

FINANCIALLY STRONG.

Community
Focused.



Lyons Bancorp, Inc.
It's all about people.

2015
ANNUAL REPORT



WOW! Committee ambassadors help foster the spirit of our "customer-first" culture throughout the year.

MISSION

The Lyons National Bank is an independent, hometown, community bank with an expanding geographic market. Our mission is to safely and profitably serve all of our customers and communities with the most professional service available. We will accomplish this by making a commitment to our most valuable assets—our employees, to treat them with integrity, compensate them appropriately, provide them with the necessary systems, technology, and appropriate training to enable them to become well respected professionals. Our employees, in turn, will provide our growing customer base with superior service and respect and will be leaders in promoting the quality of life in the communities we serve.

VISION

To be the employer and financial institution of choice, fostering an environment of opportunity, growth and prosperity for our employees, customers, shareholders and local communities.

PROFILE

Lyons Bancorp, Inc. is a bank holding company headquartered in Lyons, New York, with assets of \$868 million at December 31, 2015. Lyons Bancorp, Inc. has one banking subsidiary, The Lyons National Bank. The Lyons National Bank is a community bank with offices in Clyde, Lyons, Macedon, Newark, Ontario and Wolcott in Wayne County, Jordan in Onondaga County, Canandaigua and Geneva in Ontario County, Penn Yan in Yates County, Waterloo in Seneca County and Fairport in Monroe County. The Lyons National Bank has one subsidiary, Lyons Realty Associates Corp.

OUR CULTURE - WOW!

WOW! is a personal conviction to consciously provide our customers and fellow employees with a level of service that exceeds their expectation during each and every encounter we have with them.



ANNUAL MEETING

The annual meeting of the stockholders will take place at 4:30 p.m. on May 18, 2016, at the historic Ohmann Theatre in Lyons, NY.



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Celebrating the Hometown Advantage

In 2015, LNB introduced the Hometown Advantage theme to its marketing promotions tying LNB's hometown values, local decision making, and commitment to customer service to tangible customer benefits.

To view our Hometown Advantage TV commercials, visit **BankwithLNB.com/hometown**

President's Message



Robert A. Schick

*President & Chief Executive Officer,
Lyons Bancorp, Inc., and The Lyons
National Bank*

“We view an investment in our people the same way we view new offices and systems: dollars spent now for increased future returns.”

—Robert A. Schick

I am drafting my annual message at the same time that the presidential campaign debates – at least this is what they are being labeled – are in full swing. To fulfill my civic duty and learn more about the views and beliefs of the individual candidates, I have watched quite a few of them. Because I'm a little older and hopefully wiser, I accept that many of the candidates' statements are exaggerations or twisted truths meant to support their cause. This is American politics: play to emotions, damn the facts and denigrate the opposition. With that said, this year's rhetoric and hurtful personal attacks have hit a new zenith; or is it a new nadir? Through it all, I keep asking myself (with some disbelief), “How did we get here?”

Fortunately, when I turn away from this version of reality TV and focus on the Bank, the question of how we got here – recording our 19th consecutive year of record earnings – never enters my mind. That is because for the 19th consecutive year, our dedicated and professional employees put forth their usual outstanding effort and made it happen yet again. Kudos to each and every one of them!

Last year, Lyons Bancorp earned \$7.4 million or \$2.34 per diluted share after adjusting for the 2 for 1 stock split approved by the Board in October. That's up 2% over what we earned in 2014. To generate this increase in earnings, the Company grew by approximately \$61 million to year-end 2015 total assets of \$868 million. Our Chief Financial Officer, Diana Johnson details our financial performance in her report on subsequent pages.

While total assets grew by \$61 million, total after-tax income advanced a more modest \$162,000 in 2015 versus 2014. This slim return on a substantial amount of asset growth is a testament to the narrow interest rate spread that the financial industry has been operating under for a number of years. We did have some one-time upfront operating expenses in 2015 as we opened our 13th branch office in the Town of Perinton in Monroe County. (I'll talk more about that later.) But the fact remains, the historically low interest

rate environment we have experienced since the 2008 financial meltdown and the current relatively flat yield curve have squeezed our interest rate margin. The reason is as simple as Banking 101: our older, higher yielding loans and investments continue to mature and are replaced by new loans and investments at much lower interest rates while our funding costs are already as low as they can go. The Federal Reserve Bank (FRB) did increase short term interest rates in December by ¼%. This allowed us to increase rates on some of our Prime Rate-related variable rate commercial and customer loans. But since it happened so late in the year, the increase had no material effect on our 2015 earnings. Going forward, further increases in short-term rates may have a negative effect on our margin if market forces continue to hold down longer-term rates. This is known as a flattening of the yield curve. Banks typically have a very difficult time, earnings wise, operating in a flat yield curve

environment where there is little or no spread between short and longer-term rates. 2016 promises to be a very challenging year.

The cost of complying with the avalanche of new regulations, coupled with the mountain of existing ones, is putting

a serious dent in the profits of all banks. 2015 was a continuation of the trend. While I will be the first to admit the industry cannot police itself, the 2008 meltdown was proof of that: most of the abuses were caused by the largest of the banks and the shadow-banking industry. However, up until recently, most of the new regulations were imposed on all banks, regardless of size or complexity. There does seem to be some recognition in Washington of the dangers to community banks of the “one size fits all” mentality, as many new regulations are targeted to specific segments of the industry. While such a change in approach will slow down the increase in the cost of compliance, what is truly needed is a rollback of some overly harsh and unnecessary previously enacted regulations. Unfortunately, there seems to be very little appetite for this in Washington at this time.

“...recording our 19th consecutive year of record earnings.”



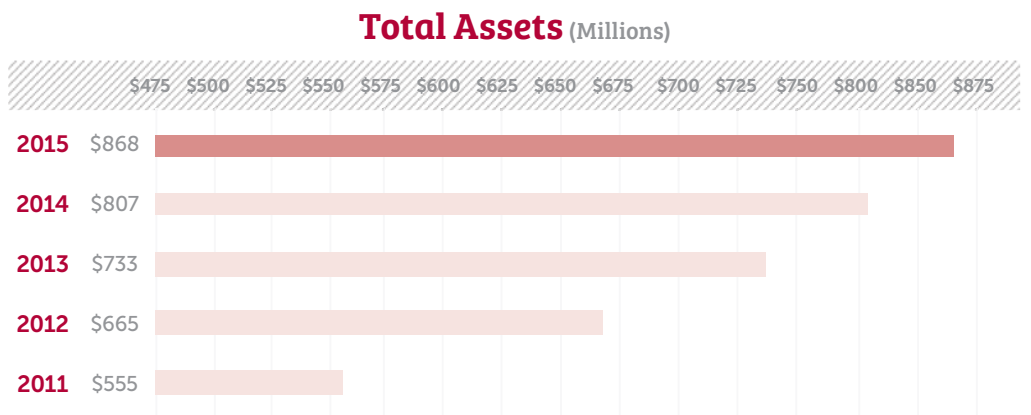
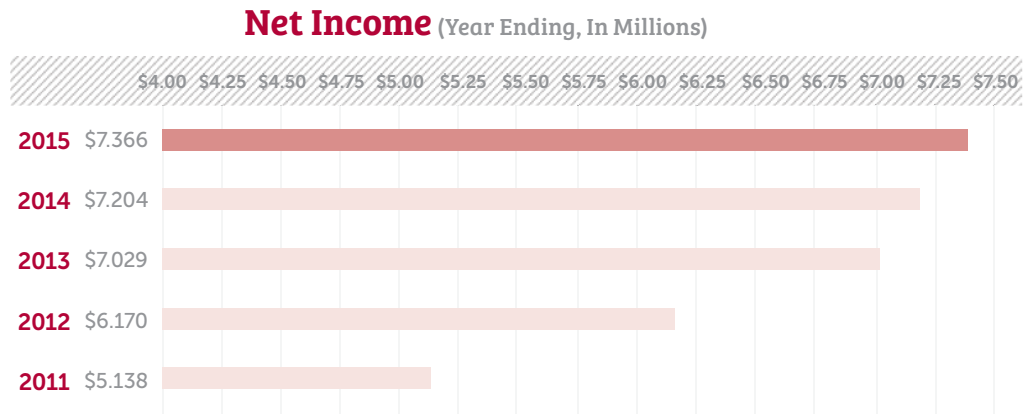
Our achievements in 2015 were not limited to financial records. In May, we broke ground on our 13th branch office, our first in Monroe County. In September, we cut the ribbon and moved into our Perinton Park Office, the official name of the branch. Like all of our branches, we have aggressive growth goals for this location. Originally, we targeted obtaining \$20 million in core deposits by year-end 2015. I am pleased to report that in less than four months, the branch staff, led by Jim Bilotta, our branch manager, closed the year at \$30 million in deposits. Our success in Perinton is yet another example of communities we serve accepting our model of hometown, friendly, personalized banking. I don't want to get too far ahead of myself, but I can envision this branch growing to \$100 million within the next decade (or sooner).

As evidence that we can do this, I point to our experience in Wolcott. We opened our permanent office there in 1995, the year after I came to the Bank. Wolcott, in northeastern Wayne County, has a population of approximately 4,500. When we opened the branch 20 years ago, few envisioned it growing to \$80+ million today. We had help achieving this level of success as a large money center bank closed its doors after deciding it could no longer operate profitably there. As we garnered a good number of their customers, we needed expanded lobby room to handle the increase in customer traffic. We completed the expansion and remodeling of our Wolcott Branch Office on time and on budget in late Spring.

While we were building our Perinton Park Office, we were also relocating and building out our new Town of Ontario office in northwestern Wayne County. Our new location gives us greater visibility and a larger facility to handle the future growth of that office. Ontario, a \$60 million branch today, should grow to \$75 million in a few short years.

Perinton Park, Wolcott and Ontario were not the only branches that increased deposits and market share in 2015. I am pleased to tell you that all but one of our other branches grew in size and market share. Overall, we welcomed more than 2,900 new customer relationships into the LNB family.

While we were growing, we also looked inward and focused on ways to stabilize, or better yet, reduce expenses and improve efficiencies by better using technology. Through our "Best Practices Initiative"



we began to systemically examine the policies and procedures in all departments and branches. Old habits are hard to break, but given the interest rate environment I discussed above, we have no choice but to become and stay operationally efficient.

A large part of our "Best Practices Initiative" was improving the work-flow and communications between our back office departments. To do just this, we needed a larger, more efficient operations center. After an exhaustive search, we moved most of our operations into our new Geneva Ops Center in October. Already, we are reaping efficiencies as a result of our move.

Our employees are our most important assets. As stated in our Mission Statement, we are committed to treating them with integrity, compensating them appropriately and providing them with the tools they need to become consummate professionals. Last year we reviewed our salary grades, focusing on our entry and lower level graded employees. Subsequently, we cumulatively increased the salaries and benefits of those employees by \$200,000 annually. We have budgeted an additional \$200,000 in 2016 to continue adjusting salary levels. We view this investment in our people the same way we view new offices and systems: dollars spent now for increased future returns.

Banks are in the business of making loans — a business with inherent risk. Fortunately, history shows that we are correct in our decision-making more than 99% of the time. We are currently working through a situation, however, that may result in an uncharacteristic loss for us. Not one that will endanger the Bank, but one that we seldom, if ever, incur.

Politics today may have us shaking our heads in wonder and disbelief, but the performance of LNB continues on the same path we started out on 19 years ago. There are always challenges and headwinds to overcome, but I for one, am confident that as long as our staff remains committed to "stay the course", our future remains promising. *Stay well!*

Robert A. Schick





LIVE UNITED
United Way
Kari Buch

United Way
Kristen Koczent

United Way
United Way of Ontario County

Certificate of Appreciation
Presented to
Lyons National Bank

*For outstanding campaign performance during the
2015 United Way of Ontario County Campaign*

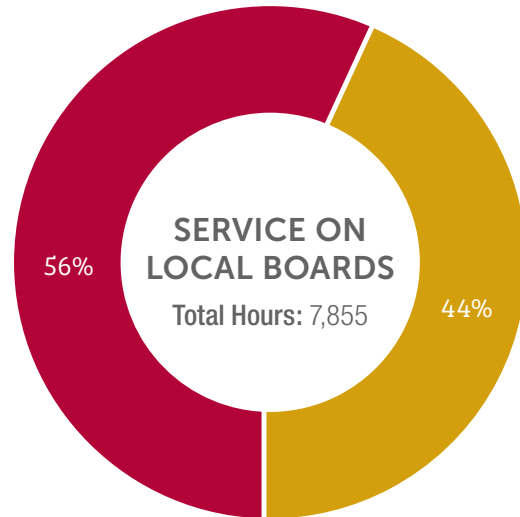
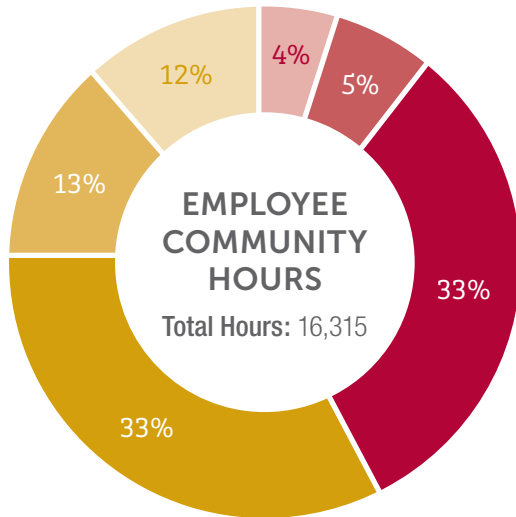
Michael Kauffman
Michael Kauffman
2015 UWOC Campaign Director

Kari E. Buch
Kari E. Buch
Regional Director



Community Strong

LNB continues to play a key role in supporting our customers and positively impacting our communities. The bank made financial contributions to 345 separate local fundraisers and organizations in 2015, and our employees volunteered in our communities for an astounding total of 16,315 hours!



- Religion
 - Conservation & Entertainment
 - Youth Enrichment & Education
 - Civic
 - Arts, Music & Entertainment
 - Community Health
-
- Member
 - Leader



Championing Meaningful Causes

At LNB, we like to make a difference. Supporting the community is second nature to us, and it's part of what makes our culture so special. Here is just a sampling of the causes we championed in 2015.



LIVE LIKE COURT

Inspired by the courage and strength of Courtney Wagner, a young girl from Canandaigua whose battle with cancer became nationally known, staff collected donations for Camp Good Days and Special Times in Courtney's memory.



ANNUAL DAY OF CARING

With our strong ties to the Lyons community, it was fitting that staff gathered at the Community Center in May to help make spruce up the grounds during the United Way Day of Caring.



DOMESTIC VIOLENCE AWARENESS

In October, Branches helped raise awareness for women and children affected by domestic violence and collected donations that were presented to the Victim Resource Center.



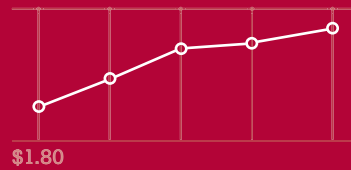
Financial Highlights

RESULTS OF OPERATIONS



Diluted Earnings Per Share

2011	2012	2013	2014	2015
\$1.88	\$2.10	\$2.24	\$2.29	\$2.34



Diana R. Johnson

*Executive Vice President &
Chief Financial Officer*

RESULTS OF OPERATIONS

For the 19th consecutive year, Lyons Bancorp, Inc. experienced earnings growth, and ended 2015 with record earnings of \$7.4 million, an increase of \$162,000 or 2.2% over 2014. This translates into earnings per diluted share of \$2.34 or a 2% increase year over year. Return on average assets was 0.88% and return on average shareholders' equity was 13.09%.

Our largest revenue source is net interest income, the difference between the interest income we earn on our interest-earning assets, primarily loans and investment securities, and the interest paid on our interest-bearing liabilities, primarily deposit accounts and borrowings. Net interest income for 2015 was \$25.9 million, an increase of \$2.6 million or 11% over 2014. This increase was due primarily to strong growth of our earning assets funded by steady deposit growth, as average earning assets increased \$65.2 million or 9% during 2015, and average interest-bearing deposits increased \$30.5 million or 5% year over year. Completing our story, average noninterest-bearing deposits increased \$24 million, providing additional funding for our strong balance sheet growth.

Our tax-equivalent margin improved year over year, measuring 3.35% during 2015, compared to

3.30% in 2014, as we were able to hold assets yields essentially flat, and reduce our overall funding costs.

