishes to caution readers not to place undue reliance on any such forward-looking statements, which speak only as of the date made. The Company wishes to advise readers that the factors listed above could affect the Company’s financial performance and could cause the Company’s actual results for future periods to differ materially from any opinions or statements expressed with respect to future periods in any current statements. Additionally, all statements in this document, including forward-looking statements, speak only as of the date they are made, and the Company undertakes no obligation to update any statement in light of new information or future events.

ITEM 1: BUSINESS

GENERAL

Pathfinder Bancorp, Inc.

Pathfinder Bancorp, Inc. (the "Company") is a federally chartered mid-tier holding company headquartered in Oswego, New York. The primary business of the Company is its investment in Pathfinder Bank (the "Bank"). The Company is majority owned by Pathfinder Bancorp, M.H.C., a federally-chartered mutual holding company (the "Mutual Holding Company"). At December 31, 2013, the Mutual Holding Company held 1,583,239 shares of the Company’s common stock (“Common Stock”), the public and the Employee Stock Ownership Plan (“ESOP”), collectively, held 1,039,943 shares (the "Minority Stockholders"). At December 31, 2013, Pathfinder Bancorp, Inc. and subsidiaries had total assets of $503.8 million, total deposits of $410.1 million and shareholders' equity of $42.7 million plus non-controlling interest of $358,000, which represents the 49% not owned by the Company as a result of the acquisition detailed in Note 23 to the Notes to Consolidated Financial Statements contained herein.

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The Company's executive office is located at 214 West First Street, Oswego, New York and the telephone number at that address is (315) 343-0057. Its internet address is www.pathfinderbank.com. Information on our website is not and should not be considered to be a part of this report.

Pathfinder Bank

The Bank is a New York-chartered stock savings bank and its deposit accounts are insured up to applicable limits by the FDIC through the Deposit Insurance Fund (“DIF”). The Bank is subject to extensive regulation by the New York State Department of Financial Services (the “Department”), as its chartering agency, and by the FDIC, as its deposit insurer and primary federal regulator. The Bank is a member of the Federal Home Loan Bank of New York (“FHLBNY”) and is subject to certain regulations by the Federal Home Loan Bank System.

The Bank is primarily engaged in the business of attracting deposits from the general public in the Bank's market area, and investing such deposits, together with other sources of funds, in loans secured by one- to four-family residential real estate, commercial real estate, small business loans, and consumer loans. The Bank invests a portion of its assets in securities issued by the United States Government and its agencies and sponsored enterprises, state and municipal obligations, corporate debt securities, mutual funds, and equity securities. The Bank also invests in mortgage-backed securities primarily issued or guaranteed by United States Government sponsored enterprises. The Bank's principal sources of funds are deposits, principal and interest payments on loans and investments, as well as borrowings from correspondent financial institutions. The principal source of income is interest on loans and investment securities. The Bank's principal expenses are interest paid on deposits, employee compensation and benefits, data processing and facilities.

Pathfinder Bank also operates through a limited purpose commercial bank subsidiary, Pathfinder Commercial Bank, which serves the depository needs of municipalities and public entities in its market area.

The Bank has Pathfinder REIT, Inc., a New York corporation, as its wholly-owned real estate investment trust subsidiary. At December 31, 2013, Pathfinder REIT, Inc. held $17.7 million in mortgages and mortgage related assets. All disclosures in this Form 10-K relating to the Bank's loans and investments include loans and investments that are held by Pathfinder REIT, Inc.

The Bank also has 100% ownership in Whispering Oaks Development Corp., a New York corporation, which is retained in case the need to operate or develop foreclosed real estate emerges.

Additionally, the Bank has 100% ownership in Pathfinder Risk Management Company, Inc. which was established to record the 51% controlling interest upon the December 2013 purchase of the Fitzgibbons Agency, an Oswego County property and casualty and life and health insurance brokerage business with $500,000 in annual revenues. Additional details can be found in Note 23 to the Notes to Consolidated Financial Statements contained herein.

Finally, the Company has a non-consolidated Delaware statutory trust subsidiary, Pathfinder Statutory Trust II, of which 100% of the common equity is owned by the Company. Pathfinder Statutory Trust II was formed in connection with the issuance of $5.2 million in trust preferred securities.

Employees

As of December 31, 2013, the Bank had 101 full-time employees and 23 part-time employees. The employees are not represented by a collective bargaining unit and we consider our relationship with our employees to be good.

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MARKET AREA AND COMPETITION

The economy in the Bank's market area is manufacturing-oriented and is also significantly dependent upon the State University of New York College at Oswego. The major manufacturing employers in the Bank's market area are Entergy Nuclear Northeast, Novelis, Constellation, NRG and Huhtamaki. The Bank is the largest depository institution headquartered in Oswego County. The Bank's business and operating results are significantly affected by the general economic conditions prevalent in its market areas. Our lending and deposit generating area is concentrated in Oswego County and surrounding counties. We are in the process of opening a branch location in Syracuse, New York, (our second branch in Onondaga County) and expect that Syracuse will become a growing portion of our business and deposit generation.

The Bank encounters strong competition both in attracting deposits and in originating real estate and other loans. Its most direct competition for deposits comes from commercial banks, savings banks, savings associations and credit unions in its market area. Competition for loans comes from such financial institutions as well as mortgage banking companies. The Bank competes for deposits by offering depositors a high level of personal service, a wide range of competitively priced financial services, and a strong network of branches, ATMs, and electronic banking. The Bank competes for real estate loans primarily through the interest rates and loan fees it charges and advertising, as well as by originating and holding in its portfolio mortgage loans which do not necessarily conform to secondary market underwriting standards. The turmoil in the residential mortgage sector of the United States economy has caused certain competitors to be less effective in the market place. While Central New York did not experience the level of speculative lending and borrowing in residential real estate that has adversely affected other regions on a national basis, certain mortgage brokers and finance companies in our area are either no longer operating, or have limited aggressive lending practices. Additionally, as certain money centers and large regional banks grapple with current economic conditions and the related credit crisis, their ability to compete as effectively has been reduced. As the economy has improved, and the need for loan growth has increased, competition from banks for the residential, commercial and business loans has increased. Of course, there are others, including tax-exempt credit unions, which continue to compete with us aggressively.

LENDING ACTIVITIES

General

Our loan portfolio is comprised of one- to four-family residential real estate loans, the majority of which have fixed rates of interest. In addition to one- to four-family residential real estate loans, our loan portfolio includes of multi-family residential and commercial real estate loans, commercial, consumer and municipal loans. Our primary lending area is within a five mile radius of a Pathfinder Bank Branch. Pathfinder Bank’s secondary focus is all remaining areas within the Bank’s CRA designated area map as well as Onondaga County.

We try to reduce our interest rate risk by making our loan portfolio less interest rate sensitive. Accordingly, we offer adjustable-rate residential and commercial mortgage loans, short-and medium-term mortgage loans, and floating rate commercial loans. In addition, we offer shorter-term consumer loans and home equity lines of credit with adjustable interest rates. However, in the current and prolonged low interest rate environment, a significant portion of our loan portfolio consists of fixed-rate loans with terms in excess of 15 years.

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Residential Real Estate Loans

Our primary lending activity consists of originating one- to four-family, owner-occupied, first and second residential mortgage loans, virtually all of which are secured by properties located in our market area. The average loan balance of our one- to four-family residential real estate loans was $80,000 at December 31, 2013.

We currently offer one- to four-family residential real estate loans with terms up to 30 years. We offer our one- to four-family residential loans with adjustable or fixed interest rates. Our fixed-rate loans include loans that generally amortize on a monthly basis over periods between 10 to 30 years. One- to four-family residential real estate loans often remain outstanding for significantly shorter periods than their contractual terms because borrowers have the right to refinance or prepay their loans. We also offer home equity loans on which we take a second mortgage.

We currently offer adjustable-rate mortgage loans with an initial interest rate fixed for one, three, or five years, and annual adjustments thereafter based on changes in a designated market index. Our adjustable-rate mortgage loans generally have an interest rate adjustment limit of 200 basis points per adjustment, with a maximum lifetime interest rate adjustment limit of 600 basis points. Our adjustable-rate mortgages are priced at a level tied to the one-year United States Treasury bill rate. We do not offer adjustable-rate mortgages that offer the possibility of negative amortization. In the current low interest rate environment we have not originated a significant dollar amount of adjustable-rate mortgage loans. We have not originated, nor have we invested in, interest-only, negative amortization or payment option ARM loans.

Regulations limit the amount our Bank may lend relative to the appraised value of the real estate securing the loan, as determined by an appraisal of the property at the time the loan is originated. For all first lien position mortgage loans we utilize outside independent appraisers. For second position mortgage loans, for existing Pathfinder Bank first Mortgages, we will use the lesser of the existing appraisal used in underwriting the first mortgage or assessed value. A service which gathers all data from Real Property Tax offices and gives the property a low, middle and high value, together with comparable properties for comparison, will be used for all other second mortgage loans. The middle value from the service will be the value used in underwriting. If the valuation method for the loan amount requested does not provide a value, or the value is not sufficient to support the loan request and it is determined that the borrower(s) are credit worthy, a full appraisal will be ordered.

For borrowers who do not obtain private mortgage insurance, our lending policies limit the maximum loan-to-value ratio on both fixed-rate and adjustable-rate mortgage loans to 90% of the appraised value of the property that is collateral for the loan. For most one- to four-family residential real estate loans with loan-to-value ratios of between 80% and 95%, we require the borrower to obtain private mortgage insurance. For first mortgage loan products, we require the borrower to obtain title insurance. For second mortgage type products, we order a last owner title search from local title companies. We also require homeowners' insurance, fire and casualty, and flood insurance, if necessary, on properties securing real estate loans.

Commercial Lending

Commercial loans consist of the following product classes: real estate, other commercial and industrial, lines of credit and municipal loans, with virtually all of the outstandings located in the counties of Oswego and Onondaga. At December 31, 2013, the average loan balance of our commercial loans, commercial lines of credit and commercial real estate loans was $178,000. At that date, our largest borrower had outstandings of $3.7 million, and the loans were performing in accordance with their terms.

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The Bank performs a credit evaluation to determine the overall transaction risk of any extension of credit (extensions of credit includes all loans, lines of credit, mortgages and exposure limits established for customers) the Bank undertakes and to assign a proper risk rating. Transaction risk may be defined as the probability that a default will take place under proposed terms and conditions, which could then result in a non-performing loan or a potential loss to the Bank. When evaluating transaction risk the following factors are always considered (unless secured and properly margined by liquid collateral):

- Financial risk - are the borrower's financial condition, profitability, and cash flow strong enough and stable enough to allow for the repayment of the loan under its proposed terms and conditions in the normal course of business and are the proposed terms and conditions reasonable. We typically require a debt service coverage ratio of 120% or higher.

- Industry risk - is the borrower's industry subject to cyclical swings or obsolescence, which may impair the borrower's ability to service the debt.

- Management risk - can the borrower's management successfully manage its affairs, is there adequate second line management, and is management of sound moral character. While these are all subjective evaluations a negative answer to any of them strongly implies a high degree of default risk. Except in rare cases, we also require personal guarantees by the principals of the borrower.

- Collateral risk - if a default takes place and restructure is either not feasible or desirable can the collateral be liquidated in a reasonable time frame and in an amount which would preclude a principal loss to the Bank.

Prior to funding a loan secured by multi-family, mixed use or commercial property, we generally obtain an environmental assessment to ascertain the existence of any environmental risks that may be associated with the property. The level of the environmental assessment depends on the facts and circumstances relating to the specific loan.

The commercial loan segment is impacted by general economic conditions but, more specifically, the industry segment in which each borrower participates. Unique competitive changes within a borrower’s specific industry, or geographic location could cause significant changes in the borrower’s revenue stream, and therefore, impact its ability to repay its obligations. Commercial real estate is also subject to general economic conditions but changes within this segment typically lag changes seen within the consumer and commercial segment. Included within this portfolio are both owner occupied real estate, in which the borrower occupies the majority of the real estate property and upon which the majority of the sources of repayment of the obligation is dependent upon, and non-owner occupied real estate, in which several tenants comprise the repayment source for this portfolio segment. The composition and competitive position of the tenant structure may cause adverse changes in the repayment of debt obligations for the non-owner occupied class within this segment.

Municipal Loans

We offer municipal loans to local municipalities which are term loans and typically unsecured.

Consumer Loans

We are authorized to make loans for a variety of personal and consumer purposes. Our procedure for underwriting consumer loans includes an assessment of the applicant’s credit history and ability to meet existing obligations and payments of the proposed loan, as well as an evaluation of the value of the collateral security, if any. Consumer loans generally entail greater risk than residential mortgage loans, particularly in the case of loans that are unsecured or are secured by assets that tend to depreciate in value, such as automobiles. In these cases, repossessed collateral for a defaulted consumer loan may not provide an adequate source of repayment for the outstanding loan, and the remaining value often does not warrant further substantial collection efforts against the borrower.

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Loan Originations, Purchases, Sales and Servicing

Pathfinder Bank originates residential, commercial and consumer loans. Pathfinder Bank's primary market area is customers that reside or work within a five mile radius of a Pathfinder Bank Branch. Pathfinder Bank's secondary market area includes the remaining areas within the banks CRA designated area map as well as Onondaga County. It is the preference of the bank that relationships be solicited and extended to customers having an economic interest in our area. However, if it is determined that a potential customer not having an economic interest in our area but is interested in a loan relationship and the bank has the ability to deliver not less than three bank products or services, these relationships will also be considered.

Our loan portfolio is comprised primarily of one- to four-family residential real estate loans and commercial loans made to businesses. The majority of the residential 1-4 family loans are owner occupied and have fixed rates of interest. The commercial loans made to businesses primarily have adjustable interest rates. In addition to one- to four-family residential real estate and commercial loans, our loan portfolio also consists of second mortgage secured home equity lines of credit and home improvement loans as well as other consumer loans such as auto loans and personal loans.

Our ability to generate each type of loan depends upon borrower demand, market interest rates, borrower preference for fixed- versus adjustable-rate loans, and the interest rates offered on each type of loan by other lenders in our market area. Although the bank has a diversified loan portfolio, a substantial portion of our borrowers' abilities to honor their contracts is dependent upon the counties' employment and economic conditions.

Pathfinder Bank benefits from a number of sources for its loan originations, including real estate broker referrals, existing customers, borrowers, builders, attorneys, and "walk-in" customers. Pathfinder Bank also employs four residential mortgage originators and four commercial lenders who actively market the bank's products and services and are responsible for generating the bulk of the loan originations. Our loan origination activity may be affected adversely by a rising interest rate environment that typically results in decreased loan demand. Other factors such as the overall health of the local economy and competition from other financial institutions can have an impact on the volume of originations. Accordingly, the profitability of this activity may vary from period to period. The majority of the fixed rate residential loans that are originated each year meet the underwriting guidelines established by Fannie Mae. In the past, we have originated residential mortgage loans for sale in the secondary market, and we may do so in the future, although we continue to service them once they are sold.

Loan Approval Procedures and Authority

The directors and management of Pathfinder Bank have developed policies that outline general goals and standards regarding commercial, residential and consumer lending activities consistent with the overall strategic objectives of the Bank.

Providing credit is an essential element of local economic development and of the healthy growth of the Bank. The policies are designed to provide employees with guidelines on acceptable levels of risk, given a broad range of factors. Although the documents enable a certain degree of autonomy by lenders, all exceptions to specific loan policy must be justified by circumstances that warrant consideration of the exception. Each employee who participates in the lending decision process must be familiar with, and understand, the contents of the policy that applies to them.

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Each loan policy sets forth the rules, guidelines and general procedures, which must be followed in the practice of granting credit and fulfilling the following responsibilities:

- Generate earnings for the Bank.
- Protect depositor's funds.
- Ensure all loan decisions, actions and recommendations are based on an accurate and thorough understanding of each customer's financial needs and conditions.
- Promote community, economic growth and development.
- Properly administer credit worthiness and documentation of all loans the lender originates or is assigned.
- Promote and maintain a favorable image for the Bank.
- Identify problems in the lender's portfolio as early as possible so that these loans can be placed on the watch list and can be afforded special care if required.

Individual Lending Authority is granted by the Board of Directors to approve an extension of credit. Each recipient of lending authority is charged with the responsibility of achieving high credit standards and accepts the accountability for his/her credit decisions. The three methods of authorizing an extension of credit are:

- Qualified lenders are individually granted loan authority;
- The Officer Loan Committee has a specified limit, and
- The Executive Loan Committee reviews all loans above the authority granted the Officers Loan Committee.

The Board of Directors has approved and delegated the administration of lending authority to the Loan Officers based on an underwriting matrix score and the borrower's total related credit.

Loans over a lender's authority are referred to an officer with the required authority level. Loans over these limits must be referred to the Officers Loan Committee for approval or recommendation to the Executive Loan Committee.

Lending authority can be increased, suspended or removed by the Board of Directors, as recommended by the President or Senior Vice President and Chief Credit Officer.

Loans to One Borrower

The legal lending limit for Pathfinder Bank to a single borrower is calculated by the Accounting Department consistent with law and reviewed by the Chief Financial Officer and is communicated to lending officers. In no case will Pathfinder Bank intentionally exceed the legal lending limit established by the FDIC and NYS Department of Financial Services. At December 31, 2013 our legal lending limit was $7.3 million.

Pathfinder Bank's internal loan policies limits the total related credit (TRC) to be extended to any one borrower (after application of the rules of attribution), with respect to any and all loans with the Bank to $4.5 million. The indebtedness includes all credit exposure whether direct or contingent, used or unused.

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ASSET QUALITY

Loan Delinquencies and Collection Procedures

When a loan becomes delinquent, we make attempts to contact the borrower to determine the cause of the delayed payments and seek a reasonable solution to permit the loan to be brought current within a reasonable period of time. The outcome can vary with each individual borrower. In the case of mortgage loans and consumer loans, a late notice is sent 15 days after an account becomes delinquent. If delinquency persists, another notice is sent at the 30 day delinquency mark and the 45 day delinquency mark and the 60 day delinquency mark as well. After 15 days, we attempt to establish telephone contact with the borrower. Included in every late notice is a letter that includes information regarding home-ownership counseling. As part of a workout agreement, we will accept partial payments during the month in order to bring the account current. If attempts to reach an agreement are unsuccessful and the customer is unable to comply with the terms of the workout agreement, we will review the account to determine if foreclosure is warranted, in which case, consistent with New York law, we send a 90 day notice of foreclosure and than a 20 day notice before legal proceedings are commenced. A consumer final demand letter is sent in the case of a consumer loan. In the case of commercial loans and commercial mortgage loans, we follow a similar notification practice with the exception of the previously mentioned information on home-ownership counseling. In addition, commercial loans do not require 90 day notices of foreclosure. Generally commercial borrowers only receive 10 day notices before legal proceedings can be commenced. Commercial loans may experience longer workout times which may trigger a need for a loan modification that could meet the requirements of a trouble debt restructured loan. Residential mortgages in excess of $300,000 and commercial lending relationships that exceed $100,000 are evaluated individually for impairment.

Foreclosed real estate

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

Loan delinquencies together with properties within our Foreclosed Real Estate portfolio are reviewed monthly at the Board of Director level.

Impaired Loans, Non-performing Loans and Troubled Debt Restructurings

The policy of Pathfinder Bank is to provide a continuous assessment of the quality of its loan portfolio through the maintenance of an internal and external loan review process. The process incorporates a loan risk grading system designed to recognize degrees of risk on individual commercial and mortgage loans in the portfolio. Management is responsible for strict monitoring of asset quality and risk grade designations.

An existing loan is considered impaired when it is probable that the bank will be unable to collect all amounts due (including both interest and principal) according to the contractual terms of the loan agreement. Loans are non-performing and placed on nonaccrual when the contractual payment of principal and interest has become 90 days past due or management has serious doubts about further collectability of principal or interest, even though the loan may be currently performing. Some loans may be considered non performing and impaired, whereas other loans may only be included in one category. Specific reserve allocations are made for loans that are determined to be impaired. Our Allowance for Loan and Lease Losses policy ("ALLL") establishes criteria for selecting loans to be measured for impairment based on the following:

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Residential and Consumer Loans:

- All loans rated substandard or worse, on nonaccrual, and above our TRC threshold balance of $300,000.
- All Troubled Debt Restructured Loans with a threshold balance of $300,000.
- Any other loans the Bank will be likely unable to collect all amounts of contractual interest and principal as scheduled in the loan agreements.

Commercial leases Lines and Loans, Commercial Real Estate and Municipal Loans:

- All loans rated substandard or worse, on nonaccrual, and above our TRC threshold balance of $100,000.
- All Troubled Debt Restructured Loans threshold balance of $100,000.
- Any other loans the Bank will be likely unable to collect all amounts of contractual interest and principal as scheduled in the loan agreements.

Impairment is measured by determining the present value of expected future cash flows or, for collateral-dependent loans, the fair value of the collateral adjusted for market conditions and selling expenses as compared to the loan carrying value.

Troubled Debt Restructurings ("TDR") are loan restructurings in which the bank, for economic or legal reasons related to an existing borrower's financial difficulties, grants a concession to the debtor that it would not otherwise consider. Typically a TDR involves a modification of terms of a debt, such as reduction of the stated interest rate for the remaining original life of the debt, extension of the maturity date at a stated interest rate lower than the current market rate for new debt with similar risk, reduction of the face amount of the debt, or reduction of accrued interest.

Classifications of Assets

Loans inherently contain credit risk. A key to minimize credit losses is being able to manage these risks effectively. Pathfinder Bank has a risk grading system for our loan assets that is designed as a tool for management and the Board of Directors to assure that Pathfinder Bank is not taking unnecessary and/or unmanageable risk.

The primary objective of the loan risk grading system is to establish a method of assessing credit risk to enable management to measure loan portfolio quality and the adequacy of the allowance for loan losses.

Loan Grades are assigned a numerical value of between 1 through 8. Most loans within the lending portfolio receive a grade of one through four, as these represent accounts with manageable risk. Loans with grades of 5 through 8 have been identified to have credit weaknesses that expose the bank to a potential loss. These loans require special monitoring and, depending on the size of the loan, will require a written action plan removing the loan from the bank's portfolio or strengthening the credit to an acceptable level. All loans that receive a risk grade of 5 and above are placed on the Watchlist Report for continuous monitoring. Loans on the Watchlist Report have additional loan loss reserve allocations assigned to them by grade and account type and may also have specific reserves assigned to individual loans. The administration of the loan grade assignments and the Watchlist Report is the responsibility of the Chief Credit Officer.

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Grades for commercial and municipal loans are assigned primarily upon current documented information in the credit and/or legal files. It is the commercial loan officer's responsibility to properly support credit extensions with all necessary documentation, financial statements, and investigation required by Pathfinder Bank. Subsequent grades are suggested by the officer assigned to each commercial relationship. Grades for residential and consumer loans are assigned primarily upon current documented information. No loan grade is assigned to a residential mortgage or consumer loan unless the loan has demonstrated signs of weakness.

Pathfinder Bank contracts with an external loan review firm to complete a Credit Risk Assessment of the loan portfolio on a regular basis to determine the current level and direction of the bank's credit risk. The loan review process incorporates a risk based approach that separates the loan portfolio in to High, Moderate, and Low risk buckets. The goal is to cover 100% of the High, 50% of the Moderate, and 10% of the Low risk loans in the portfolio. The external loan review firm communicates the results of their findings to the Executive Loan Committee in writing and by periodically attending the Executive Loan Committee meetings. Any serious issues discovered in an external loan review are communicated to the President of Pathfinder Bank immediately.

Allowance for Loan Losses

The allowance for loan losses represents management's estimate of losses inherent in the loan portfolio as of the date of the statement of condition and it is recorded as a reduction of loans. The allowance is increased by the provision for loan losses, and decreased by charge-offs, net of recoveries. Loans deemed to be uncollectible are charged against the allowance for loan losses, and subsequent recoveries, if any, are credited to the allowance. All, or part, of the principal balance of loans receivable are charged off to the allowance as soon as it is determined that the repayment of all, or part, of the principal balance is highly unlikely. Non-residential consumer loans are generally charged off no later than 120 days past due on a contractual basis, unless productive collection efforts are providing results. Consumer loans may be charged off earlier in the event of bankruptcy, or if there is an amount that is deemed uncollectible. No portion of the allowance for loan losses is restricted to any individual loan product and the entire allowance is available to absorb any and all loan losses.

The allowance for loan losses is maintained at a level considered adequate to provide for losses that can be reasonably anticipated. Management performs a quarterly evaluation of the adequacy of the allowance. The allowance is based on three major components which are; specific components for larger loans, recent historical losses and several qualitative factors applied to a general pool of loans, and an unallocated component.

The first component is the specific component that relates to loans that are classified as impaired. For these loans, an allowance is established when the discounted cash flows or collateral value of the impaired loan are lower than the carrying value of that loan.

The second or general component covers pools of loans, by loan class, not considered impaired, smaller balance homogenous loans, such as residential real estate, home equity and other consumer loans. These pools of loans are evaluated for loss exposure first based on historical loss rates for each of these categories of loans. The ratio of net charge-offs to loan outstandings within each product class, over the most recent eight quarters, lagged by one quarter, is used to generate the historical loss rates. In addition, qualitative factors are added to the historical loss rates in arriving at the total allowance for loan loss need for this general pool of loans. The qualitative factors include changes in national and local economic trends, the rate of growth in the portfolio, trends of delinquencies and nonaccrual balances, changes in loan policy, and changes in lending management experience and related staffing. Each factor is assigned a value to reflect improving, stable or declining conditions based on management's best judgment using relevant information available at the time of the evaluation. These qualitative factors, applied to each product class, make the evaluation inherently subjective, as it requires material estimates that may be susceptible to significant revision as more information becomes available. Adjustments to the factors are supported through documentation of changes in conditions in a narrative accompanying the allowance for loan loss analysis and calculation.

