

STEWARDSHIP FINANCIAL CORP
Form 10-Q
November 13, 2015

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended September 30, 2015

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

For the transition period from _____ to _____

Commission file number 1-33377

Stewardship Financial Corporation

(Exact name of registrant as specified in its charter)

New Jersey 22-3351447
(State or other jurisdiction of (I.R.S. Employer Identification No.)
incorporation or organization)

630 Godwin Avenue, Midland Park, NJ 07432
(Address of principal executive offices) (Zip Code)

(201) 444-7100

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(Registrant's telephone number, including area code)

(Former name, former address and former fiscal year, if changed since last report)

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

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

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

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

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes No

The number of shares outstanding, net of treasury stock, of the Registrant's Common Stock, no par value, as of November 9, 2015 was 6,079,986.

Stewardship Financial Corporation

INDEX

PART I - FINANCIAL INFORMATION

ITEM 1 - FINANCIAL STATEMENTS

Consolidated Statements of Financial Condition at September 30, 2015 (Unaudited) and December 31, 2014

Consolidated Statements of Income for the Three and Nine Months ended September 30, 2015 and 2014 (Unaudited)

Consolidated Statements of Comprehensive Income for the Three and Nine Months ended September 30, 2015 and 2014 (Unaudited)

Consolidated Statement of Changes in Shareholders' Equity for the Nine Months ended September 30, 2015 and 2014 (Unaudited)

Consolidated Statements of Cash Flows for the Nine Months ended September 30, 2015 and 2014 (Unaudited)

Notes to Consolidated Financial Statements (Unaudited)

ITEM 2 - MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

ITEM 3 - QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

ITEM 4 - CONTROLS AND PROCEDURES

PART II - OTHER INFORMATION

ITEM 6 - EXHIBITS

SIGNATURES

EXHIBIT INDEX

Index**PART I – FINANCIAL INFORMATION****Item 1. Financial Statements**

Stewardship Financial Corporation and Subsidiary

Consolidated Statements of Financial Condition

	September 30, 2015 (Unaudited)	December 31, 2014
Assets		
Cash and due from banks	\$ 15,825,000	\$ 9,849,000
Other interest-earning assets	200,000	237,000
Cash and cash equivalents	16,025,000	10,086,000
Securities available for sale	86,994,000	124,918,000
Securities held to maturity; estimated fair value of \$61,380,000 (at September 30, 2015) and \$56,233,000 (at December 31, 2014)	60,252,000	55,097,000
FHLB-NY stock, at cost	3,035,000	3,777,000
Mortgage loans held for sale	1,570,000	—
Loans, net of allowance for loan losses of \$8,805,000 (at September 30, 2015) and \$9,602,000 (at December 31, 2014)	509,270,000	467,699,000
Premises and equipment, net	6,883,000	6,577,000
Accrued interest receivable	1,861,000	1,994,000
Other real estate owned, net	587,000	1,308,000
Bank owned life insurance	14,008,000	13,708,000
Other assets	7,164,000	8,387,000
Total assets	\$ 707,649,000	\$ 693,551,000
Liabilities and shareholders' equity		
Liabilities		
Deposits:		
Noninterest-bearing	\$ 151,078,000	\$ 136,721,000
Interest-bearing	434,790,000	419,755,000
Total deposits	585,868,000	556,476,000
Federal Home Loan Bank of New York advances	49,500,000	66,700,000
Subordinated debentures and subordinated notes	23,176,000	7,217,000
Accrued interest payable	487,000	308,000
Accrued expenses and other liabilities	1,600,000	3,881,000
Total liabilities	660,631,000	634,582,000

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Commitments and contingencies	—	—
Shareholders' equity		
Preferred stock, no par value; 2,500,000 shares authorized; 15,000 shares issued and outstanding at December 31, 2014.		
Liquidation preference of \$15,000,000	—	14,984,000
Common stock, no par value; 10,000,000 shares authorized; 6,093,282 and 6,034,933 shares issued and outstanding at September 30, 2015 and December 31, 2014, respectively	41,444,000	41,125,000
Retained earnings	5,959,000	3,817,000
Accumulated other comprehensive loss, net	(385,000)	(957,000)
Total shareholders' equity	47,018,000	58,969,000
Total liabilities and shareholders' equity	\$ 707,649,000	\$ 693,551,000

See notes to unaudited consolidated financial statements.

Index

Stewardship Financial Corporation and Subsidiary

Consolidated Statements of Income

(Unaudited)

	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2015	2014	2015	2014
Interest income:				
Loans	\$5,689,000	\$5,125,000	\$16,758,000	\$15,478,000
Securities held to maturity				
Taxable	243,000	193,000	683,000	374,000
Non-taxable	114,000	154,000	363,000	501,000
Securities available for sale				
Taxable	320,000	565,000	1,024,000	1,940,000
Non-taxable	6,000	6,000	18,000	18,000
FHLB dividends	30,000	22,000	93,000	71,000
Other interest-earning assets	10,000	4,000	27,000	18,000
Total interest income	6,412,000	6,069,000	18,966,000	18,400,000
Interest expense:				
Deposits	545,000	433,000	1,503,000	1,352,000
Repurchase agreements	—	72,000	—	254,000
FHLB-NY borrowing	213,000	159,000	640,000	457,000
Subordinated debentures and subordinated notes	235,000	127,000	485,000	377,000
Total interest expense	993,000	791,000	2,628,000	2,440,000
Net interest income before provision for loan losses	5,419,000	5,278,000	16,338,000	15,960,000
Provision for loan losses	(400,000)	250,000	(1,100,000)	250,000
Net interest income after provision for loan losses	5,819,000	5,028,000	17,438,000	15,710,000
Noninterest income:				
Fees and service charges	541,000	510,000	1,577,000	1,435,000
Bank owned life insurance	103,000	100,000	300,000	302,000
Gain on calls and sales of securities	—	—	152,000	—
Gain on sales of mortgage loans	52,000	32,000	117,000	46,000
Loss on sale of loans	—	—	—	(241,000)
Gain on sale of other real estate owned	—	—	53,000	54,000
Miscellaneous	142,000	122,000	439,000	374,000
Total noninterest income	838,000	764,000	2,638,000	1,970,000
Noninterest expenses:				
Salaries and employee benefits	2,785,000	2,624,000	8,181,000	7,859,000
Occupancy, net	427,000	439,000	1,317,000	1,514,000
Equipment	175,000	167,000	496,000	530,000
Data processing	468,000	433,000	1,380,000	1,255,000