Our provisions for loan losses are based upon our assessment of a variety of factors, including loan credit quality, the general economic environment and growth in our loan portfolio. In 2015, we provided \$1.3 million for loan losses, compared to \$750,000 in 2014. The increase in the provision for 2015 is reflective of strong loan growth across most loan portfolios. At December 31, 2015 our non-performing loans totaled 0.68% of total loans, as compared to 0.73% at December 31, 2014, and compared favorably to our peer's ratio of 0.86%. Our net charge offs to average loans during 2015 totaled 0.11%, up from the prior year, primarily due to one commercial relationship. The percent of our commercial and agriculture loan portfolio with an aggregate "pass" rating within our internal risk rating system improved to 94.6%, compared to 94.0% in 2014.

Noninterest income is an important revenue source for us, and consists primarily of service charges on deposit accounts, loan servicing fees, cardholder fees, financial services fees, gains and losses on the sale or impairment of securities, and gains

on sale of loans. In 2015, noninterest income represented 24% of all revenue sources and totaled \$8.3 million, an increase of \$864,000 or 12% over 2014 levels and is reflected across most major categories of noninterest income.

Noninterest expense consists primarily of compensation and employee benefits, occupancy and equipment expenses, advertising, data processing, professional fees, FDIC insurance, and other operating expenses. In 2015, total noninterest expense was \$22.6 million, an increase of \$2.6 million or 13% over 2014. Increases in salaries and wages totaled \$695,000 and were primarily the result of annual wage increases and a partial year of expense relating to staffing at our newest branch location in Perinton. Pension and other benefits expense increased \$603,000 or 22% in 2015, due primarily to increases in pension-related costs and employer-paid health insurance. Advertising costs increased \$133,000 or 24% year over year, due in part to our entry into Monroe County.

	2015			2014		
	AVERAGE BALANCE (\$)	INTEREST INC/EXP (\$)	AVERAGE YIELD/COST (%)	AVERAGE BALANCE (\$)	INTEREST INC/EXP (\$)	AVERAGE YIELD/COST (%)
Interest-earning Assets:						
Residential real estate	228,497	8,748	3.83%	211,088	8,250	3.91%
Commercial and agriculture real estate	186,513	8,662	4.64%	167,688	7,834	4.67%
Commercial and agriculture loans	134,051	5,925	4.42%	116,296	5,216	4.49%
Consumer installment loans	26,207	1,514	5.78%	26,428	1,603	6.07%
TOTAL LOANS	575,268	24,849	4.32%	521,500	22,903	4.39%
Investments	202,850	5,225	2.58%	190,620	4,860	2.55%
Federal funds sold & other interest-earning assets	14,538	36	0.25%	15,326	37	0.24%
TOTAL INTEREST-EARNING ASSETS	792,656	30,110	3.80%	727,446	27,800	3.82%
Non interest-earning assets	48,518			42,323		
TOTAL ASSETS	841,174			769,769		

Interest-bearing Liabilities:

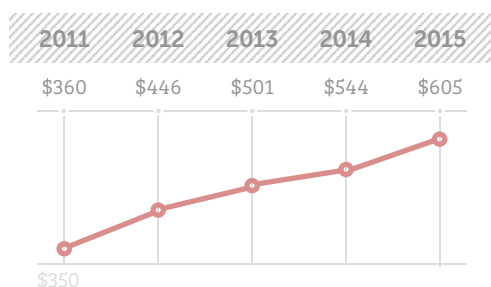
Interest-bearing checking	95,546	229	0.24%	83,668	185	0.22%
Money market and savings accounts	334,876	1,246	0.37%	316,288	1,608	0.51%
Time deposits	160,349	1,389	0.87%	160,341	1,365	0.85%
Borrowings	21,030	134	0.64%	11,079	84	0.76%
Junior subordinated debentures	9,100	534	5.87%	9,217	553	6.00%
TOTAL INTEREST-BEARING LIABILITIES	620,901	3,532	0.57%	580,593	3,795	0.65%
Non interest-bearing deposits	155,917			131,897		
Other non interest-bearing liabilities	8,009			5,620		
TOTAL LIABILITIES	784,827			718,110		
Total equity	56,347			51,659		
TOTAL LIABILITIES AND EQUITY	841,174			769,769		
Net interest spread			3.23%			3.17%
Net interest income/margin on earning assets		26,578	3.35%	24,005	3.30%	
Tax equivalent adjustment		(726)		(738)		
Net interest income per financial statements		25,852		23,267		

ANALYSIS OF FINANCIAL CONDITION

During 2015, we continued to experience solid loan and deposit growth, supported by a strong capital base. Total assets on December 31, 2015 were \$868.2 million, an increase of \$61.3 million or 8% over December 31, 2014. Total equity at December 31, 2015 was \$58.7 million, an increase of \$6.2 million or 12% over December 31, 2014.

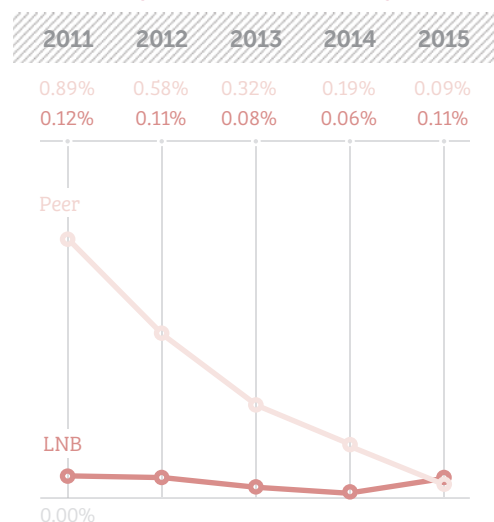
Total loans were \$605.2 million at December 31, 2015, an increase of \$60.7 million or 11% from December 31, 2014. We continued to support

Total Gross Loans (Millions)



our strategy of maintaining balance within the loan portfolio between consumer and commercial loans, ending the year with 45% consumer - related loans versus 55% commercial - related

Net Charged-off Loans to Average Loans



Financial Highlights CONT.

loans, essentially unchanged from last year. We are well positioned to continue prudent lending to the individuals, families and businesses here in our Upstate New York marketplace and look forward to another year of solid loan growth.

We maintain an investment portfolio to provide us with important liquidity considerations and earnings potential. Our investment portfolio consists primarily of United States Agency debt, mortgage-backed securities either guaranteed by the U.S. government or issued by the Federal Home Loan Bank, and state and local government debt. As of December 31, 2015, our investment

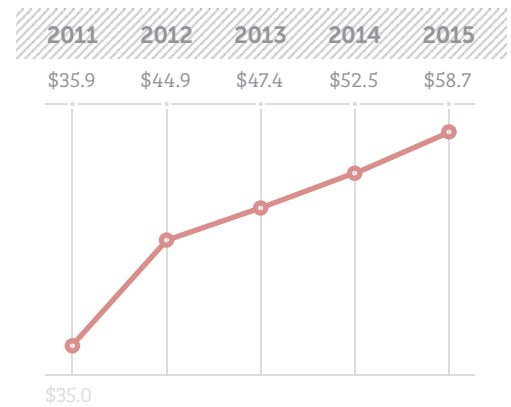
portfolio totaled \$195.2 million, a decrease of \$9.4 million over December 31, 2014 and had an average tax-equivalent yield of 2.58% during 2015. The majority of our portfolio is classified as available for sale, and may be used for liquidity purposes as needed.

Deposits generated within our local markets are the major source of funds for our lending and investment activities. Total deposits at December 31, 2015 were \$772.1 million, an increase of \$73.9 million or 11% over December 31, 2014. We continued to experience strong growth in our core retail and commercial deposit base, with most of our branches increasing their presence in the communities they serve.

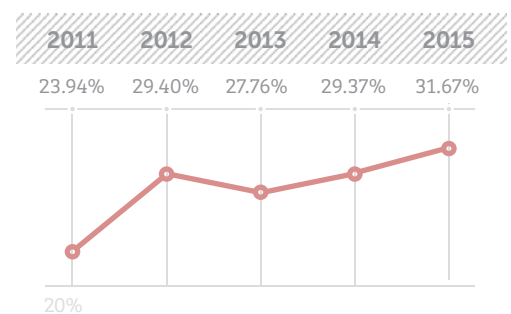
Total equity was \$58.7 million at December 31, 2015. Our Board of Directors is committed to providing a solid return to our shareholders and declared a total of \$0.78 per share in dividends during 2015. This represents a yield of 2.52% based on our year end market price of \$31.00 per share.

Please refer to our Consolidated Financial Report as of December 31, 2015 for more information regarding our 2015 results.

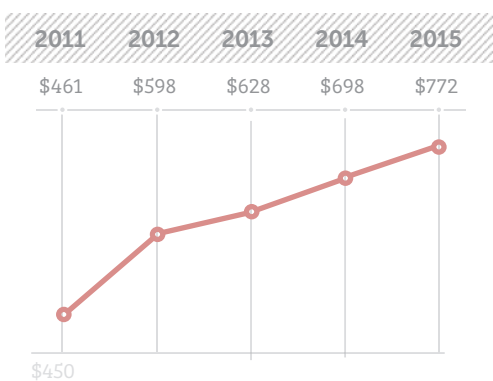
Total Equity (Millions)



Dividends Declared to Net Income



Total Deposits (Millions)



New, Larger Operations Center Opens

On October 1, 2015, business owners, government leaders, chamber members, and LNB staff celebrated the grand opening of our new Geneva-based Operations Center located at the corners of Castle and Exchange Streets.

Nearly 40 employees from eight different departments, including Accounting, Collections, Commercial & Consumer Loan Operations, Deposit Operations, Human Resources, Mortgage & Consumer Loan

Underwriting, and Training now work under one roof in the renovated downtown space.

“Moving from a 6,000 square foot facility to 16,000 square feet enabled us to consolidate departments from three different locations,” said Trevor Thomas, Vice President and Operations Manager. “The efficiencies of departments working and interacting in the same location have already been noticeable.”



Selected Financial Data

Year Ended December 31

(In thousands, except per share data ⁽¹⁾)

	2015	2014	2013	2012	2011
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Financial Statement Highlights (\$)

Assets	868,161	806,844	732,830	665,472	555,451
Loans, gross	605,201	544,464	500,884	445,906	359,951
Deposits	772,111	698,202	627,919	598,305	460,999
Other borrowings	20,126	38,791	42,000	5,000	42,058
Junior subordinated debentures	8,867	9,217	9,217	9,217	9,217
Total equity	58,678	52,506	47,410	44,884	35,894
Interest and dividend income	29,384	27,062	24,963	23,147	21,215
Interest expense	3,532	3,795	2,952	3,556	3,653
Net interest income	25,852	23,267	22,011	19,591	17,562
Provision for loan losses	1,275	750	525	450	965
Net securities gains	167	139	429	215	407
Net income	7,366	7,204	7,029	6,170	5,138

Per Share Information (\$)

Basic earnings per share	2.47	2.42	2.36	2.22	1.99
Cash dividends declared	0.78	0.71	0.66	0.63	0.48
Book value per share	19.51	17.62	15.89	15.08	13.89

Selected Ratios

Return on average assets	0.88%	0.94%	1.01%	0.99%	0.96%
Return on average shareholders' equity	13.09%	13.96%	15.22%	14.93%	14.47%
Leverage ratio (Bank)	8.14%	8.21%	8.38%	8.26%	8.42%
Dividend payout ratio	31.21%	28.97%	20.12%	34.98%	22.75%

Other Selected Data (In Whole Numbers)

Employees (full time equivalent)	185	175	163	155	139
Banking Offices	13	12	12	11	11

(1) Per share data reflects a 2-for-1 stock split in the form of a stock dividend, effective October 30, 2015





Bringing the WOW!

LNB's WOW! Employee Program ranks number one on our key initiatives each and every year. That's how important positive attitudes and customer service are to our culture. Our commitment to going the extra mile is celebrated quarterly through our WOW! recognition awards and annually at our employee event. Congratulations to all of our staff for their focus on customer service and to those who received special recognitions this year. It truly is, "all about people."



PRESIDENT'S CHOICE AWARD

Deborah Odell reacts to receiving the 2015 President's Employee of the Year Award at our western-themed WOW! celebration. Each year, Robert Schick personally selects an employee that demonstrates a personal conviction to provide customers and employees with a level of service that exceeds their expectations.



QUARTERLY WOW! AWARD WINNERS

Quarterly WOW! award winners for 2015 include (l to r): Jacqueline M. Hironimus, ACH/Cash Management Operations Specialist (Q4); Laurie J. Klino, Mortgage /Home Equity Processor (Q3); Joseph F. Charlton, Customer Service Representative in Canandaigua (Q3); Melonie L. Tiffany, Senior Auditor (Q1), Cathy J. DeMay, Assistant Branch Manager in Ontario (Q2), and Susan A. Doebelin, Head Teller in Seneca County (Q2) (Absent from photo).



Tapping Our Talent

In December, LNB's Board of Directors approved the promotions of nine exemplary employees. We are pleased to recognize their accomplishments and share their well-deserved recognition.



Deborah A. Odell

Director of Training

Promoted from Assistant Vice President to Vice President



Joseph M. Arbogast

Mortgage Specialist II

Promoted from Banking Officer to Assistant Vice President



Amanda M. McDonald

Senior Credit Underwriter

Promoted from Banking Officer to Assistant Vice President



Allison E. Britton

Training Assistant

Promoted to Banking Officer



David J. DeRaddo, CFP®

Wealth Manager

Promoted to Banking Officer



Heidi E. King

Assistant Branch Manager II,
Canandaigua Office

Promoted to Banking Officer



Craig R. Mietz

Mortgage Underwriter I

Promoted to Banking Officer



Shannon M. Romano

Executive Administrative Assistant

Promoted to Banking Officer



Craig A. Schojan

Mortgage Underwriter II

Promoted to Banking Officer



THE

WWW



FACTO





A Great Start at Perinton Park

September 12, 2015, marked the official Grand Opening Day of our first Monroe County full-service office located in Fairport, NY. The 5,176 square foot building sits on a 1.2 acre lot that is tied to the Perinton Park sidewalks and trails.

In addition to a Community Room, the space has offices for staff dedicated to commercial lending, mortgage origination and financial services. Response from the community has been warm and welcoming with yearend core totaling \$30 million.



Board of Directors & Executive Staff



LARGE PHOTO LEFT (from left to right) **Andrew F. Fredericksen CPA**, Consultant, Petrella Phillips, LLC, **Diana R. Johnson**, Executive Vice President & Chief Financial Officer, **Robert A. Schick**, President & Chief Executive Officer, **Phillip M. McCann**, Executive Vice President & Chief Risk Officer, **Joseph A. Fragnoli**, Owner, Super Casuals. TOP RIGHT PHOTO (from left to right) **Stephen V. DeRaddo**, Executive Vice President & Senior Retail Lending Officer, **Clair J. Britt, Jr.**, Executive Vice President & Senior Commercial Lending Officer, **Thomas L. Kime**, Executive Vice President & Chief Operating Officer, **Kaye Stone-Ganzs**, President & CEO, Stone Goose Enterprises, Inc., **Brad A. Person**, President & General Manager, Nuttall Golf Cars Inc. and Nuttall Golf Car Leasing, LLC, **Shannon Romano**, Banking Officer & Executive Administrative Assistant. BOTTOM RIGHT PHOTO (from left to right) **David J. Breen, Jr.** General Manager, Herrema's Market Place, **Dale H. Hemminger**, President & General Manager, Hemdale Farms & Greenhouses, **James A. Homburger**, Real Estate Broker, Performance Properties, **Case A. Marshall**, CFO & Vice President, Marshall Companies, **Carol Snook**, Banking Officer & Corporate/Executive Secretary, **James E. Santelli**, Retired Vice President & Co-owner, Santelli Lumber Co.