The third or 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 specific and general losses in the portfolio and generally comprises less than 10% of the total allowance for loan loss.

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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. Loans that experience insignificant payment delays and payment shortfalls generally are not classified as impaired. Management determines the significance of payment delays and shortfalls on a case-by case basis, taking into consideration all of the circumstances surrounding the loan and the borrower, including the length and reason for the delay, the borrower's prior payment record and the amount of shortfall in relation to what is owed. Impairment is measured by either the present value of the expected future cash flows discounted at the loan's effective interest rate or the fair value of the underlying collateral if the loan is collateral dependent. The majority of the Company's loans utilize the fair value of the underlying collateral.

An allowance for loan loss is established for an impaired loan if its carrying value exceeds its estimated fair value. The estimated fair values of substantially all of the Company's impaired loans are measured based on the estimated fair value of the loan's collateral. For loans secured by real estate, estimated fair values are determined primarily through third-party appraisals. When a real estate secured loan becomes impaired, a decision is made regarding whether an updated certified appraisal of the real estate is necessary. This decision is based on various considerations, including the age of the most recent appraisal, the loan-to-value ratio based on the original appraisal, and the condition of the property. Appraised values are discounted to arrive at the estimated selling price of the collateral, which is considered to be the estimated fair value. The discounts also include estimated costs to sell the property.

For commercial and industrial loans secured by non-real estate collateral, such as accounts receivable, inventory and equipment, estimated fair values are determined based on the borrower's financial statements, inventory reports, account receivable agings or equipment appraisals or invoices. Indications of value from these sources are generally discounted based on the age of the financial information or the quality of the assets.

Large groups of homogeneous loans are collectively evaluated for impairment. Accordingly, the Company does not separately identify individual residential mortgage loans less than $300,000, home equity and other consumer loans for impairment disclosures, unless such loans are related to borrowers with impaired commercial loans or they are the subject to a troubled debt restructuring agreement for those with a carrying value in excess of $300,000.

Commercial loans whose terms are modified are classified as troubled debt restructurings if the Company grants such borrowers concessions and it is deemed that those borrowers are experiencing financial difficulty. Concessions granted under a troubled debt restructuring generally include but are not limited to a temporary reduction in the interest rate or an extension of a loan's stated maturity date. Commercial loans classified as troubled debt restructurings with a carrying value in excess of $100,000 are designated as impaired and evaluated as discussed above.

The allowance calculation methodology includes further segregation of loan classes into risk rating categories. The borrower's overall financial condition, repayment sources, guarantors and value of the collateral, if appropriate, are evaluated not less than annually for commercial loans or when credit deficiencies arise on all loans. Credit quality risk ratings include regulatory classifications of special mention, substandard, doubtful and loss.

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In addition, regulatory agencies, as an integral part of their examination process, periodically review the Company's allowance for loan losses and 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, which may not be currently available to management. Based on management's comprehensive analysis of the loan portfolio, management believes the current level of the allowance for loan losses is adequate.

INVESTMENT ACTIVITIES

Our investment policy is established by the board of directors. This policy dictates that investment decisions will be made based on the safety of the investment, liquidity requirements, potential returns, cash flow targets, and consistency with our interest rate risk management. The board of directors, as a whole, acts in the capacity of an investment committee and is responsible for overseeing our investment program and evaluating on an ongoing basis our investment policy and objectives. Our president and chief financial officer have the authority to purchase securities within specific guidelines established by the investment policy. All transactions are reviewed by the board of directors at its regular meeting.

All investment securities must meet regulatory guidelines and be permissible bank investments, including United States Government obligations, securities of various federal agencies and of state and municipal governments, deposits at the Federal Home Loan Bank of New York (FHLBNY), certificates of deposit at federally insured institutions, and federal funds. Within certain regulatory limits, we may also invest a portion of our assets in mutual funds, equity securities and investment grade corporate debt securities. We are also required to maintain an investment in FHLBNY stock.

All securities purchased will be classified at the time of purchase as either a held-to-maturity or available-for-sale. The bank does not maintain a trading account. Securities purchased with the intent and ability to hold until maturity may be classified as held-to-maturity. Securities placed in the held-to-maturity category will be accounted for at amortized cost.

Securities that do not qualify or are not categorized as held to maturity are classified as available-for-sale. This classification includes securities that may be sold in response to changes in interest rates, the security's prepayment risk, liquidity needs, the availability of and the yield on alternative investments, and funding sources and terms. These securities are reported at fair value, which will be determined on a monthly basis in conjunction with the preparation of board report financial statements. Unrealized gains and losses are reported as a separate component of capital, net of tax. The aggregate change in value of the portfolio will be reported to the Board of Directors monthly.

The general objectives of the investment portfolio are to provide for the overall asset/liability management of the bank, generate a reasonable rate of return consistent with the safety of principal, provide a source of liquidity, provide adequate capital where needed, minimize the bank's tax liability, and minimize the bank's interest rate and credit risk. We purchase securities to provide necessary liquidity for day-to-day operations, and when investable funds exceed loan demand. The effect that the proposed security would have on our credit and interest rate risk and risk-based capital is also considered.

Our securities classified as available-for-sale, other than mortgage-backed securities, consisted of Federal agency obligations, primarily Federal Farm Credit Bank (FFCB) notes, FHLBNY notes, Federal National Mortgage Association (FNMA) and Federal Home Loan Mortgage Corporation (FHLMC) obligations with remaining maturities of one to six years. Mortgage backed securities are discussed in the next section.

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Included within the security portfolio are three mutual fund positions. The first is a mutual fund backed by adjustable rate mortgage-backed securities and cash equivalents. The second material equity security listed is a mutual fund consisting primarily of investment grade dividend-paying common stocks of large capitalization companies, i.e., companies with market capitalization in excess of $5 billion. The third fund, Financial Institutions Fund, LLC invests primarily in equity securities issued by community banks and thrift institutions and holding companies of such banks and thrifts located principally in the Northeastern United States. The fund seeks out banks and thrifts with less than $5.0 billion in assets that are high performing or ones that represent M&A values or are strategically located in a market where a major competitor was recently acquired by a larger institution.

We also have a $2.4 million investment in FHLBNY stock at December 31, 2013, which is classified separately from securities due to the restrictions on sale or transfer. For further information regarding our securities portfolio, see Note 4 to the Consolidated Financial Statements.

MORTGAGE-BACKED SECURITIES AND COLLATERALIZED MORTGAGE OBLIGATIONS

We purchase mortgage-backed securities and collateralized mortgage obligations guaranteed by Fannie Mae, Freddie Mac and Ginnie Mae. We invest in mortgage-backed securities and collateralized mortgage obligations to achieve positive interest rate spreads with minimal administrative expense, and to lower our credit risk. We regularly monitor the credit quality of this portfolio.

Mortgage-backed securities and collateralized mortgage obligations are created by the pooling of mortgages and the issuance of a security with an interest rate which is less than the interest rate on the underlying mortgages. These securities typically represent a participation interest in a pool of single-family or multi-family mortgages, although we focus our investments on mortgage related securities backed by one- to four-family mortgages. The issuers of such securities pool and resell the participation interests in the form of securities to investors such as Pathfinder Bank, and in the case of government agency sponsored issues, guarantee the payment of principal and interest to investors. Mortgage-backed securities and collateralized mortgage obligations generally yield less than the loans that underlie such securities because of the cost of payment guarantees, if any, and credit enhancements. These fixed-rate securities are usually more liquid than individual mortgage loans.

SOURCES OF FUNDS

General

Deposits have traditionally been our primary source of funds for use in lending and investment activities. We also rely on advances from the FHLBNY. In addition to deposits and borrowings, we derive funds from scheduled loan payments, investment maturities, loan prepayments, retained earnings and income on earning assets. While scheduled loan payments and income on earning assets are relatively stable sources of funds, deposit inflows and outflows can vary widely and are influenced by prevailing market interest rates, economic conditions and competition from other financial institutions.

Deposits

A majority of our depositors are persons who work or reside in Oswego and Onondaga Counties. We offer a selection of deposit instruments, including checking, savings, money market deposit accounts, and certificates of deposit. Deposit account terms vary, with the principal differences being the minimum balance required, the amount of time the funds must remain on deposit and the interest rate. We establish interest rates, maturity terms, service fees and withdrawal penalties on a periodic basis. Management determines the rates and terms based on rates paid by competitors, our need for funds or liquidity, and overall growth goals.

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The Certificate of Deposit Account Registry Service ("CDARS") is a form of brokered deposit program in which the Bank has been a participant since 2009. In addition to offering depositors enhanced FDIC insurance coverage, being a participant in CDARS allows the Bank to fund its balance sheet through their One-Way Buy program. This program uses a competitive bid process to allocate funding. Management believes this arrangement is a viable source of funding provided that the Bank maintains its well-capitalized status. The Bank may participate in CDARS up to 15% of reported total assets or $75.6 million as of December 31, 2013.

Borrowings

We may obtain advances from the FHLBNY utilizing the security of the common stock we own in the FHLBNY and our qualifying residential mortgage, provided certain standards related to creditworthiness are met. These advances are made pursuant to several credit programs, each of which has its own interest rate and range of maturities. Federal Home Loan Bank advances are generally available to meet seasonal and other withdrawals of deposit accounts and to permit increased lending.

REGULATION AND SUPERVISION

General

The Company and the Mutual Holding Company ("MHC") are federally chartered and, up until July 21, 2011, were subject to regulation by the Office of Thrift Supervision ("OTS") as savings and loan holding companies. However, under the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act"), which is discussed further below, the OTS's functions relating to savings and loan holding companies were transferred to the Board of Governors of the Federal Reserve System ("Federal Reserve"). The Company and the MHC therefore became regulated by the Federal Reserve as of the above date.

Regulatory requirements applicable to the Bank, the Company and the Mutual Holding Company are referred to below or elsewhere herein. This description of statutory and regulatory provisions does not purport to be a complete description of all such statutes and regulations applicable to the MHC, the Company, or the Bank. Any change in these laws or regulations, whether by Congress or the applicable regulatory agencies, could have a material adverse impact on the Bank, the Company or the Mutual Holding Company.

Dodd-Frank Act

The Dodd-Frank Act is significantly changing the current bank regulatory structure and affecting the lending, investment, trading and operating activities of financial institutions and their holding companies. The Dodd-Frank Act changed the current primary federal regulator of the Company and the Mutual Holding Company from the OTS to the Federal Reserve. The Federal Reserve now supervises and regulates all savings and loan holding companies, such as the Company and the Mutual Holding Company. The Dodd-Frank Act requires the Federal Reserve to set minimum capital levels for depository institution holding companies that are as stringent as those required for the insured depository subsidiaries, and the components of Tier 1 capital will be restricted to capital instruments that are currently considered to be Tier 1 capital for insured depository institutions. Under the Dodd-Frank Act, the proceeds of trust preferred securities are excluded from Tier 1 capital unless such securities were issued prior to May 19, 2010 by bank or savings and loan holding companies with less than $15 billion of assets. The legislation also establishes a floor for capital requirements of insured depository institutions, which cannot be lower than the standards in effect when the legislation was enacted and directs the federal banking regulators to implement new leverage and capital requirements. These new leverage and capital requirements must take into account off-balance sheet activities and other risks, including risks relating to securitized products and derivatives. The required regulations were issued in 2013 and are discussed later.

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The Dodd-Frank Act also created a new Consumer Financial Protection Bureau with broad powers to supervise and enforce consumer protection laws. The Consumer Financial Protection Bureau has broad rule-making authority for a wide range of consumer protection laws that apply to all banks and savings institutions such as Pathfinder Bank, including the authority to prohibit “unfair, deceptive or abusive” acts and practices. The Consumer Financial Protection Bureau has examination and enforcement authority over all banks and savings institutions with more than $10 billion in assets. Banks and savings institutions with $10 billion or less in assets continue to be examined by their applicable bank regulators. The Dodd-Frank Act also provides for regulations requiring originators of certain securitized loans to retain a percentage of the risk for transferred loans, established regulatory rate-setting for certain debit and interchange fees, repealed restrictions on the payment of interest on commercial demand deposits and contained a number of reforms related to mortgage originations. The legislation also weakened the federal preemption available for national banks and federal savings associations, and gives state attorneys general the ability to enforce applicable federal consumer protection laws.

The Dodd-Frank Act broadened the base for Federal Deposit Insurance Corporation insurance assessments. Assessments are now being based on the average consolidated total assets less tangible equity capital of a financial institution. The legislation also permanently increased the maximum amount of deposit insurance for banks, savings institutions and credit unions to $250,000 per depositor, and non-interest bearing transaction accounts had unlimited deposit insurance through December 31, 2012. The Dodd-Frank Act increased stockholder influence over boards of directors by requiring companies to give stockholders a non-binding vote on executive compensation and so-called “golden parachute” payments, and authorizing the Securities and Exchange Commission to promulgate rules that would allow stockholders to nominate and solicit votes for their own candidates using a company’s own proxy materials. These particular requirements were not imposed on the Company in 2012. The legislation also directs the Federal Reserve to promulgate rules prohibiting excessive compensation paid to bank holding company executives, regardless of whether the company is publicly traded or not.

New York State Banking Law and FDIC Regulation

The Bank derives its lending, investment and other authority primarily from the applicable provisions of New York State Banking Law and the regulations of the New York State Banking Department, as limited by FDIC regulations. In particular, the applicable provisions of New York State Banking Law and regulations governing the investment authority and activities of an FDIC insured state-chartered savings bank, and its subsidiary commercial bank, have been substantially limited by the Federal Deposit Insurance Corporation Improvement Act of 1991 (“FDICIA”) and the FDIC regulations issued pursuant thereto. Under these laws and regulations, savings banks, including the Bank, may invest in real estate mortgages, consumer and commercial loans, certain types of debt securities, including certain corporate debt securities and obligations of federal, state and local governments and agencies, certain types of corporate equity securities and certain other assets. New York State chartered savings banks may also invest in subsidiaries under their service corporation investment authority. A savings bank may use this power to invest in corporations that engage in various activities authorized for savings banks, plus any additional activities, which may be authorized by the Banking Board. Under FDICIA and the FDIC’s implementation of regulations, the Bank’s investment and service corporation activities are limited to activities permissible for a national bank unless the FDIC otherwise permits it.

The FDIC and the Superintendent have broad enforcement authority over the Bank. Under this authority, the FDIC and the Superintendent have the ability to issue formal or informal orders to correct violations of laws or unsafe or unsound banking practices.

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FDIC Insurance on Deposits

The Federal Deposit Insurance Corporation, or FDIC, insures deposits at FDIC insured financial institutions such as the Bank. Deposit accounts in the Bank are insured by the FDIC generally up to a maximum of $250,000 per depositor and up to a maximum of $250,000 for self-directed retirement accounts. The FDIC charges the insured financial institutions assessments to maintain the Deposit Insurance Fund.

Under the FDIC's current risk-based assessment system, insured institutions are generally assigned to a "risk category" based on supervisory evaluations, regulatory capital levels and certain other risk factors. Assessments are based on the risk category to which an institution is assigned and certain risk adjustments assigned by FDIC regulations.

In February 2011, the FDIC published a final rule under the Dodd-Frank Act to reform the deposit insurance assessment system. The rule redefined the assessment base used for calculating deposit insurance assessments effective April 1, 2011. Under the new rule, assessments are based on an institution's average consolidated total assets minus average tangible equity rather than total deposits. Since the new base is much larger than the former base, the FDIC also lowered assessment rates so that the total amount of revenue collected from the industry was not significantly altered. The new range is 2½ basis points to 45 basis points of total consolidated assets less tangible equity. The new rule benefitted smaller financial institutions, which typically rely more on deposits for funding, and shifts more of the burden for supporting the insurance fund to larger institutions, which have greater access to non-deposit sources of funding. As a result of the change in the assessment base, the Company experienced an approximate 50% reduction in its quarterly assessment charges effective with the second quarter of 2011.

In addition to the FDIC assessments, the Financing Corporation ("FICO") is authorized to impose and collect, with the approval of the FDIC, assessments for anticipated payments, issuance costs and custodial fees on bonds issued by the FICO in the 1980s to recapitalize the former Federal Savings and Loan Insurance Corporation. The bonds issued by the FICO are due to mature in 2017 through 2019. During the year ended December 31, 2013, the Bank paid $29,000 in fees related to the FICO.

Insurance of deposits may be terminated by the FDIC upon a finding that an institution has engaged in unsafe or unsound practices, is in an unsafe or unsound condition to continue operations or has violated any applicable law, regulation, rule, order or condition imposed by the FDIC. We do not currently know of any practice, condition or violation that may lead to termination of our deposit insurance.

Regulatory Capital Requirements

The FDIC has adopted risk-based capital guidelines to which the Bank is subject. The guidelines establish a systematic analytical framework that makes regulatory capital requirements more sensitive to differences in risk profiles among banking organizations. The Bank is required to maintain certain levels of regulatory capital in relation to regulatory risk-weighted assets. The ratio of such regulatory capital to regulatory risk-weighted assets is referred to as the Bank's "risk-based capital ratio." Risk-based capital ratios are determined by allocating assets and specified off-balance sheet items to four risk-weighted categories ranging from 0% to 100%, with higher levels of capital being required for the categories perceived as representing greater risk.

These guidelines divide a savings bank's capital into two tiers. The first tier ("Tier I") includes common equity, retained earnings, certain non-cumulative perpetual preferred stock (excluding auction rate issues) and minority interests in equity accounts of consolidated subsidiaries, less goodwill and other intangible assets (except mortgage servicing rights and purchased credit card relationships subject to certain limitations). Supplementary ("Tier II") capital includes, among other items, Tier 1 capital, cumulative perpetual and long-term limited-life preferred stock, mandatory convertible securities, certain hybrid capital instruments, term subordinated debt and the allowance for loan and lease losses, subject to certain limitations, less required deductions. Savings banks are required to maintain a total risk-based capital ratio of at least 8%, and a Tier I risk based capital level of at least 4%.

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In addition, the FDIC has established regulations prescribing a minimum Tier I leverage ratio (Tier I capital to adjusted total average assets as specified in the regulations). These regulations provide for a minimum Tier I leverage ratio of 3% for banks that meet certain specified criteria, including that they have the highest examination rating and are not experiencing or anticipating significant growth. All other banks are required to maintain a Tier I leverage ratio of at least 4%.

The FDIC may set higher leverage and risk-based capital requirements on individual institutions when particular circumstances warrant. Savings banks experiencing or anticipating significant growth are expected to maintain capital ratios, including tangible capital positions, well above the minimum levels.

In July 2013, the FDIC and the other federal bank regulatory agencies issued a final rule that will revise their leverage and risk-based capital requirements and the method for calculating risk-weighted assets to make them consistent with agreements that were reached by the Basel Committee on Banking Supervision and certain provisions of the Dodd-Frank Act. Among other things, the rule establishes a new common equity Tier 1 minimum capital requirement (4.5% of risk-weighted assets), increases the minimum Tier 1 capital to risk-based assets requirement (from 4% to 6% of risk-weighted assets) and assigns a higher risk weight (150%) to exposures that are more than 90 days past due or are on nonaccrual status and to certain commercial real estate facilities that finance the acquisition, development or construction of real property. The final rule also requires unrealized gains and losses on certain "available-for-sale" securities holdings to be included for purposes of calculating regulatory capital unless a one-time opt-out is exercised and requires more stringent treatment of mortgage servicing assets and certain deferred tax assets. The rule limits a banking organization's capital distributions and certain discretionary bonus payments if the banking organization does not hold a "capital conservation buffer" consisting of 2.5% of common equity Tier 1 capital to risk-weighted assets in addition to the amount necessary to meet its minimum risk-based capital requirements. The final rule becomes effective for the Bank on January 1, 2015. The capital conservation buffer requirement will be phased in beginning January 1, 2016 and ending January 1, 2019, when the full capital conservation buffer requirement will be effective.

SBLF Participation

On September 1, 2011, the Company entered into a Securities Purchase Agreement with the Secretary of the Treasury ("Treasury") pursuant to which the Company sold to the Treasury 13,000 shares of its Senior Non-Cumulative Perpetual Preferred Stock, Series B ("Series B Preferred Stock"), having a liquidation preference of $1,000 per share for aggregate proceeds of $13,000,000. This transaction was entered into as part of the Treasury's Small Business Lending Fund Program ("SBLF"). In connection therewith, the Company redeemed all 6,771 shares of its Fixed Rate Cumulative Perpetual Preferred Stock, Series A ("Series A Preferred Stock") sold to the Treasury on September 11, 2009 in connection with the Treasury's Capital Purchase Program ("CPP"). The Company paid $6,786,000 to the Treasury to redeem the Series A Preferred Stock, which included the original investment of $6,771,000, plus accrued dividends. In connection with its participation in SBLF, the Company repurchased from Treasury, a warrant (the "Warrant") to purchase 154,354 shares of the Company's common stock at an exercise price per share of $6.58. The Warrant was previously issued to Treasury in connection with the Company's participation in the CPP. The repurchase price of the Warrant was an agreed upon price of $537,633.

Accordingly, the Company is no longer subject to restrictions of the CPP program. The SBLF program does have its own requirements, which are summarized below:

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The Series B Preferred Stock is entitled to receive non-cumulative dividends payable quarterly, on each January 1, April 1, July 1 and October 1, beginning October 1, 2011. The dividend rate, which is calculated on the aggregate Liquidation Amount, was initially set at 4.2% per annum based upon the current level of "Qualified Small Business Lending", or "QSBL" (as defined in the Securities Purchase Agreement) by the Bank. The dividend rate for dividend periods subsequent to the initial period is set based upon the "Percentage Change in Qualified Lending" (as defined in the Securities Purchase Agreement) between each dividend period and the "Baseline" QSBL level. Such dividend rate may vary from 1% per annum to 5% per annum for the second through tenth dividend periods, from 1% per annum to 7% per annum for the eleventh through the first half of the nineteenth dividend periods. If the Series B Preferred Stock remains outstanding for more than four-and-one-half years, the dividend rate will be fixed at 9%. Prior to that time, in general, the dividend rate decreases as the level of the Bank's QSBL increases. The Company's dividend rate as of the date of this report is 1.00%. Such dividends are not cumulative, but the Company may only declare and pay dividends on its common stock (or any other equity securities junior to the Series B Preferred Stock) if it has declared and paid dividends for the current dividend period on the Series B Preferred Stock, and is subject to other restrictions on its ability to repurchase or redeem other securities.

The Company may redeem the shares of Series B Preferred Stock, in whole or in part, at any time at a redemption price equal to the sum of the Liquidation Amount per share and the per-share amount of any unpaid dividends for the then-current period, subject to any required prior approval by the Company's primary federal banking regulator.

The Company's ability to pay common stock dividends is conditional on payment of the Series B Preferred Stock Dividends described above. In addition, the SBLF program requires the Company to file quarterly reports on QSBL lending, which must be audited annually. The Company must also outreach and advertise the availability of QSBL to organizations and individuals who represent minorities, women and veterans. The Company must annually certify that no business loans are made to principals of businesses who have been convicted of a sex crime against a minor. Finally, the SBLF program requires the Company to file quarterly, annual and other reports provided to shareholders concurrently with the Treasury.

Limitations on Bank Dividends and Other Capital Distributions

The FDIC has the authority to use its enforcement powers to prohibit a savings bank from paying dividends if, in its opinion, the payment of dividends would constitute an unsafe or unsound practice. Federal law also prohibits the payment of dividends by a bank that will result in the bank failing to meet its applicable capital requirements on a pro forma basis. New York law also restricts the Bank from declaring a dividend that would reduce its capital below the amount that is required to be maintained by state law and regulation. The Bank is also subject to dividend notification requirements to the Federal Reserve by virtue of the Company being a savings and loan holding company. The Federal Reserve may object to a proposed dividend if the Bank will become undercapitalized or the dividend is deemed to be unsafe or unsound or violate a law, regulation or order. An inability of the Bank to pay dividends may inhibit the Company's ability to pay dividends.

Prompt Corrective Action

The federal banking agencies have promulgated regulations to implement the system of prompt corrective action required by federal law. Under the regulations, a bank is deemed to be (i) "well capitalized" if it has total risk-based capital of 10% or more, has a Tier I risk-based capital ratio of 6% or more, has a Tier I leverage capital ratio of 5% or more and is not subject to any written capital order or directive; (ii) "adequately capitalized" if it has a total risk based capital ratio of 8% or more, a Tier I risk-based capital ratio of 4% or more and a Tier I leverage capital ratio of 4% or more (3% under certain circumstances) and does not meet the definition of "well capitalized"; (iii) "undercapitalized" if it has a total risk-based capital ratio that is less than 8%, a Tier I risk-based capital ratio that is less than 4% or a Tier I leverage capital ratio that is less than 4% (3% under certain circumstances); (iv) "significantly undercapitalized" if it has a total risk-based capital ratio that is less than 6%, a Tier I risk-based capital ratio that is less than 3% or a Tier I leverage capital ratio that is less than 3%; and (v) “critically undercapitalized” if it has a ratio of tangible equity to total assets that is equal to or less than 2%. Federal law and regulations also specify circumstances under which a federal banking agency may reclassify a well capitalized institution as adequately capitalized and may require an adequately capitalized institution to comply with supervisory actions as if it were in the next lower category (except that the FDIC may not reclassify a significantly undercapitalized institution as critically undercapitalized).