Advisory Boards

CANANDAIGUA



FROM LEFT TO RIGHT: **Jack Moran**, Roseland Bowl Family Fun Center; **Charles Potter**, Potter HVAC and Metal Fab, Inc.; **Gail Herman**, The Medicine Shoppe Canandaigua; **David Damaske**, Parkview Fairways Golf Course; **Eugene Hermet**, Retired - Curtice Bums Foods. NOT PICTURED: **April Dawson**, Constellation Brands

GENEVA



FROM LEFT TO RIGHT: **Robb Flowers**, Hobart and William Smith College; **Anne Nenneau**, CCN International; **Peter D'Amico**, D'Amico Chrysler Dodge Jeep; **Steve Blowers**, Blowers Agri Service, Inc.; **Bernie Lynch**, Lynch Furniture; **Robert Tewksbury**, Pearl Technologies, Inc. NOT PICTURED: **Jason Feinberg**, MD, Finger Lakes Health

PENN YAN



FROM LEFT TO RIGHT: **Paul Marble Jr.**, Marble's Automotive and Glass; **Jeff Kennedy**, Morgan Marine; **Bonnie Curbeau**, Curbeau Realty; **James Long**, Longs' Cards and Books; **Neil Simmons**, Simmons Vineyards; **Michael Linehan**, Yates County Chamber of Commerce; **Steve Perry**, Knapp & Schlappi Lumber Co., Inc. NOT PICTURED: **Henry Martin**, Town of Benton Dairy Farmer

SENECA COUNTY



FROM LEFT TO RIGHT: **Sal Franzone**, Ciccino's Pizzeria and Restaurant; **Kenneth (Doc) Padgett**, Past President and current Chancellor of NYCC; **Eugene Pierce**, Glenora Wine Cellars, Inc. and Knapp Winery; **Raymond Tuuri, Jr.**, Finger Lakes Equipment Rental; **Steve Wadhams**, Wadhams Enterprises, Inc. NOT PICTURED: **Robert Sessler**, Retired - Sessler Companies

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“Thank you, to our trusted advisory board members who offer insight regarding issues facing our local economies and provide valuable feedback that helps us better serve our communities.”

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Executive Vice President & Chief Financial Officer



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New Location, Same Great Service in Ontario

Our Ontario Branch staff didn't have to go far during the summer to keep tabs on their soon-to-be new office. Located just across the parking lot on the corner of Furnace Road and Route 104, they were able to watch the larger, more visible space transform.

"We had a lot to be excited about," said Jean Tsepas, Branch Manager in Ontario. "Our customers and staff had a bird's eye view of the construction and that added to our anticipation. We just love it here."

Grand Opening events were held in October and the feedback from customers has been unanimously positive. A staff of six provide our customers with LNB's hometown, personalized service and the space includes offices for our dedicated Commercial Lender, Corey Stulpin, Mortgage Specialist, Carl Nasello, and Wealth Manager, Ray Warrick.



Heavy Hearts...

We recently lost two avid advocates of LNB and, more importantly, icons of our local community: Carl Fribolin and Frank Pullano. We will all miss them terribly!



Carl Fribolin

CARL FRIBOLIN

Carl was a member of our Geneva Advisory Board. When we made the decision to expand into Geneva, Carl was the first name we considered when forming the Advisory Board. Thankfully, he accepted the invitation and we benefited from his years of wise counsel. He was a young 86 at the time.

Carl was a successful businessman in the seed industry for many years, and after he joined our Advisory Board, Carl thrust himself into the vineyard and wine industry at the still young age of 88. He was also active in and supported many not-for-profit organizations in education, health care and youth organizations. In Geneva, Carl is best known for saving and restoring the historic Smith Opera House. The restoration of The Smith spurred the rebirth of downtown Geneva. Carl died in January 2016, at the age of 97.



Frank Pullano

FRANK PULLANO

Frank was the unofficial "Mayor of Geneva" and strong supporter of LNB. He was often the first person newcomers to Geneva would meet. A retired Chief Warrant Officer, Frank remained active with the American Legion, organizing and MC'ing many of the annual Memorial Day, Fourth of July and Veteran's Day ceremonies. He cared deeply and worked hard for the betterment of veterans in our area. Frank died in February 2016, at the age of 86.



FINANCIALLY STRONG.

Community
Focused.



Lyons Bancorp, Inc.
It's all about people.

**FINANCIAL
REPORT**
December 31, 2015

Annual Meeting

The annual meeting of the stockholders will take place at 4:30 p.m. on May 18, 2016, at the historic Ohmann Theatre in Lyons, New York.



Lyons Bancorp, Inc.

It's all about people.

PROFILE

Lyons Bancorp, Inc. is a bank holding company headquartered in Lyons, New York, with assets of \$868 million at December 31, 2015. Lyons Bancorp, Inc. has one banking subsidiary, The Lyons National Bank.

The Lyons National Bank is a community bank with offices in Clyde, Lyons, Macedon, Newark, Ontario and Wolcott in Wayne County, Jordan in Onondaga County, Canandaigua and Geneva in Ontario County, Penn Yan in Yates County, Waterloo in Seneca County and Fairport in Monroe County. The Lyons National Bank has one subsidiary, Lyons Realty Associates Corp.

STOCK SYMBOL

LYBC

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Lyons Bancorp, Inc. & The Lyons National Bank

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Consultant

Petrella Phillips, LLC

Case A. Marshall

Vice President & Chief Operating Officer

Marshall Companies

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Executive Vice President & Senior Commercial Lending Officer

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Stephen J. Wadhams

MAIN OFFICE

35 William Street
Lyons, NY 14489
(315) 946-4871
BankwithLNB.com

Lyons Bancorp, Inc.

Consolidated Financial Report

December 31, 2015

Bonadio & Co., LLP
Certified Public Accountants

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Report of Independent Registered Public Accounting Firm

March 11, 2016

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

We have audited the accompanying consolidated balance sheets of Lyons Bancorp Inc. and subsidiary, as of December 31, 2015 and 2014, and the related consolidated statements of income, comprehensive income, stockholders' equity, and cash flows for each of the years in the two-year period ended December 31, 2015. Lyons Bancorp Inc. and subsidiary's management is responsible for these consolidated financial statements. 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 consolidated financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Lyons Bancorp Inc. and subsidiary as of December 31, 2015 and 2014, and the results of their operations and their cash flows for each of the years in the two-year period ended December 31, 2015, in conformity with accounting principles generally accepted in the United States of America.

432 North Franklin Street, Suite 60
Syracuse, New York 13204
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www.bonadio.com

Bonadio & Co., LLP
Syracuse, New York
March 11, 2016

Bonadio & Co., LLP

Lyons Bancorp, Inc.

Consolidated Balance Sheets

December 31, 2015 and 2014

Assets	2015	2014
	(In thousands)	
Cash and due from banks	\$ 15,416	\$ 13,309
Interest-bearing deposits in banks	14,365	12,524
Cash and Cash Equivalents	29,781	25,833
Investment securities:		
Available for sale	138,387	141,204
Held to maturity	51,222	57,231
Restricted equity securities	5,576	6,143
Total Investment Securities	195,185	204,578
Loans	605,201	544,464
Less allowance for loan losses	(8,188)	(7,549)
Net Loans	597,013	536,915
Land, premises and equipment, net	20,880	16,441
Bank owned life insurance	14,895	13,684
Accrued interest receivable and other assets	10,407	9,393
Total Assets	\$ 868,161	\$ 806,844
Liabilities and Equity		
Liabilities		
Deposits:		
Interest-bearing	\$ 599,194	\$ 556,450
Non-interest-bearing	172,917	141,752
Total Deposits	772,111	698,202
Borrowings from Federal Home Loan Bank	20,126	38,791
Junior subordinated debentures	8,867	9,217
Accrued interest payable and other liabilities	8,379	8,128
Total Liabilities	809,483	754,338
Equity		
Lyons Bancorp, Inc. stockholders' equity:		
Common stock	1,507	747
Paid-in capital	11,840	12,226
Retained earnings	48,032	42,999
Accumulated other comprehensive loss	(2,540)	(3,308)
Treasury stock, at cost	(217)	(214)
Total Lyons Bancorp, Inc. Stockholders' Equity	58,622	52,450
Noncontrolling interest	56	56
Total Equity	58,678	52,506
Total Liabilities and Equity	\$ 868,161	\$ 806,844

See notes to consolidated financial statements.

Lyons Bancorp, Inc.

Consolidated Statements of Income Years Ended December 31, 2015 and 2014

	2015	2014
	(In thousands, except per share data)	
Interest Income		
Loans	\$ 24,849	\$ 22,903
Investment securities:		
Taxable	3,062	2,656
Non-taxable	1,473	1,503
Total Interest Income	<u>29,384</u>	<u>27,062</u>
Interest Expense		
Deposits	2,864	3,158
Borrowings	668	637
Total Interest Expense	<u>3,532</u>	<u>3,795</u>
Net Interest Income	25,852	23,267
Provision for Loan Losses	<u>1,275</u>	<u>750</u>
Net Interest Income after Provision for Loan Losses	<u>24,577</u>	<u>22,517</u>
Noninterest Income		
Service charges on deposit accounts	2,800	2,760
Cardholder fees	1,751	1,324
Financial services fees	878	847
Loan servicing fees	865	791
Net realized gains from sales/calls of available for sale securities	167	139
Realized gains on loans sold	1,070	904
Earnings on investment in bank owned life insurance	388	388
Other	353	255
Total Noninterest Income	<u>8,272</u>	<u>7,408</u>
Noninterest Expense		
Salaries and wages	9,543	8,848
Pensions and benefits	3,301	2,698
Occupancy	2,336	2,224
Data processing	1,407	1,298
Professional fees	1,296	1,105
FDIC and OCC assessments	701	655
Advertising	693	560
Cardholder expense	670	362
Office supplies	434	400
Other	2,211	1,847
Total Noninterest Expense	<u>22,592</u>	<u>19,997</u>
Income before Income Taxes	10,257	9,928
Income Tax Expense	<u>2,886</u>	<u>2,719</u>
Net income attributable to noncontrolling interest and Lyons Bancorp, Inc.	7,371	7,209
Less: Net income attributable to noncontrolling interest	<u>5</u>	<u>5</u>
Net Income	<u>\$ 7,366</u>	<u>\$ 7,204</u>
Earnings Per Share – basic ⁽¹⁾	<u>\$ 2.47</u>	<u>\$ 2.42</u>
Earnings Per Share – diluted ⁽¹⁾	<u>\$ 2.34</u>	<u>\$ 2.29</u>

(1) Per share amounts have been adjusted to reflect a 2-for-1 stock split in the form of a stock dividend, effective October 30, 2015.

See notes to consolidated financial statements.

Lyons Bancorp, Inc.

Consolidated Statements of Comprehensive Income Years Ended December 31, 2015 and 2014

	<u>2015</u>	<u>2014</u>
	(In thousands)	
Net income	\$ 7,366	\$ 7,204
Other comprehensive income :		
Securities available for sale:		
Net unrealized gains during the year	868	2,856
Reclassification adjustment for gains included in income	(167)	(139)
Securities held to maturity:		
Reclassification adjustment for amortization of unrealized losses included in income	84	68
Unrealized gains (losses) during the year of restricted equity securities	22	(13)
Pension and postretirement benefits:		
Amortization of prior service credit	(3)	(3)
Amortization of net loss	224	49
Net actuarial gain (loss)	177	(2,668)
Cash flow hedge:		
Losses on the effective portion of cash flow hedge	(121)	(191)
Reclassification adjustment for losses included in income	196	199
	<u>1,280</u>	<u>158</u>
Tax expense	<u>(512)</u>	<u>(63)</u>
Other comprehensive income	<u>768</u>	<u>95</u>
Comprehensive income	<u><u>\$ 8,134</u></u>	<u><u>\$ 7,299</u></u>

See notes to consolidated financial statements.

Lyons Bancorp, Inc.

Consolidated Statements of Stockholders' Equity Years Ended December 31, 2015 and 2014

(In thousands, except per share data)

	Common Stock	Paid-In Capital	Retained Earnings	Accumulated Other Comprehensive Loss	Treasury Stock	Noncontrolling Interest	Total
Balance - January 1, 2014	\$ 747	\$ 12,201	\$ 37,911	\$ (3,403)	\$ (102)	\$ 56	\$ 47,410
Net income attributable to noncontrolling interests and Lyons Bancorp, Inc.	-	-	7,204	-	-	5	7,209
Total other comprehensive income, net	-	-	-	95	-	-	95
Purchase of treasury stock	-	-	-	-	(314)	-	(314)
Issuance of treasury stock	-	-	-	-	73	-	73
Deferred compensation shares awarded, net	-	25	-	-	129	-	154
Dividends to noncontrolling interests	-	-	-	-	-	(5)	(5)
Cash dividends declared, \$0.71 ⁽¹⁾ per share	-	-	(2,116)	-	-	-	(2,116)
Balance - December 31, 2014	747	12,226	42,999	(3,308)	(214)	56	\$ 52,506
Net income attributable to noncontrolling interests and Lyons Bancorp, Inc.	-	-	7,366	-	-	5	7,371
Total other comprehensive income, net	-	-	-	768	-	-	768
Stock split in the form of a stock dividend	747	(747)	-	-	-	-	-
Conversion of trust preferred securities	13	337	-	-	-	-	350
Purchase of treasury stock	-	-	-	-	(155)	-	(155)
Deferred compensation shares awarded, net	-	24	-	-	152	-	176
Dividends to noncontrolling interests	-	-	-	-	-	(5)	(5)
Cash dividends declared, \$0.78 ⁽¹⁾ per share	-	-	(2,333)	-	-	-	(2,333)
Balance - December 31, 2015	\$ 1,507	\$ 11,840	\$ 48,032	\$ (2,540)	\$ (217)	\$ 56	\$ 58,678

(1) Per share amounts have been adjusted to reflect a 2-for-1 stock split in the form of a stock dividend, effective October 30, 2015.

See notes to consolidated financial statements.

Lyons Bancorp, Inc.

Consolidated Statements of Cash Flows

Years Ended December 31, 2015 and 2014

	2015	2014
	(In thousands)	
Cash Flows from Operating Activities		
Net income	\$ 7,366	\$ 7,204
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for loan losses	1,275	750
Earnings on investment in bank owned life insurance	(388)	(388)
Net realized gain from sales/calls of available for sale securities	(167)	(139)
Realized gains on loans sold	(1,070)	(904)
Loss on sale of real estate owned and other repossessed assets	-	2
Deferred compensation expense	234	218
Net amortization on securities	186	346
Depreciation and amortization	978	947
Deferred income tax benefit	(125)	(203)
Contribution to defined benefit pension plan	(1,000)	(1,000)
(Increase) decrease in accrued interest receivable and other assets	(855)	572
Increase in accrued interest payable and other liabilities	1,295	204
Loans originated for sale	(47,210)	(47,692)
Proceeds from sales of loans	51,855	45,791
Net Cash Provided by Operating Activities	12,374	5,708
Cash Flows from Investing Activities		
Purchases of securities available for sale	(50,288)	(57,329)
Proceeds from sales of securities available for sale	20,559	44,475
Proceeds from maturities and calls of securities available for sale	32,945	14,275
Purchases of held to maturity securities	(6,955)	(33,101)
Proceeds from maturities of securities held to maturity	13,247	7,294
Net decrease (increase) in restricted equity securities	589	(250)
Proceeds from sales of commercial loans	2,691	2,853
Net increase in portfolio loans	(67,764)	(43,977)
Proceeds from sale of real estate owned, net and other repossessed assets	-	14
Purchase of bank owned life insurance	(823)	(600)
Premises and equipment purchases, net	(5,417)	(2,407)
Net Cash Used in Investing Activities	(61,216)	(68,753)
Cash Flows from Financing Activities		
Net increase in demand and savings deposits	75,959	61,202
Net (decrease) increase in time deposits	(2,050)	9,081
Net decrease in overnight borrowings from Federal Home Loan Bank	(22,600)	(7,400)
Proceeds from term borrowings from Federal Home Loan Bank	5,000	5,000
Repayment of term borrowings from Federal Home Loan Bank	(1,065)	(809)
Purchase of treasury stock	(155)	(314)
Issuance of treasury stock	-	73
Dividends paid	(2,299)	(2,087)
Net Cash Provided by Financing Activities	52,790	64,746
	3,948	1,701
Cash and Cash Equivalents – Beginning	25,833	24,132
Cash and Cash Equivalents – Ending	\$ 29,781	\$ 25,833
Supplementary Cash Flow Information		
Interest paid	\$ 3,534	\$ 3,765
Income taxes paid	\$ 3,306	\$ 3,104
Non-cash Disclosure		
Transfer of loans to foreclosed real estate and other repossessed assets	\$ 126	\$ 16
Conversion of Trust III debentures to common stock	\$ 350	\$ -

See notes to consolidated financial statements.

Lyons Bancorp, Inc.

Notes to Consolidated Financial Statements

December 31, 2015 and 2014

Note 1 - Summary of Significant Accounting Policies

Nature of Operations

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

The Company owns all of the voting common shares of Lyons Capital Statutory Trust I (Trust I), Lyons Capital Statutory Trust II (Trust II) and Lyons Statutory Trust III (Trust III). Trust I was formed in 2003, Trust II was formed in 2004, and Trust III was formed in 2009. The Trusts were each formed for the purpose of securitizing trust preferred securities, the proceeds of which were advanced to the Company and contributed to the Bank as additional capital.

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

Basis of Presentation

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

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

Reclassification

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

Lyons Bancorp, Inc.

Notes to Consolidated Financial Statements

December 31, 2015 and 2014

Note 1 - Summary of Significant Accounting Policies (Continued)

Use of Estimates

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

Recently Issued Accounting Pronouncements

In January 2016, the FASB issued ASU 2016-01, *Financial Instruments—Overall (Topic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities*. ASU 2016-01 amends the guidance on the classification and measurement of financial instruments. Some of the amendments in ASU 2016-01 include the following: 1) requires equity investments (except those accounted for under the equity method of accounting or those that result in consolidation of the investee) to be measured at fair value with changes in fair value recognized in net income; 2) simplifies the impairment assessment of equity investments without readily determinable fair values by requiring a qualitative assessment to identify impairment; 3) requires public business entities to use the exit price notion when measuring the fair value of financial instruments for disclosure purposes; and 4) requires an entity to present separately in other comprehensive income the portion of the total change in the fair value of a liability resulting from a change in the instrument-specific credit risk when the entity has elected to measure the liability at fair value; among others. For public business entities, the amendments of ASU 2016-01 are effective for fiscal years beginning after December 15, 2017, including interim periods within those fiscal years. The Company is currently evaluating the effects of the ASU 2016-01 on its financial statements and disclosures, if any.

In February 2016, the FASB issued ASU 2016-02, *Leases (Topic 842)*. ASU No. 2016-02 seeks to increase transparency and comparability among organizations by recognizing lease assets and lease liabilities on the balance sheet and by disclosing key information about leasing arrangements. Under the new guidance a lessee will be required to recognize assets and liabilities for leases with lease terms of more than 12 months. Consistent with current GAAP, the recognition, measurement, and presentation of expenses and cash flows arising from a lease by a lessee will depend primarily on its classification as a finance or an operating lease. However, unlike current GAAP, which requires only capital leases to be recognized on the balance sheet, ASU No. 2016-02 will require both operating and finance leases to be recognized on the balance sheet. Additionally, the ASU will require disclosures to help investors and other financial statement users better understand the amount, timing, and uncertainty of cash flows arising from leases, including qualitative and quantitative requirements. Lessor accounting will remain largely unchanged from current GAAP. However, the ASU contains some targeted improvements that are intended to align, where necessary, lessor accounting with the lessee accounting model and with the updated revenue recognition guidance issued in 2014. The amendments in ASU No. 2016-02 are effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years, for public entities. The Company is currently evaluating the effects of the ASU 2016-02 on its financial statements and disclosures, if any.

Lyons Bancorp, Inc.

Notes to Consolidated Financial Statements

December 31, 2015 and 2014

Note 1 - Summary of Significant Accounting Policies (Continued)

Investment Securities

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

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

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

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

- The length of time and the extent to which the fair value has been less than the amortized cost basis;
- The level of credit enhancement provided by the structure which includes, but is not limited to, credit subordination positions, excess spreads, overcollateralization, protective triggers;
- Changes in the near term prospects of the issuer or underlying collateral of a security, such as changes in default rates, loss severities given default and significant changes in prepayment assumptions;

Lyons Bancorp, Inc.

Notes to Consolidated Financial Statements

December 31, 2015 and 2014

Note 1 - Summary of Significant Accounting Policies (Continued)

Investment Securities - continued

- The level of excess cash flow generated from the underlying collateral supporting the principal and interest payments of the debt securities; and
- Any adverse change to the credit conditions of the issuer of the security such as credit downgrades by the rating agencies.

Loans

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

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

Interest income is accrued on the unpaid principal balance. The accrual of interest on loans is discontinued at the time the loan is 90 days past due unless the credit is well-secured and in process of collection. Credit card loans and other personal loans are typically charged off no later than 180 days past due. Past due status is based on contractual terms of the loan. In all cases, loans are placed on nonaccrual or charged-off at an earlier date if collection of principal or interest is considered doubtful. All interest accrued but not collected for loans that are placed on nonaccrual or charged off is reversed against interest income or the allowance for loan losses if the interest income was earned in a prior period. The interest on these loans is accounted for on the cash-basis or cost-recovery method, until qualifying for return to accrual. Loans are returned to accrual status when all the principal and interest amounts contractually due are brought current and future payments are reasonably assured.

Management, considering current information and events regarding the borrowers' ability to repay their obligations, considers a loan to be impaired when it is probable that the Company will be unable to collect all amounts due according to the contractual terms of the loan agreement. When a loan is considered to be impaired, the amount of the impairment is measured based on the present value of expected future cash flows discounted at the loan's effective interest rate, or at the loan's observable fair value or the fair value of underlying collateral if the loan is collateral-dependent. Impairment

Lyons Bancorp, Inc.

Notes to Consolidated Financial Statements

December 31, 2015 and 2014

Note 1 - Summary of Significant Accounting Policies (Continued)

Loans - continued

losses are included in the allowance for loan losses through a charge to the provision for loan losses. Cash receipts on impaired loans are generally applied to reduce the principal balance outstanding. In considering loans for evaluation of impairment, management generally excludes smaller balance commercial and agriculture real estate loans, commercial and agriculture loans (less than \$50,000) and smaller balance, homogeneous loans: residential mortgage loans, home equity loans, and all consumer loans, unless subject to a troubled debt restructuring. These loans are collectively evaluated for risk of loss.

Loans Held for Sale

Generally, loans held for sale consist of residential mortgage loans that are originated and are intended to be sold through agreements the Bank has with the Federal Home Loan Bank (FHLB) and the Federal Home Loan Mortgage Corporation (Freddie Mac). Realized gains and losses on sales are computed using the specific identification method. These loans are carried on the consolidated balance sheet at the lower of cost or estimated fair value determined in the aggregate. Residential loans held for sale totaled \$1 million and \$4.7 million at December 31, 2015 and 2014, respectively, and are included in loans on the consolidated balance sheets.

During 2015 and 2014, the Company sold residential mortgage loans totaling \$51.9 million and \$45.8 million, respectively, and realized gains on these sales were \$906,000 and \$756,000, respectively. These residential real estate loans are generally sold without recourse in accordance with standard secondary market loan sale agreements. When residential mortgage loans are sold, the Company typically retains all servicing rights, which provides the Company with a source of fee income. In connection with the sales in 2015 and 2014, the Company recorded mortgage-servicing assets of \$448,000 and \$373,000, respectively. Amortization of mortgage-servicing assets amounted to \$235,000 in 2015 and \$209,000 in 2014. Net mortgage-servicing assets included in other assets in the consolidated balance sheets totaled \$943,000 and \$730,000 net of amortization, as of December 31, 2015 and 2014, respectively.

Government-guaranteed loans which may be sold after origination are not classified as held for sale in as much as sale of such loans is largely dependent upon the extent to which gains may be realized. During 2015 and 2014, the Company sold commercial loans backed by Small Business Administration guarantees totaling \$2.7 million and \$2.9 million, respectively, and realized gains on these sales were \$164,000 and \$148,000, respectively. There were no commercial loans held for sale at December 31, 2015.

Total loans serviced for others amounted to \$235.5 million and \$200.2 million at December 31, 2015 and 2014, respectively.

Allowance for Loan Losses

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

Lyons Bancorp, Inc.

Notes to Consolidated Financial Statements

December 31, 2015 and 2014

Note 1 - Summary of Significant Accounting Policies (Continued)

Allowance for Loan Losses - continued

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

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

General Component

The general component of the allowance is based on historical loss experience adjusted for qualitative factors stratified by the following loan classes: residential real estate, commercial real estate, agricultural real estate, commercial and agricultural loans, and consumer installment segments. Management uses a rolling average of historical losses based on a time frame appropriate to capture relevant loss data for each loan class. The historical loss factor is adjusted for the following qualitative factors: levels and trends in delinquencies; trends in volume and terms of loans; effects of changes in risk selection and underwriting standards and other changes in lending policies, procedures and practices; experience/ability/depth of lending management and staff; and national and local economic trends and conditions. There were no changes in the Company's policies or its methodology pertaining to the general component of the allowance during 2015 or 2014.

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

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

Commercial real estate - Loans in this class represent both extensions of credit for owner-occupied real estate and income-producing properties throughout the local region. The underlying cash flows of the operating commercial businesses (owner-occupied) and income properties (non-owner occupied) can be adversely impacted by a downturn in the economy as evidenced by increased vacancy rates, which in turn, will have an effect on the credit quality in this class. In a majority of cases, the Company obtains rent rolls annually and continually monitors the cash flows of non-owner occupied loans commensurate with sound lending practices.

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

Lyons Bancorp, Inc.

Notes to Consolidated Financial Statements

December 31, 2015 and 2014

Note 1 - Summary of Significant Accounting Policies (Continued)

Allowance for Loan Losses - continued

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

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

Specific Component

The specific component relates to loans that are classified as impaired. Impairment is measured on a loan by loan basis for commercial and agricultural loans, commercial real estate and agricultural real estate greater than \$50,000 by either the present value of expected future cash flows discounted at the loan's effective interest rate or the fair value of the collateral, less costs to sell, if determined to be more appropriate. An allowance is established when the discounted cash flow or collateral value of the impaired loan is lower than the carrying value of that loan. Large groups of smaller balance homogeneous loans are collectively evaluated for impairment. Accordingly, the Company does not separately identify individual consumer or residential real estate loans for impairment disclosures, unless such loans are subject to a troubled debt restructuring agreement.

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

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

Loans that experience insignificant payment delays and payment shortfalls generally are not classified as impaired. Management determines the significance of payment delays and payment shortfalls on a case-by-case basis, taking into consideration all of the circumstances surrounding the loan and the borrower, including the length of the delay, the reason for the delay, the borrower's prior payment record, and the amount of the shortfall in relation to the principal and interest owed.

Unallocated Component

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

Lyons Bancorp, Inc.

Notes to Consolidated Financial Statements

December 31, 2015 and 2014

Note 1 - Summary of Significant Accounting Policies (Continued)

Troubled Debt Restructurings

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

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

Land, Premises and Equipment

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

Bank Owned Life Insurance

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

Foreclosed Real Estate

Included in other assets are real estate properties acquired through, or by deed in lieu of, loan foreclosure. These properties are initially recorded at fair value less estimated selling costs at the date of foreclosure. Any write-downs based on the asset’s fair value at date of foreclosure are charged to the allowance for loan losses. After foreclosure, property held for sale is carried at the lower of the new basis or fair value less any costs to sell. Costs of significant property improvements are capitalized, whereas costs relating to holding property are expensed. Valuations are periodically performed by management, and any subsequent write-downs are recorded as a charge to operations, if necessary, to reduce the carrying value of the property to the lower of its cost or fair value less cost to sell. Foreclosed real estate at December 31, 2015 was approximately \$126,000. The recorded investment in real estate in process of foreclosure at December 31, 2015 was approximately \$27,000. There was no foreclosed real estate at December 31, 2014.

Lyons Bancorp, Inc.

Notes to Consolidated Financial Statements

December 31, 2015 and 2014

Note 1 - Summary of Significant Accounting Policies (Continued)

Treasury Stock

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

Interest Rate Swap Agreement

The Company utilizes an interest rate swap agreement as part of its management of interest rate risk to modify the repricing characteristics of its floating-rate junior subordinate debentures. For this swap agreement, amounts receivable or payable are recognized as accrued under the terms of the agreement, and the net differential is recorded as an adjustment to interest expense of the related debentures. The interest rate swap agreement is designated as a cash flow hedge. Therefore, the effective portion of the swap's unrealized gain or loss was initially recorded as a component of other comprehensive income, net of tax. The ineffective portion of the unrealized gain or loss, if any, is immediately reported in other operating income. The Company considers its interest rate swap agreement to be fully effective and accordingly it has not recorded any gains or losses in earnings during 2015 or 2014.

Advertising Costs

Advertising costs are expensed as incurred.

Noncontrolling Interest

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

Income Taxes

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

Transfers of Financial Assets

Transfers of financial assets are accounted for as sales when control over the assets has been surrendered. Control over transferred assets is deemed to be surrendered when (1) the assets have been isolated from the Company, (2) the transferee obtains the right (free of conditions that constrain it from taking advantage of that right) to pledge or exchange the transferred assets, and (3) the

Lyons Bancorp, Inc.

Notes to Consolidated Financial Statements

December 31, 2015 and 2014

Note 1 - Summary of Significant Accounting Policies (Continued)

Transfers of Financial Assets - continued

Company does not maintain effective control over the transferred assets through an agreement to repurchase them before their maturity.

Earnings Per Share

Basic earnings per share represents income available to common shareholders divided by the weighted-average number of common shares outstanding during the period. Diluted earnings per share reflects additional common shares that would have been outstanding if dilutive potential common shares had been issued, as well as adjustments to net income for interest expense relating to convertible securities, net of tax, that would result from the assumed issuance. Treasury shares are not deemed outstanding for earnings per share calculations. See Note 12 for earnings per share calculations.

Comprehensive Income

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

Statements of Cash Flows

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

Off-Balance-Sheet Financial Instruments

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

Segment Reporting

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

Note 2 - Restrictions on Cash and Due from Banks

The Bank is required to maintain reserve funds in cash and/or on deposit with the Federal Reserve Bank. The required reserve at December 31, 2015 and 2014 was \$13.3 million and \$9.5 million, respectively.

Lyons Bancorp, Inc.

Notes to Consolidated Financial Statements

December 31, 2015 and 2014

Note 3 - Investments

The amortized cost and fair value of investment securities, with gross unrealized gains and losses, are as follows at December 31, 2015 and 2014:

(In thousands)	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
December 31, 2015:				
Available for Sale:				
United States agencies	\$ 41,432	\$ 107	\$ (336)	\$ 41,203
State and local governments	67,514	1,235	(11)	68,738
Mortgage-backed securities	28,913	26	(493)	28,446
Total Available for Sale	<u>\$ 137,859</u>	<u>\$ 1,368</u>	<u>\$ (840)</u>	<u>\$ 138,387</u>
Held to Maturity:				
United States agencies	\$ 2,784	\$ 169	\$ -	\$ 2,953
State and local governments	5,231	48	-	5,279
Mortgage-backed securities	41,207	598	(98)	41,707
Corporate	2,000	-	-	2,000
Total Held to Maturity	<u>\$ 51,222</u>	<u>\$ 815</u>	<u>\$ (98)</u>	<u>\$ 51,939</u>
Restricted Equity Securities	<u>\$ 5,552</u>	<u>\$ 24</u>	<u>\$ -</u>	<u>\$ 5,576</u>
(In thousands)	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
December 31, 2014:				
Available for Sale:				
United States agencies	\$ 51,334	\$ 278	\$ (731)	\$ 50,881
State and local governments	65,638	847	(125)	66,360
Mortgage-backed securities	24,404	89	(530)	23,963
Total Available for Sale	<u>\$ 141,376</u>	<u>\$ 1,214</u>	<u>\$ (1,386)</u>	<u>\$ 141,204</u>
Held to Maturity:				
United States agencies	\$ 2,741	\$ 84	\$ -	\$ 2,825
State and local governments	5,975	53	-	6,028
Mortgage-backed securities	48,515	474	(133)	48,856
Total Held to Maturity	<u>\$ 57,231</u>	<u>\$ 611</u>	<u>\$ (133)</u>	<u>\$ 57,709</u>
Restricted Equity Securities	<u>\$ 6,141</u>	<u>\$ 2</u>	<u>\$ -</u>	<u>\$ 6,143</u>

Lyons Bancorp, Inc.

Notes to Consolidated Financial Statements

December 31, 2015 and 2014

Note 3 – Investments (Continued)

All of the above mortgage-backed securities are residential direct pass through securities or collateralized mortgage obligations issued or backed by U.S. government sponsored enterprises (GSEs). Restricted equity securities primarily include non-marketable Federal Home Loan Bank New York (FHLB NY) stock and non-marketable Federal Reserve Bank (FRB) stock, both of which are required to be held for regulatory purposes and for borrowing availability. The required investment in FHLB NY stock is tied to both the Company's borrowing levels with the FHLB and commitments to sell residential mortgage loans to the FHLB. Holdings of FHLB NY stock and FRB stock totaled \$4.6 million and \$500,000 at December 31, 2015, respectively, and \$5.2 million and \$500,000 at December 31, 2014, respectively. These securities are carried at par, which is also cost. The Company has an investment in Federal Agricultural Mortgage Corp (Farmer Mac) class A stock totaling \$65,000 and \$43,000 at December 31, 2015 and 2014, respectively, in order to participate in certain lending activities with Farmer Mac. The stock is actively traded on the NYSE, pays a dividend, and is reflective of current market value. Restricted equity securities also include miscellaneous investments carried at par, which is also cost.