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The regulations require that savings banks that have insufficient capital take certain corrective actions. For example, a savings bank that is categorized as "undercapitalized" is subject to growth limitations, may generally not make capital distributions, including paying dividends, and would be required to submit an acceptable capital restoration plan. A holding company that controls such a savings bank would be required to guarantee that the savings bank complies with the restoration plan in an amount of up to the lesser of 5% of the institution's total assets or the amount of capital needed for the institution to achieve compliance with regulatory capital requirements. A "significantly undercapitalized" savings bank is subject to additional restrictions. Savings banks deemed by the FDIC to be "critically undercapitalized" would be subject to the appointment of a receiver or conservator within specified time frames.

The Bank currently meets the criteria to be classified as a "well capitalized" savings institution. The previously mentioned final regulatory capital rule that will increase regulatory capital requirements will adjust the prompt corrective action categories accordingly. Additional details can be found in Note 18 to the Notes to Consolidated Financial Statements contained herein.

Transactions with Affiliates and Insiders

Under current federal law, transactions between depository institutions and their affiliates are governed by Sections 23A and 23B of the Federal Reserve Act and its implementing regulations. An affiliate of a savings bank is any company or entity that controls, is controlled by, or is under common control with the savings bank, other than a subsidiary of the savings bank. In a holding company context, at a minimum, the parent holding company of a savings bank, and any companies that are controlled by such parent holding company, are affiliates of the savings bank. Generally, Section 23A limits the extent to which the savings bank or its subsidiaries may engage in "covered transactions" with any one affiliate to an amount equal to 10% of such savings bank's capital stock and surplus and contains an aggregate limit on all such transactions with all affiliates to an amount equal to 20% of such capital stock and surplus. The term "covered transaction" includes the making of loans or other extensions of credit to an affiliate, the purchase of assets from an affiliate, an investment in the securities of an affiliate, the acceptance of securities of an affiliate as collateral for a loan or extension of credit, the issuance of a guarantee, acceptance, or letter of credit on behalf of an affiliate and certain other transactions resulting in credit exposure to an affiliate. Section 23A also establishes specific collateral requirements for certain transactions such as loans or extensions of credit to, or guarantees, acceptances on letters of credit issued on behalf of an affiliate. Section 23B requires that covered transactions and a broad list of other specified transactions be on terms substantially the same, or no less favorable, to the savings bank or its subsidiary as similar transactions with nonaffiliates.

Section 22(h) of the Federal Reserve Act and its implementing regulations restrict a savings bank with respect to loans to directors, executive officers, and principal stockholders. Under Section 22(h), loans to directors, executive officers and stockholders who control, directly or indirectly, 10% or more of voting securities of a savings bank and certain related interests of any of the foregoing, may not exceed, together with all other outstanding loans to such persons and affiliated entities, the savings bank's total unimpaired capital and unimpaired surplus. Section 22(h) also prohibits loans above amounts prescribed by the appropriate federal banking agency to directors, executive officers, and stockholders who control 10% or more of voting securities of a stock savings bank, and their respective related interests, unless such loan is approved in advance by a majority of the board of directors of the savings bank. Any "interested" director may not participate in the voting. Further, pursuant to Section 22(h), loans to directors, executive officers and principal stockholders must generally be made on terms substantially the same as offered in comparable transactions to other persons. Section 22(g) of the Federal Reserve Act places additional limitations on loans to executive officers.

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Qualified Thrift Lender Test

In order for the Company and the Mutual Holding Company to be regulated as savings and loan holding companies (rather than as bank holding companies), Pathfinder Bank must qualify as a Qualified Thrift Lender. To qualify as a Qualified Thrift Lender, Pathfinder Bank must be a "domestic building and loan association," as defined in the Internal Revenue Code, or comply with the Qualified Thrift Lender test. Under the Qualified Thrift Lender test, a savings bank is required to maintain at least 65% of its "portfolio assets" (total assets less: (1) specified liquid assets up to 20% of total assets; (2) intangibles, including goodwill; and (3) the value of property used to conduct business) in certain "qualified thrift investments" (primarily residential mortgages and related investments, including certain mortgage-backed and related securities) in at least nine months out of each 12-month period. As of December 31, 2013 Pathfinder Bank met the Qualified Thrift Lender test.

Supervisory Agreement

During May 2009, the Company entered into a Supervisory Agreement with the OTS. The agreement was issued in connection with the identification of certain violations of applicable statutory and regulatory restrictions on capital distributions and transactions with affiliates.

On November 26, 2013, the Company was informed by the Federal Reserve that the Supervisory Agreement was hereby terminated, indicating that the Company has complied with the terms of the Agreement.

Federal Holding Company Regulation

General. The Company and the Mutual Holding Company have elected to be regulated as savings and loan holding companies within the meaning of the Home Owners' Loan Act. The Company and the Mutual Holding Company are registered with the Federal Reserve and are subject to Federal Reserve regulations, examinations, supervision and reporting requirements. As such, the Federal Reserve has enforcement authority over the Company and the Mutual Holding Company, and their non-savings institution subsidiaries. Among other things, this authority permits the Federal Reserve to restrict or prohibit activities that are determined to be a serious risk to the subsidiary savings institution. The Federal Reserve assumed regulatory authority over savings and loan holding companies from OTS on July 21, 2011, pursuant to the Dodd-Frank Act. See "The Dodd-Frank Act" above.

Permitted Activities. Under federal regulation and policy, a mutual holding company and a federally chartered mid-tier holding company, such as the Company, may engage in the following activities: (i) investing in the stock of a savings association; (ii) acquiring a mutual association through the merger of such association into a savings association subsidiary of such holding company or an interim savings association subsidiary of such holding company; (iii) merging with or acquiring another holding company, one of whose subsidiaries is a savings association; (iv) investing in a corporation, the capital stock of which is available for purchase by a savings association under federal law or under the law of any state where the subsidiary savings association or associations share their home offices; (v) furnishing or performing management services for a savings association subsidiary of such company; (vi) holding, managing or liquidating assets owned or acquired from a savings subsidiary of such company; (vii) holding or managing properties used or occupied by a savings association subsidiary of such company; (viii) acting as trustee under deeds of trust; (ix) any other activity that (A) has been deemed to be permissible for bank holding companies under Section 4(c) of the Bank Holding Company Act of 1956, unless the Federal Reserve, by regulation, prohibits or limits any such activity for savings and loan holding companies; or (B) in which multiple savings and loan holding companies were authorized (by regulation) to directly engage in March 5, 1987; (x) any activity permissible for financial holding companies under Section 4(k) of the Bank Holding Company Act (provided certain criteria are met), including securities and insurance underwriting; and (xi) purchasing, holding, or disposing of stock acquired in connection with a qualified stock issuance if the purchase of such stock by such savings and loan holding company is approved by the Federal Reserve. If a mutual holding company acquires or merges with another holding company, the holding company acquired or the holding company resulting from such merger or acquisition may only invest in assets and engage in activities listed in (i) through (xi) above, and has a period of two years to cease any nonconforming activities and divest of any nonconforming investments.

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Federal Law Act prohibits a savings and loan holding company, directly or indirectly, or through one or more subsidiaries, from acquiring another savings association or holding company thereof, without prior written approval of the Federal Reserve. It also prohibits the acquisition or retention of, with certain exceptions, more than 5% of a nonsubsidiary savings association, a nonsubsidiary holding company, or a nonsubsidiary company engaged in activities other than those permitted by federal law; or acquiring or retaining control of an institution that is not federally insured. In evaluating applications by holding companies to acquire savings associations, the Federal Reserve must consider factors such as the financial and managerial resources and future prospects of the company and association involved, the effect of the acquisition on the risk to the deposit insurance funds, the convenience and needs of the community and competitive factors.

The Federal Reserve is prohibited from approving any acquisition that would result in a multiple savings and loan holding company controlling savings associations in more than one state, subject to two exceptions: (i) the approval of interstate supervisory acquisitions by savings and loan holding companies, and (ii) the acquisition of a savings institution in another state if the laws of the state of the target savings institution specifically permit such acquisitions. The states vary in the extent to which they permit interstate savings and loan holding company acquisitions.

Unlike bank holding companies, savings and loan holding companies are not currently subject to specific consolidated regulatory capital requirements. The Dodd-Frank Act, however, requires the promulgation of such capital requirements for depository institution holding companies, including savings and loan holding companies, that are no less stringent, both quantitatively and in terms of components of capital, than those applicable to institutions themselves. The previously discussed final rule regarding regulatory capital requirements implements the Dodd-Frank Act's directive as to savings and loan holding companies. The consolidated regulatory capital requirements will apply to savings and loan holding companies as of January 1, 2015. As is the case with institutions themselves, the capital conservation buffer will be phased in between 2016 and 2019.

The Dodd-Frank Act extended the "source of strength" doctrine to savings and loan holding companies. The Federal Reserve has promulgated regulations implementing the "source of strength" policy that require savings and loan holding companies to act as a source of strength to their subsidiary depository institutions by providing capital, liquidity and other support in times of financial stress.

The Federal Reserve has issued a policy statement regarding the payment of dividends and other capital distributions by bank holding companies that it has made applicable to savings and loan holding companies as well. In general, the policy provides that dividends should be paid only out of current earnings and only if the prospective rate of earnings retention by the holding company appears consistent with the organization's capital needs, asset quality and overall financial condition. Regulatory guidance provides for prior regulatory consultation as to capital distributions in certain circumstances such as where the company's net income for the past three years, net of dividends previously paid over that period, is insufficient to fully fund the dividend or the company's overall rate of earnings retention is inconsistent with the company's capital needs and overall financial condition. The ability of a holding company to pay dividends may be restricted if a subsidiary depository institution becomes undercapitalized. The guidance also provides for regulatory review prior to a holding company redeeming or repurchasing capital instruments in certain situations. These regulatory policies could affect the ability of the Company to pay dividends, repurchase shares of common stock or otherwise engage in capital distributions.

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Since the Company has chosen to participate in the Treasury's SBLF program, it is permitted to pay dividends on its common stock provided certain Tier 1 capital minimums are exceeded and SBLF dividends have been declared and paid to Treasury as of the most recent dividend period.

Waivers of Dividends by Mutual Holding Company. The Dodd-Frank Act requires federally-chartered mutual holding companies to give the Federal Reserve notice before waiving the receipt of dividends, and provides that in the case of "grandfathered" mutual holding companies, like the Mutual Holding Company, the Federal Reserve "may not object" to a dividend waiver if the board of directors of the mutual holding company waiving dividends determines that the waiver: (i) would not be detrimental to the safe and sound operation of the subsidiary savings bank; and (ii) is consistent with the board's fiduciary duties to members of the mutual holding company. To qualify as a grandfathered mutual holding company, a mutual holding company must have been formed, issued stock and waived dividends prior to December 1, 2009. The Dodd-Frank Act further provides that the Federal Reserve may not consider waived dividends in determining an appropriate exchange ratio upon the conversion of a grandfathered mutual holding company to stock form. In September 2011, however, the Federal Reserve issued an interim final rule that also requires, as a condition to waiving dividends, that each mutual holding company obtain the approval of a majority of the eligible votes of its members within 12 months prior to the declaration of the dividend being waived. The Federal Reserve has requested comments on the interim final rule, and there can be no assurance that the rule will be amended to eliminate or modify the member vote requirement for dividend waivers by grandfathered mutual holding companies, such as the Mutual Holding Company in the future, or as to what conditions the Federal Reserve may place on any dividend waivers. The Mutual Holding Company has not requested a current dividend waiver and, is not planning to waive future dividends at this time.

Conversion of the Mutual Holding Company to Stock Form. Federal regulations permit the Mutual Holding Company to convert from the mutual form of organization to the capital stock form of organization (a "Conversion Transaction"). There can be no assurance when, if ever, a Conversion Transaction will occur. In a Conversion Transaction a new holding company would be formed as the successor to the Company (the "New Holding Company"), the Mutual Holding Company's corporate existence would end, and certain depositors of the Bank would receive the right to subscribe for additional shares of the New Holding Company. In a Conversion Transaction, each share of common stock held by stockholders other than the Mutual Holding Company ("Minority Stockholders") would be automatically converted into a number of shares of common stock of the New Holding Company determined pursuant to an exchange ratio (determined by an independent valuation) that ensures that Minority Stockholders own the same percentage of common stock in the New Holding Company as they owned in the Company immediately prior to the Conversion Transaction. The total number of shares held by Minority Stockholders after a Conversion Transaction also would be increased by any purchases by Minority Stockholders in the stock offering conducted as part of the Conversion Transaction. Under a provision of the Dodd-Frank Act applicable to the Mutual Minority Stockholders should not be diluted because of any dividends waived by the Mutual Holding Company (and waived dividends should not be considered in determining an appropriate exchange ratio), in the event the Mutual Holding Company converts to stock form. Any such Conversion Transaction would require various member and stockholder approvals, as well as regulatory approval.

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Federal Securities Law

The common stock of the Company is registered with the SEC under the Securities Exchange Act of 1934, as amended ("Exchange Act"). The Company is subject to the information, proxy solicitation, insider trading restrictions and other requirements of the SEC under the Exchange Act.

The Company Common Stock held by persons who are affiliates (generally officers, directors and principal stockholders) of the Company may not be resold without registration or unless sold in accordance with certain resale restrictions. If the Company meets specified current public information requirements, each affiliate of the Company is able to sell in the public market, without registration, a limited number of shares in any three-month period.

Securities and Exchange Commission Reporting

The Company maintains an Internet website located at www.pathfinderbank.com on which, among other things, the Company makes available, free of charge, various reports that it files with or furnishes to the Securities and Exchange Commission, including its Annual Report on Form 10-K, quarterly reports on Form 10-Q, and current reports on Form 8-K. These reports are made available as soon as reasonably practicable after filing with the Securities and Exchange Commission. The Company has also made available on its website its Audit Committee Charter, Compensation Committee Charter, Governance Guidelines (which serve as the Nominating / Governance Committee's charter) and Code of Ethics.

The Company's Annual Report on Form 10-K may be accessed on the Company's website at www.pathfinderbank.com/annualmeeting.

Federal Reserve System

The Federal Reserve requires all depository institutions to maintain noninterest-bearing reserves at specified levels against their transaction accounts (primarily checking, money management and NOW checking accounts). At December 31, 2013, the Bank was in compliance with these reserve requirements.

Federal Community Reinvestment Regulation

Under the Community Reinvestment Act, as amended (the "CRA"), as implemented by FDIC regulations, a savings bank has a continuing and affirmative obligation, consistent with its safe and sound operation, to help meet the credit needs of its entire community, including low and moderate income neighborhoods. The CRA does not establish specific lending requirements or programs for financial institutions nor does it limit an institution's discretion to develop the types of products and services that it believes are best suited to its particular community, consistent with the CRA. The CRA requires the FDIC, in connection with its examination of a savings institution, to assess the institution's record of meeting the credit needs of its community and to take such record into account in its evaluation of certain applications by such institution.

The CRA requires the FDIC to provide a written evaluation of an institution's CRA performance utilizing a four-tiered descriptive rating system. The Bank's latest CRA rating was "satisfactory."

New York State Community Reinvestment Regulation

The Bank is also subject to provisions of the New York State Banking Law which impose continuing and affirmative obligations upon banking institutions organized in New York State to serve the credit needs of its local community ("NYCRA") which are substantially similar to those imposed by the CRA. Pursuant to the NYCRA, a bank must file an annual NYCRA report and copies of all federal CRA reports with the Department. The NYCRA requires the

Department to make a biennial written assessment of a bank's compliance with the NYCRA, utilizing a four-tiered rating system and make such assessment available to the public. The NYCRA also requires the Superintendent to consider a bank's NYCRA rating when reviewing a bank's application to engage in certain transactions, including mergers, asset purchases and the establishment of branch offices or automated teller machines, and provides that such assessment may serve as a basis for the denial of any such application. The Bank's NYCRA rating as of its latest examination was "satisfactory."

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Sarbanes-Oxley Act of 2002

The Sarbanes-Oxley Act of 2002 (“Sarbanes Oxley”) was signed into law on July 30, 2002. Sarbanes-Oxley is a law that addresses, among other issues, corporate governance, auditing and accounting, executive compensation, and enhanced and timely disclosure of corporate information. As directed by Section 302(a) of Sarbanes-Oxley, the Company’s Chief Executive Officer and Chief Financial Officer are each required to certify that the Company’s quarterly and annual reports do not contain any untrue statement of a material fact. The rules have several requirements, including having these officers certify that: they are responsible for establishing, maintaining and regularly evaluating the effectiveness of our internal controls; they have made certain disclosures to our auditors and the audit committee of the Board of Directors about our internal controls; and they have included information in our quarterly and annual reports about their evaluation and whether there have been significant changes in our internal controls or in other factors that could significantly affect internal controls subsequent to the evaluation. As part of the Dodd-Frank Act, the outside auditor attestation requirement on internal controls of companies with less than $75 million in market capitalization, like the Company, was rescinded. Disclosure of management attestations on internal control over financial reporting will continue to be required for smaller reporting companies, including the Company. We have existing policies, procedures and systems designed to comply with these regulations, and continue to further enhance and document our policies, procedures and systems to ensure continued compliance with these regulations.

FEDERAL AND STATE TAXATION

Federal Taxation

The following discussion of federal taxation is intended only to summarize certain pertinent federal income tax matters and is not a comprehensive description of the tax rules applicable to the Company or the Bank.

Bad Debt Reserves. Prior to the Tax Reform Act of 1996 (“the 1996 Act”), the Bank was permitted to establish a reserve for bad debts and to make annual additions to the reserve. The Bank has chosen to be on the direct charge-off method, net of recoveries, in its calculation of taxable income.

Taxable Distributions and Recapture. Prior to the 1996 Act, bad debt reserves created prior to January 1, 1988 were subject to recapture into taxable income should the Bank fail to meet certain thrift asset and definitional tests. New federal legislation eliminated these thrift related recapture rules. However, under current law, pre-1988 reserves remain subject to recapture should the Bank cease to retain a bank or thrift charter or make certain non-dividend distributions.

Minimum Tax. The Internal Revenue Code imposes an alternative minimum tax ("AMT") at a rate of 20% on a base of regular taxable income plus certain tax preferences ("alternative minimum taxable income" or "AMTI"). The AMT is payable to the extent such AMTI is in excess of an exemption amount. Net operating losses can offset no more than 90% of AMTI. Certain payments of alternative minimum tax may be used as credits against regular tax liabilities in future years.

Net Operating Loss Carryovers. A financial institution may carry back net operating losses to the preceding two taxable years and forward to the succeeding 20 taxable years.

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State Taxation

New York Taxation. The Company is subject to the New York State Franchise Tax on Banking Corporations in an annual amount equal to the greater of (i) 7.1% of the Bank's "entire net income" allocable to New York State during the taxable year, or (ii) the applicable alternative minimum tax. The alternative minimum tax is generally the greater of (a) 0.01% of the value of the Bank's assets allocable to New York State with certain modifications, (b) 3% of the Company’s "alternative entire net income" allocable to New York State, or (c) $1,250. Entire net income is similar to federal taxable income, subject to certain modifications and alternative entire net income is equal to entire net income without certain modifications. Net operating losses arising in the current period can be carried forward to the succeeding 20 taxable years.

Neither the Internal Revenue Service nor New York State has examined our federal or state tax returns within the past 5 years.

ITEM 1A: RISK FACTORS

Not required of a smaller reporting company.

ITEM 1B: UNRESOLVED STAFF COMMENTS

None.

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ITEM 2: PROPERTIES

The Bank conducts its business through its main office located in Oswego, New York, six branch offices located in Oswego County, a branch location in Onondaga County. The Bank anticipates opening a branch in Syracuse, New York in the second quarter of 2014. Management believes that the Bank's facilities are adequate for the business conducted. The following table sets forth certain information concerning the main office and each branch office of the Bank at December 31, 2013. The aggregate net book value of the Bank's premises and equipment was $11.6 million at December 31, 2013. For additional information regarding the Bank's properties, see Notes 8 and 16 to the Consolidated Financial Statements.

LOCATION	OPENING DATE	OWNED/LEASED
Main Office 214 West First Street Oswego, New York 13126	1874	Owned
Plaza Branch Route 104, Ames Plaza Oswego, New York 13126	1989	Owned (1)
Mexico Branch Norman & Main Streets Mexico, New York 13114	1978	Owned
Oswego East Branch 34 East Bridge Street Oswego, New York 13126	1994	Owned
Lacona Branch 1897 Harwood Drive Lacona, New York 13083	2002	Owned

Fulton Branch 5 West First Street South Fulton, New York 13069	2003	Owned (2)
Central Square Branch 3025 East Ave Central Square, New York 13036	2005	Owned
Cicero Branch 6194 State Route 31 Cicero, New York 13039	2011	Owned
Syracuse Branch 302-310 South Salina Street Syracuse, New York 13202	2014	Leased (3)

(1) The building is owned; the underlying land is leased with an annual rent of $22,000
(2) The building is owned; the underlying land is leased with an annual rent of $33,000
(3) The premises will be leased upon opening in 2Q 2014 with an annual rent of $58,000

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ITEM 3: LEGAL PROCEEDINGS

There are various claims and lawsuits to which the Company is periodically involved that are incidental to the Company's business. In the opinion of management, such claims and lawsuits in the aggregate are not expected to have a material adverse impact on the Company's consolidated financial condition and results of operations.

ITEM 4: MINE SAFETY DISCLOSURE

Not applicable

PART II

ITEM 5: MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES

Pathfinder Bancorp, Inc.'s common stock currently trades on the NASDAQ Capital Market under the symbol "PBHC". There were 420 shareholders of record as of March 14, 2014. The following table sets forth the high and low closing bid prices and dividends paid per share of common stock for the periods indicated:

Quarter Ended:	High	Low	Dividend Paid
December 31, 2013	$ 14.03	$ 12.78	$ 0.03
September 30, 2013	$ 16.00	$ 12.47	$ 0.03
June 30, 2013	$ 15.75	$ 11.40	$ 0.03
March 31, 2013	$ 13.04	$ 10.30	$ 0.03
December 31, 2012	$ 11.00	$ 10.00	$ 0.03
September 30, 2012	$ 10.65	$ 9.00	$ 0.03
June 30, 2012	$ 10.00	$ 8.80	$ 0.03
March 31, 2012	$ 9.75	$ 8.83	$ 0.03

Dividends and Dividend History

The Company has historically paid regular quarterly cash dividends on its common stock. The Board of Directors presently intends to continue the payment of regular quarterly cash dividends, subject to the need for those funds for debt service and other purposes. Payment of dividends on the common stock is subject to determination and declaration by the Board of Directors and will depend upon a number of factors, including capital requirements, regulatory limitations on the payment of dividends, Pathfinder Bank and its subsidiaries' results of operations and financial condition, tax considerations, and general economic conditions. The Company's mutual holding company, Pathfinder Bancorp, M.H.C., may elect to waive or receive dividends each time the Company declares a dividend. Dividend waivers must receive the non-objection of the Federal Reserve and the approval of the Mutual Holding Company's members who are comprised of the Bank's depositors. Historically, the Federal Reserve has not provided its non-objection to the waiver of dividends by mutual holding companies. The Mutual Holding Company did not waive the right to receive its portion of the cash dividends declared during 2013 or 2012.

The Company has confirmed that there were no stock repurchases in the three month period ending December 31, 2013.

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ITEM 6: SELECTED FINANCIAL DATA

The Company is the parent company of the Bank and Pathfinder Statutory Trust II. The Bank has four operating subsidiaries – Pathfinder Commercial Bank, Pathfinder REIT, Inc., Pathfinder Risk Management Company, Inc., and Whispering Oaks Development Corp.

The following selected consolidated financial data sets forth certain financial highlights of the Company and should be read in conjunction with the consolidated financial statements and related notes, and the "Management's Discussion and Analysis of Financial Condition and Results of Operations" included elsewhere in this annual report on Form 10-K.

	2013	2012	2011	2010	2009
Year End (In thousands)					
Total assets	$503,793	$477,796	$442,980	$408,545	$371,692
Investment securities (AFS)	80,959	108,339	100,395	85,327	72,754
Investment securities (HTM)	34,412	-	-	-	-
Loans receivable, net	336,592	329,247	300,770	281,648	259,387
Deposits	410,140	391,805	366,129	326,502	296,839
Advances or borrowings	40,853	34,964	26,074	41,000	36,000
Equity	43,070	40,747	37,841	30,592	29,238
For the Year (In thousands)					
Net interest income	$15,619	$14,857	$14,263	$13,331	$11,777
Core noninterest income (a)	2,581	2,627	2,451	2,854	2,724
Net gains on sales, redemptions and impairment of investment securities	365	375	791	211	112
Net gains (losses) on sales of loans and foreclosed real estate	470	61	(50)	(45)	54
Noninterest expense (b)	14,336	13,207	12,758	11,274	10,381
Regulatory assessments	415	311	390	515	745
Interest income	18,883	18,765	18,604	18,139	17,806
Interest expense	3,264	3,908	4,341	4,808	6,029
Provision for loan losses	1,032	825	940	1,050	876
Net income attributable to the Company	2,406	2,648	2,323	2,505	1,615
Per Share					
Net income (basic)	$0.96	$0.88	$0.53	$0.82	$0.61
Net income (diluted)	0.95	0.87	0.52	0.82	0.61
Book value per common share	11.33	10.60	9.49	9.81	9.31
Tangible book value per common share (c)	10.16	9.13	8.02	8.26	7.77
Cash dividends declared	0.12	0.12	0.12	0.12	0.12
Performance Ratios					
Return on average assets	0.48%	0.57%	0.55%	0.64%	0.45%
Return on average equity	5.86	6.68	6.75	8.07	7.04
Return on average tangible equity (c)	6.47	7.40	7.59	9.20	8.45
Return on average common equity	8.58	8.26	5.09	8.20	7.10
Average equity to average assets	8.24	8.48	8.21	7.89	6.40
Equity to total assets at end of period	8.55	8.53	8.54	7.49	7.87

Dividend payout ratio (d)	12.47	11.37	12.87	11.90	18.45
Net interest rate spread	3.32	3.38	3.62	3.58	3.40
Net interest margin	3.43	3.50	3.76	3.73	3.56

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Year End (In thousands)	2013		2012		2011		2010		2009	
Average interest-earning assets to average interest-bearing liabilities	115.85		113.89		112.22		110.84		109.05	
Noninterest income to average assets	0.69		0.66		0.76		0.77		0.81	
Noninterest expense to average assets	2.96		2.89		3.14		3.00		3.10	
Efficiency ratio (e)	79.14		75.53		77.56		71.95		76.36	
Asset Quality Ratios										
Nonperforming loans as a percent of total loans	1.57	%	1.66	%	1.55	%	2.08	%	0.88	%
Nonperforming assets as a percent of total assets	1.18		1.25		1.19		1.54		0.67	
Allowance for loan losses to loans receivable	1.48		1.35		1.31		1.28		1.17	
Allowance for loan losses as a percent of nonperforming loans	94.22		81.13		84.18		61.58		133.07	
Regulatory Capital Ratios (Bank Only)										
Total Core Capital (to Risk-Weighted Assets)	14.1	%	14.2	%	14.9	%	13.5	%	14.0	%
Tier 1 Capital (to Risk-Weighted Assets)	12.8		12.9		13.7		12.2		12.7	
Tier 1 Capital (to Assets)	8.7		8.8		9.4		8.1		8.4	
Number of:										
Banking offices	8		8		8		7		7	
Fulltime equivalent employees	112		110		110		105		99	

(a) Exclusive of net gains (losses) on sales and impairment of investment securities and net gains (losses) on sales of loans and foreclosed real estate.

(b) Exclusive of regulatory assessments.

(c) Tangible equity excludes intangible assets.

(d) The dividend payout ratio is calculated using dividends declared and not waived by the Mutual Holding Company, divided by net income.

(e) The efficiency ratio is calculated as noninterest expense, including regulatory assessments, divided by the sum of taxable-equivalent net interest income and noninterest income excluding net gains on sales, redemptions and impairment of investment securities and net gains (losses) on sales of loans and foreclosed real estate.

ITEM 7: MANAGEMENT’S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

INTRODUCTION

Throughout Management’s Discussion and Analysis (“MD&A”) the term, “the Company”, refers to the consolidated entity of Pathfinder Bancorp, Inc. Pathfinder Bank and Pathfinder Statutory Trust II are wholly owned subsidiaries of Pathfinder Bancorp, Inc., however, Pathfinder Statutory Trust II is not consolidated for reporting purposes (see Note 11 of the consolidated financial statements). Pathfinder Commercial Bank, Pathfinder REIT, Inc., Pathfinder Risk

Management Company, Inc., and Whispering Oaks Development Corp. are wholly owned subsidiaries of Pathfinder Bank. At December 31, 2013, Pathfinder Bancorp, M.H.C, the Company's mutual holding company parent, whose activities are not included in the consolidated financial statements or the MD&A, held 60.4% of the Company's outstanding common stock and the public held 39.6% of the outstanding common stock.

The Company's business strategy is to operate as a well-capitalized, profitable, and independent community bank dedicated to providing value-added products and services to our customers. Generally, the Company has sought to implement this strategy by emphasizing retail, business, and municipal deposits as its primary source of funds. These funds are redeployed in locally-originated residential first mortgage loans, loans to business enterprises operating in its markets, and, to a lesser extent, in investment securities. Specifically, the Company's business strategy incorporates the following elements: (i) operating as an independent community-oriented financial institution; (ii) maintaining capital in excess of regulatory requirements; (iii) emphasizing investment in one-to-four family residential mortgage loans, loans to small businesses, and investment securities; and (iv) maintaining a strong retail, business and municipal deposit base.

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The Company's net income is primarily dependent on its net interest income, which is the difference between interest income earned on its investments in mortgage and other loans, investment securities and other assets, and its cost of funds consisting of interest paid on deposits and borrowings. The Company's net income is also affected by its provision for loan losses, noninterest income (service charges and servicing rights, net gains and losses on sales and redemptions of securities, loans and foreclosed real estate), noninterest expense (employee compensation and benefits, occupancy and equipment costs, data processing costs), and income taxes. Earnings of the Company are also affected significantly by general economic and competitive conditions, particularly changes in market interest rates, government policies, and actions of regulatory authorities. These events are beyond the control of the Company. In particular, the general level of market interest rates tend to be highly cyclical.

APPLICATION OF CRITICAL ACCOUNTING POLICIES

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

The most significant accounting policies followed by the Company are presented in Note 1 to the consolidated financial statements. These policies, along with the disclosures presented in the other financial statement notes and in this discussion, provide information on how significant assets and liabilities are valued in the consolidated financial statements and how those values are determined. Based on the valuation techniques used and the sensitivity of financial statement amounts to the methods, assumptions, and estimates underlying those amounts, management has identified the allowance for loan losses, deferred income taxes, pension obligations, the evaluation of investment securities for other than temporary impairment, the annual evaluation of the Company’s goodwill for possible impairment, and the estimation of fair values for accounting and disclosure purposes to be the accounting areas that require the most subjective and complex judgments. These areas could be the most subject to revision as new information becomes available. Management performs an annual evaluation of the Company’s goodwill for possible impairment. Based on the results of the 2013 evaluation, management has determined that the carrying value of goodwill is not impaired as of December 31, 2013. The evaluation approach is described in Note 9 of the consolidated financial statements.

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The allowance for loan losses represents management's estimate of probable loan losses inherent in the loan portfolio. Determining the amount of the allowance for loan losses is considered a critical accounting estimate because it requires significant judgment on the use of estimates related to the amount and timing of expected future cash flows on impaired loans, estimated losses on pools of homogeneous loans based on historical loss experience, and consideration of current economic trends and conditions, all of which may be susceptible to significant change. The Company establishes a specific allowance for all commercial loans in excess of the total related credit threshold of $100,000 and single borrower residential mortgage loans in excess of the total related credit threshold of $300,000 identified as being impaired which are on nonaccrual and have been risk rated under the Company's risk rating system as substandard, doubtful, or loss. In addition, an accruing substandard loan could be identified as being impaired. The measurement of impaired loans is generally based upon the present value of future cash flows discounted at the historical effective interest rate, except that all collateral-dependent loans are measured for impairment based on the fair value of the collateral, less costs to sell. The majority of the Company's impaired loans are collateral-dependent. For all other loans and leases, the Company uses the general allocation methodology that establishes an allowance to estimate the probable incurred loss for each risk-rating category. The loan portfolio also represents the largest asset type on the consolidated statement of condition. Note 1 to the consolidated financial statements describes the methodology used to determine the allowance for loan losses and a discussion of the factors driving changes in the amount of the allowance for loan losses is included in this report.

Deferred income tax assets and liabilities are determined using the liability method. Under this method, the net deferred tax asset or liability is recognized for the future tax consequences. This is attributable to the differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases as well as net operating and capital loss carry forwards. Deferred tax assets and liabilities are measured using enacted tax rates applied to taxable income in the years in which those temporary differences are expected to be recovered or settled. The affect on deferred tax assets and liabilities of a change in tax rates is recognized in income tax expense in the period that includes the enactment date. If current available evidence about the future raises doubt about the likelihood of a deferred tax asset being realized, a valuation allowance is established. The judgment about the level of future taxable income, including that which is considered capital, is inherently subjective and is reviewed on a continual basis as regulatory and business factors change. A valuation allowance of $458,000 was maintained at December 31, 2013, as management believes it may not generate sufficient capital gains to offset its capital loss carry forward. The Company's effective tax rate differs from the statutory rate due primarily to non-taxable income from investment securities and bank owned life insurance.

Pension and postretirement benefit plan liabilities and expenses are based upon actuarial assumptions of future events, including fair value of plan assets, interest rates, and the length of time the Company will have to provide those benefits. The assumptions used by management are discussed in Note 12 to the Notes to Consolidated Financial Statements contained herein.

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

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The estimation of fair value is significant to several of our assets; including investment securities available for sale, interest rate derivative (discussed in detail in Note 19 to the Notes to Consolidated Financial Statements contained herein), intangible assets, foreclosed real estate, and the value of loan collateral when valuing loans. These are all recorded at either fair value, or the lower of cost or fair value. Fair values are determined based on third party sources, when available. Furthermore, accounting principles generally accepted in the United States require disclosure of the fair value of financial instruments as a part of the notes to the consolidated financial statements. Fair values on our available-for-sale securities may be influenced by a number of factors; including market interest rates, prepayment speeds, discount rates, and the shape of yield curves.

Fair values for securities available for sale are obtained from an independent third party pricing service. Where available, fair values are based on quoted prices on a nationally recognized securities exchange. If quoted prices are not available, fair values are measured using quoted market prices for similar benchmark securities. Management made no adjustments to the fair value quotes that were provided by the pricing source. The fair values of foreclosed real estate and the underlying collateral value of impaired loans are typically determined based on evaluations by third parties, less estimated costs to sell. When necessary, appraisals are updated to reflect changes in market conditions.

RECENT EVENTS

On December 4, 2013, the Company announced that through its subsidiary, Pathfinder Bank, and its subsidiary, Pathfinder Risk Management Inc. (“Risk Management”), a Purchase and Sale Agreement was executed to acquire a majority interest in the Fitzgibbons Agency, LLC (“Fitzgibbons”), a local insurance agency serving the same geographic area as Pathfinder Bank. Details of this transaction are included in Note 23 to these financial statements.

On December 19, 2013, the Company announced that its Board of Directors declared a quarterly dividend of $.03 per common share. The dividend is payable on February 7, 2014 to shareholders of record on January 15, 2014.

EXECUTIVE SUMMARY AND RESULTS OF OPERATIONS

Most earnings performance metrics for 2013 generally declined from those reported for 2012. While basic and diluted earnings per share improved over 2012, net income, return on average assets, return on average equity, and net interest margin all decreased in 2013.

Net income for 2013 was $2.4 million, a $242,000 decrease from 2012.Return on average assets and return on average equity were 0.48% and 5.86%, respectively, as compared to 0.57% and 6.68% in 2012. Net interest income increased $762,000 in 2013 as compared to 2012 due to an increase in earning assets and a reduction in the rates paid on interest bearing liabilities. Additionally, increases in personnel costs, an increase in the provision for loan losses and increases in other expenses all contributed to the decrease in net income. Partially offsetting these year over year increases in expenses was the receipt of $395,000 from the sale of $8.8 million of residential loans in 2013. The reasons for these changes are provided in the sections titled “Noninterest Income” and “Noninterest Expense”.

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Total assets increased $26.0 million to $503.8 million, partially funded by deposits which grew by $18.3 million during 2013 primarily as a result of increases in money market deposit accounts and CDARS deposits. These funds were invested in the loan portfolio and the investment securities portfolio, with the remainder in cash. Growth of the loan portfolio was limited by the previously mentioned residential loan sale as gross loans grew 2.4% to $341.6 million. The Company's opening of its downtown Syracuse branch office is expected to enhance its commercial and consumer loan business within Onondaga County.

Asset quality continues to report mixed results as net loan charge-offs as a percentage of period end loans for 2013 were 0.15% as compared to 0.10% in 2012. Net charge-offs for 2013 were $492,000 as compared to $304,000 in 2012 with the increase residing in all major product segments. The charge-offs were previously provided for within the allowance for loan losses. Management continues to adhere to conservative underwriting policies and works closely with borrowers who have experienced difficulty in order to mitigate loss to the Bank. The ratio of the allowance for loan losses to year end loans increased slightly to 1.48% at December 31, 2013 as compared to 1.35% at December 31, 2012 and 1.31% at December 31, 2011. The increase in 2013 was caused, in part, by the need for a specific reserve established in the first quarter of 2013 for one large commercial borrower. Nonperforming loans to year end loans declined modestly to 1.57% at December 31, 2013 from 1.66% at December 31, 2012. Delinquency trends worsened modestly when comparing total past due loans as a percent of total loans at December 31, 2013 as compared to December 31, 2012, with the largest increase within the 60-89 day past due category and centered in the commercial segment.

The Company's shareholders' equity increased $2.0 million to $42.7 million at December 31, 2013 and December 31, 2012. The $2.1 million increase in retained earnings between these two time periods resulted largely from the generation of earnings less dividends declared.

Net Interest Income

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

The following comments refer to the table of Average Balances and Rates and the Rate/Volume Analysis, both of which follow below.

Net interest income, on a tax-equivalent basis, increased $788,000, or 5.2%, to $16.1 million for the year ended December 31, 2013, as compared to $15.3 million for the year ended December 31, 2012. The increase in net interest income is principally due to the increase in average commercial loan balances and the decrease in rates paid on time deposits and Federal Home Loan Bank ("FHLBNY") borrowings. When comparing 2013 against 2012, the yield on average earning assets declined by 27 basis points, whereas the rates paid on interest bearing liabilities declined by 21 basis points. The Company's net interest margin for 2013 decreased to 3.43% from 3.50% in 2012.

The average balance of interest-earning assets increased $31.5 million, or 7.2%, during 2013 and the average balance of interest-bearing liabilities increased by $20.7 million, or 5.4%. The increase in the average balance of interest earning assets primarily resulted from a $24.9 million increase in the average balance of the loan portfolio. This was funded by the increase in interest-bearing liabilities primarily in NOW, money market, ("MMDA") and savings and club accounts. Interest income, on a tax-equivalent basis, increased $144,000, or 0.8%, during 2013. The decrease in yield on interest earning assets to 4.13% in 2013 from 4.40% in 2012 was more than offset by the increase in average volume. This increase in average volume was centered in the commercial loan products. Interest expense on interest-bearing liabilities decreased $644,000, or 16.5%, as the rates paid dropped 21 basis points to 0.81% in 2013 from 1.02% in 2012. Maturing time deposits were either replaced at current lower market rates or, at the customer's option, invested in MMDA. FHLBNY advances were replaced with advances of a shorter term and at current lower market rates.

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Average Balances and Rates

The following table sets forth information concerning average interest-earning assets and interest-bearing liabilities and the yields and rates thereon. Interest income and resultant yield information in the table is on a fully tax-equivalent basis using marginal federal income tax rates of 34%. Averages are computed on the daily average balance for each month in the period divided by the number of days in the period. Yields and amounts earned include loan fees. Nonaccrual loans have been included in interest-earning assets for purposes of these calculations.

	For the Years Ended December 31,								
	2013			2012			2011		
(Dollars in thousands)	Average Balance	Interest	Average Yield / Cost	Average Balance	Interest	Average Yield / Cost	Average Balance	Interest	Average Yield / Cost
Interest-earning assets:									
Real estate loans residential	$172,294	$7,810	4.53 %	$168,354	$8,233	4.89 %	$153,735	$8,029	5.22 %
Real estate loans commercial	90,042	4,729	5.25 %	72,894	4,194	5.75 %	70,050	4,372	6.24 %
Commercial loans	51,218	2,441	4.77 %	45,598	2,161	4.74 %	38,533	1,904	4.94 %
Consumer loans	25,178	1,416	5.62 %	26,956	1,535	5.69 %	28,468	1,726	6.06 %
Taxable investment securities	94,597	1,748	1.85 %	93,352	1,927	2.06 %	79,236	2,231	2.82 %
Tax-exempt investment securities	25,972	1,152	4.44 %	23,716	1,100	4.64 %	11,716	571	4.87 %
Interest-earning time deposit	1,612	19	1.18 %	1,994	24	1.20 %	176	2	1.14 %
Interest-earning deposits	6,901	7	0.10 %	3,426	4	0.12 %	4,147	5	0.12 %
Total interest-earning assets	467,814	19,322	4.13 %	436,290	19,178	4.40 %	386,061	18,840	4.88 %
Noninterest-earning assets:									
Other assets	33,809			32,593			35,647		
Allowance for loan losses	(4,865)			(4,224)			(3,872)		
Net unrealized gains on available for sale securities	1,088			2,594			1,293		
Total assets	$497,846			$467,253			$419,129		
Interest-bearing liabilities:									
NOW accounts	$37,733	$80	0.21 %	$31,819	$82	0.26 %	$30,274	87	0.29 %
Money management accounts	13,962	26	0.19 %	14,395	43	0.30 %	12,964	43	0.33 %

MMDA accounts	81,734	364	0.45	%	77,401	427	0.55	%	64,352	438	0.68	%
Savings and club accounts	69,284	54	0.08	%	63,962	54	0.08	%	60,713	78	0.13	%
Time deposits	160,823	1,954	1.22	%	159,283	2,290	1.44	%	139,299	2,590	1.86	%
Junior subordinated debentures	5,155	162	3.14	%	5,155	169	3.28	%	5,155	163	3.16	%
Borrowings	35,128	624	1.78	%	31,079	843	2.71	%	31,255	942	3.01	%
Total interest-bearing liabilities	403,819	3,264	0.81	%	383,094	3,908	1.02	%	344,012	4,341	1.26	%
Noninterest-bearing liabilities:												
Demand deposits	48,814				40,759				35,971			
Other liabilities	4,185				3,765				4,722			
Total liabilities	456,818				427,618				384,705			
Shareholders' equity	41,028				39,635				34,424			
Total liabilities & shareholders' equity	$497,846				$467,253				$419,129			
Net interest income		$16,058				$15,270				$14,499		
Net interest rate spread			3.32	%			3.38	%			3.62	%
Net interest margin			3.43	%			3.50	%			3.76	%
Ratio of average interest-earning assets to average interest-bearing liabilities			115.85	%			113.89	%			112.22	%

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Interest Income

Changes in interest income result from changes in the average balances of loans, securities, and interest-earning deposits and the related yields on those balances. Interest income on a tax-equivalent basis increased $144,000, or 0.8%.

Average interest earning asset balances increased $31.5 million, or 7.2% in 2013, with yields decreasing 27 basis points to 4.13%. The Company's average residential mortgage loan portfolio increased modestly by $3.9 million, or 2.3%, due principally to the previously mentioned loan sale. The average yield on this portfolio decreased 36 basis points to 4.53% in 2013 as higher rate amortizing mortgages were replaced with new originations reflecting current market rates. The average balance of commercial real estate loans increased $17.1 million, or 23.5%, and the yield decreased 50 basis points to 5.25% in 2013. Average commercial loans increased $5.6 million, or 12.3%, while the yield increased 3 basis points to 4.77% in 2013. This increase in average commercial loans reflects the Company’s plan to continue to diversify its loan portfolio.

Interest income on consumer loans decreased $119,000 in 2013 from the prior year period due to a 6.6% decline in average balances and a 7 basis point decrease in yield.

Interest income on taxable investment securities decreased 9.3% from 2012 as the average yield decreased 21 basis points from 2012 to 2013. Interest income on tax-exempt securities increased $52,000, or 4.7%, when compared to the prior year as tax-equivalent yields on these issues continued to be attractive investment alternatives.

Interest Expense

Changes in interest expense result from changes in the average balances of deposits and borrowings and the related interest costs on those balances. Interest expense decreased $644,000, or 16.5%, in 2013 compared to 2012. The average rate paid on all interest-bearing liabilities was 0.81% in 2013 as compared to 1.02% in 2012, a 21 basis point decrease. The decrease in interest expense was largely due to the decrease in rates paid on time deposits as maturing certificates of deposit were either replaced at lower current market rates or invested in MMDA. Additionally, interest expense on FHLBNY borrowings declined as higher rate maturing advances were replaced with advances of a shorter duration and lower rate. A smaller but noteworthy component of the decrease in interest expense was the $63,000 decrease in year over year expenses on MMDA as the company successfully gathered higher average balances of MMDA at lower rates paid.

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Rate/Volume Analysis

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

	Years Ended December 31,					
	2013 vs. 2012 Increase/(Decrease) Due to			2012 vs. 2011 Increase/(Decrease) Due to		
(In thousands)	Volume	Rate	Total Increase (Decrease)	Volume	Rate	Total Increase (Decrease)
Interest Income:						
Real estate loans residential	$ 189	$ (612)	$ (423)	$ 732	$ (528)	$ 204
Real estate loans commercial	924	(389)	535	173	(351)	(178)
Commercial loans	268	12	280	337	(80)	257
Consumer loans	(100)	(19)	(119)	(89)	(102)	(191)
Taxable investment securities	25	(204)	(179)	358	(662)	(304)
Tax-exempt investment securities	102	(50)	52	557	(28)	529
Interest-earning time deposits	(5)	-	(5)	22	-	22
Interest-earning deposits	3	-	3	(3)	2	(1)
Total interest income	1,406	(1,262)	144	2,087	(1,749)	338
Interest Expense:						
NOW accounts	14	(16)	(2)	4	(9)	(5)
Money management accounts	(1)	(16)	(17)	4	(4)	-
MMDA accounts	23	(86)	(63)	81	(92)	(11)
Savings and club accounts	4	(4)	-	4	(28)	(24)
Time deposits	22	(358)	(336)	338	(638)	(300)
Junior subordinated debentures	-	(7)	(7)	-	6	6
Borrowings	99	(318)	(219)	(5)	(94)	(99)
Total interest expense	161	(805)	(644)	426	(859)	(433)
Net change in net interest income	$ 1,245	$ (457)	$ 788	$ 1,661	$ (890)	$ 771

Provision for Loan Losses

The Company recorded $1.0 million in provision for loan losses as compared to $825,000 recorded in the prior year. This year over year increase reflects higher levels of net charge-offs in 2013, the need for an additional specific reserve on one large commercial borrower and a growing loan portfolio. The Company views the current level of the allowance for loan losses as adequate to absorb the probable and estimable losses within its loan portfolio.

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Noninterest Income

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

The following table sets forth certain information on noninterest income for the years indicated.

	Twelve Months Ended December 31,					
(Dollars In thousands)	2013	2012	Change			
Service charges on deposit accounts	$1,175	$1,112	$63		5.7	%
Earnings and gain on bank owned life insurance	224	309	(85	)	-27.5	%
Loan servicing fees	146	211	(65	)	-30.8	%
Debit card interchange fees	469	426	43		10.1	%
Other charges, commissions and fees	567	569	(2	)	-0.4	%
Noninterest income before gains	2,581	2,627	(46	)	-1.8	%
Net gains on sales and redemptions of investment securities	365	375	(10	)	-2.7	%
Net gains on sales of loans and foreclosed real estate	470	61	409		670.5	%
Total noninterest income	$3,416	$3,063	$353		11.5	%

As indicated in the above table, total noninterest income for the twelve months ended December 31, 2013 increased from the prior year due principally to greater net gains on sales of loans and foreclosed real estate. The Company recorded a gain of $395,000 from the sale of $8.8 million in residential loans in the second quarter of 2013. Service charges on deposit accounts increased in 2013 reflecting insufficient funds and overdraft fee activity. Earnings and gains on bank owned life insurance reported declined as compared with 2012 when we recorded a gain on life insurance proceeds due to the death of a former Company director. Loan servicing fees declined in 2013 due to the previously mentioned residential loan sale and increasing FNMA guarantee charges which are netted against loan servicing fees. Debit card interchange fees increased in 2013 over the prior year reflecting higher levels of use.

Noninterest Expense

The following table sets forth certain information on noninterest expense for the years indicated.

	Twelve Months Ended December 31,					
(Dollars In thousands)	2013	2012	Change			
Salaries and employee benefits	$8,081	$7,496	$585		7.8	%
Building occupancy	1,476	1,427	49		3.4	%
Data processing	1,444	1,437	7		0.5	%
Professional and other services	659	654	5		0.8	%
Amortization of intangible assets	1	-	1		NM(1)	
Advertising	537	453	84		18.5	%
FDIC assessments	415	311	104		33.4	%
Audits and exams	219	248	(29	)	-11.7	%
Other expenses	1,919	1,492	427		28.6	%
Total noninterest expenses	$14,751	$13,518	$1,233		9.1	%

(1) Not meaningful

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As indicated above, total noninterest expense for 2013 increased over the prior year due largely to the increase in salaries and employee benefits reflecting wage increases, increased costs under the Company's self insurance program, and ESOP compensation expenses. Other expenses increased due to additional community service donations, charitable contributions, the write-down of a repossessed asset, and fraud losses. The repossessed asset write-down was related to a $65,000 loss on a repossessed boat and fraud losses in the amount of $77,000 was principally due to a merchant security breach that occurred in December 2013.

Income Tax Expense

In 2013, the Company reported income tax expense of $847,000 compared with $929,000 in 2012. As the effective tax rate was 26.0% for both years, the decrease in income tax expense was due to the decrease in income before tax between 2012 and 2013. See Note 15 to the consolidated financial statements for the reconciliation of the statutory tax rate to the effective tax rate.