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

The Company elected to transfer six available for sale (AFS) securities with an aggregate fair value of \$25.2 million to a classification of held to maturity (HTM) on December 31, 2013. The transfer from AFS to HTM was recorded at the fair value of the AFS securities at the time of transfer. The net unrealized holding loss of \$330,000, net of tax, at the date of transfer was retained in accumulated other comprehensive loss, with the associated pretax amount of the unrealized losses retained in the carrying amount of the HTM securities. Such amounts are being amortized to interest income over the remaining life of the securities. The fair value of the transferred AFS securities became the carrying amount of the HTM securities at December 31, 2013, with no unrealized gain or loss at this date. During 2015, \$84,000 of the net unrealized holding loss was amortized into income with a remaining net unamortized loss of \$238,000, net of tax.

Lyons Bancorp, Inc.

Notes to Consolidated Financial Statements

December 31, 2015 and 2014

Note 3 – Investments (Continued)

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

(In thousands)	Less than 12 Months		12 Months or More		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
December 31, 2015:						
United States agencies	\$ 21,183	\$ (180)	\$ 9,837	\$ (156)	\$ 31,020	\$ (336)
State and local governments	4,517	(9)	321	(2)	4,838	(11)
Mortgage-backed securities	19,492	(272)	8,746	(319)	28,238	(591)
	<u>\$ 45,192</u>	<u>\$ (461)</u>	<u>\$ 18,904</u>	<u>\$ (477)</u>	<u>\$ 64,096</u>	<u>\$ (938)</u>

(In thousands)	Less than 12 Months		12 Months or More		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
December 31, 2014:						
United States agencies	\$ 9,984	\$ (16)	\$ 22,836	\$ (715)	\$ 32,820	\$ (731)
State and local governments	12,461	(83)	2,608	(42)	15,069	(125)
Mortgage-backed securities	21,309	(168)	16,189	(495)	37,498	(663)
	<u>\$ 43,754</u>	<u>\$ (267)</u>	<u>\$ 41,633</u>	<u>\$ (1,252)</u>	<u>\$ 85,387</u>	<u>\$ (1,519)</u>

On a quarterly basis, the Company performs an assessment to determine whether there have been any events or economic circumstances indicating that a security with an unrealized loss has suffered other-than-temporary impairment. Consideration is given to (1) the length of time and the extent to which the fair value has been less than the amortized cost basis, (2) the financial condition of the issuer (and guarantor, if any) and adverse conditions specifically related to the security, industry or geographic area, (3) failure of the issuer of the security to make scheduled interest or principal payments, (4) any changes to the rating of a security by a rating agency, (5) the presence of credit enhancements, if any, including the guarantee of the federal government or any of its agencies, (6) whether the Company intends to sell or more likely than not be required to sell the debt security, and (7) if the present value of the expected cash flow is not sufficient to recover the entire amortized cost.

There were thirty securities with unrealized losses at December 31, 2015, while at December 31, 2014 there were sixty securities with unrealized losses. Substantially all of the unrealized losses on the Company's securities were caused by market interest rate changes from those in effect when the securities

Lyons Bancorp, Inc.

Notes to Consolidated Financial Statements

December 31, 2015 and 2014

Note 3 – Investments (Continued)

were purchased by the Company. The contractual terms of these securities do not permit the issuer to settle the securities at a price less than par value. Except for certain state and local government obligations, all securities rated by an independent rating agency carry an investment grade rating. Financial information relating to unrated state and government obligations is reviewed for indications of adverse conditions that may indicate other-than-temporary impairment. Because the Company does not intend to sell the securities with unrealized losses and it believes it is not likely to be required to sell the securities before recovery of their amortized cost basis, which may be, and is likely to be, maturity, the Company does not consider these securities to be other-than-temporarily impaired at December 31, 2015. In addition, there were no other-than-temporary impairment charges in 2015 and 2014.

The amortized cost and fair value of debt securities at December 31, 2015, by contractual maturity, are shown below. Expected maturities may differ from contractual maturities because borrowers may have the right to call or prepay obligations without call or prepayment penalties.

(In thousands)	<u>Available for Sale</u>		<u>Held to Maturity</u>	
	<u>Amortized Cost</u>	<u>Fair Value</u>	<u>Amortized Cost</u>	<u>Fair Value</u>
Due in one year or less	\$ 3,922	\$ 3,946	\$ 613	\$ 614
Due after one year through five years	53,742	53,989	1,618	1,632
Due after five years through ten years	51,252	51,975	2,915	2,948
Due after ten years	30	31	4,869	5,038
Securities not due at a single maturity date	28,913	28,446	41,207	41,707
	<u>\$ 137,859</u>	<u>\$ 138,387</u>	<u>\$ 51,222</u>	<u>\$ 51,939</u>

During 2015, the Company sold \$20.6 million of available for sale securities, while in 2014 the Company sold \$44.5 million of available for sale securities. Gross gains on the sales of investments in 2015 were \$167,000. Gross gains on the sales of investment securities in 2014 were \$139,000. Investment securities with carrying amounts of \$125.7 million and \$99.7 million at December 31, 2015 and 2014, respectively, were pledged to secure deposits as required or permitted by law.

Lyons Bancorp, Inc.

Notes to Consolidated Financial Statements

December 31, 2015 and 2014

Note 4 – Loans

Loans consist of the following at December 31, 2015 and 2014:

	<u>2015</u>	<u>2014</u>
	(In thousands)	
Real estate:		
Residential:		
1-4 family	\$ 162,855	\$ 147,285
Home equity	84,158	70,681
Commercial	149,894	143,426
Agriculture	42,105	35,047
Total mortgage loans on real estate	<u>439,012</u>	<u>396,439</u>
Commercial loans	102,671	89,584
Agriculture loans	37,458	32,355
Consumer installment loans:		
Direct	15,698	14,173
Indirect	10,362	11,913
Total consumer installment loans	<u>26,060</u>	<u>26,086</u>
Total loans	<u>\$ 605,201</u>	<u>\$ 544,464</u>

Net unamortized loan origination costs totaled \$1.2 million and \$770,000 at December 31, 2015 and 2014, respectively and are included with their related loan class.

The Company has transferred a portion of its originated commercial, commercial real estate, agriculture and agriculture real estate loans to participating lenders. The amounts transferred have been accounted for as sales and are therefore not included in the Company's accompanying consolidated balance sheets. The Company and participating lenders share ratably in cash flows and any gains or losses that may result from a borrower's lack of compliance with contractual terms of the loan. The Company continues to service the loans on behalf of the participating lenders and, as such, collects cash payments from the borrowers, remits payments (net of servicing fees) to participating lenders and disburses required escrow funds to relevant parties. At December 31, 2015 and 2014 the Company was servicing loans for participants aggregating \$18.7 million and \$11.4 million, respectively.

Loans are considered past due if the required principal and interest payments have not been received as of the date such payments are due. Generally loans are placed on nonaccrual status if principal or interest payments become 90 days or more past due and/or management deems the collectability of the principal and/or interest to be in question, as well as when required by regulatory requirements. There has been an increase from the previous year in 30-89 Days Past Due, primarily a result of one large commercial loan relationship in non-accrual status.

Lyons Bancorp, Inc.

Notes to Consolidated Financial Statements

December 31, 2015 and 2014

Note 4 – Loans (Continued)

The following table presents past due loans by classes of the loan portfolio at December 31, 2015 and 2014:

(In thousands)	<u>Current</u>	<u>30-89 Days Past Due</u>	<u>90 Days and Greater</u>	<u>Total Loans</u>	<u>Loans on Nonaccrual</u>
December 31, 2015:					
Residential real estate:					
1-4 family	\$ 162,651	\$ 159	\$ 45	\$ 162,855	\$ 45
Home equity	84,026	105	27	84,158	220
Commercial real estate	146,142	3,561	190	149,894	2,838
Agriculture real estate	42,105	-	-	42,105	-
Commercial loans	101,209	646	817	102,671	1,015
Agriculture loans	37,458	-	-	37,458	-
Consumer installment loans:					
Direct	15,642	56	-	15,698	-
Indirect	10,268	94	-	10,362	-
Total	\$ 599,501	\$ 4,621	\$ 1,079	\$ 605,201	\$ 4,118

(In thousands)	<u>Current</u>	<u>30-89 Days Past Due</u>	<u>90 Days and Greater</u>	<u>Total Loans</u>	<u>Loans on Nonaccrual</u>
December 31, 2014:					
Residential real estate:					
1-4 family	\$ 146,805	\$ -	\$ 480	\$ 147,285	\$ 548
Home equity	70,526	155	-	70,681	213
Commercial real estate	143,151	51	224	143,426	3,193
Agriculture real estate	35,047	-	-	35,047	-
Commercial loans	89,529	32	23	89,584	23
Agriculture loans	32,355	-	-	32,355	-
Consumer installment loans:					
Direct	14,121	52	-	14,173	-
Indirect	11,903	10	-	11,913	-
Total	\$ 543,437	\$ 300	\$ 727	\$ 544,464	\$ 3,977

At December 31, 2015 and 2014, there were no loans that were over 90 days delinquent and still accruing interest.

Lyons Bancorp, Inc.

Notes to Consolidated Financial Statements

December 31, 2015 and 2014

Note 4 – Loans (Continued)

Activity in the allowance for loan losses for the years ended December 31, 2015 and 2014 follows:

(In thousands)

	Commercial	Commercial Real Estate	Agriculture	Agriculture Real Estate	Residential Real Estate	Consumer	Unallocated	Total
2015								
Beginning balance	\$ 1,336	\$ 2,620	\$ 380	\$ 361	\$ 1,987	\$ 385	\$ 480	\$ 7,549
Provisions for loan losses	700	745	73	81	(221)	107	(210)	1,275
Recoveries of loans previously charged off	9	-	-	-	3	49	-	61
Loans charged off	(38)	(454)	-	-	(40)	(165)	-	(697)
Ending balance	<u>\$ 2,007</u>	<u>\$ 2,911</u>	<u>\$ 453</u>	<u>\$ 442</u>	<u>\$ 1,729</u>	<u>\$ 376</u>	<u>\$ 270</u>	<u>\$ 8,188</u>
2014								
Beginning balance	\$ 1,049	\$ 2,464	\$ 337	\$ 295	\$ 1,887	\$ 511	\$ 589	\$ 7,132
Provisions for loan losses	485	156	43	66	145	(36)	(109)	750
Recoveries of loans previously charged off	2	-	-	-	20	47	-	69
Loans charged off	(200)	-	-	-	(65)	(137)	-	(402)
Ending balance	<u>\$ 1,336</u>	<u>\$ 2,620</u>	<u>\$ 380</u>	<u>\$ 361</u>	<u>\$ 1,987</u>	<u>\$ 385</u>	<u>\$ 480</u>	<u>\$ 7,549</u>

The allocation of the allowance for loan losses by loan class is as follows at December 31, 2015 and 2014:

(In thousands)

December 31, 2015	Commercial	Commercial Real Estate	Agriculture	Agriculture Real Estate	Residential Real Estate	Consumer	Unallocated	Total
Amount of allowance for loan losses on loans individually evaluated for impairment	\$ 674	\$ 907	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 1,581
Amount of allowance for loan losses on loans collectively evaluated for impairment	<u>1,333</u>	<u>2,004</u>	<u>453</u>	<u>442</u>	<u>1,729</u>	<u>376</u>	<u>270</u>	<u>6,607</u>
Total allowance for loan losses	<u>\$ 2,007</u>	<u>\$ 2,911</u>	<u>\$ 453</u>	<u>\$ 442</u>	<u>\$ 1,729</u>	<u>\$ 376</u>	<u>\$ 270</u>	<u>\$ 8,188</u>
Loans individually evaluated for impairment	\$ 890	\$ 2,920	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 3,810
Loans collectively evaluated for impairment	<u>101,781</u>	<u>146,974</u>	<u>37,458</u>	<u>42,105</u>	<u>247,013</u>	<u>26,060</u>	<u>-</u>	<u>601,391</u>
Total Loans	<u>\$ 102,671</u>	<u>\$ 149,894</u>	<u>\$ 37,458</u>	<u>\$ 42,105</u>	<u>\$ 247,013</u>	<u>\$ 26,060</u>	<u>\$ -</u>	<u>\$ 605,201</u>

Lyons Bancorp, Inc.

Notes to Consolidated Financial Statements

December 31, 2015 and 2014

Note 4 – Loans (Continued)

December 31, 2014	Commercial	Commercial Real Estate	Agriculture	Agriculture Real Estate	Residential Real Estate	Consumer	Unallocated	Total
Amount of allowance for loan losses on loans individually evaluated for impairment	\$ -	\$ 970	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 970
Amount of allowance for loan losses on loans collectively evaluated for impairment	1,336	1,650	380	361	1,987	385	480	6,579
Total allowance for loan losses	<u>\$ 1,336</u>	<u>\$ 2,620</u>	<u>\$ 380</u>	<u>\$ 361</u>	<u>\$ 1,987</u>	<u>\$ 385</u>	<u>\$ 480</u>	<u>\$ 7,549</u>
Loans individually evaluated for impairment	\$ 23	\$ 3,367	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 3,390
Loans collectively evaluated for impairment	89,561	140,059	32,355	35,047	217,966	26,086	-	541,074
Total Loans	<u>\$ 89,584</u>	<u>\$ 143,426</u>	<u>\$ 32,355</u>	<u>\$ 35,047</u>	<u>\$ 217,966</u>	<u>\$ 26,086</u>	<u>\$ -</u>	<u>\$ 544,464</u>

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

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

Lyons Bancorp, Inc.

Notes to Consolidated Financial Statements

December 31, 2015 and 2014

Note 4 – Loans (Continued)

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

The following table summarizes information regarding impaired loans by loan portfolio class as of December 31, 2015 and 2014:

(In thousands)	<u>Recorded Investment</u>	<u>Unpaid Principal Balance</u>	<u>Related Allowance</u>	<u>Average Recorded Investment</u>	<u>Interest Income Recognized</u>
December 31, 2015					
With no related allowance recorded:					
Commercial loans	\$ 125	\$ 125	\$ -	\$ 50	\$ 2
Commercial real estate	190	229	-	201	-
Agriculture real estate	-	-	-	-	-
With an allowance recorded:					
Commercial loans	890	897	674	516	-
Commercial real estate	2,648	3,295	907	2,803	-
Total	<u>\$ 3,853</u>	<u>\$ 4,546</u>	<u>\$ 1,581</u>	<u>\$ 3,570</u>	<u>\$ 2</u>
Summary:					
Commercial	\$ 3,853	\$ 4,546	\$ 1,581	\$ 3,570	\$ 2
Agriculture	-	-	-	-	-
Total	<u>\$ 3,853</u>	<u>\$ 4,546</u>	<u>\$ 1,581</u>	<u>\$ 3,570</u>	<u>\$ 2</u>
December 31, 2014					
With no related allowance recorded:					
Commercial loans	\$ 23	\$ 26	\$ -	\$ 32	\$ 2
Commercial real estate	256	280	-	242	9
Agriculture real estate	-	-	-	27	-
With an allowance recorded:					
Commercial loans	-	-	-	6	-
Commercial real estate	3,111	3,666	970	3,160	-
Total	<u>\$ 3,390</u>	<u>\$ 3,972</u>	<u>\$ 970</u>	<u>\$ 3,467</u>	<u>\$ 11</u>
Summary:					
Commercial	\$ 3,390	\$ 3,972	\$ 970	\$ 3,440	\$ 11
Agriculture	-	-	-	27	-
Total	<u>\$ 3,390</u>	<u>\$ 3,972</u>	<u>\$ 970</u>	<u>\$ 3,467</u>	<u>\$ 11</u>

Lyons Bancorp, Inc.

Notes to Consolidated Financial Statements

December 31, 2015 and 2014

Note 4 – Loans (Continued)

There were no troubled debt restructurings for the years ended December 31, 2015 or 2014.

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

Credit Quality

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

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

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

Loans rated a “9” are considered “doubtful”. Loans classified as doubtful have all the weaknesses inherent in those classified as substandard with the added characteristic that the weaknesses make collection or liquidation in full, on the basis of currently existing facts, highly questionable and improbable. There were no doubtful loans at December 31, 2015 or 2014.

Loans rated a “10” are considered uncollectible (“loss”) and of such little value that their continuance as loans is not warranted. This classification does not mean that the loan has absolutely no recovery or salvage value, but rather that it is not practical or desirable to defer writing off this basically worthless loan even though partial recovery may be affected in the future. There were no loss loans at December 31, 2015 or 2014.