Earnings Per Share

Basic and diluted earnings per share were $0.96 and $0.95, respectively, in 2013 as compared to $0.88 and $0.87, respectively, in 2012. The increase in basic and diluted earnings per share comparing year over year twelve month periods was largely due to the lack of need for SBLF preferred stock dividend payments during 2013 as positive updated lending information provided to the U.S. Treasury resulted in a credit against the dividend rate for the twelve month year to date period

CHANGES IN FINANCIAL CONDITION

Investment Securities

The investment portfolio represents 25% of the Company's average earning assets and is designed to generate a favorable rate of return consistent with safety of principal while assisting the Company in meeting its liquidity needs and interest rate risk strategies. All of the Company's investments are classified as either available-for-sale or held-to-maturity. The Company does not hold any trading securities. In the third quarter of 2013 the Company identified 55 available-for-sale securities with an estimated fair value of $32.5 million that the Company estimated contained the largest degree of volatility during periods of interest rate changes. These securities reported a net unrealized loss position of $1.3 million at September 30, 2013 and were reclassified to held-to-maturity ("HTM") status at September 30, 2013. The after tax impact of this unrealized loss position was approximately $799,000, and became frozen upon transfer with no impact on the Company's income statement as a result of this transfer. The Company invests primarily in securities issued by United States Government agencies and sponsored enterprises ("GSEs"), mortgage-backed securities, state and municipal obligations, mutual funds, equity securities, investment grade corporate debt instruments, and common stock issued by the Federal Home Loan Bank of New York (FHLBNY). By investing in these types of assets, the Company reduces the credit risk of its asset base but must accept lower yields than would typically be available on loan products. Our mortgage backed securities portfolio is comprised predominantly of pass-through securities guaranteed by Fannie Mae, Freddie Mac, or Ginnie Mae and does not, to our knowledge, include any securities backed by sub-prime or other high-risk mortgages.

At December 31, 2013, investment securities increased 6.5% to $115.4 million from $108.4 million at December 31, 2012. There were no securities that exceeded 10% of consolidated shareholders' equity. See Note 4 to the consolidated financial statements for further discussion on securities.

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The following table sets forth the carrying value of the Company's investment portfolio at December 31:

	Available-for-Sale		Held-to-Maturity	
(In Thousands)	2013	2012	2013	2012
Investment Securities:				
US treasury, agencies and GSEs	$16,597	$6,183	$1,872	$-
State and political subdivisions	6,587	27,471	21,371	-
Corporate	13,696	23,006	3,746	-
Residential mortgage-backed	42,142	48,556	7,423	-
Mutual funds	1,644	2,691	-	-
Equity securities	293	432	-	-
Total investment securities	$80,959	$108,339	$34,412	$-

The following table sets forth the scheduled maturities, amortized cost, fair values and average yields for the Company's investment securities at December 31, 2013. Average yield is calculated on the amortized cost to maturity and adjusted to a fully tax-equivalent basis.

AVAILABLE-FOR-SALE

	One Year or Less			One to Five Years			Five to Ten Years		
(Dollars in thousands)	Amortized Cost	Annualized Weighted Avg Yield		Amortized Cost	Annualized Weighted Avg Yield		Amortized Cost	Annualized Weighted Avg Yield	
Debt investment securities:									
US Treasury, agencies and GSEs	$1,003	0.24	%	$11,923	0.73	%	$4,009	1.50	%
State and political subdivisions	881	1.20	%	4,923	2.01	%	625	2.14	%
Corporate	4,535	1.28	%	8,802	2.11	%	-	-	
Total	$6,419	1.10	%	$25,648	1.45	%	$4,634	1.59	%
Mortgage-backed securities:									
Residential mortgage-backed	$-	-		$194	4.23	%	$9,558	2.20	%
Total	$-	-		$194	4.23	%	$9,558	2.20	%
Other non-maturity investments:									
Mutual funds	$1,282	7.06	%	$-	-		$-	-	
Equity securities	271	5.47	%	-	-		-	-	
Total	$1,553	6.78	%	$-	-		$-	-	
Total investment securities	$7,972	2.21	%	$25,842	1.47	%	$14,192	2.00	%

	More Than Ten Years		Total Investment Securities			
(Dollars in thousands)	Amortized Cost	Annualized Weighted Avg Yield	Amortized Cost	Fair Value	Annualized Weighted Avg Yield	
Debt investment securities:						
US Treasury, agencies and GSEs	$-	-	$16,935	$16,597	0.88	%
State and political subdivisions	-	-	6,429	6,587	1.91	%
Corporate	161	-	13,498	13,696	1.80	%
Total	$161	-	$36,862	$36,880	1.41	%

Mortgage-backed securities:							
Residential mortgage-backed	$32,626	2.26	%	$42,378	$42,142	2.26	%
Total	$32,626	2.26	%	$42,378	$42,142	2.26	%
Other non-maturity investments:							
Mutual funds	$-	-		$1,282	$1,644	7.06	%
Equity securities	-	-		$271	293	5.47	%
Total	$-	-		$1,553	$1,937	6.82	%
Total investment securities	$32,787	2.25	%	$80,793	$80,959	1.98	%

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HELD-TO-MATURITY

	One Year or Less			One to Five Years			Five to Ten Years		
(Dollars in thousands)	Amortized Cost	Annualized Weighted Avg Yield		Amortized Cost	Annualized Weighted Avg Yield		Amortized Cost	Annualized Weighted Avg Yield	
Debt investment securities:									
US Treasury, agencies and GSEs	$-	-		$-	-		$1,872	2.65	%
State and political subdivisions	186	0.60	%	824	1.18	%	8,367	2.80	%
Corporate	-	-		-	-		2,121	4.39	%
Total	$186	0.60	%	$824	1.18	%	$12,360	3.05	%
Mortgage-backed securities:									
Residential mortgage-backed	$-	-		$-	$-		$2,857	2.73	%
Total	$-	-		$-	$-		$2,857	2.73	%
Total investment securities	$186	0.60	%	$824	1.18	%	$15,217	2.99	%

	More Than Ten Years			Total Investment Securities			
(Dollars in thousands)	Amortized Cost	Annualized Weighted Avg Yield		Amortized Cost	Fair Value	Annualized Weighted Avg Yield	
Debt investment securities:							
US Treasury, agencies and GSEs	$-	-		$1,872	$1,847	2.65	%
State and political subdivisions	11,994	3.57	%	$21,371	21,264	1.15	%
Corporate	1,625	2.53	%	3,746	3,718	3.58	%
Total	$13,619	3.45	%	$26,989	$26,829	1.59	%
Mortgage-backed securities:							
Residential mortgage-backed	$4,566	3.14	%	$7,423	$7,393	2.98	%
Total	$4,566	3.14	%	$7,423	$7,393	2.98	%
Total investment securities	$18,185	3.37	%	$34,412	$34,222	1.89	%

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The above noted yield information does not give effect to changes in fair value that are reflected in accumulated other comprehensive loss in consolidated shareholders' equity.

Loans Receivable

Average loans receivable represent 72% of the Company's average earning assets and account for the greatest portion of total interest income. Yields range from 4.53% on residential loans to 5.62% on consumer loans. The Company currently has the largest portion of its loan portfolio in the residential real estate product segment and it anticipates a continued commitment to financing the purchase or improvement of residential real estate in its market area. The Company also extends credit to businesses within its marketplace secured by commercial real estate, equipment, inventories, and accounts receivable. In support of the strategy to diversify its loan portfolio, it is anticipated that small business lending in the form of mortgages, term loans, leases, and lines of credit will provide the most opportunity for balance sheet and revenue growth over the near term. At December 31, 2013, commercial real estate, commercial and municipal loans comprised 43.2% of the total loan portfolio, and residential loans declined to 49.3% of the loan portfolio from 53.0% at December 31, 2012. The decrease in the proportion of total loans by the residential loan portfolio reflects the Company's effort to diversify the loan portfolio, aided by the residential loan sale that occurred in the second quarter of 2013.

	December 31,				
(In thousands)	2013	2012	2011	2010	2009
Residential real estate (1)	$168,493	$176,968	$162,395	$147,722	$135,102
Commercial real estate	95,510	82,357	73,628	69,060	62,250
Commercial and municipal loans	52,241	48,826	40,336	39,833	35,447
Home equity and junior liens	21,223	22,141	24,251	25,271	26,086
Consumer loans	4,166	3,456	4,140	3,410	3,580
Total loans receivable	$341,633	$333,748	$304,750	$285,296	$262,465

(1) Includes loans held for sale at December 31, 2009. (None at December 31, 2013, 2012, 2011, and 2010)

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The following table shows the amount of loans outstanding, including net deferred costs, as of December 31, 2013 which, based on remaining scheduled repayments of principal, are due in the periods indicated. Demand loans having no stated schedule of repayments, no stated maturity, and overdrafts are reported as one year or less. Adjustable and floating rate loans are included in the period on which interest rates are next scheduled to adjust, rather than the period in which they contractually mature. Fixed rate loans are included in the period in which the final contractual repayment is due.

(In thousands)	Due Under One Year	Due 1-5 Years	Due Over Five Years	Total
Real estate:				
Commercial real estate	$1,548	$5,435	$88,527	$95,510
Residential real estate	57	6,655	161,781	168,493
	1,605	12,090	250,308	264,003
Other Commercial	24,125	17,206	10,910	52,241
Home Equity and junior liens	45	1,298	19,880	21,223
Consumer	514	2,659	993	4,166
Total loans	$26,289	$33,253	$282,091	$341,633

Interest rates:	Due After One Year
Fixed	$ 165,679
Variable	149,665
Total loans	$ 315,344

Total loans receivable increased $7.9 million or 2.4% when compared to the prior year, primarily due to the growth in commercial real estate and commercial and municipal loans. Residential real estate loans declined 4.8% due to the $8.8 million residential loan sale in the second quarter of 2013. The Company does not originate sub-prime, Alt-A, negative amortizing or other higher risk structured residential mortgages. Commercial and municipal loans increased $3.4 million in support of the Company's strategy to balance its diversification among its product segments. Commercial real estate loans reported significant growth as this segment reported a $13.2 million or 16.0% year over year increase.

Home equity and junior liens loans decreased 4.2% to $21.2 million at December 31, 2013, as a result in changes in credit standards and rate structures during 2013.

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Nonperforming Loans and Assets

The following table represents information concerning the aggregate amount of nonperforming assets:

	December 31,				
(Dollars in thousands)	2013	2012	2011	2010	2009
Nonaccrual loans:					
Commercial real estate and commercial loans	$2,709	$2,726	$2,594	$4,224	$1,021
Consumer	447	776	706	365	111
Residential real estate	2,194	2,046	1,428	1,335	1,181
Total nonaccrual loans	5,350	5,548	4,728	5,924	2,313
Total nonperforming loans	5,350	5,548	4,728	5,924	2,313
Foreclosed real estate	619	426	536	375	181
Total nonperforming assets	$5,969	$5,974	$5,264	$6,299	$2,494
Troubled debt restructurings not included above	$2,459	$1,937	$595	$1,587	$680
Nonperforming loans to total loans	1.57 %	1.66 %	1.55 %	2.08 %	0.88 %
Nonperforming assets to total assets	1.18 %	1.25 %	1.19 %	1.54 %	0.67 %

Nonperforming assets include nonaccrual loans, nonaccrual troubled debt restructurings (“TDR”), and foreclosed real estate. Loans are considered modified in a TDR when, due to a borrower’s financial difficulties, the Company makes a concession(s) to the borrower that it would not otherwise consider. These modifications may include an extension of the term of the loan, and granting a period when interest-only payments can be made, with the principal payments made over the remaining term of the loan or at maturity. TDRs are included in the above table within the following categories of nonaccrual loans or TDRs not included above (the latter also known as accruing TDRs).

As indicated in the above table, total nonperforming loans decreased modestly at December 31, 2013, when compared to December 31, 2012, as the increase in nonaccrual residential loans was more than offset by decreases in nonaccrual consumer, commercial real estate and commercial loans. Management continues to monitor and react to national and local economic trends as well as general portfolio conditions which may impact the quality of the portfolio, and considers these environmental factors in support of the allowance for loan loss reserve. Management believes that the current level of the allowance for loan losses, at $5.0 million, adequately addresses the current level of risk within the loan portfolio. The Company maintains strict loan underwriting standards and carefully monitors the performance of the loan portfolio.

Foreclosed real estate (“FRE”) balances increased at December 31, 2013, from the prior year as the carrying values of the sales throughout 2013 were replaced with FRE balances with higher carrying values. Two of the additions to FRE balances were commercial properties totaling $209,000. The total inventory of FRE remained at eight properties at December 31, 2013 and 2012.

The Company sold a repossessed boat in 2013, with a carrying value of $235,000 at December 31, 2012, which resulted in a $65,000 write-down during 2013.

The Company generally places a loan on nonaccrual status and ceases accruing interest when loan payment performance is deemed unsatisfactory and the loan is past due 90 days or more. There are no loans that are past due 90 days or more and still accruing interest. The Company considers a loan impaired when, based on current information and events, it is probable that the Company will be unable to collect the scheduled payments of principal and interest when due according to the contractual terms of the loan.

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Had the loans in nonaccrual status performed in accordance with their original terms, additional interest income of $117,000 and $124,000 would have been recorded for the years ended December 31, 2013 and December 31, 2012, respectively.

The measurement of impaired loans is generally based upon the fair value of the collateral, with a portion of the impaired loans measured based upon the present value of future cash flows discounted at the historical effective interest rate. The Company used the fair value of collateral to measure impairment on commercial loans and commercial real estate loans. At December 31, 2013 and December 31, 2012, the Company had $5.7 million and $6.7 million in loans, which were deemed to be impaired, having specific reserves of $1.0 million and $923,000, respectively. The $1.0 million year over year decrease in impaired loans was principally due to the $1.2 million decrease in impaired residential mortgage loans. In 2013, the Company elected to change the threshold for individually measuring impairment on residential mortgage loans to $300,000 from $100,000, unless the loan is part of the total related credit to an impaired commercial real estate or commercial loan. The increase in impaired commercial real estate loans of $805,000 was partially offset by a $556,000 decrease in impaired commercial loans, home equity and junior liens, and consumer loans, collectively. The threshold for individually measuring impairment on commercial real estate or commercial loans remains at $100,000 at December 31, 2013.

Management has identified potential problem loans totaling $10.3 million as of December 31, 2013, compared to $11.7 million as of December 31, 2012. These loans have been internally classified as special mention or substandard, yet are not currently considered impaired or in nonaccrual status. Management has identified potential credit problems which may result in the borrowers not being able to comply with the current loan repayment terms and which may result in possible future impaired loan reporting. The decrease in potential problem loans is principally due to decreases in commercial real estate as one large commercial real estate borrower was identified as impaired in 2013, thereby removed from potential problem loan status. Potential problem loans within the home equity and junior liens product class declined by $400,000.

As a result, the ratio of the allowance to loan and lease losses to period-end loans at December 31, 2013 was 1.48% as compared to December 31, 2012 of 1.35%. The increase was driven by the required specific allowance required from the previously mentioned newly impaired large commercial borrower during 2013 and the growth in the loan portfolio.

Appraisals are obtained at the time a real estate secured loan is originated. For commercial real estate held as collateral, the property is generally inspected every two years. When evaluating our ability to collect from secondary sources, appraised values are adjusted to reflect the age of appraisal, the condition of the property, the current local real estate market, and cost to sell. Properties are re-appraised when our evaluation of the current property condition and the local real estate market suggests values may not be accurate. Troubled Debt Restructurings ("TDR") are loan restructurings in which the Bank, for economic or legal reasons related to an existing borrower's financial difficulties, grants a concession to the debtor that it would not otherwise consider. Typically a TDR involves a modification of terms of a debt, such as reduction of the stated interest rate for the remaining original life of the debt, extension of the maturity date at a stated interest rate lower than the current market rate for new debt with similar risk, reduction of the face amount of the debt, or reduction of accrued interest. Further details regarding TDRs can be found in Note 5.

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

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Allowance for Loan Losses

The allowance for loan losses is established through provision for loan losses and reduced by loan charge-offs net of recoveries. The allowance for loan losses represents the amount available for probable credit losses in the Company's loan portfolio as estimated by management. In its assessment of the qualitative factors used in arriving at the required allowance for loan losses, management considers changes in national and local economic trends, the rate of the portfolio growth, trends in delinquencies and nonaccrual balances, changes in loan policy, and changes in management experience and staffing. These factors, coupled with the recent historical loss experience within the loan portfolio by product segment support the estimable and probable losses within the loan portfolio.

The Company establishes a specific allocation for all commercial loans identified as being impaired with a balance in excess of $100,000. These loans are on nonaccrual or have been risk rated under the Company's risk rating system as substandard, doubtful, or loss. The measurement of impaired loans is generally based upon the present value of future cash flows discounted at the historical effective interest rate, except that all collateral-dependent loans are measured for impairment based on the fair value of the collateral, less costs to sell. The majority of the Company's impaired loans are collateral-dependent. The Company uses the fair value of collateral, less costs to sell to measure impairment on commercial and commercial real estate loans. Residential real estate loans in excess of $300,000 will also be included in this individual loan review. Residential real estate loans less than this amount will be included in impaired loans if it is part of the total related credit to a previously identified impaired commercial loan.

The allowance for loan losses at December 31, 2013 and 2012 was $5.0 million and $4.5 million, or 1.48% and 1.35% of total year end loans, respectively. Net loan charge-offs were $492,000 during 2013, as compared to $304,000 in 2012. The increase in net charge-offs were reported in all loan portfolio segments. As a result, the ratio of net charge-offs to period end was 0.15% in 2013 as compared to 0.10% in 2012.

The following table sets forth the allocation of allowance for loan losses by loan category for the periods indicated. The allocation of the allowance by category is not necessarily indicative of future losses and does not restrict the use of the allowance to absorb losses in any category.

	2013		2012		2011		2010		2009	
(Dollars in thousands)	Allocation of the Allowance	Percent of Loans to Total Loans	Allocation of the Allowance	Percent of Loans to Total Loans	Allocation of the Allowance	Percent of Loans to Total Loans	Allocation of the Allowance	Percent of Loans to Total Loans	Allocation of the Allowance	Percent of Loans to Total Loans
Residential real estate	$649	49.3 %	$811	53.1 %	$664	53.2 %	$750	51.7 %	$763	51.5 %
Commercial real estate	2,302	28.0 %	1,748	24.6 %	1,346	24.2 %	1,204	24.2 %	1,009	23.7 %
Commercial and municipal	1,233	15.3 %	1,192	14.7 %	1,114	13.2 %	1,083	14.0 %	864	13.5 %
Home equity and junior liens	433	6.2 %	494	6.6 %	501	8.0 %	424	8.9 %	390	9.9 %
Consumer loans	136	1.2 %	168	1.0 %	162	1.4 %	89	1.2 %	76	1.4 %
Unallocated	288		88		193		98		(24)	
Total	$5,041	100.0 %	$4,501	100.0 %	$3,980	100.0 %	$3,648	100.0 %	$3,078	100.0 %

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The following table sets forth the allowance for loan losses for the periods indicated and related ratios:

(Dollars In thousands)	2013	2012	2011	2010	2009
Balance at beginning of year	$4,501	$3,980	$3,648	$3,078	$2,472
Provisions charged to operating expenses	1,032	825	940	1,050	876
Recoveries of loans previously charged-off:					
Commercial real estate and loans	41	64	1	55	-
Consumer	71	65	49	36	20
Residential real estate	47	75	49	19	3
Total recoveries	159	204	99	110	23
Loans charged off:					
Commercial real estate and loans	(319)	(231)	(304)	(385)	(74)
Consumer	(179)	(169)	(166)	(157)	(134)
Residential real estate	(153)	(108)	(237)	(48)	(85)
Total charged-off	(651)	(508)	(707)	(590)	(293)
Net charge-offs	(492)	(304)	(608)	(480)	(270)
Balance at end of year	$5,041	$4,501	$3,980	$3,648	$3,078
Net charge-offs to average loans outstanding	0.15 %	0.10 %	0.21 %	0.18 %	0.11 %
Allowance for loan losses to year-end loans	1.48 %	1.35 %	1.31 %	1.28 %	1.17 %

Deposits

The Company’s deposit base is drawn from eight full-service offices in its market area. The deposit base consists of demand deposits, money management and money market deposit accounts, savings, and time deposits. During 2013, 61% of the Company's average deposit base of $412.4 million consisted of core deposits. Core deposits, which exclude time deposits, are considered to be more stable and provide the Company with a lower cost source of funds than time deposits. The Company will continue to emphasize retail core deposits by maintaining its network of full service offices and providing depositors with a full range of deposit product offerings. With the opening of our Syracuse Branch in 2014, we anticipate increasing our deposit gathering capability. In addition, Pathfinder Commercial Bank, our commercial bank subsidiary, seeks business growth by focusing on its local identification and service excellence within the municipal deposit marketplace.

Average deposits increased $24.7 million, or 6.4%, when compared to 2012. The increase in average deposits primarily related to increases in demand accounts, NOW accounts, money market deposit accounts and savings accounts. At December 31, 2013, retail deposits, commercial deposits and municipal deposits increased $9.2 million, $8.9 million and $6.6 million, respectively.

At December 31, 2013, time deposits in excess of $100,000 totaled $88.7 million, or 55% of time deposits and 22% of total deposits. At December 31, 2012, these deposits totaled $85.1 million, or 52% of time deposits and 22% of total deposits.

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The following table indicates the amount of the Company's certificates of deposit of $100,000 or more by time remaining until maturity as of December 31, 2013:

(In thousands)	
Remaining Maturity:	
Three months or less	$ 39,555
Three through six months	18,492
Six through twelve months	15,700
Over twelve months	14,980
Total	$ 88,727

Borrowings

Short-term borrowings are comprised primarily of advances and overnight borrowing at the Federal Home Loan Bank of New York ("FHLBNY"). At December 31, 2013 and December 31, 2012 there were $24.0 million and $9.0 million, respectively, in short-term borrowings outstanding.

The following table represents information regarding short-term borrowings during 2013, 2012 and 2011:

(Dollars in thousands)	2013	2012	2011
Maximum outstanding at any month end	$ 27,860	$ 14,085	$ 11,106
Average amount outstanding during the year	14,876	5,781	5,371
Average interest rate during the year	0.40 %	0.45 %	0.50 %

Long-term borrowed funds consist of advances and repurchase agreements from the FHLBNY and junior subordinated debentures associated with our outstanding Trust Preferred Securities. Long-term borrowed funds, which include the ESOP loan, and junior subordinated debentures, totaled $22.0 million at December 31, 2013 as compared to $31.1 million at December 31, 2012.

Capital

The Company's shareholders' equity at December 31, 2013, was $42.7 million as compared to $40.7 million at December 31, 2012. The Company added $2.1 million to retained earnings through net income less dividends declared on common stock. Accumulated other comprehensive loss worsened by $427,000 due principally to the after tax impact of the decline in unrealized holding gains of the available for sale securities portfolio which occurred as market interest rates increase in 2013 and the September 2013 transfer of available for sale securities to held-to-maturity status which froze the loss in face value on these securities, collectively negatively impacting shareholders' equity by $2.2 million. Partially offsetting this decline was the current year decrease in net actuarial loss, after tax, on the Company's retirement plans of $1.6 million. This favorable impact was the result of positive earnings performance on the Company's frozen pension plan assets and higher interest rates causing a reduction in the pension benefit obligation.

Risk-based capital provides the basis for which all banks are evaluated in terms of capital adequacy. Capital adequacy is evaluated primarily by the use of ratios which measure capital against total assets, as well as against total assets that are weighted based on defined risk characteristics. The Company's goal is to support growth and expansion activities, while maintaining a strong capital position and exceeding regulatory standards. At December 31, 2013, the Bank exceeded all regulatory required minimum capital ratios and met the regulatory definition of a "well-capitalized" institution, i.e. a leverage capital ratio exceeding 5%, a Tier 1 risk-based capital ratio exceeding 6% and a total risk-based capital ratio exceeding 10%. As a result of the Dodd-Frank Act, the Company's ability to raise new capital through the use of trust preferred securities may be limited because these securities will no longer be included in Tier 1 capital. In addition, our ability to generate or originate additional revenue producing assets may be constrained in the future in order to comply with anticipated heightened capital standards required by state and federal regulation. See Note 18 to the consolidated financial statements for further discussion on regulatory capital requirements.

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LIQUIDITY

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

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

For the year ended 2013, as indicated in the Consolidated Statement of Cash Flows, the Company reported net cash flows from financing activities of $24.2 million generated principally by increased balances of demand and savings deposits, money market deposit accounts and short-term borrowings. Additionally, $5.1 million was provided through operating activities. This was invested in available-for-sale investment securities of $11.1 million, net, and net increase in loan outstandings of $9.1 million. As a recurring source of liquidity, the Company's investment securities provided $22.2 million in proceeds from maturities and principal reductions for the year ended 2013.

The Company has a number of existing credit facilities available to it. Total credit available under the existing lines is approximately $149.8 million. At December 31, 2013, the Company had $40.0 million outstanding under existing credit facilities.

The Asset Liability Management Committee of the Company is responsible for implementing the policies and guidelines for the maintenance of prudent levels of liquidity. As of December 31, 2013, management reported to the Board of Directors that the Company is in compliance with its liquidity policy guidelines.

OFF-BALANCE SHEET ARRANGEMENTS

The Company is also a party to financial instruments with off-balance sheet risk in the normal course of business to meet the financing needs of its customers. These financial instruments include commitments to extend credit and standby letters of credit. At December 31, 2013, the Company had $41.0 million in outstanding commitments to extend credit and standby letters of credit. See Note 16 to Notes to Consolidated Financial Statements contained herein.

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ITEM 7A: QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Not required of a smaller reporting company.

ITEM 8: FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

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Pathfinder Bancorp, Inc.

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MANAGEMENT'S REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING

The Company's management is responsible for establishing and maintaining adequate internal control over financial reporting, as such term is defined in Rules 13a-15(f) and 15d-15(f) of the Securities Exchange Act of 1934, as amended. 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 policies or procedures may deteriorate. The Company's internal control over financial reporting is a process designed under the supervision of the Company's principal executive officer and principal financial officer to provide reasonable assurance regarding the reliability of financial reporting and the preparation of the Company's financial statements for external reporting purposes in accordance with United States generally accepted accounting principles.

Under the supervision and with the participation of management, including the Company's principal executive officer and principal financial officer, the Company conducted an evaluation of the effectiveness of its internal control over financial reporting based on the framework in Internal Control – Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission. Based on its evaluation under that framework, management concluded that the Company's internal control over financial reporting was effective as of December 31, 2013. In addition, based on our assessment, management has determined that there were no material weaknesses in the Company's internal controls over financial reporting.

This annual report does not include an attestation report of the Company's independent registered public accounting firm regarding internal control over financial reporting pursuant to the rules of the Dodd-Frank Act that exempts the Company from such attestation and requires only management's report.

/s/ Thomas W. Schneider	/s/ James A. Dowd
Thomas W. Schneider President & Chief Executive Officer	James A. Dowd Senior Vice President and Chief Financial Officer

Oswego, New York
March 17, 2014

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Report of Independent Registered Public Accounting Firm

To the Board of Directors and Shareholders of
Pathfinder Bancorp, Inc.
Oswego, New York

We have audited the accompanying consolidated statements of condition of Pathfinder Bancorp, Inc. and subsidiaries (the "Company") as of December 31, 2013 and 2012 and the related consolidated statements of income, comprehensive income, changes in shareholders' equity and cash flows for each of the years then ended. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement. The Company is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. Our audit included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the consolidated financial statements, assessing 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.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Pathfinder Bancorp, Inc. and subsidiaries as of December 31, 2013 and 2012 and the results of their operations and their cash flows for each of the years then ended in conformity with accounting principles generally accepted in the United States of America.

/s/ BONADIO & CO., LLP

Bonadio & Co., LLP
Syracuse, New York
March 17, 2014

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PATHFINDER BANCORP, INC.
CONSOLIDATED STATEMENTS OF CONDITION

(In thousands, except share and per share data)	December 31, 2013	December 31, 2012
ASSETS:		
Cash and due from banks	$6,535	$6,435
Interest earning deposits	10,040	2,230
Total cash and cash equivalents	16,575	8,665
Interest earning time deposits	500	2,000
Available-for-sale securities, at fair value	80,959	108,339
Held-to-maturity securities, at amortized cost (fair value of $34,222 and $0, respectively)	34,412	-
Federal Home Loan Bank stock, at cost	2,440	1,929
Loans	341,633	333,748
Less: Allowance for loan losses	5,041	4,501
Loans receivable, net	336,592	329,247
Premises and equipment, net	11,644	10,108
Accrued interest receivable	1,715	1,717
Foreclosed real estate	619	426
Intangible assets, net	187	-
Goodwill	4,367	3,840
Bank owned life insurance	8,268	8,046
Other assets	5,515	3,479
Total assets	$503,793	$477,796
LIABILITIES AND SHAREHOLDERS' EQUITY:		
Deposits:		
Interest-bearing	$361,969	$347,892
Noninterest-bearing	48,171	43,913
Total deposits	410,140	391,805
Short-term borrowings	24,000	9,000
Long-term borrowings	16,853	25,964
Junior subordinated debentures	5,155	5,155
Accrued interest payable	86	140
Other liabilities	4,489	4,985
Total liabilities	460,723	437,049
Shareholders' equity:		
Preferred stock - SBLF, par value $0.01 per share; $1,000 liquidation preference; 13,000 shares authorized; 13,000 shares issued and outstanding	13,000	13,000
Common stock, par value $0.01; authorized 10,000,000 shares; 2,979,969 and 2,980,469 shares issued and 2,623,182 and 2,618,182 shares outstanding, respectively	30	30
Additional paid in capital	8,226	8,120
Retained earnings	28,788	26,685
Accumulated other comprehensive loss	(1,745)	(1,318)
Unearned ESOP	(826)	(936)
Treasury stock, at cost; 356,787,and 362,287 shares, respectively	(4,761)	(4,834)
Total Pathfinder Bancorp, Inc shareholders' equity	42,712	40,747

Noncontrolling interest	358	-
Total equity	43,070	40,747
Total liabilities and shareholders' equity	$503,793	$477,796

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

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PATHFINDER BANCORP, INC.
CONSOLIDATED STATEMENTS OF INCOME

(In thousands, except per share data)	For the year ended December 31, 2013	For the year ended December 31, 2012
Interest and dividend income:		
Loans, including fees	$16,347	$16,082
Debt securities:		
Taxable	1,574	1,762
Tax-exempt	762	728
Dividends	174	165
Interest earning time deposits	19	24
Federal funds sold and interest earning deposits	7	4
Total interest income	18,883	18,765
Interest expense:		
Interest on deposits	2,478	2,896
Interest on short-term borrowings	60	26
Interest on long-term borrowings	726	986
Total interest expense	3,264	3,908
Net interest income	15,619	14,857
Provision for loan losses	1,032	825
Net interest income after provision for loan losses	14,587	14,032
Noninterest income:		
Service charges on deposit accounts	1,175	1,112
Earnings and gain on bank owned life insurance	224	309
Loan servicing fees	146	211
Net gains on sales and redemptions of investment securities	365	375
Net gains on sales of loans and foreclosed real estate	470	61
Debit card interchange fees	469	426
Other charges, commissions & fees	567	569
Total noninterest income	3,416	3,063
Noninterest expense:		
Salaries and employee benefits	8,081	7,496
Building occupancy	1,476	1,427
Data processing	1,444	1,437
Professional and other services	659	654
Amortization of intangible assets	1	-
Advertising	537	453
FDIC assessments	415	311
Audits and exams	219	248
Other expenses	1,919	1,492
Total noninterest expenses	14,751	13,518
Income before income taxes	3,252	3,577
Provision for income taxes	847	929
Net income attributable to noncontrolling interest and Pathfinder Bancorp, Inc.	2,405	2,648
Net loss attributable to noncontrolling interest	(1)	-

Net income attributable to Pathfinder Bancorp, Inc.	$2,406	$2,648
Preferred stock dividends	-	449
Net income available to common shareholders	$2,406	$2,199
Earnings per common share - basic	$0.96	$0.88
Earnings per common share - diluted	$0.95	$0.87
Dividends per common share	$0.12	$0.12

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

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Pathfinder Bancorp, Inc.
Consolidated Statements of Comprehensive Income

	Years Ended	
(In thousands)	December 31, 2013	December 31, 2012
Net Income	$2,405	$2,648
Other Comprehensive Income		
Retirement Plans:		
Retirement plan net losses recognized in plan expenses	381	395
Gain on plan losses not recognized in plan expenses and pension plan curtailment	2,590	1,025
Net unrealized gains on retirement plans	2,971	1,420
Unrealized holding gains on financial derivative:		
Change in unrealized holding losses on financial derivative	(2)	(53)
Reclassification adjustment for interest expense included in net income	62	58
Net unrealized gain on financial derivative	60	5
Unrealized holding (losses) gains on available-for-sale securities:		
Unrealized holding (losses) gains arising during the period	(2,075)	1,192
Reclassification adjustment for net gains included in net income	(365)	(375)
Net unrealized (losses) gains on securities available-for-sale securities	(2,440)	817
Unrealized loss on securities transferred to held-to-maturity(1)	(1,302)	-
Other comprehensive (loss) income, before tax	(711)	2,242
Tax effect	284	(896)
Other comprehensive (loss) income, net of tax	(427)	1,346
Comprehensive income	$1,978	$3,994
Comprehensive income attributable to noncontrolling interest	$(1)	$-
Comprehensive income attributable to Pathfinder Bancorp, Inc.	$1,979	$3,994
Tax Effect Allocated to Each Component of Other Comprehensive Income		
Retirement plan net losses recognized in plan expenses	$(152)	$(158)
Gain on plan losses not recognized in plan expenses and pension plan curtailment	(1,036)	(410)
Change in unrealized holding losses on financial derivative	(1)	21
Reclassification adjustment for interest expense included in net income	(24)	(23)
Unrealized holding (losses) gains arising during the period	830	(476)
Reclassification adjustment for net gains included in net income	146	150
Unrealized loss on securities transferred to held-to-maturity(1)	521	-
Income tax effect related to other comprehensive income	$284	$(896)

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

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

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PATHFINDER BANCORP, INC.
CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY
Years ended December 31, 2013 and December 31, 2012

(In thousands, except share and per share data)	Preferred Stock	Common Stock	Additional Paid in Capital	Retained Earnings	Accumulated Other Com-prehensive Loss	Unearned ESOP	Treasury Stock	Non controlling Interest	Total
Balance, January 1, 2013	$ 13,000	$ 30	$ 8,120	$ 26,685	$ (1,318)	$ (936)	$ (4,834)	$ -	$ 40,747
Net income	-	-	-	2,406	-	-	-	-	2,406
Other comprehensive loss, net of tax	-	-	-	-	(427)	-	-	-	(427)
ESOP shares earned (12,500 shares)	-	-	53	-	-	110	-	-	163
Stock based compensation	-	-	81	-	-	-	-	-	81
Stock options exercised	-	-	(28)	-	-	-	73	-	45
Common stock dividends declared ($0.12 per share)	-	-	-	(303)	-	-	-	-	(303)
Change in noncontrolling interest	-	-	-	-	-	-	-	358	358
Balance, December 31, 2013	$ 13,000	$ 30	$ 8,226	$ 28,788	$ (1,745)	$ (826)	$ (4,761)	$ 358	$ 43,070
Balance, January 1, 2012	$ 13,000	$ 30	$ 8,730	$ 24,618	$ (2,664)	$ (1,039)	$ (4,834)	$ -	$ 37,841
Net income	-	-	-	2,648	-	-	-	-	2,648
Other comprehensive	-	-	-	-	1,346	-	-	-	1,346

income, net of tax									
Purchase of CPP Warrants from Treasury	-	-	(706)	169	-	-	-	-	(537)
Preferred stock dividends - SBLF	-	-	-	(449)	-	-	-	-	(449)
ESOP shares earned (11,645 shares)	-	-	11	-	-	103	-	-	114
Stock based compensation	-	-	79	-	-	-	-	-	79
Stock options exercised	-	-	6	-	-	-	-	-	6
Common stock dividends declared ($0.12 per share)	-	-	-	(301)	-	-	-	-	(301)
Balance, December 31, 2012	$ 13,000	$ 30	$ 8,120	$ 26,685	$ (1,318)	$ (936)	$ (4,834)	$ -	$ 40,747

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

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PATHFINDER BANCORP, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands)	Years Ended December 31, 2013	2012
OPERATING ACTIVITIES		
Net income	$2,406	$2,648
Adjustments to reconcile net income to net cash flows from operating activities:		
Provision for loan losses	1,032	825
Deferred income tax expense (benefit)	202	(276)
Proceeds from sales of loans	11,459	212
Originations of loans held-for-sale	(11,016)	(195)
Realized gains on sales and redemptions of:		
Real estate acquired through foreclosure	(27)	(44)
Loans	(443)	(17)
Available-for-sale investment securities	(365)	(375)
Premise and equipment	(6)	-
Depreciation	715	781
Amortization of mortgage servicing rights	10	7
Amortization of deferred loan costs	111	160
Earnings on bank owned life insurance	(222)	(272)
Realized gain on proceeds from bank owned life insurance	(2)	(37)
Net amortization of premiums and discounts on investment securities	722	1,053
Amortization of intangible assets	1	-
Stock based compensation and ESOP expense	243	193
Net change in accrued interest receivable	2	(32)
Pension plan contribution	-	(2,600)
Net change in other assets and liabilities	289	735
Net cash flows from operating activities	5,111	2,766
INVESTING ACTIVITIES		
Purchase of investment securities available-for-sale	(30,036)	(50,662)
Purchase of investment securities held-to-maturity	(10,433)	-
Net purchases of Federal Home Loan Bank stock	(511)	(401)
Proceeds from maturities of interest earning time deposits	1,500	-
Proceeds from maturities and principal reductions of investment securities available-for-sale	21,831	26,346
Proceeds from maturities and principal reductions of investment securities held-to-maturity	355	-
Proceeds from sales and redemptions of:		
Available-for-sale investment securities	7,151	16,511
Real estate acquired through foreclosure	375	470
Premise and equipment	18	-
Acquisition of controlling interest in Fitzgibbons Agency, net of cash acquired of $18	(356)	-
Proceeds from bank owned life insurance	2	202
Net change in loans	(9,075)	(29,819)
Purchase of premises and equipment	(2,263)	(192)
Net cash flows from investing activities	(21,442)	(37,545)
FINANCING ACTIVITIES		

Net change in demand deposits, NOW accounts, savings accounts, money management deposit accounts, MMDA accounts and escrow deposits	21,764	15,700
Net change in time deposits and brokered deposits	(3,429)	9,976
Net change in short-term borrowings	15,000	9,000
Payments on long-term borrowings	(9,111)	(4,110)
Proceeds from long-term borrowings	-	4,000
Purchase of CPP warrants from the US Treasury	-	(537)
Proceeds from exercise of stock options	45	5
Cash dividends paid to preferred shareholder - SBLF	(83)	(507)
Cash dividends paid to common shareholders	(303)	(301)
Change in noncontrolling interest, net	358	-
Net cash flows from financing activities	24,241	33,226
Change in cash and cash equivalents	7,910	(1,553)
Cash and cash equivalents at beginning of period	8,665	10,218
Cash and cash equivalents at end of period	$16,575	$8,665

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PATHFINDER BANCORP, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands)	Years Ended December 31, 2013	2012
CASH PAID DURING THE PERIOD FOR:		
Interest	$3,318	$3,913
Income taxes	967	403
NON-CASH INVESTING ACTIVITY		
Real estate acquired in exchange for loans	587	357
Transfer of available-for-sale securities to held-to-maturity	32,495	-

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

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Nature of Operations

The accompanying consolidated financial statements include the accounts of Pathfinder Bancorp, Inc. (the “Company”) and its wholly owned subsidiary, Pathfinder Bank (the “Bank”). The Bank has four wholly owned operating subsidiaries, Pathfinder Commercial Bank, Pathfinder Risk Management Company, Inc. (“PRMC”), Pathfinder REIT, Inc. and Whispering Oaks Development Corp. All significant inter-company accounts and activity have been eliminated in consolidation. Although the Company owns, through its subsidiary PRMC, 51% of the membership interest in Fitzgibbons Agency, LLC (“Fitzgibbons”), the Company is required to consolidate 100% of Fitzgibbons within the consolidated financial statements. The 49% of which the Company does not own is accounted for separately as noncontrolling interests within the consolidated financial statements.

The Company has seven offices located in Oswego County and one office in Onondaga County which opened for business in the first quarter of 2012. The Company plans to open an additional location in downtown Syracuse with a target opening in the 2nd quarter of 2014. The Company is primarily engaged in the business of attracting deposits from the general public in the Company’s market area, and investing such deposits, together with other sources of funds, in loans secured by one-to-four family residential real estate, commercial real estate, business assets and in investment securities.

Pathfinder Bancorp, M.H.C., (the “Holding Company”) a mutual holding company whose activity is not included in the accompanying consolidated financial statements, owns approximately 60.4% of the outstanding common stock of the Company.

Use of Estimates in the Preparation of Consolidated Financial Statements

The preparation of consolidated financial statements in conformity with accounting principles generally accepted in the United States of America 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 financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. Management has identified the allowance for loan losses, deferred income taxes, pension obligations, the annual evaluation of the Company’s goodwill for possible impairment and the evaluation of investment securities for other than temporary impairment and the estimation of fair values for accounting and disclosure purposes to be the accounting areas that require the most subjective and complex judgments, and as such, could be the most subject to revision as new information becomes available.

The Company is subject to the regulations of various governmental agencies. The Company also undergoes periodic examinations by the regulatory agencies which may subject it to further changes with respect to asset valuations, amounts of required loss allowances, and operating restrictions resulting from the regulators' judgments based on information available to them at the time of their examinations.

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Significant Group Concentrations of Credit Risk

Most of the Company's activities are with customers located primarily in Oswego and Onondaga counties of New York State. A large portion of the Company's portfolio is centered in residential and commercial real estate. The Company closely monitors real estate collateral values and requires additional reviews of commercial real estate appraisals by a qualified third party for commercial real estate loans in excess of $400,000. Note 4 discusses the types of securities that the Company invests in. Note 5 discusses the types of lending that the Company engages in. The Company does not have any significant concentrations to any one industry or customer.

Advertising

The Company follows the policy of charging the costs of advertising to expense as incurred.

Noncontrolling Interest

Noncontrolling interest represents the portion of ownership and profit or loss that is attributable to the minority owners of the Fitzgibbons Agency.

Cash and Cash Equivalents

Cash and cash equivalents include cash on hand, amounts due from banks and interest-bearing deposits (with original maturity of three months or less).

Investment Securities

The Company classifies investment securities as either available-for-sale or held-to-maturity. The Company does not hold any securities considered to be trading. Available-for-sale securities are reported at fair value, with net unrealized gains and losses reflected as a separate component of shareholders' equity, net of the applicable income tax effect. Held-to-maturity securities are those that the Company has the ability and intent to hold until maturity and are reported at amortized cost. These securities include those that were transferred from available-for-sale to held-to-maturity in the third quarter of 2013, and more fully explained in Note 4 to the financial statements.

Gains or losses on investment security transactions are based on the amortized cost of the specific securities sold. Premiums and discounts on securities are amortized and accreted into income using the interest method over the period to maturity.

Note 4 to the consolidated financial statements includes additional information about the Company's accounting policies with respect to the impairment of investment securities.

Federal Home Loan Bank Stock

Federal law requires a member institution of the Federal Home Loan Bank ("FHLB") system to hold stock of its district FHLB according to a predetermined formula. The stock is carried at cost.

Mortgage Loans Held-for-Sale

Mortgage loans held-for-sale are carried at the lower of cost or fair value. Fair value is determined in the aggregate. There were no loans held-for-sale or forward commitments outstanding as of December 31, 2013 and 2012.

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Transfers of Financial Assets

Transfers of financial assets, including sales of loans and loan participations, 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.

Loans

The Company grants mortgage, commercial, municipal, and consumer loans to customers. Loans that management has the intent and ability to hold for the foreseeable future or until maturity or pay-off are stated at their outstanding unpaid principal balances, less the allowance for loan losses plus net deferred loan origination costs. The ability of the Company's debtors to honor their contracts is dependent upon the real estate and general economic conditions in the market area. Interest income is generally recognized when income is earned using the interest method. Nonrefundable loan fees received and related direct origination costs incurred are deferred and amortized over the life of the loan using the interest method, resulting in a constant effective yield over the loan term. Deferred fees are recognized into income and deferred costs are charged to income immediately upon prepayment of the related loan.

The loans receivable portfolio is segmented into residential mortgage, commercial and consumer loans. The residential mortgage segment consists of one-to-four family first-lien residential mortgages and construction loans. Commercial loans consist of the following classes: real estate, lines of credit, other commercial and industrial, and municipal loans. Consumer loans include both home equity lines of credit and loans with junior liens and other consumer loans.

Allowance for Loan Losses

The allowance for loan losses represents management's estimate of losses inherent in the loan portfolio as of the date of the statement of condition and it is recorded as a reduction of loans. The allowance is increased by the provision for loan losses, and decreased by charge-offs, net of recoveries. Loans deemed to be uncollectible are charged against the allowance for loan losses, and subsequent recoveries, if any, are credited to the allowance. All, or part, of the principal balance of loans receivable are charged off to the allowance as soon as it is determined that the repayment of all, or part, of the principal balance is highly unlikely. Non-residential consumer loans are generally charged off no later than 120 days past due on a contractual basis, unless productive collection efforts are providing results. Consumer loans may be charged off earlier in the event of bankruptcy, or if there is an amount that is deemed uncollectible. No portion of the allowance for loan losses is restricted to any individual loan product and the entire allowance is available to absorb any and all loan losses.

The allowance for loan losses is maintained at a level considered adequate to provide for losses that can be reasonably anticipated. Management performs a quarterly evaluation of the adequacy of the allowance. The allowance is based on three major components which are; specific components for larger loans, recent historical losses and several qualitative factors applied to a general pool of loans, and an unallocated component.

The first component is the specific component that relates to loans that are classified as impaired. For these loans, an allowance is established when the discounted cash flows or collateral value of the impaired loan is lower than the carrying value of that loan.

The second or general component covers pools of loans, by loan class, not considered impaired, smaller balance homogeneous loans, such as residential real estate, home equity and other consumer loans. These pools of loans are evaluated for loss exposure first based on historical loss rates for each of these categories of loans. The ratio of net charge-offs to loan outstandings within each product class, over the most recent eight quarters, lagged by one quarter, is used to generate the historical loss rates. In addition, qualitative factors are added to the historical loss rates in arriving at the total allowance for loan loss need for this general pool of loans. The qualitative factors include changes in national and local economic trends, the rate of growth in the portfolio, trends of delinquencies and nonaccrual balances, changes in loan policy, and changes in lending management experience and related staffing. Each factor is assigned a value to reflect improving, stable or declining conditions based on management's best judgment using relevant information available at the time of the evaluation. These qualitative factors, applied to each product class, make the evaluation inherently subjective, as it requires material estimates that may be susceptible to significant revision as more information becomes available. Adjustments to the factors are supported through documentation of changes in conditions in a narrative accompanying the allowance for loan loss analysis and calculation.

The third or 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 specific and general losses in the portfolio and generally comprises less than 10% of the total allowance for loan loss.

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. Loans that experience insignificant payment delays and payment shortfalls generally are not classified as impaired. Management determines the significance of payment delays and shortfalls on a case-by case basis, taking into consideration all of the circumstances surrounding the loan and the borrower, including the length and reason for the delay, the borrower's prior payment record and the amount of shortfall in relation to what is owed. Impairment is measured by either the present value of the expected future cash flows discounted at the loan's effective interest rate or the fair value of the underlying collateral if the loan is collateral dependent. The majority of the Company's loans utilize the fair value of the underlying collateral.

An allowance for loan loss is established for an impaired loan if its carrying value exceeds its estimated fair value. The estimated fair values of substantially all of the Company's impaired loans are measured based on the estimated fair value of the loan's collateral. For loans secured by real estate, estimated fair values are determined primarily through third-party appraisals, less costs to sell. Appraised values are discounted to arrive at the estimated selling price of the collateral, which is considered to be the estimated fair value. The discounts also include estimated costs to sell the property.

For commercial and industrial loans secured by non-real estate collateral, such as accounts receivable, inventory and equipment, estimated fair values are determined based on the borrower's financial statements, inventory reports, accounts receivable agings or equipment appraisals or invoices. Indications of value from these sources are generally discounted based on the age of the financial information or the quality of the assets.

Large groups of homogeneous loans are collectively evaluated for impairment. Accordingly, the Company does not separately identify individual residential mortgage loans less than $300,000, home equity and other consumer loans for impairment disclosures, unless such loans are related to borrowers with impaired commercial loans or they are the subject to a troubled debt restructuring agreement for those with a carrying value in excess of $300,000.

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Commercial loans whose terms are modified are classified as troubled debt restructurings if the Company grants such borrowers concessions and it is deemed that those borrowers are experiencing financial difficulty. Concessions granted under a troubled debt restructuring generally include but are not limited to a temporary reduction in the interest rate or an extension of a loan's stated maturity date. Commercial loans classified as troubled debt restructurings with a carrying value in excess of $100,000 are designated as impaired and evaluated as discussed above.

The allowance calculation methodology includes further segregation of loan classes into risk rating categories. The borrower's overall financial condition, repayment sources, guarantors and value of the collateral, if appropriate, are evaluated not less than annually for commercial loans or when credit deficiencies arise on all loans. Credit quality risk ratings include regulatory classifications of special mention, substandard, doubtful and loss. See Note 5 for a description of these regulatory classifications.

In addition, Federal regulatory agencies, as an integral part of their examination process, periodically review the Company's allowance for loan losses and 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, which may not be currently available to management. Based on management's comprehensive analysis of the loan portfolio, management believes the current level of the allowance for loan losses is adequate.

Income Recognition on Impaired and Nonaccrual Loans

For all classes of loans receivable, the accrual of interest is discontinued when the contractual payment of principal or interest has become 90 days past due or management has serious doubts about further collectability of principal or interest, even though the loan may be currently performing. A loan may remain on accrual status if it is in the process of collection and is either guaranteed or well secured. When a loan is placed on nonaccrual status, unpaid interest is reversed and charged to interest income. Interest received on nonaccrual loans, including impaired loans, generally is either applied against principal or reported as interest income, according to management's judgment as to the collectability of principal. Generally, loans are restored to accrual status when the obligation is brought current, has performed in accordance with the contractual terms for a reasonable period of time, generally six months, and the ultimate collectability of the total contractual principal and interest is no longer in doubt. Nonaccrual troubled debt restructurings are restored to accrual status if principal and interest payments, under the modified terms, are current for six consecutive months after modification.