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

Lyons Bancorp, Inc.

Notes to Consolidated Financial Statements

December 31, 2015 and 2014

Note 4 – Loans (Continued)

Credit Quality – continued

The following table presents the classes of the commercial and agriculture loan portfolios summarized by the aggregate pass rating and the criticized and classified ratings of special mention and substandard within the Company's internal risk rating system as of December 31, 2015 and 2014:

(In thousands)

	<u>Commercial</u>	<u>Commercial Real Estate</u>	<u>Agriculture</u>	<u>Agriculture Real Estate</u>	<u>Total</u>
December 31, 2015					
Grade:					
Pass	\$ 95,597	\$ 142,258	\$ 36,407	\$ 40,028	\$ 314,290
Special Mention	1,624	285	40	39	1,988
Substandard	<u>5,450</u>	<u>7,351</u>	<u>1,011</u>	<u>2,038</u>	<u>15,850</u>
Total	<u>\$ 102,671</u>	<u>\$ 149,894</u>	<u>\$ 37,458</u>	<u>\$ 42,105</u>	<u>\$ 332,128</u>
December 31, 2014					
Grade:					
Pass	\$ 82,421	\$ 135,495	\$ 31,535	\$ 32,963	\$ 282,414
Special Mention	2,228	321	-	43	2,592
Substandard	<u>4,935</u>	<u>7,610</u>	<u>820</u>	<u>2,041</u>	<u>15,406</u>
Total	<u>\$ 89,584</u>	<u>\$ 143,426</u>	<u>\$ 32,355</u>	<u>\$ 35,047</u>	<u>\$ 300,412</u>

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

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

Lyons Bancorp, Inc.

Notes to Consolidated Financial Statements

December 31, 2015 and 2014

Note 4 – Loans (Continued)

Credit Quality – continued

The following table presents the classes of the residential real estate and consumer loan portfolios summarized by performing or nonaccrual as of December 31, 2015 and 2014:

(In thousands)

	<u>1-4 Family</u>	<u>Home Equity</u>	<u>Consumer - Direct</u>	<u>Consumer - Indirect</u>	<u>Total</u>
December 31, 2015					
Performing	\$ 162,810	\$ 83,938	\$ 15,698	\$ 10,362	\$ 272,808
Nonaccrual	<u>45</u>	<u>220</u>	<u>-</u>	<u>-</u>	<u>265</u>
Total	<u>\$ 162,855</u>	<u>\$ 84,158</u>	<u>\$ 15,698</u>	<u>\$ 10,362</u>	<u>\$ 273,073</u>
December 31, 2014					
Performing	\$ 146,737	\$ 70,468	\$ 14,173	\$ 11,913	\$ 243,291
Nonaccrual	<u>548</u>	<u>213</u>	<u>-</u>	<u>-</u>	<u>761</u>
Total	<u>\$ 147,285</u>	<u>\$ 70,681</u>	<u>\$ 14,173</u>	<u>\$ 11,913</u>	<u>\$ 244,052</u>

Note 5 - Land, Premises and Equipment

Land, premises and equipment, net consist of the following at December 31, 2015 and 2014:

	<u>2015</u>	<u>2014</u>
	(In thousands)	
Land	\$ 4,239	\$ 2,956
Buildings	15,145	12,736
Furniture and equipment	7,019	5,845
Leasehold improvements	2,846	2,076
Construction in progress	<u>-</u>	<u>219</u>
	<u>29,249</u>	<u>23,832</u>
Less accumulated depreciation	<u>(8,369)</u>	<u>(7,391)</u>
	<u>\$ 20,880</u>	<u>\$ 16,441</u>

Lyons Bancorp, Inc.

Notes to Consolidated Financial Statements

December 31, 2015 and 2014

Note 5 - Land, Premises and Equipment (Continued)

Depreciation and amortization expense in 2015 and 2014 are included in noninterest expense as follows:

	<u>2015</u>	<u>2014</u>
	(In thousands)	
Buildings	\$ 332	\$ 317
Furniture and equipment	550	587
Leasehold improvements	96	43
	<u>\$ 978</u>	<u>\$ 947</u>

At December 31, 2015, the Bank leased four of its branch facilities, as well as two operations facilities under non-cancelable operating leases. Future minimum rental payments under these leases are as follows:

Years Ending December 31,	(In thousands)
2016	\$ 304
2017	304
2018	313
2019	327
2020	256
Thereafter	1,529
	<u>\$ 3,033</u>

Rent expense under the operating leases totaled \$298,000 and \$224,000 in 2015 and 2014, respectively.

At December 31, 2015, the Bank leased out space under non-cancelable operating leases. Future minimum rental payments to be received by the Company under these leases are as follows:

Years Ending December 31,	(In thousands)
2016	87
2017	74
2018	75
2019	77
2020	79
Thereafter	95
	<u>\$ 487</u>

Rent income under the operating leases totaled \$126,000 and \$132,000 in 2015 and 2014, respectively.

Lyons Bancorp, Inc.

Notes to Consolidated Financial Statements

December 31, 2015 and 2014

Note 6 - Deposits

Certificates of deposit in denominations of \$250,000 and over were \$52.7 million and \$64.9 million at December 31, 2015 and 2014, respectively.

At December 31, 2015, scheduled maturities of time deposits are as follows:

Years Ending December 31,	(In thousands)
2016	\$ 122,429
2017	28,986
2018	6,123
2019	1,879
2020	1,503
2021	56
	<u>\$ 160,976</u>

Note 7 - Borrowings

Borrowings consist of overnight advances and amortizing borrowings. At December 31, 2015 and 2014, there were \$12 million and \$34.6 million in overnight advances outstanding, respectively. The table below details additional information related to overnight advances for the years ended December 31,

	<u>2015</u>	<u>2014</u>
	(Dollars in thousands)	
Average outstanding balance	\$ 16,308	\$ 6,817
Interest expense	\$ 68	\$ 31
Weighted average interest rate during the year	0.42%	0.45%
Weighted average interest rate at end of year	0.52%	0.32%

Long term debt at December 31, 2015 and 2014 consists of the following FHLB advances:

	<u>Amount</u>		<u>Weighted Average Rate</u>	
	<u>2015</u>	<u>2014</u>	<u>2015</u>	<u>2014</u>
	(Dollars in thousands)			
Amortizing advances, due January 2019, requiring monthly principal and interest payments of \$86,311	\$ 3,207	\$ 4,191	1.39%	1.39%
Amortizing advances, due October 2020, requiring monthly principal and interest payments of \$86,289	4,919	-	1.38%	-
Total	<u>\$ 8,126</u>	<u>\$ 4,191</u>	<u>1.38%</u>	<u>1.39%</u>

Lyons Bancorp, Inc.

Notes to Consolidated Financial Statements

December 31, 2015 and 2014

Note 7 – Borrowings (Continued)

At December 31, 2015, scheduled principal payments on amortizing advances are as follows:

Years Ending December 31,	(In thousands)
2016	\$ 1,971
2017	1,998
2018	2,027
2019	1,187
2020	943
	<u>\$ 8,126</u>

As a member of the FHLB, the Bank can use certain unencumbered mortgage-related assets to secure borrowings from the FHLB. At December 31, 2015, total unencumbered mortgage-related loans were \$43 million. Additional assets may also qualify as collateral for FHLB advances.

The Company, through the Bank, can use certain unencumbered collateral to secure borrowings at the Federal Reserve Bank. At December 31, 2015, total unencumbered collateral in the form of home equity loans and other consumer loans was \$46.1 million.

The Company, through the Bank, had available unsecured line of credit agreements with correspondent banks permitting borrowings up to a maximum of \$15.0 million at both December 31, 2015 and 2014. There were no outstanding advances against those lines at December 31, 2015 or 2014.

Note 8 - Junior Subordinated Debentures

On June 27, 2003, the Company issued \$1.035 million in junior subordinated debentures due June 27, 2033, to Trust I. The Company owns all of the \$35,000 in common equity of Trust I and the debentures are the sole asset of Trust I. Trust I issued \$1.0 million of floating-rate trust capital securities in a non-public offering. The floating-rate capital securities provide for quarterly distributions at a variable annual coupon rate, reset quarterly, based on three-month LIBOR plus 2.75%. The coupon rate was 3.35% at December 31, 2015 and 3.01% at December 31, 2014. The securities are callable by the Company, subject to any required regulatory approval, at par, after June 2008.

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

Lyons Bancorp, Inc.

Notes to Consolidated Financial Statements

December 31, 2015 and 2014

Note 8 - Junior Subordinated Debentures (Continued)

On August 23, 2004, the Company issued \$5.155 million in junior subordinated debentures due August 23, 2034, to Trust II. The Company owns all of the \$155,000 in common equity of Trust II and the debentures are the sole asset of Trust II. Trust II issued \$5.0 million of floating-rate trust capital securities in a non-public offering. The floating-rate capital securities provide for quarterly distributions at a variable annual coupon rate, reset quarterly, based on three-month LIBOR plus 2.65%. The coupon rate was 3.03% at December 31, 2015 and 2.88% at December 31, 2014. The securities are callable by the Company subject to any required regulatory approval, at par, after August 2009.

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

In December 2009, the Company entered into an interest rate swap agreement (swap) with an effective date of February 23, 2011. The Company designated the swap as a cash flow hedge and it is intended to protect against the variability of cash flows associated with Trust II. The swap modifies the pricing characteristic of Trust II, wherein the Company receives interest at three-month LIBOR plus 2.65% from a counterparty and pays a fixed rate of interest of 6.80% to the same counterparty calculated on a notional amount of \$5.0 million. This agreement will expire on November 23, 2019. The swap agreement was entered into with a counterparty that met the Company's credit standards, and the agreement contains collateral provisions protecting the at-risk party. The Company believes that the credit risk inherent in this contract is not significant. At December 31, 2015, the company pledged \$690,000 cash collateral to the counterparty.

At December 31, 2015 and 2014, the fair value of the swap agreement was a loss of \$528,000 and \$603,000, respectively, and was the amount the Company would have expected to pay to terminate the agreement. The fair value of the swap is included in other liabilities in the accompanying consolidated balance sheets. The net effect of the swap increased interest expense by \$196,000 and \$199,000 in 2015 and 2014, respectively.

On February 12, 2010, the Company issued \$3.027 million in junior subordinated debentures due February 12, 2040, to Trust III. The Company owns all of the \$95,000 in common equity of Trust III and the debentures are the sole asset of Trust III. Trust III issued \$2.932 million of fixed rate convertible trust capital securities in a non-public offering. These capital securities provide for quarterly distributions at a fixed annual coupon rate of 6.00%. The securities are callable by the Company, subject to any required regulatory approval, at par, after February 2015. Holders of the trust securities may convert the securities, at any time, into shares of the Company's common stock at a conversion price of \$13.89 per share, subject to adjustments for splits, stock dividends, recapitalization and the like and issuances on a pro rata basis below the current market value, in-kind dividends and tender offers above market value. In 2015, 25,200 shares totaling \$350,000 were converted to common stock. There were no conversions in 2014.

The Company unconditionally guarantees the Trust III capital securities. The terms of the junior subordinated debentures and the common equity of Trust III mirror the terms of the convertible trust capital securities issued by Trust III. The Company used the net proceeds from this offering to fund an additional \$2.9 million capital investment in the Bank for its operations and future growth.

Lyons Bancorp, Inc.

Notes to Consolidated Financial Statements

December 31, 2015 and 2014

Note 8 - Junior Subordinated Debentures (Continued)

The accounts of Trust I, Trust II and Trust III are not included in the consolidated financial statements of the Company. However, for regulatory purposes, the trust capital securities qualify as Tier I capital of the Company subject to a 25% of capital limitation under risk-based capital guidelines. The portion that exceeds the 25% of capital limitation qualifies as Tier II capital. At December 31, 2015 and 2014, \$8.6 million and \$9.0 million in trust capital securities qualified as Tier I capital, respectively.

Note 9 - Income Taxes

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

	<u>2015</u>	<u>2014</u>
	(In thousands)	
Current tax provision:		
Federal	\$ 2,775	\$ 2,698
State	236	224
Total current tax provision	<u>3,011</u>	<u>2,922</u>
Deferred tax expense/(benefit):		
Federal	(197)	(210)
State	72	7
Total deferred tax benefit	<u>(125)</u>	<u>(203)</u>
	<u>\$ 2,886</u>	<u>\$ 2,719</u>

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

	<u>2015</u>	<u>2014</u>
Statutory federal tax rate	34.0%	34.0%
Increase (decrease) resulting from:		
Tax-exempt interest income	(5.3)	(5.6)
Non-taxable earnings on bank-owned life insurance	(1.3)	(1.3)
Nondeductible expenses	0.1	0.2
Disallowed interest expense	0.2	0.2
Other, net	0.4	(0.1)
Effective tax rate	<u>28.1%</u>	<u>27.4%</u>

Lyons Bancorp, Inc.

Notes to Consolidated Financial Statements

December 31, 2015 and 2014

Note 9 - Income Taxes (Continued)

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

	<u>2015</u>	<u>2014</u>
	(In thousands)	
Deferred tax assets:		
Allowance for loan losses	\$ 3,095	\$ 2,920
Compensation and benefits	3,358	3,411
Net unrealized loss on available for sale securities	-	68
Net unrealized loss on held to maturity securities transferred from available for sale	159	193
Other	741	702
Total deferred tax assets	<u>7,353</u>	<u>7,294</u>
Deferred tax liabilities:		
Prepaid pension	924	994
Depreciation	717	661
Net unrealized gain on available for sale securities	221	-
Other	889	650
Total deferred tax liabilities	<u>2,751</u>	<u>2,305</u>
Net deferred tax assets	<u>\$ 4,602</u>	<u>\$ 4,989</u>

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

Note 10 - Stockholders' Equity

Preferred Stock – The Company is authorized to issue 5,000 shares of preferred stock having a par value of \$0.50 per share and a stated value of \$1,000 per share. None of the shares of the authorized preferred stock have been issued. The board of directors is authorized to issue these shares of preferred stock without stockholder approval in different classes and series and, with respect to each class or series, to determine the dividend rate, the redemption provisions, conversion provisions, liquidation preference, and other rights, privileges, and restrictions.

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

Lyons Bancorp, Inc.

Notes to Consolidated Financial Statements

December 31, 2015 and 2014

Note 10 - Stockholders' Equity (continued)

On October 30, 2015, the Company effected a 2-for-1 stock split in form of a stock dividend resulting of the issuance of 1.5 million shares.

The common stock and treasury stock of the Company at December 31, 2015 and 2014 are as follows:

	<u>2015</u>	<u>2014</u>
Common stock, authorized shares, \$0.50 par value	<u>5,000,000</u>	<u>5,000,000</u>
Issued shares	3,012,756	2,987,556
Less: treasury stock shares	<u>(8,370)</u>	<u>(10,544)</u>
Outstanding shares	<u>3,004,386</u>	<u>2,977,012</u>

The amounts of income tax expense (benefit) allocated to each component of other comprehensive income are as follows for the years ended December 31, 2015 and 2014:

	<u>2015</u>	<u>2014</u>
	(In thousands)	
Securities available for sale:		
Net unrealized gains during the year	\$ 347	\$ 1,143
Reclassification adjustment for gains included in income	(67)	(56)
Securities held to maturity:		
Reclassification adjustment for amortization of unrealized losses included in income	33	27
Unrealized gains (losses) during the year of restricted equity securities	9	(5)
Pension and postretirement benefits:		
Amortization of prior service credit	(1)	(1)
Amortization of net loss	90	20
Net actuarial gain (loss)	71	(1,067)
Cash flow hedge		
Losses on the effective portion of cash flow hedge	(48)	(77)
Reclassification adjustment for losses included in income	<u>78</u>	<u>79</u>
Tax expense	<u>\$ 512</u>	<u>\$ 63</u>

Lyons Bancorp, Inc.

Notes to Consolidated Financial Statements

December 31, 2015 and 2014

Note 10 - Stockholders' Equity (Continued)

Reclassifications out of accumulated other comprehensive loss for the years ended December 31, 2015 and 2014 are as follows:

Details About Accumulated Other Comprehensive (Loss) Income Components	Amount Reclassified from Accumulated Other Comprehensive (Loss) Income		Affected Line Item In The Statement Where Net Income is Presented
	<u>2015</u>	<u>2014</u>	
	(In Thousands)		
Unrealized gains and losses on available for sale securities (before tax)	\$ 167	\$ 139	Net realized gains from sales/calls of available for sale securities
Tax benefit	<u>(67)</u>	<u>(56)</u>	Income tax expense
Net of tax	<u>100</u>	<u>83</u>	
Amortization of unrealized losses on securities transferred to held to maturity (before tax):	<u>(84)</u>	<u>(68)</u>	Interest Income – investment securities, taxable
Tax expense	<u>33</u>	<u>27</u>	Income tax expense
Net of tax	<u>(51)</u>	<u>(41)</u>	
Amortization of pension and postretirement benefit plan items (before tax):			
Prior service credit	<u>3</u>	<u>3</u>	
Net losses	<u>(224)</u>	<u>(49)</u>	
Tax expense	<u>89</u>	<u>19</u>	Pensions and benefits expense
Net of tax	<u>(132)</u>	<u>(27)</u>	Income tax expense
Gains and losses on cash flow hedge (before tax)	<u>(196)</u>	<u>(199)</u>	Interest expense - borrowings
Tax expense	<u>78</u>	<u>79</u>	Income tax expense
Net of tax	<u>(118)</u>	<u>(120)</u>	
Total reclassification for the year, net of tax	<u>\$ (201)</u>	<u>\$ (105)</u>	

Lyons Bancorp, Inc.

Notes to Consolidated Financial Statements

December 31, 2015 and 2014

Note 10 - Stockholders' Equity (Continued)

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

(In thousands)	Unrealized gains (losses) on securities available for sale	Unrealized losses on securities transferred to held to maturity	Unrealized gains on restricted equity securities	Pension and postretirement benefits	Unrealized losses on cash flow hedge	Total
Balance – January 1, 2014	\$ (1,733)	\$ (330)	\$ 9	\$ (982)	\$ (367)	\$ (3,403)
Other comprehensive income (loss) before reclassifications	1,713	-	(8)	(1,601)	(114)	(10)
Amounts reclassified from accumulated other comprehensive loss	(83)	41	-	27	120	105
Other comprehensive income (loss) for 2014	1,630	41	(8)	(1,574)	6	95
Balance – December 31, 2014	(103)	(289)	1	(2,556)	(361)	(3,308)
Other comprehensive income (loss) before reclassifications	521	-	13	106	(73)	567
Amounts reclassified from accumulated other comprehensive loss	(100)	51	-	132	118	201
Other comprehensive income for 2015	421	51	13	238	45	768
Balance – December 31, 2015	\$ 318	\$ (238)	\$ 14	\$ (2,318)	\$ (316)	\$ (2,540)

Note 11 - Pension and Postretirement Benefit Plans

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

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

The Company engages independent, external actuaries to compute the amounts of liabilities and expense relating to these plans, subject to the assumptions that the Company selects. The benefit obligation for these plans represents the liability of the Company for current and retired employees, and is affected primarily by the following: service cost (benefits attributed to employee service during the period); interest cost (interest on the liability due to the passage of time); actuarial gains/losses (experience during the year different from that assumed and changes in plan assumptions); and benefits paid to participants.

Lyons Bancorp, Inc.

Notes to Consolidated Financial Statements

December 31, 2015 and 2014

Note 11 - Pension and Postretirement Benefit Plans (Continued)

The following table provides a reconciliation of the changes in the Pension Plan's and Healthcare Plan's benefit obligations and fair value of assets and the accumulated benefit obligation for the Pension Plan and Healthcare Plan as of and for the years ended December 31, 2015 and 2014:

	Pension Plan		Healthcare Plan	
	2015	2014	2015	2014
	(In thousands)			
Change in benefit obligation:				
Benefit obligation at beginning of year	\$ 12,626	\$ 8,875	\$ 545	\$ 471
Service cost	1,135	856	6	3
Interest cost	489	429	24	22
Actuarial (gain) loss	(1,082)	2,753	109	85
Expected expenses	(98)	(99)	-	-
Benefits paid	(326)	(188)	(32)	(36)
Benefit obligation at end of year	12,744	12,626	652	545
Change in plan assets:				
Fair value of plan assets at beginning of year	11,150	9,651	-	-
Actual return on plan assets	(84)	808	-	-
Employer contribution	1,000	1,000	32	36
Actual expenses paid	(101)	(121)	-	-
Benefits paid	(326)	(188)	(32)	(36)
Fair value of plan assets at end of year	11,639	11,150	-	-
Funded status recognized	\$ (1,105)	\$ (1,476)	\$ (652)	\$ (545)
Accumulated benefit obligation	\$ 10,571	\$ 10,351	\$ 652	\$ 545

The underfunded status of the Pension and Healthcare Plans as of December 31, 2015 and 2014 has been recognized in other liabilities in the consolidated balance sheets.

Lyons Bancorp, Inc.

Notes to Consolidated Financial Statements

December 31, 2015 and 2014

Note 11 - Pension and Postretirement Benefit Plans (Continued)

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

	Pension Plan		Healthcare Plan	
	2015	2014	2015	2014
Components of net periodic benefit cost:	(In thousands)			
Service cost	\$ 1,135	\$ 856	\$ 6	\$ 3
Interest cost	489	429	24	22
Expected return on plan assets	(710)	(616)	-	-
Amortization of prior service cost (credit)	1	1	(4)	(4)
Amortization of net loss	209	40	15	9
Net periodic benefit cost	<u>1,124</u>	<u>710</u>	<u>41</u>	<u>30</u>
Other changes in plan assets and benefit obligations recognized in other comprehensive income:				
Net (gain) loss	(286)	2,584	109	85
Recognized actuarial loss	(209)	(40)	(15)	(9)
Recognized prior service (cost) credit	(1)	(1)	4	4
Recognized in other comprehensive income	<u>(496)</u>	<u>2,543</u>	<u>98</u>	<u>80</u>
Total recognized in net periodic benefit cost and other comprehensive income	<u>\$ 628</u>	<u>\$ 3,253</u>	<u>\$ 139</u>	<u>\$ 110</u>

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

	Pension Plan		Healthcare Plan	
	2015	2014	2015	2014
	(In thousands)			
Prior service cost (credit)	\$ 2	\$ 2	\$ (12)	\$ (14)
Net actuarial loss	2,129	2,426	199	142
	<u>\$ 2,131</u>	<u>\$ 2,428</u>	<u>\$ 187</u>	<u>\$ 128</u>

The estimated costs that will be amortized from accumulated other comprehensive loss into net periodic cost during 2016 are as follows:

	Pension Plan	Healthcare Plan	Total
	(In thousands)		
Prior service cost (credit)	\$ 1	\$ (4)	\$ (3)
Net actuarial loss	175	24	199
Total	<u>\$ 176</u>	<u>\$ 20</u>	<u>\$ 196</u>

Lyons Bancorp, Inc.

Notes to Consolidated Financial Statements

December 31, 2015 and 2014

Note 11 - Pension and Postretirement Benefit Plans (Continued)

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

	Pension Plan		Healthcare Plan	
	2015	2014	2015	2014
Discount rates:				
Benefit cost for Plan Year	3.95%	4.93%	3.81%	4.73%
Benefit obligation at end of Plan Year	4.32%	3.95%	4.16%	3.81%
Expected long-term return on plan assets	6.50%	6.50%	N/A	N/A
Rate of compensation increase:				
Benefit cost for Plan Year	3.00%	3.00%	N/A	N/A
Benefit obligation at end of Plan Year	3.00%	3.00%	N/A	N/A

The assumed health care cost trend rate used in the postretirement benefit plan at December 31, 2015 was 4.00%. Assumed health care trend rates may have a significant effect on the amounts reported for this plan. A 1% increase in the trend rate would increase the periodic benefit cost by \$5,000 and increase the accumulated postretirement benefit obligation by \$87,000.

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

The Company utilizes the Healthy Annuitant/Employee Mortality Table (RP-2014) to measure its pension plan obligation. In 2014, the Company used RP-2014 adjusted to reflect the Mortality Improvement Scale of 2014 (MP-2014), while in 2015, the Company utilized RP-2014 adjusted to reflect the Mortality Improvement Scale of 2015 (MP-2015). The change in mortality improvement scales decreased the projected benefit obligation by approximately \$208,000 in 2015.

The Company's funding policy is to contribute, at a minimum, an actuarially determined amount that will satisfy the minimum funding requirements determined under the appropriate sections of the Internal Revenue Code. While the Company has satisfied the minimum funding requirement for 2015, it expects to contribute to the Pension Plan during 2016. However, the amount of the contribution is not known at this time.

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

Years Ending December 31,	Pension Plan	Healthcare Plan
	(In thousands)	
2016	\$ 301	\$ 42
2017	341	42
2018	377	42
2019	411	42
2020	448	42
2021 - 2025	3,054	211
	<u>\$ 4,932</u>	<u>\$ 421</u>

Lyons Bancorp, Inc.

Notes to Consolidated Financial Statements

December 31, 2015 and 2014

Note 11 - Pension and Postretirement Benefit Plans (Continued)

The fair value of the Company's pension plan assets at December 31, 2015 and 2014 by asset category are as follows:

	Total	(Level 1) Quoted Prices in Active Markets for Identical Assets	(Level 2) Significant Other Observable Inputs	(Level 3) Significant Unobservable Inputs
	(In thousands)			
December 31, 2015:				
Cash equivalents:				
Foreign currencies	\$ 6	\$ 6	\$ -	\$ -
Short term investment funds	602	-	602	-
Total cash equivalents	608	6	602	-
Equity securities:				
Common stock	2,104	2,104	-	-
Depository receipts	54	54	-	-
Commingled pension trust funds	1,698	-	1,698	-
Exchange traded funds	1,639	1,639	-	-
Total equity securities	5,495	3,797	1,698	-
Fixed income securities:				
Collateralized mortgage obligations	98	-	98	-
Commingled pension trust funds	2,878	-	2,878	-
Corporate bonds	553	-	553	-
Federal Home Loan Mortgage Corporation	44	-	44	-
Federal National Mortgage Association	316	-	316	-
Government National Mortgage Association II	62	-	62	-
Government issues	1,155	-	1,155	-
Total fixed income securities	5,106	-	5,106	-
Other financial instruments				
Commingled pension trust funds	430	-	-	430
Total other financial instruments	430	-	-	430
Total	<u>\$ 11,639</u>	<u>\$ 3,803</u>	<u>\$ 7,406</u>	<u>\$ 430</u>

Lyons Bancorp, Inc.

Notes to Consolidated Financial Statements

December 31, 2015 and 2014

Note 11 - Pension and Postretirement Benefit Plans (Continued)

	(Level 1) Quoted Prices in Active Markets for Identical Assets	(Level 2) Significant Other Observable Inputs	(Level 3) Significant Unobservable Inputs
Total	Assets	Inputs	Inputs
(In thousands)			
December 31, 2014:			
Cash equivalents:			
Foreign currencies	\$ 5	\$ 5	\$ -
Government issues	37	-	37
Short term investment funds	933	-	933
Total cash equivalents	975	5	970
Equity securities:			
Common stock	2,173	2,173	-
Depository receipts	27	27	-
Preferred stock	21	21	-
Commingled pension trust funds	1,593	-	1,593
Exchange traded funds	1,560	1,560	-
Total equity securities	5,374	3,781	1,593
Fixed income securities:			
Auto loan receivable	49	-	49
Collateralized mortgage obligations	100	-	100
Commingled pension trust funds	3,110	-	3,110
Corporate bonds	438	-	438
Federal Home Loan Mortgage Corporation	11	-	11
Federal National Mortgage Association	288	-	288
Government National Mortgage Association II	18	-	18
Government issues	758	-	758
Other asset backed securities	24	-	24
Other securities	5	-	5
Total fixed income securities	4,801	-	4,801
Total	\$ 11,150	\$ 3,786	\$ 7,364

At December 31, 2015 and 2014, the portfolio was managed by two investment firms. In addition, as of December 31, 2015 and 2014, approximately \$482,000 and \$456,000, respectively, of Pension Plan monies had not yet been allocated to either investment manager. At December 31, 2015, control was split at approximately 58%, 38% and 4% unallocated. At December 31, 2014, the portfolio was split at approximately 57%, 39% and 4% unallocated.

Lyons Bancorp, Inc.

Notes to Consolidated Financial Statements

December 31, 2015 and 2014

Note 11 - Pension and Postretirement Benefit Plans (Continued)

At December 31, 2015, there were the following investment concentrations:

- Two commingled pension trust funds, which were 7% and 11% of the total portfolio,
- An exchange traded fund, which was 7% of the total portfolio, and
- The short term investment fund, which was 5% of the total portfolio.

At December 31, 2014, there were two commingled pension trust funds and a short term investment fund accounting for 13%, 9% and 8% of the entire investment portfolio.

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

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

- Level 1—Quoted prices in active markets for identical assets or liabilities.
- Level 2—Inputs other than Level 1 that are observable, either directly or indirectly, such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities.
- Level 3—Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities.

In instances in which the inputs used to measure fair value fall into different levels of the fair value hierarchy, the fair value measurement has been determined based on the lowest level input that is significant to the fair value measurement in its entirety. Investments valued using the Net Asset Value (NAV) are classified as Level 2 if the Pension Plan can redeem its investment with the investee at the NAV at the measurement date. If the Pension Plan can never redeem the investment with the investee at the NAV, it is considered a Level 3. If the Pension Plan can redeem the investment at the NAV at a future date, the Pension Plan's assessment of the significance of a particular item to the fair value measurement in its entirety requires judgment, including the consideration of inputs specific to the asset.

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

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Notes to Consolidated Financial Statements

December 31, 2015 and 2014

Note 11 - Pension and Postretirement Benefit Plans (Continued)

The following is a table of the pricing methodology and unobservable inputs used by JP Morgan in pricing Level 3 commingled pension trust funds:

<u>Commingled Pension Trust Funds (CPTF) –Other</u>	<u>Principal Valuation Technique(s) Used</u>	<u>Unobservable Inputs</u>
CPTF (Strategic Property) of JPMorgan Chase Bank, N.A.	Market, income, debt service and sales comparison	Credit spreads, discount rate, loan to value ratio, terminal capitalization rate and value per square foot

The following table sets forth a summary of the changes in Level 3 assets for the year ended December 31, 2015:

Balance, January 1, 2015	\$ -
Purchases	375
Unrealized gains	55
Balances, December 31, 2015	<u>\$ 430</u>

There were no transfers in or out of Level 3 in the years ended December 31, 2015 and 2014.

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

The overall investment strategy is to achieve a mix of approximately 97% of investments for long-term growth and 3% for near-term benefit payments with a wide diversification of asset types, fund strategies, and fund managers. The target allocations are shown in the table below. Cash equivalents consist primarily of short term investment funds. Equity securities primarily include investments in common stock, depository receipts, commingled pension trust funds and exchange traded funds. Fixed income securities include primarily commingled pension trust funds, corporate bonds, government issues, U.S. government agency and GSE mortgage backed securities. Other investments are real estate interests and related investments held within a commingled pension trust fund.

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

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

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

Lyons Bancorp, Inc.

Notes to Consolidated Financial Statements

December 31, 2015 and 2014

Note 11 - Pension and Postretirement Benefit Plans (Continued)

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

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

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

Equity securities:

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

Fixed income securities:

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

Other financial instruments:

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

All other investments not prohibited by policy are permitted. At December 31, 2015 and 2014, the Pension Plan held certain investments which are no longer deemed acceptable to acquire. These positions will be liquidated when the investment managers deem that such liquidation is in the best interest of the Pension Plan.

Lyons Bancorp, Inc.

Notes to Consolidated Financial Statements

December 31, 2015 and 2014

Note 11 - Pension and Postretirement Benefit Plans (Continued)

The target allocation for 2016 and actual allocation of plan assets as of December 31, 2015 and 2014 are as follows:

Asset Category	Target Allocation 2016	% of Plan Assets at December 31,	
		2015	2014
Cash equivalents	0-20%	5.2%	8.7%
Equity securities	40-60%	47.2%	48.2%
Fixed income securities	40-60%	43.9%	43.1%
Other financial instruments	0-5%	3.7%	-

Defined Contribution Plan

The Bank has a contributory 401(k) Plan for substantially all employees. Employees are eligible to contribute a percentage of their salary up to the maximum as determined by the Internal Revenue Service. The Bank is required to match 75% of the employees' contributions up to a maximum of 6% of the employees' salaries. The Bank contributed \$316,000 and \$300,000 under these provisions during 2015 and 2014, respectively.

Supplemental Employee Retirement Plans

The Company maintains supplemental employee retirement plans (the "SERP") for certain executives. All benefits provided under the SERP are unfunded and, as these executives retire, the Company will make payments to plan participants. The unfunded status of the SERP at December 31, 2015 and 2014 was \$3.2 million and \$3.0 million, respectively, and is recorded in other liabilities in the consolidated balance sheets. Compensation expense related to the SERP was \$265,000 and \$260,000 for the years ended December 31, 2015 and 2014.