For nonaccrual loans, when future collectability of the recorded loan balance is expected, interest income may be recognized on a cash basis. In the case where a nonaccrual loan had been partially charged off, recognition of interest on a cash basis is limited to that which would have been recognized on the recorded loan balance at the contractual interest rate. Cash interest receipts in excess of that amount are recorded as recoveries to the allowance for loan losses until prior charge-offs have been fully recovered.

Off-Balance Sheet Credit Related Financial Instruments

In the ordinary course of business, the Company has entered into commitments to extend credit, including commitments under standby letters of credit. Such financial instruments are recorded when they are funded.

Premises and Equipment

Premises and equipment are stated at cost, less accumulated depreciation. Depreciation is computed on a straight-line basis over the estimated useful lives of the related assets, ranging up to 40 years for premises and 10 years for equipment. Maintenance and repairs are charged to operating expenses as incurred. The asset cost and accumulated depreciation are removed from the accounts for assets sold or retired and any resulting gain or loss is included in the determination of income.

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Foreclosed Real Estate

Properties acquired through foreclosure, or by deed in lieu of foreclosure, are recorded at their fair value less estimated costs to sell. Fair value is typically determined based on evaluations by third parties. Costs incurred in connection with preparing the foreclosed real estate for disposition are capitalized to the extent that they enhance the overall fair value of the property. Any write-downs on the asset's fair value less costs to sell at the date of acquisition are charged to the allowance for loan losses. Subsequent write downs and expenses of foreclosed real estate are included as a valuation allowance and recorded in noninterest expense.

Goodwill and Intangible Assets

Goodwill represents the excess cost of an acquisition over the fair value of the net assets acquired. Goodwill is not amortized, but is evaluated annually for impairment. Intangible assets, such as customer relationships, are amortized over their useful lives, generally over 15 years.

Mortgage Servicing Rights

Originated mortgage servicing rights are recorded at their fair value at the time of transfer of the related loans and are amortized in proportion to and over the period of estimated net servicing income or loss. The carrying value of the originated mortgage servicing rights is periodically evaluated for impairment or between annual evaluations under certain circumstances.

Stock-Based Compensation

Compensation costs related to share-based payment transactions are recognized based on the grant-date fair value of the stock-based compensation issued. Compensation costs are recognized over the period that an employee provides service in exchange for the award. Compensation costs related to the Employee Stock Ownership Plan are dependent upon the average stock price and the shares committed to be released to plan participants through the period in which income is reported.

Retirement Benefits

The Company has a non-contributory defined benefit pension plan that covered substantially all employees. On May 14, 2012, the Company informed its employees of its decision to freeze participation and benefit accruals under the plan, primarily to reduce some of the volatility in earnings that can accompany the maintenance of a defined benefit plan. The freeze became effective June 30, 2012. Compensation earned by employees up to June 30, 2012 is used for purposes of calculating benefits under the plan but there will be no future benefit accruals after this date. Participants as of June 30, 2012 will continue to earn vesting credit with respect to their frozen accrued benefits as they continue to work. Pension expense under these plans is charged to current operations and consists of several components of net pension cost based on various actuarial assumptions regarding future experience under the plans.

Gains and losses, prior service costs and credits, and any remaining transition amounts that have not yet been recognized through net periodic benefit cost are recognized in accumulated other comprehensive loss, net of tax effects, until they are amortized as a component of net periodic cost. Plan assets and obligations are measured as of the Company's statement of condition date.

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The Company has unfunded deferred compensation and supplemental executive retirement plans for selected current and former employees and officers that provide benefits that cannot be paid from a qualified retirement plan due to Internal Revenue Code restrictions. These plans are nonqualified under the Internal Revenue Code, and assets used to fund benefit payments are not segregated from other assets of the Company, therefore, in general, a participant's or beneficiary's claim to benefits under these plans is as a general creditor.

The Company sponsors an Employee Stock Ownership Plan ("ESOP") covering substantially all full time employees. The cost of shares issued to the ESOP but not committed to be released to the participants is presented in the consolidated statement of condition as a reduction of shareholders' equity. ESOP shares are released to the participants proportionately as the loan is repaid. The Company records ESOP compensation expense based on the shares committed to be released and allocated to the participant's accounts multiplied by the average share price of the Company's stock over the period. Dividends related to unallocated shares are recorded as compensation expense.

Derivative Financial Instruments

Derivatives are recorded on the statement of condition as assets and liabilities measured at their fair value. The accounting for increases and decreases in the value of derivatives depends upon the use of derivatives and whether the derivatives qualify for hedge accounting. The Company currently has one interest rate swap, which has been determined to be a cash flow hedge. The fair value of cash-flow hedging instruments ("Cash Flow Hedge") is recorded in either other assets or other liabilities. On an ongoing basis, the statement of condition is adjusted to reflect the then current fair value of the Cash Flow Hedge. The related gains or losses are reported in other comprehensive income (loss) and are subsequently reclassified into earnings, as a yield adjustment in the same period in which the related interest on the hedged item (primarily a variable-rate debt obligation) affect earnings. To the extent that the Cash Flow Hedge is not effective, the ineffective portion of the Cash Flow Hedge is immediately recognized as interest expense.

Income Taxes

Provisions for income taxes are based on taxes currently payable or refundable and deferred income taxes on temporary differences between the tax basis of assets and liabilities and their reported amounts in the consolidated financial statements. Deferred tax assets and liabilities are reported in the consolidated financial statements at currently enacted income tax rates applicable to the period in which the deferred tax assets and liabilities are expected to be realized or settled.

Earnings Per Share

Basic earnings per common share are computed by dividing net income, after preferred stock dividends and preferred stock discount accretion, by the weighted average number of common shares outstanding throughout each year. Diluted earnings per share gives effect to weighted average shares that would be outstanding assuming the exercise of issued stock options and warrants using the treasury stock method. Unallocated shares of the Company's ESOP plan are not included when computing earnings per share until they are committed to be released.

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Segment Reporting

The Company has evaluated the activities relating to its strategic business units. The controlling interest in the Fitzgibbons Agency is dissimilar in nature and management when compared to the Company's other strategic business units which are judged to be similar in nature and management. The Company has determined that the Fitzgibbons Agency is below the reporting threshold in size in accordance with Accounting Standards Codification 280. Accordingly, the Company has determined it has no reportable segments.

Comprehensive Income (Loss)

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 statement of condition, such items, along with net income, are components of comprehensive income.

Accumulated other comprehensive (loss) represents the sum of these items, with the exception of net income, as of the balance sheet date and is represented in the table below.

	As of December 31,	
Accumulated Other Comprehensive Loss By Component:	2013	2012
Unrealized loss for pension and other postretirement obligations	$(1,637)	$(4,608)
Tax effect	655	1,843
Net unrealized loss for pension and other postretirement obligations	(982)	(2,765)
Unrealized loss on financial derivative instruments used in cash flow hedging relationships	(135)	(195)
Tax effect	54	78
Net unrealized loss on financial derivative instruments used in cash flow hedging relationships	(81)	(117)
Unrealized gains on available-for-sale securities	166	2,606
Tax effect	(67)	(1,042)
Net unrealized gains on available-for-sale securities	99	1,564
Unrealized loss on securities transferred to held-to-maturity	(1,302)	-
Tax effect	521	-
Net unrealized loss on securities transferred to held-to-maturity	(781)	-
Accumulated other comprehensive loss	$(1,745)	$(1,318)

Reclassifications

Certain amounts in the 2012 consolidated financial statements have been reclassified to conform to the current year presentation. These reclassifications had no effect on net income as previously reported.

NOTE 2: NEW ACCOUNTING PRONOUNCEMENTS

In January 2014, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") 2014-04 – Receivables-Troubled Debt Restructurings by Creditors (Subtopic 310-40). Topic 310-40 provides guidance on situations in which a creditor obtains one or more collateral assets in satisfaction of all or part of the receivable. That guidance indicates that a creditor should reclassify a collateralized mortgage loan such that the loan should be derecognized and the collateral asset recognized when it determines that there has been in substance a repossession or foreclosure by the creditor, that is, the creditor receives physical possession of the debtor's assets regardless of whether formal foreclosure proceedings take place. However, the terms in substance repossession or foreclosure and physical possession are not defined in the accounting literature and there is diversity about when a creditor should derecognize the loan receivable and recognize the real estate property. That diversity has been highlighted by recent extended foreclosure timelines and processes related to residential real estate properties. The amendments in this Update apply to all creditors who obtain physical possession (resulting from an in substance repossession or foreclosure) of residential real estate property collateralizing a consumer mortgage loan in satisfaction of a receivable and are effective for public business entities for annual periods, and interim periods within those annual periods, beginning after December 15, 2014. The Company does not expect a material impact on its consolidated statements of condition, results of operations, or cash flows.

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NOTE 3: EARNINGS PER SHARE

Basic earnings per share are calculated by dividing net income available to common shareholders by the weighted average number of common shares outstanding during the period. Net income available to common shareholders is net income to Pathfinder Bancorp, Inc. less the total of preferred dividends declared. Diluted earnings per share include the potential dilutive effect that could occur upon the assumed exercise of issued stock options using the Treasury Stock method. Unallocated common shares held by the ESOP are not included in the weighted-average number of common shares outstanding for purposes of calculating earnings per common share until they are committed to be released to plan participants.

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

	Years Ended December 31,	
(In thousands, except per share data)	2013	2012
Basic Earnings Per Common Share		
Net income available to common shareholders	$2,406	$2,199
Weighted average common shares outstanding	2,517	2,504
Basic earnings per common share	$0.96	$0.88
Diluted Earnings Per Common Share		
Net income available to common shareholders	$2,406	$2,199
Weighted average common shares outstanding	2,517	2,504
Effect of assumed exercise of stock options	14	8
Effect of assumed exercise of stock warrants	-	4
Diluted weighted average common shares outstanding	2,531	2,516
Diluted earnings per common share	$0.95	$0.87

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NOTE 4: INVESTMENT SECURITIES

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

	December 31, 2013			
(In thousands)	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Available-for-Sale Portfolio				
Debt investment securities:				
US Treasury, agencies and GSEs	$16,935	$2	$(340)	$16,597
State and political subdivisions	6,429	164	(6)	6,587
Corporate	13,498	198	-	13,696
Residential mortgage-backed - US agency	42,378	496	(732)	42,142
Total	79,240	860	(1,078)	79,022
Equity investment securities:				
Mutual funds:				
Ultra short mortgage fund	643	5	-	648
Large cap equity fund	456	195	-	651
Other mutual funds	183	162	-	345
Common stock - financial services industry	271	22	-	293
Total	1,553	384	-	1,937
Total available-for-sale	$80,793	$1,244	$(1,078)	$80,959
Held-to-Maturity Portfolio				
Debt investment securities:				
US Treasury, agencies and GSEs	$1,872	$-	$(25)	$1,847
State and political subdivisions	21,371	11	(118)	21,264
Corporate	3,746	16	(44)	3,718
Residential mortgage-backed - US agency	7,423	-	(30)	7,393
Total held-to-maturity	$34,412	$27	$(217)	$34,222

	December 31, 2012			
Available-for-Sale Portfolio (In thousands)	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Debt investment securities:				
US Treasury, agencies and GSEs	$6,175	$16	$(8)	$6,183
State and political subdivisions	26,413	1,065	(7)	27,471
Corporate	22,942	468	(404)	23,006
Residential mortgage-backed - US agency	47,113	1,139	(1)	48,251
Residential mortgage-backed - private label	296	9	-	305
Total	102,939	2,697	(420)	105,216
Equity investment securities:				
Mutual funds:				
Ultra short mortgage fund	1,286	5	-	1,291
Large cap equity fund	905	176	-	1,081
Other mutual funds	183	136	-	319

Common stock - financial services industry	420	12	-	432
Total	2,794	329	-	3,123
Total investment securities	$105,733	$3,026	$(420)	$108,339

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The Company's investments in mortgage-backed securities include pass-through securities and collateralized mortgage obligations issued and guaranteed by Fannie Mae, Freddie Mac, and GNMA. As of December 31, 2013 and December 31, 2012, no private-label mortgage-backed securities or collateralized mortgage obligations were held in the securities portfolio. The Company's investments in state and political obligation securities generally are municipal obligations that are general obligations supported by the general taxing authority of the issuer, and in some cases are insured. The obligations issued by school districts are supported by state aid. Primarily, these investments are issued by municipalities within New York State.

The Company elected to transfer 55 available-for-sale ("AFS") securities with an aggregate fair value of $32.5 million to a classification of held-to-maturity ("HTM") on September 30, 2013. In accordance with FASB ASC 320-10-55-24, the transfer from AFS to HTM must be recorded at the fair value of the AFS securities at the time of transfer. The net unrealized holding loss of $799,000, net of tax, at the date of transfer was retained in accumulated other comprehensive loss, with the associated pre-tax amount retained in the carrying value of the HTM securities. Such amounts will be amortized to interest income over the remaining life of the securities. The fair value of the transferred AFS securities became the book value of the HTM securities at September 30, 2013, with no unrealized gain or loss at this date. Future reporting periods, with potential changes in market value for these securities, would likely record an unrealized gain or loss for disclosure purposes.

The amortized cost and estimated fair value of debt investments at December 31, 2013 by contractual maturity are shown below. Expected maturities may differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without penalties.

	Available-for-Sale		Held-to-Maturity	
	Amortized Cost	Estimated Fair Value	Amortized Cost	Estimated Fair Value
(In thousands)				
Due in one year or less	$6,419	$6,438	$186	$186
Due after one year through five years	25,648	25,835	824	825
Due after five years through ten years	4,634	4,446	12,360	12,302
Due after ten years	161	161	13,619	13,516
Sub-total	36,862	36,880	26,989	26,829
Residential mortgage-backed - US agency	42,378	42,142	7,423	7,393
Totals	$79,240	$79,022	$34,412	$34,222

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

	December 31, 2013								
	Less than Twelve Months			Twelve Months or More			Total		
Available-for-Sale	Number of Individual Securities	Unrealized Losses	Fair Value	Number of Individual Securities	Unrealized Losses	Fair Value	Number of Individual Securities	Unrealized Losses	Fair Value
(Dollars in thousands)									
US Treasury, agencies and GSE's	14	$ (340)	$ 15,573	-	$ -	$ -	14	$ (340)	$ 15,573
State and political subdivisions	1	(4)	114	3	(2)	397	4	(6)	511
Corporate	-	-	-	-	-	-	-	-	-
Residential mortgage-backed - US agency	25	(682)	23,442	1	(50)	878	26	(732)	24,320
Totals	40	$ (1,026)	$ 39,129	4	$ (52)	$ 1,275	44	$ (1,078)	$ 40,404
Held-to-Maturity									
US Treasury, agencies and GSE's	2	$ (25)	$ 1,847	-	$ -	$ -	2	$ (25)	$ 1,847
State and political subdivisions	37	(118)	17,814	-	-	-	37	(118)	17,814
Corporate	4	(44)	3,171	-	-	-	4	(44)	3,171
Residential mortgage-backed - US agency	6	(30)	5,526	-	-	-	6	(30)	5,526
Totals	49	$ (217)	$ 28,358	-	$ -	$ -	49	$ (217)	$ 28,358

	December 31, 2012								
	Less than Twelve Months			Twelve Months or More			Total		
Available-for-Sale	Number of Individual Securities	Unrealized Losses	Fair Value	Number of Individual Securities	Unrealized Losses	Fair Value	Number of Individual Securities	Unrealized Losses	Fair Value
(Dollars in thousands)									
US Treasury, agencies and GSE's	1	$ (8)	$ 992	-	$ -	$ -	1	$ (8)	$ 992
State and political subdivisions	8	(7)	2,008	-	-	-	8	(7)	2,008
Corporate	2	(14)	974	2	(390)	1,580	4	(404)	2,554
Residential mortgage-backed -	2	(1)	1,411	-	-	-	2	(1)	1,411

US agency									
Totals	13	$ (30)	$ 5,385	2	$ (390)	$ 1,580	15	$ (420)	$ 6,965

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

Management does not believe any individual unrealized loss in other securities within the portfolio as of December 31, 2013 represents OTTI. One individual municipal security is rated below investment grade, yet the current unrealized loss is less than $1,000 and has only been in place for 1 month. All other related securities are rated A2 or better by Moody's and have been in unrealized loss positions for 11 months or less, with the exception of 3 municipal securities and 1 mortgage-backed security. The 3 municipal securities are issuances from school districts located within the bank's primary market area. The mortgage-backed security was issued by Fannie Mae. The unrealized losses in the portfolio are primarily attributable to changes in interest rates. The Company does not intend to sell these securities, nor is it more likely than not that the Company will be required to sell these securities prior to the recovery of the amortized cost.

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In determining whether OTTI has occurred for equity securities, the Company considers the applicable factors described above and the length of time the equity security's fair value has been below the carrying amount. Management has determined that we have the intent and ability to retain the equity securities for a sufficient period of time to allow for recovery. All of the Company's equity securities had a fair value greater than the book value at December 31, 2013.

Gross realized gains (losses) on sales and redemptions of securities for the years ended December 31 are detailed below:

(In thousands)	2013	2012
Realized gains	$ 370	$ 397
Realized losses	(5)	(22)
	$ 365	$ 375

As of December 31, 2013 and December 31, 2012, securities with a fair value of $58.6 million and $46.0 million, respectively, were pledged to collateralize certain municipal deposit relationships. As of the same dates, securities with a fair value of $21.6 million and $37.8 million were pledged against certain borrowing arrangements.

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

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NOTE 5: LOANS

Major classifications of loans are as follows:

(In thousands)	December 31, 2013	December 31, 2012
Residential mortgage loans:		
1-4 family first-lien residential mortgages	$166,298	$173,955
Construction	1,982	2,655
Total residential mortgage loans	168,280	176,610
Commercial loans:		
Real estate	95,536	82,329
Lines of credit	14,444	13,748
Other commercial and industrial	32,675	31,477
Municipal	5,122	3,588
Total commercial loans	147,777	131,142
Consumer loans:		
Home equity and junior liens	21,110	22,073
Other consumer	4,166	3,469
Total consumer loans	25,276	25,542
Total loans	341,333	333,294
Net deferred loan costs	300	454
Less allowance for loan losses	(5,041)	(4,501)
Loans receivable, net	$336,592	$329,247

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

As of December 31, 2013 and December 31, 2012, residential mortgage loans with a carrying value of $114.8 million and $58.6 million, respectively, have been pledged by the Company to the Federal Home Loan Bank of New York ("FHLBNY") under a blanket collateral agreement to secure the Company's line of credit and term borrowings.

Loan Origination / Risk Management

The Company has lending policies and procedures in place that are designed to maximize loan income within an acceptable level of risk. Management and the Board of Directors reviews and approves these policies and procedures on a regular basis. A reporting system supplements the review process by frequently providing management with reports related to loan production, loan quality, loan delinquencies, nonperforming and potential problem loans. Diversification in the loan portfolio is a means of managing risk associated with fluctuations in economic conditions.

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Risk Characteristics of Portfolio Segments

Each portfolio segment generally carries its own unique risk characteristics.

The residential mortgage loan segment is impacted by general economic conditions, unemployment rates in the Bank's service area, real estate values and the forward expectation of improvement or deterioration in economic conditions.

The commercial loan segment is impacted by general economic conditions but, more specifically, the industry segment in which each borrower participates. Unique competitive changes within a borrower's specific industry, or geographic location could cause significant changes in the borrower's revenue stream, and therefore, impact its ability to repay its obligations. Commercial real estate is also subject to general economic conditions but changes within this segment typically lag changes seen within the consumer and commercial segment. Included within this portfolio are both owner occupied real estate, in which the borrower occupies the majority of the real estate property and upon which the majority of the sources of repayment of the obligation is dependent upon, and non-owner occupied real estate, in which several tenants comprise the repayment source for this portfolio segment. The composition and competitive position of the tenant structure may cause adverse changes in the repayment of debt obligations for the non-owner occupied class within this segment.

The consumer loan segment is impacted by general economic conditions, unemployment rates in the Company's service area, and the forward expectation of improvement or deterioration in economic conditions.

Real estate loans, including residential mortgages, commercial real estate loans and home equity, comprise 84% of the portfolio in 2013, identical to the composition in 2012. Loans secured by real estate provide the best collateral protection and thus significantly reduce the inherent risk in the portfolio.

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

Description of Credit Quality Indicators

The Company utilizes an eight tier risk rating system to evaluate the quality of its loan portfolio. Loans that are risk rated "1" through "4" are considered "Pass" loans. In accordance with regulatory guidelines, loans rated "5" through "8" a termed "criticized" loans and loans rated "6" through "8" are termed "classified" loans. A description of the Company's cred quality indicators follows.

For Commercial Loans:

1. Prime: A loan that is fully secured by properly margined Pathfinder Bank deposit account(s) or an obligation of the US Government. It may also be unsecured if it is supported by a very strong financial condition and, in the case of a commercial loan, excellent management. There exists an unquestioned ability to repay the loan in accordance with its terms.

2. Strong: Desirable relationship of somewhat less stature than Prime grade. Possesses a sound documented repayment source, and back up, which will allow repayment within the terms of the loan. Individual loans backed by solid assets, character and integrity. Ability of individual or company management is good and well established. Probability of serious financial deterioration is unlikely.

3. Satisfactory: Stable financial condition with cash flow sufficient for debt service coverage. Satisfactory loans of average strength having some deficiency or vulnerability to changing economic or industry conditions but performing as agreed with documented evidence of repayment capacity. May be unsecured loans to borrowers with satisfactory credit and financial strength. Satisfactory provisions for management succession and a secondary source of repayment exists.

4. Satisfactory Watch: A four is not a criticized or classified credit. These credits do not display the characteristics of a criticized asset as defined by the regulatory definitions. A credit is given a Satisfactory Watch designation if there are matters or trends observed deserving attention somewhat beyond normal monitoring. Borrowing obligations may be handled according to agreement but could be adversely impacted by developing factors such as industry conditions, operating problems, litigation pending of a significant nature or declining collateral quality and adequacy.

5. Special Mention: A warning risk grade that portrays one or more weaknesses that may be tolerated in the short term. Assets in this category are currently protected but are potentially weak. This loan would not normally be booked as a new credit, but may have redeeming characteristics persuading the Bank to continue working with the borrower. Loans accorded this classification have potential weaknesses which may, if not checked or corrected, weaken the company's assets, inadequately protect the Bank's position or effect the orderly, scheduled reduction of the debt at some future time.

6. Substandard: The relationship is inadequately protected by the current net worth and cash flow capacity of the borrower, guarantor/endorser, or of the collateral pledged. Assets have a well-defined weakness or weaknesses that jeopardize the orderly liquidation of the debt. The relationship shows deteriorating trends or other deficient areas. The loan may be nonperforming and expected to remain so for the foreseeable future. Relationship balances may be adequately secured by asset value; however a deteriorated financial condition may necessitate collateral liquidation to effect repayment. A relationship with an unacceptable financial condition requiring excessive attention of the officer due to the nature of the credit risk or lack of borrower cooperation. All loans on nonaccrual or in a bankruptcy are not graded higher than Substandard.

7. Doubtful: The relationship has all the weaknesses inherent in a credit graded 5 with the added characteristic that the weaknesses make collection on the basis of currently existing facts, conditions and value, highly questionable or improbable. The possibility of some loss is extremely high, however its classification as an anticipated loss is deferred until a more exact determination of the extent of loss is determined. Loans in this category must be on nonaccrual.

8. Loss: Loans are considered uncollectible and of such little value that continuance as bankable assets is not warranted. It is not practicable or desirable to defer writing off this basically worthless asset even though partial recovery may be possible in the future.

For Residential Mortgage and Consumer Loans:

Residential mortgage and consumer loans are assigned a "Pass" rating unless the loan has demonstrated signs of weakness as indicated by the ratings below.

5. Special Mention: All loans sixty days past due are classified Special Mention. The loan is not upgraded until it has been current for six consecutive months.

6. Substandard: All loans 90 days past due are classified Substandard. The loan is not upgraded until it has been current for six consecutive months.

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7. Doubtful: The relationship has all the weaknesses inherent in a credit graded 5 with the added characteristic that the weaknesses make collection on the basis of currently existing facts, conditions and value, highly questionable or improbable. The possibility of some loss is extremely high.

The risk ratings for classified loans are evaluated at least quarterly for commercial loans or when credit deficiencies arise, such as delinquent loan payments, for commercial, residential mortgage or consumer loans. See further discussion of risk ratings in Note 1.