Deferred Compensation Plans

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

The Company obtains shares for the new deferred compensation plan either through open market purchases or from treasury shares. The amount of awarded shares is based on the amount earned by each executive under the deferred compensation plan. The executives are awarded a number of shares based on the amount of deferred compensation earned divided by the value of the shares. The value of the shares purchased on the open market is the price paid. The value of the shares from treasury is the average daily closing price of the stock for each day within the past quarter. Total deferred compensation shares were 133,978 and 126,372 at December 31, 2015 and 2014 respectively. Total shares awarded

Lyons Bancorp, Inc.

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December 31, 2015 and 2014

Note 11 - Pension and Postretirement Benefit Plans (Continued)

were 7,606 and 7,940 for 2015 and 2014, respectively. There were no unvested shares at December 31, 2015. Compensation expense is recognized over the vesting period, and is based upon the total amount of the value of the shares awarded to each executive. Compensation expense related to the plan was approximately \$134,000 and \$133,000 for the years ended December 31, 2015 and 2014, respectively.

Note 12 - Earnings Per Share

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

	<u>2015</u>	<u>2014</u>
	(in thousands, except per share data)	
Net income available to common shareholders	\$ 7,371	\$ 7,204
Adjustment for dilutive potential common shares	101	106
Net income available for diluted common shares	<u>\$ 7,472</u>	<u>\$ 7,310</u>
Weighted average common shares used to calculate basic EPS ⁽¹⁾	2,988,981	2,981,162
Add: effect of common stock equivalents ⁽¹⁾	202,656	211,104
Weighted average common shares used to calculate diluted EPS ⁽¹⁾	<u>3,191,637</u>	<u>3,192,266</u>
Earnings per common share ⁽¹⁾ :		
Basic	<u>\$ 2.47</u>	<u>\$ 2.42</u>
Diluted	<u>\$ 2.34</u>	<u>\$ 2.29</u>

(1) Per share amounts have been adjusted to reflect a 2-for-1 stock split in the form of a stock dividend, effective October 30, 2015.

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Note 13 - Related Party Transactions

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

The rollforward of loans to related parties for the years ended December 31 is as follows:

	<u>2015</u>	<u>2014</u>
	(In thousands)	
Beginning balance, January 1	\$ 12,021	\$ 10,967
New loans	745	2,761
Sold Loans	-	(520)
Repayments	<u>(2,249)</u>	<u>(1,187)</u>
Ending balance, December 31	<u>\$ 10,517</u>	<u>\$ 12,021</u>

The Bank has an operating lease with one of its directors. Under the terms of the lease, the Bank received monthly payments of \$4,139 through October 2015. The operating lease ended in October, 2015.

Note 14 - Commitments and Contingent Liabilities

The Bank is a party to financial instruments with off-balance-sheet risk in the normal course of business to meet the financing needs of its customers. These financial instruments include commitments to extend credit and standby letters of credit. These instruments involve, to varying degrees, elements of credit and interest rate risk in excess of the amounts recognized in the consolidated balance sheets. The Bank uses the same credit policies in making commitments and conditional obligations as it does for on-balance-sheet instruments.

The Bank's exposure to credit loss in the event of nonperformance by the other party to the financial instrument for commitments to extend credit and standby letters of credit is represented by the contractual notional amount of those instruments summarized as follows at December 31:

	<u>2015</u>	<u>2014</u>
	(In thousands)	
Commitments to extend credit:		
Commitments to grant loans	\$ 47,171	\$ 53,377
Unfunded commitments under commercial lines of credit	68,836	63,668
Unfunded commitments under consumer lines of credit	54,254	48,309
Standby letters of credit	<u>10,924</u>	<u>8,739</u>
	<u>\$ 181,185</u>	<u>\$ 174,093</u>

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December 31, 2015 and 2014

Note 14 - Commitments and Contingent Liabilities (Continued)

Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. Since many of the commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements.

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

Standby letters of credit are conditional lending commitments issued by the Bank to guarantee the performance of a customer to a third party. These letters of credit are primarily issued to support public and private borrowing arrangements. Generally, letters of credit issued have expiration dates within one year. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loan facilities to customers. The Bank's policy for obtaining collateral, and the nature of such collateral, is essentially the same as that involved in making commitments to extend credit. The Bank generally holds collateral supporting those commitments. Such collateral amounted to \$7.6 million and \$7.5 million at December 31, 2015 and 2014, respectively. The amount of the liability related to guarantees under standby letters of credit was not material at December 31, 2015 and 2014.

In addition to other investors, the Bank sells residential mortgage loans to the FHLB. The agreement with the FHLB includes a maximum credit enhancement liability of \$7.9 million and \$6.4 million at December 31, 2015 and 2014 respectively, which the Bank may be required to pay if realized losses on any of the sold mortgages exceed the amount held in the FHLB's spread account. The FHLB is funding the spread account annually based on the outstanding balance of loans sold. The Bank's historical losses on residential mortgages have been substantially lower than the amount being funded to the spread account. As such, the Bank does not anticipate recognizing any losses and, accordingly, has not recorded a liability for the credit enhancement.

In addition to pledging investment securities to secure deposits, the Bank has entered into an agreement with the FHLB whereby the FHLB agrees to issue letters of credit for the benefit of securing municipal deposits. In the event the FHLB makes a payment under this agreement, such payment will constitute an advance to the Bank and shall be immediately due and payable. The Bank has pledged unencumbered mortgage-related assets to secure letters of credit from the FHLB. As of both December 31, 2015 and 2014, the Bank had letters of credit outstanding with the FHLB of \$33.1 million.

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Note 15 - Concentrations of Credit

The Company's loan customers are located primarily in the New York communities served by the Bank. Investments in state and local government securities also involve governmental entities within the Company's market area. Although operating in numerous communities in New York State, the Company is still dependent on the general economic conditions of New York. The largest concentration of credit by industry is Lessor's of Nonresidential Buildings, with loans outstanding of \$29.5 million or 4.87% of total loans as of December 31, 2015. Risk related to this concentration is controlled through adherence to loan policy guidelines, including appropriate debt service coverage, adequate property values substantiated by current appraisals, and obtaining guarantors where appropriate. The Company, as a matter of policy, does not extend credit to any single borrower, or group of related borrowers, in excess of its legal lending limit. Further information on the Company's lending activities is provided in "Note 4 Loans" in Notes to Consolidated Financial Statements.

Note 16 - Regulatory Matters

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

Capital

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

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

Lyons Bancorp, Inc.

Notes to Consolidated Financial Statements

December 31, 2015 and 2014

Note 16 - Regulatory Matters (Continued)

Capital - continued

in the Basel Committee's 2004 "Basel II" capital accords and implements the requirements of Section 939A of the Dodd-Frank Act to remove references to credit ratings utilized in the federal banking agencies' rules. The Basel III Capital Rules were effective for the Company and the Bank on January 1, 2015 (subject to a phase-in period).

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

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

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

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Notes to Consolidated Financial Statements

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Note 16 - Regulatory Matters (Continued)

Capital - continued

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

(Dollars in thousands)

	Actual		For Capital Adequacy Purposes		To be Well Capitalized under Prompt Corrective Action Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
December 31, 2015:						
Total risk-based capital						
Consolidated	\$77,527	12.0 %	\$≥51,478	≥8.0 %	\$≥64,348	≥10.0 %
Bank	\$78,254	12.2 %	\$≥51,467	≥8.0 %	\$≥64,334	≥10.0 %
Tier 1 capital						
Consolidated	\$69,426	10.8 %	\$≥38,609	≥6.0 %	\$≥51,478	≥8.0 %
Bank	\$70,155	10.9 %	\$≥38,600	≥6.0 %	\$≥51,467	≥8.0 %
Tier 1 leverage						
Consolidated	\$69,426	8.0 %	\$≥34,548	≥4.0 %	\$≥43,185	≥ 5.0 %
Bank	\$70,155	8.1 %	\$≥34,463	≥4.0 %	\$≥43,078	≥ 5.0 %
Common Equity Tier 1						
Consolidated	\$60,844	9.5 %	\$≥28,957	≥4.5 %	\$≥41,826	≥ 6.5 %
Bank	\$70,155	10.9 %	\$≥28,950	≥4.5 %	\$≥41,817	≥ 6.5 %

Lyons Bancorp, Inc.

Notes to Consolidated Financial Statements

December 31, 2015 and 2014

Note 16 - Regulatory Matters (Continued)

Capital - continued

(Dollars in thousands)

	<u>Actual</u>		<u>For Capital Adequacy Purposes</u>		<u>To be Well Capitalized under Prompt Corrective Action Provisions</u>	
	<u>Amount</u>	<u>Ratio</u>	<u>Amount</u>	<u>Ratio</u>	<u>Amount</u>	<u>Ratio</u>
December 31, 2014:						
Total risk-based capital						
Consolidated	\$71,904	12.4 %	\$≥46,324	≥8.0 %	\$≥57,905	≥10.0 %
Bank	\$72,478	12.5 %	\$≥46,283	≥8.0 %	\$≥57,853	≥10.0 %
Tier 1 capital						
Consolidated	\$64,673	11.2 %	\$≥23,162	≥4.0 %	\$≥34,743	≥6.0 %
Bank	\$65,247	11.3 %	\$≥23,141	≥4.0 %	\$≥34,712	≥6.0 %
Tier 1 leverage						
Consolidated	\$64,673	8.1 %	\$≥31,816	≥4.0 %	\$≥39,769	≥ 5.0 %
Bank	\$65,247	8.2 %	\$≥31,793	≥4.0 %	\$≥39,742	≥ 5.0 %

Management believes, as of December 31, 2015, that the Company and the Bank meet all capital adequacy requirements to which they are subject.

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

Dividend Restrictions

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

At December 31, 2015, the Bank's retained earnings available for the payment of dividends was approximately \$15.7 million.

Lyons Bancorp, Inc.

Notes to Consolidated Financial Statements

December 31, 2015 and 2014

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

Determination of Fair Value

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

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

Fair Value Hierarchy

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

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

Level 2: Valuation is based upon inputs other than quoted prices included within level 1 that are observable either directly or indirectly. The valuation may be based on quoted prices for similar assets or liabilities, quoted prices in markets that are not active, or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the asset or liability.

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

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

Lyons Bancorp, Inc.

Notes to Consolidated Financial Statements

December 31, 2015 and 2014

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

The following information should not be interpreted as an estimate of the fair value of the entire Company since a fair value calculation is only provided for a limited portion of the Company's assets and liabilities. Due to a wide range of valuation techniques and the degree of subjectivity used in making the estimates, comparisons between the Company's disclosures and those of other companies may not be meaningful. The following methods and assumptions were used to estimate the fair values of the Company's financial instruments at December 31, 2015 and 2014:

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

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

Investment Securities

The fair value of securities available for sale and held to maturity are determined by obtaining quoted market prices on nationally recognized securities exchanges (Level 1), or pricing models (Level 2), which consider standard input factors such as observable market data, benchmark yields, interest rate volatilities, broker/dealer quotes, credit spreads and new issue data. For certain securities which are not traded in active markets or are subject to transfer restrictions, valuations are adjusted to reflect illiquidity and/or non-transferability, and such adjustments are generally based on available market evidence (Level 3). In the absence of such evidence, management's best estimate is used. Management's best estimate consists of external support on certain Level 3 investments. Management has determined that the fair value of local government securities in the held to maturity portfolio approximate their carrying value. Restricted equity securities have restrictions on their sale and are primarily carried at cost due to their limited marketability. The fair value of the Company's investment in Farmer Mac is determined by obtaining quoted market prices on nationally recognized securities exchanges (Level 1).

Loans Held for Sale

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

Loans

The fair values of loans are estimated using discounted cash flow analyses, using market rates at the balance sheet date that reflect the credit and interest rate-risk inherent in the loans, resulting in a Level 3 classification. Projected future cash flows are calculated based upon contractual maturity or call dates, projected repayments and prepayments of principal.

Impaired Loans

The fair value of loans considered impaired is generally determined based upon independent third party appraisals of the properties (market approach), or discounted cash flows based upon the expected proceeds. These assets are included as Level 3 fair values, based upon the lowest level of input that is significant to the fair value measurements. The fair value consists of the loan balances of \$3.8 million and \$3.1 million, net of valuation allowances of \$1.6 million and \$970,000 as of December 31, 2015 and 2014, respectively.

Lyons Bancorp, Inc.

Notes to Consolidated Financial Statements

December 31, 2015 and 2014

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

Accrued Interest Receivable and Payable

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

Mortgage Servicing Rights

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

Deposits

The fair values disclosed for demand and savings deposits are, by definition, equal to the amount payable on demand at the reporting date (that is, their carrying amounts). Fair values for fixed-rate certificates of deposit are estimated using a discounted cash flow calculation that applies market interest rates on comparable instruments to a schedule of aggregated expected monthly maturities on time deposits, resulting in a Level 2 classification.

Borrowings from the Federal Home Loan Bank

Fair values of borrowings from the FHLB are estimated using discounted cash flow analysis, based on quoted prices for new borrowings from the FHLB with similar credit risk characteristics, terms and remaining maturity, resulting in a Level 2 classification. These prices obtained from this active market represent a market value that is deemed to represent the transfer price if the liability were assumed by a third party.

Junior Subordinated Debentures

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

Interest Rate Swap Agreements

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

Off-Balance Sheet Financial Instruments

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

Lyons Bancorp, Inc.

Notes to Consolidated Financial Statements

December 31, 2015 and 2014

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

Assets and Liabilities Measured at Fair Value on a Recurring Basis

For financial assets measured at fair value on a recurring basis, the fair value measurements by level within the fair value hierarchy used at December 31, 2015 and 2014 are as follows:

<u>Carrying Value</u>	<u>(Level 1) Quoted Prices in Active Markets for Identical Assets</u>	<u>(Level 2) Significant Other Observable Inputs</u>	<u>(Level 3) Significant Unobservable Inputs</u>
	(In thousands)		
December 31, 2015:			
Securities available for sale:			
United States agencies	\$ 41,203	\$ -	\$ 41,203
State and local governments	68,738	-	68,738
Mortgage-backed securities	28,446	-	28,446
Total securities available for sale	<u>\$ 138,387</u>	<u>\$ -</u>	<u>\$ 138,387</u>
Restricted equity security	<u>\$ 65</u>	<u>\$ 65</u>	<u>\$ -</u>
Interest rate swap agreements	<u>\$ (528)</u>	<u>\$ -</u>	<u>\$ (528)</u>
December 31, 2014:			
Securities available for sale:			
United States agencies	\$ 50,881	\$ -	\$ 50,881
State and local governments	66,360	-	66,360
Mortgage-backed securities	23,963	-	23,963
Total securities available for sale	<u>\$ 141,204</u>	<u>\$ -</u>	<u>\$ 141,204</u>
Restricted equity security	<u>\$ 43</u>	<u>\$ 43</u>	<u>\$ -</u>
Interest rate swap agreements	<u>\$ (603)</u>	<u>\$ -</u>	<u>\$ (603)</u>

Lyons Bancorp, Inc.

Notes to Consolidated Financial Statements

December 31, 2015 and 2014

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

Assets Measured at Fair Value on a Nonrecurring Basis

Assets measured at fair value on a nonrecurring basis were not significant at December 31, 2015 and 2014.

The carrying amounts and estimated fair values of the Company's financial instruments at December 31, 2015 and 2014 are as follows:

	Fair Value Hierarchy	2015		2014	
		Carrying Amount	Fair Value	Carrying Amount	Fair Value
(In thousands)					
Financial assets:					
Cash and due from banks	1	\$ 15,416	\$ 15,416	\$ 13,309	\$ 13,309
Interest-bearing deposits in banks	1	14,365	14,365	12,524	12,524
Investment securities	1 and 2	195,185	195,902	204,578	205,056
Loans, net of allowance	2 and 3	597,013	600,183	536,915	542,137
Accrued interest receivable	1	2,616	2,616	2,335	2,335
Mortgage servicing rights	2	943	943	730	730
Financial liabilities:					
Demand and savings deposits	1	\$ 611,135	\$ 611,135	\$ 535,176	\$ 535,176
Certificates of deposit	2	160,976	160,898	163,026	163,224
Borrowings from FHLB	2	20,126	20,072	38,791	38,790
Junior subordinated debentures	2	8,867	8,879	9,217	9,235
Interest rate swap agreements	2	528	528	603	603
Accrued interest payable	1	158	158	160	160

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