The following table presents the segments and classes of the loan portfolio summarized by the aggregate pass rating and the criticized and classified ratings of special mention, substandard and doubtful within the Company's internal risk rating system:

	As of December 31, 2013				
(In thousands)	Pass	Special Mention	Substandard	Doubtful	Total
Residential mortgage loans:					
1-4 family first-lien residential mortgages	$160,013	$1,649	$4,622	$14	$166,298
Construction	1,982	-	-	-	1,982
Total residential mortgage loans	161,995	1,649	4,622	14	168,280
Commercial loans:					
Real estate	90,162	918	4,456	-	95,536
Lines of credit	12,941	560	943	-	14,444
Other commercial and industrial	31,159	468	899	149	32,675
Municipal	5,122	-	-	-	5,122
Total commercial loans	139,384	1,946	6,298	149	147,777
Consumer loans:					
Home equity and junior liens	19,567	487	976	80	21,110
Other consumer	4,040	30	74	22	4,166
Total consumer loans	23,607	517	1,050	102	25,276
Total loans	$324,986	$4,112	$11,970	$265	$341,333

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

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Nonaccrual and Past Due Loans

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

An age analysis of past due loans, exclusive of deferred costs, segregated by class of loans were as follows:

	As of December 31, 2013					
(In thousands)	30-59 Days Past Due	60-89 Days Past Due	90 Days and Over	Total Past Due	Current	Total Loans Receivable
Residential mortgage loans:						
1-4 family first-lien residential mortgages	$2,213	$1,472	$2,194	$5,879	$160,419	$166,298
Construction	-	-	-	-	1,982	1,982
Total residential mortgage loans	2,213	1,472	2,194	5,879	162,401	168,280
Commercial loans:						
Real estate	1,407	1,901	1,934	5,242	90,294	95,536
Lines of credit	341	113	381	835	13,609	14,444
Other commercial and industrial	2,045	1,289	394	3,728	28,947	32,675
Municipal	-	-	-	-	5,122	5,122
Total commercial loans	3,793	3,303	2,709	9,805	137,972	147,777
Consumer loans:						
Home equity and junior liens	954	281	402	1,637	19,473	21,110
Other consumer	46	51	45	142	4,024	4,166
Total consumer loans	1,000	332	447	1,779	23,497	25,276
Total loans	$7,006	$5,107	$5,350	$17,463	$323,870	$341,333

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

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Year-end nonaccrual loans, segregated by class of loan, were as follows:

(In thousands)	December 31, 2013	December 31, 2012
Residential mortgage loans:		
1-4 family first-lien residential mortgages	$ 2,194	$ 2,046
	2,194	2,046
Commercial loans:		
Real estate	1,934	1,794
Lines of credit	381	334
Other commercial and industrial	394	598
	2,709	2,726
Consumer loans:		
Home equity and junior liens	402	730
Other consumer	45	46
	447	776
Total nonaccrual loans	$ 5,350	$ 5,548

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

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

The Company is required to disclose new TDRs for each reporting period for which an income statement is being presented.

The Company has determined that there was a new TDR with a recorded investment of $404,000 in the year ended December 31, 2013.

- The modification made within the residential real estate loan class resulted in a pre-modification and post-modification recorded investment of $400,000 and $407,000, respectively. The post-modification recorded investment included late charges, accrued interest, and closing costs as a result of the restructuring. Economic concessions granted included a reduction in loan interest rate, extended payment terms, and an advance of additional monies for closing costs without an associated increase in collateral. The Company was required to establish a specific reserve against this loan of $61,000, which was a component of the provision for loan losses in the third quarter of 2013.

The Company has determined that there were $1.1 million of recorded investment in new TDRs in the year ended December 31, 2012. The following highlights the qualitative and quantitative information by loan class.

- Modifications made within the commercial real estate loan class included two loans with pre-modification and post-modification recorded investments of $564,000 and $358,000, respectively. Economic concessions granted included interest only periods, extended payment terms and a reduction in loan interest rate. The Company was required to increase the reserve against these two loans by $211,000 which was a component of the provision for loan losses in the third quarter of 2012.

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- Modifications made within the home equity and junior liens loan class included two loans with pre-modification and post-modification recorded investments which were unchanged at $279,000. Economic concessions granted included interest only periods, extended payment terms and a reduction in loan interest rate. An additional provision was not required as a result of these modifications.

- The first modification made within the other commercial and industrial loan class included a consolidation of three credit facilities into a single loan with a pre-modification and post-modification recorded investment of $439,000 and $468,000, respectively. The post-modification recorded investment included late charges, accrued interest, and closing costs as a result of the restructuring. Economic concessions granted included reduced principal amortization and an extended payment term. Management's review indicates adequate collateral coverage in support of this loan. An additional provision was not required as a result of this modification. The second modification made in this loan class resulted in a pre-modification and post-modification recorded investment of $84,000 and $18,000, respectively. Economic concessions granted included an advance of additional monies without an associated increase in collateral and a 12 month interest only period. The Company was required to increase the reserve against this loan by $90,000, which was a component of the provision for loan losses in the fourth quarter of 2012.

The sole TDR executed in 2013 indicated above was not in payment default at any time during 2013.

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

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Impaired Loans

The following table summarizes impaired loans information by portfolio class:

	December 31, 2013			December 31, 2012		
(In thousands)	Recorded Investment	Unpaid Principal Balance	Related Allowance	Recorded Investment	Unpaid Principal Balance	Related Allowance
With no related allowance recorded:						
1-4 family first-lien residential mortgages	$550	$550	$-	$844	$844	$-
Commercial real estate	1,496	1,499	-	1,554	1,571	-
Commercial lines of credit	196	196	-	358	370	-
Other commercial and industrial	266	266	-	657	801	-
Home equity and junior liens	294	294	-	380	380	-
Other consumer	-	-	-	-	-	-
With an allowance recorded:						
1-4 family first-lien residential mortgages	402	402	59	1,307	1,307	215
Commercial real estate	2,045	2,054	649	1,182	1,182	401
Commercial lines of credit	185	200	135	-	-	-
Other commercial and industrial	139	139	107	225	230	207
Home equity and junior liens	165	165	84	155	155	95
Other consumer	2	2	2	5	5	5
Total:						
1-4 family first-lien residential mortgages	952	952	59	2,151	2,151	215
Commercial real estate	3,541	3,553	649	2,736	2,753	401
Commercial lines of credit	381	396	135	358	370	-
Other commercial and industrial	405	405	107	882	1,031	207
Home equity and junior liens	459	459	84	535	535	95
Other consumer	2	2	2	5	5	5
Totals	$5,740	$5,767	$1,036	$6,667	$6,845	$923

The following table presents the average recorded investment in impaired loans for the years ended December 31:

(In thousands)	2013	2012
1-4 family first-lien residential mortgages	$ 1,407	$ 1,682
Commercial real estate	3,605	2,506
Commercial lines of credit	406	417
Other commercial and industrial	694	718
Home equity and junior liens	512	488
Other consumer	3	3
Total	$ 6,627	$ 5,814

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The following table presents the interest income recognized on impaired loans for the years ended December 31:

(In thousands)	2013	2012
1-4 family first-lien residential mortgages	$ 26	$ 108
Commercial real estate	176	71
Commercial lines of credit	15	14
Other commercial and industrial	32	29
Home equity and junior liens	28	10
Other consumer	-	1
Total	$ 277	$ 233

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NOTE 6: ALLOWANCE FOR LOAN LOSSES

Changes in the allowance for loan losses for the years ended December 31, 2013 and 2012 and information pertaining to the allocation of the allowance for loan losses and balances of the allowance for loan losses and loans receivable based on individual and collective impairment evaluation by loan portfolio class at the indicated dates are summarized in the tables below. An allocation of a portion of the allowance to a given portfolio class does not limit the Company's ability to absorb losses in another portfolio class.

	December 31, 2013				
(In thousands)	1-4 family first-lien residential mortgage	Residential construction mortgage	Commercial real estate	Commercial lines of credit	Other commercial and industrial
Allowance for loan losses:					
Beginning Balance	$811	$-	$1,748	$440	$750
Charge-offs	(153)	-	(46)	(124)	(149)
Recoveries	47	-	19	22	-
Provisions	(56)	-	581	59	233
Ending balance	$649	$-	$2,302	$397	$834
Ending balance: related to loans individually evaluated for impairment	$59	$-	$649	$135	$107
Ending balance: related to loans collectively evaluated for impairment	$590	$-	$1,653	$262	$727
Loans receivables:					
Ending balance	$166,298	$1,982	$95,536	$14,444	$32,675
Ending balance: individually evaluated for impairment	$952	$-	$3,541	$381	$405
Ending balance: collectively evaluated for impairment	$165,346	$1,982	$91,995	$14,063	$32,269

	Municipal	Home equity and junior liens	Other consumer	Unallocated	Total
Allowance for loan losses:					
Beginning Balance	$2	$494	$168	$88	$4,501
Charge-offs	-	(81)	(98)	-	(651)
Recoveries	-	19	52	-	159
Provisions	-	1	14	200	1,032
Ending balance	$2	$433	$136	$288	$5,041
Ending balance: related to loans individually evaluated for impairment	$-	$84	$2	$-	$1,036
Ending balance: related to loans collectively evaluated for impairment	$2	$349	$134	$288	$4,005
Loans receivables:					
Ending balance	$5,122	$21,110	$4,166		$341,333

Ending balance: individually evaluated for impairment	$-	$459	$2	$5,740
Ending balance: collectively evaluated for impairment	$5,122	$20,651	$4,164	$335,592

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(In thousands)	December 31, 2012 1-4 family first-lien residential mortgage	Residential construction mortgage	Commercial real estate	Commercial lines of credit	Other commercial and industrial
Allowance for loan losses:					
Beginning Balance	$664	$-	$1,346	$463	$649
Charge-offs	(108)	-	(142)	-	(89)
Recoveries	75	-	14	50	-
Provisions	180	-	530	(73)	190
Ending balance	$811	$-	$1,748	$440	$750
Ending balance: related to loans individually evaluated for impairment	$215	$-	$401	$-	$207
Ending balance: related to loans collectively evaluated for impairment	$596	$-	$1,347	$440	$543
Loans receivables:					
Ending balance	$173,955	$2,655	$82,329	$13,748	$31,477
Ending balance: individually evaluated for impairment	$2,151	$-	$2,736	$358	$882
Ending balance: collectively evaluated for impairment	$171,804	$2,655	$79,593	$13,390	$30,595

	Municipal	Home equity and junior liens	Other consumer	Unallocated	Total
Allowance for loan losses:					
Beginning Balance	$2	$501	$162	$193	$3,980
Charge-offs	-	(8)	(161)	-	(508)
Recoveries	-	6	59	-	204
Provisions	-	(5)	108	(105)	825
Ending balance	$2	$494	$168	$88	$4,501
Ending balance: related to loans individually evaluated for impairment	$-	$95	$5	$-	$923
Ending balance: related to loans collectively evaluated for impairment	$2	$399	$163	$88	$3,578
Loans receivables:					
Ending balance	$3,588	$22,073	$3,469		$333,294
Ending balance: individually evaluated for impairment	$-	$535	$5		$6,667
Ending balance: collectively evaluated for impairment	$3,588	$21,538	$3,464		$326,627

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NOTE 7: SERVICING

Loans serviced for others are not included in the accompanying consolidated statements of condition. The unpaid principal balances of mortgage and other loans serviced for others were $28,597,000 and $24,775,000 at December 31, 2013 and 2012, respectively. The balance of capitalized servicing rights included in other assets at December 31, 2013 and 2012, was $80,000 and $2,000, respectively.

The following summarizes mortgage servicing rights capitalized and amortized:

(In thousands)	2013	2012
Mortgage servicing rights capitalized	$ 88	$ 2
Mortgage servicing rights amortized	$ 10	$ 7

NOTE 8: PREMISES AND EQUIPMENT

A summary of premises and equipment at December 31, is as follows:

(In thousands)	2013	2012
Land	$ 1,794	$ 1,544
Buildings	9,711	10,056
Furniture, fixtures and equipment	9,827	9,051
Construction in progress	1,718	186
	23,050	20,837
Less: Accumulated depreciation	11,406	10,729
	$ 11,644	$ 10,108

The $1.5 million increase in Construction in progress relates principally to the Bank's purchase of three properties in the amount of $1.4 million from the Mutual Holding Company in December 2013. Depreciation of these properties will begin in 2014 in accordance with the Bank's fixed asset policy.

NOTE 9: GOODWILL AND INTANGIBLE ASSETS

Goodwill represents the excess cost of an acquisition over the fair value of the net assets acquired. Goodwill is not amortized, but is evaluated annually for impairment or between annual evaluations in certain circumstances. Management performs an annual assessment of the Company's goodwill to determine whether or not any impairment of the carrying value may exist. The Company is permitted to assess qualitative factors to determine if it is more likely than not that the fair value of the reporting unit is less than the carrying value. For purposes of this assessment, management considers the Company and its subsidiaries as a whole to be the reporting unit. Based on the results of the assessment, management has determined that the carrying value of goodwill in the amount of $4.4 million is not impaired as of December 31, 2013.

Of the total amount of the goodwill carried in the Company's books as of December 31, 2013, $3.8 million of this amount is due to prior periods' acquisitions of branches and $526,000 is due to the acquisition of the Fitzgibbons Agency. The latter is more fully disclosed in Note 23 to the Notes to Consolidated Financial Statements contained herein.

The identifiable intangible asset of $187,000 as of December 31, 2013 is due to the acquisition of the Fitzgibbons Agency and represents the customer list intangible. This amount differs from the $188,000 recorded at the time of acquisition on December 1, 2013 due to amortization of $1,000 taken during December 2013. The future weighted amortization of this intangible asset is 7.5 years.

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The gross carrying amount and accumulated amortization for this identifiable intangible asset are as follows:

(In thousands)	December 31, 2013	2012
Gross carrying amount	$ 188	$ -
Accumulated amortization	(1)	-
Net amortizing intangibles	$ 187	$ -

The estimated amortization expense for each of the five succeeding years ended December 31, is as follows:

(In thousands)	
2014	$ 13
2015	13
2016	13
2017	13
2018	13
Thereafter	$ 122

NOTE 10: DEPOSITS

A summary of deposits at December 31, is as follows:

(In thousands)	2013	2012
Savings accounts	$68,924	$63,501
Time accounts	71,165	78,176
Time accounts of $100,000 or more	88,727	85,145
Money management accounts	13,337	14,441
MMDA accounts	83,867	73,519
Demand deposit interest-bearing	32,281	29,693
Demand deposit noninterest-bearing	48,171	43,913
Mortgage escrow funds	3,668	3,417
Total Deposits	$410,140	$391,805

At December 31, 2013, the scheduled maturities of time deposits are as follows:

(In thousands)	
Year of Maturity:	
2014	$ 118,732
2015	18,857
2016	4,981
2017	7,603
2018	3,521
Thereafter	6,198
Total	$ 159,892

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NOTE 11: BORROWED FUNDS

The composition of borrowings (excluding junior subordinated debentures) at December 31 is as follows:

(In thousands)	2013	2012
Short-term:		
FHLB Advances	$ 24,000	$ 9,000
Long-term:		
FHLB advances	$ 16,000	$ 20,000
ESOP loan payable	853	964
Citigroup Repurchase agreements	-	5,000
Total long-term borrowings	$ 16,853	$ 25,964

Terms of the ESOP loan payable, which is based on a variable rate, are detailed in Note 14.

The principal balances, interest rates and maturities of the remaining borrowings, all of which are at a fixed rate, at December 31, 2013 are as follows:

Term	Principal	Rates
(Dollars in thousands)		
Advances with FHLB		
due within 1 year	5,000	2.85% - 3.07 %
due within 2 years	2,000	2.79 %
due within 3 years	3,000	2.12 %
due within 4 years	4,000	1.36% - 2.56 %
due within 10 years	2,000	2.55 %
Total advances with FHLB	$ 16,000	
Total long-term fixed rate borrowings	$ 16,000	

At December 31, 2013, scheduled repayments of long-term debt are as follows (in thousands):

2014	$5,110
2015	2,110
2016	3,110
2017	4,110
2018	110
Thereafter	2,303
	$16,853

The Company has access to Federal Home Loan Bank advances, under which it can borrow at various terms and interest rates. Residential mortgage loans with a carrying value of $114.8 million and FHLB stock with a carrying value of $2.4 million have been pledged by the Company under a blanket collateral agreement to secure the Company's borrowings at December 31, 2013. The total outstanding indebtedness under borrowing facilities with the FHLB cannot exceed the total value of the assets pledged under the blanket collateral agreement. The Company has a $21.6 million line of credit available at December 31, 2013 with the Federal Reserve Bank of New York through its Discount Window and has pledged various corporate and municipal securities against the line. The Company has $13.4 million in lines of credit available with three other correspondent banks. $6.4 million of that line of credit is available on an unsecured basis and the remaining $7.0 million must be collateralized with marketable investment securities. Interest on the lines is determined at the time of borrowing.

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The Company has a non-consolidated subsidiary trust, Pathfinder Statutory Trust II, of which the Company owns 100% of the common equity. The Trust issued $5,000,000 of 30 year floating rate Company-obligated pooled capital securities of Pathfinder Statutory Trust II. The Company borrowed the proceeds of the capital securities from its subsidiary by issuing floating rate junior subordinated deferrable interest debentures having substantially similar terms. The capital securities mature in 2037 and are treated as Tier 1 capital by the Federal Deposit Insurance Corporation and the Federal Reserve Board (“FRB”). The capital securities of the trust are a pooled trust preferred fund of Preferred Term Securities VI, Ltd. and are tied to the 3-month LIBOR (25 basis points) plus 1.65% for a total of 1.90% at December 31, 2013 with a five-year call provision. The Company guarantees all of these securities.

The Company's equity interest in the trust subsidiary of $155,000 is reported in "Other assets". For regulatory reporting purposes, the Federal Reserve has indicated that the preferred securities will continue to qualify as Tier 1 Capital subject to previously specified limitations, until further notice. If regulators make a determination that Trust Preferred Securities can no longer be considered in regulatory capital, the securities become callable and the Company may redeem them.

NOTE 12: EMPLOYEE BENEFITS AND DEFERRED COMPENSATION AND SUPPLEMENTAL RETIREMENT PLANS

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

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The following tables set forth the changes in the plans' benefit obligations, fair value of plan assets and the plans' funded status as of December 31:

	Pension Benefits		Postretirement Benefits	
(In thousands)	2013	2012	2013	2012
Change in benefit obligations:				
Benefit obligations at beginning of year	$9,465	$10,167	$450	$401
Service cost	-	166	-	-
Interest cost	379	397	18	17
Actuarial (gain) loss	(1,277)	863	(28)	68
Curtailment gain	-	(1,919)	-	-
Benefits paid	(234)	(209)	(38)	(36)
Benefit obligations at end of year	8,333	9,465	402	450
Change in plan assets:				
Fair value of plan assets at beginning of year	10,786	7,549	-	-
Actual return on plan assets	2,139	846	-	-
Benefits paid	(234)	(209)	(38)	(36)
Employer contributions	-	2,600	38	36
Fair value of plan assets at end of year	12,691	10,786	-	-
Funded Status - asset (liability)	$4,358	$1,321	$(402)	$(450)

Amounts recognized in accumulated other comprehensive loss as of December 31 are as follows:

	Pension Benefits		Postretirement Benefits	
(In thousands)	2013	2012	2013	2012
Net loss, net of curtailment gain	$1,543	$4,466	$94	$142
Tax Effect	617	1,786	38	57
	$926	$2,680	$56	$85

Gains and losses in excess of 10% of the greater of the benefit obligation or the fair value of assets are amortized over the average remaining service period of active participants.

The accumulated benefit obligation for the defined benefit pension plan was $8,333,000 and $9,465,000 at December 31, 2013 and 2012, respectively. The postretirement plan had an accumulated benefit obligation of $402,000 and $450,000 at December 31, 2013 and 2012, respectively.

The significant assumptions used in determining the benefit obligations as of December 31, are as follows:

	Pension Benefits		Postretirement Benefits	
	2013	2012	2013	2012
Weighted average discount rate	4.95%	4.05%	4.95%	4.05%
Rate of increase in future compensation levels	-	-	-	-

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Assumed health care cost trend rates have a significant effect on the amounts reported for the postretirement health care plan. The annual rates of increase in the per capita cost of covered medical and prescription drug benefits for future years were assumed to be 7.0% for 2014, gradually decreasing to 5.00% in 2018 and remain at that level thereafter.

The composition of the net periodic benefit plan cost for the years ended December 31 is as follows:

	Pension Benefits		Postretirement Benefits	
	2013	2012	2013	2012
(In thousands)				
Service cost	$-	$166	$-	$-
Interest cost	379	397	18	17
Expected return on plan assets	(854)	(809)	-	-
Amortization of transition obligation	-	-	-	2
Amortization of net losses	361	381	20	13
Net periodic benefit plan (benefit) cost	$(114)	$135	$38	$32

The significant assumptions used in determining the net periodic benefit plan cost for years ended December 31, were as follows:

	Pension Benefits		Postretirement Benefits	
	2013	2012	2013	2012
Weighted average discount rate	4.05%	4.40%	4.05%	4.40%
Expected long term rate of return on plan assets	8.00%	8.00%	-	-
Rate of increase in future compensation levels	-	-	-	-

The long term rate of return on assets assumption was set based on historical returns earned by equities and fixed income securities, adjusted to reflect expectations of future returns as applied to the plan's target allocation of asset classes. Equities and fixed income securities were assumed to earn real rates of return in the ranges of 5.0%-9.0% and 2.0%-6.0%, respectively. The long-term inflation rate was estimated to be 3.0%. When these overall return expectations are applied to the plan's target allocation, the expected rate of return was determined to be in the range of 7.0% to 11.0%. Management has chosen to use a 7.5% expected long-term rate of return to reflect current economic conditions and expected returns.

The estimated net actuarial loss that will be amortized from accumulated other comprehensive loss into net periodic benefit plan cost during 2014 is $30,000. The estimated amortization of the unrecognized transition obligation and actuarial loss for the post retirement health plan in 2014 is $13,000. The expected net periodic benefit plan cost for 2014 is estimated at a $474,000 negative expense for both retirement plans.

Plan assets are invested in diversified investment funds of the RSI Retirement Trust (the "Trust"), a private placement investment fund. The investment funds include a series of equity and bond mutual funds or commingled trust funds, each with its own investment objectives, investment strategies and risks, as detailed in the Statement of Investment Objectives and Guidelines. The Trust has been given discretion by the Plan Sponsor to determine the appropriate strategic asset allocation versus plan liabilities, as governed by the Trust's Statement of Investment Objectives and Guidelines.

The long-term investment objectives are to maintain plan assets at a level that will sufficiently cover long-term obligations and to generate a return on plan assets that will meet or exceed the rate at which long-term obligations will grow. A broadly diversified combination of equity and fixed income portfolios and various risk management techniques are used to help achieve these objectives.

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In addition, significant consideration is paid to the plan's funding levels when determining the overall asset allocation. If the plan is considered to be well-funded, approximately 65% of the plan's assets are allocated to equities and approximately 35% allocated to fixed-income. Asset rebalancing normally occurs when the equity and fixed-income allocations vary by more than 10% from their respective targets (i.e., a 10% policy range guideline).

The investment goal is to achieve investment results that will contribute to the proper funding of the pension plan by exceeding the rate of inflation over the long-term. In addition, investment managers for the Trust are expected to provide above average performance when compared to their peer managers. Performance volatility is also monitored. Risk/volatility is further managed by the distinct investment objectives of each of the Trust funds and the diversification within each fund.

Pension plan assets measured at fair value are summarized below:

	At December 31, 2013			
(In thousands)	Level 1	Level 2	Level 3	Total Fair Value
Asset Category:				
Mutual funds - equity				
Large-cap value (a)	$1,372	$-	$-	$1,372
Small-cap core (b)	1,801	-	-	1,801
Large-cap Growth (c)	2,068	-	-	2,068
International Core (d)	1,447	-	-	1,447
Common/collective trusts - equity				
Large-cap core (e)	-	1,533	-	1,533
Large-cap value (f)	-	771	-	771
Common/collective trusts - fixed income				
Market duration fixed (g)	-	1,226	-	1,226
Mutual Funds-Fixed Income				
Intermediate duration (h)	2,473	-	-	2,473
Company common stock	-	-	-	-
Cash Equivalents-Money market	-	-	-	-
Total	$9,161	$3,530	$-	$12,691

(a) This category consists of investments whose sector and industry exposures are maintained within a narrow band around Russell 1000 index. The portfolio holds approximately 150 stocks.
(b) This category contains stocks whose sector weightings are maintained within a narrow band around those of the Russell 2000 index. The portfolio will typically hold more than 300 stocks.
(c) This category consists of a pair of mutual funds, one that seeks fast growing large-cap companies with sustainable franchises and positive price momentum, the other invests primarily in large cap growth companies based in the US.
(d) This category has investments in medium to large non-US companies, including high quality, durable growth companies and companies based in countries with stable economic and political systems.
(e) This fund tracks the performance of the S&P 500 Index by purchasing the securities represented in the Index in approximately the same weightings as the Index.
(f) This category contains large-cap stocks with above-average yields. The portfolio typically holds between 60 and 70 stocks.
(g) This category consists of an index fund that tracks the Barclays Capital U.S. Aggregate Bond Index. The fund invests in Treasury, agency, corporate, mortgage-backed and asset-backed securities.
(h) This category consists of two funds, one containing a diversified portfolio of high-quality bonds and other fixed income securities, including U.S. Government obligations, mortgage-related and asset backed securities, corporate and municipal bonds, CMOs, and other securities rated Baa or better. The second fund emphasizes a

more globally diversified portfolio of higher-quality, intermediate-term bonds.

	At December 31, 2012			
(In thousands)	Level 1	Level 2	Level 3	Total Fair Value
Asset Category:				
Mutual funds - equity				
Large-cap value (a)	$1,018	$-	$-	$1,018
Small-cap core (b)	1,339	-	-	1,339
Large-cap core (c)	752	-	-	752
Large-cap value (d)	1,239	-	-	