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Advertising	195,000	288,000	665,000	629,000
FDIC insurance premium	87,000	133,000	317,000	477,000
Charitable contributions	90,000	45,000	230,000	135,000
Miscellaneous	898,000	860,000	2,693,000	2,790,000
Total noninterest expenses	5,125,000	4,989,000	15,279,000	15,189,000
Income before income tax expense	1,532,000	803,000	4,797,000	2,491,000
Income tax expense	532,000	251,000	1,658,000	707,000
Net income	1,000,000	552,000	3,139,000	1,784,000
Dividends on preferred stock	114,000	170,000	456,000	512,000
Net income available to common shareholders	\$886,000	\$382,000	\$2,683,000	\$1,272,000
Basic and diluted earnings per common share	\$0.15	\$0.06	\$0.44	\$0.21
Weighted average number of basic and diluted common shares outstanding	6,091,627	6,026,848	6,074,763	5,994,800

See notes to unaudited consolidated financial statements.

Index

Stewardship Financial Corporation and Subsidiary

Consolidated Statements of Comprehensive Income

(Unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2015	2014	2015	2014
Net income	\$1,000,000	\$552,000	\$3,139,000	\$1,784,000
Other comprehensive income (loss), net of tax:				
Change in unrealized holding gains (losses) on securities available for sale	265,000	(187,000)	403,000	2,473,000
Reclassification adjustment for gains in net income	—	—	(91,000)	—
Loss on securities reclassified from available for sale to held to maturity	—	—	—	(457,000)
Accretion of loss on securities reclassified to held to maturity	29,000	36,000	150,000	47,000
Change in fair value of interest rate swap	39,000	44,000	110,000	112,000
Total other comprehensive income (loss)	333,000	(107,000)	572,000	2,175,000
Total comprehensive income	\$1,333,000	\$445,000	\$3,711,000	\$3,959,000

See notes to unaudited consolidated financial statements.

Index

Stewardship Financial Corporation and Subsidiary

Consolidated Statement of Changes in Shareholders' Equity

(Unaudited)

	Nine Months Ended September 30, 2015					Accumulated Other Comprehensive Income, Net	Total
	Preferred Stock	Common Stock Shares	Amount	Retained Earnings			
Balance -- December 31, 2014	\$ 14,984,000	6,034,933	\$41,125,000	\$3,817,000	\$(957,000)	\$58,969,000	
Cash dividends paid on common stock	—	—	—	(364,000)	—	(364,000)	
Payment of discount on dividend reinvestment plan	—	—	(2,000)	—	—	(2,000)	
Cash dividends declared on preferred stock	—	—	—	(456,000)	—	(456,000)	
Common stock issued under dividend reinvestment plan	—	8,204	44,000	—	—	44,000	
Common stock issued under stock plans	—	6,233	33,000	—	—	33,000	
Issuance of restricted stock	—	50,974	279,000	(279,000)	—	—	
Amortization of restricted stock, net	—	(7,062)	(38,000)	118,000	—	80,000	
Tax benefit from restricted stock vesting	—	—	3,000	—	—	3,000	
Amortization of issuance costs	16,000	—	—	(16,000)	—	—	
Repurchase of SBLF preferred stock	(15,000,000)	—	—	—	—	(15,000,000)	
Net income	—	—	—	3,139,000	—	3,139,000	
Other comprehensive income	—	—	—	—	572,000	572,000	
Balance -- September 30, 2015	\$—	6,093,282	\$41,444,000	\$5,959,000	\$(385,000)	\$47,018,000	

	Nine Months Ended September 30, 2014					Accumulated Other Comprehensive Income, Net	Total
	Preferred Stock	Common Stock Shares	Amount	Retained Earnings			
Balance -- December 31, 2013	\$ 14,974,000	5,943,767	\$40,690,000	\$1,905,000	\$(3,790,000)	\$53,779,000	
Cash dividends paid on common stock	—	—	—	(179,000)	—	(179,000)	
Payment of discount on dividend reinvestment plan	—	—	(1,000)	—	—	(1,000)	
Cash dividends declared on preferred stock	—	—	—	(512,000)	—	(512,000)	
Common stock issued under dividend reinvestment plan	—	5,097	23,000	—	—	23,000	
Common stock issued under stock plans	—	30,776	141,000	—	—	141,000	

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Issuance of restricted stock	—	49,661	249,000	(249,000)	—	—
Amortization of restricted stock	—	—	—	48,000	—	48,000
Amortization of issuance costs	7,000	—	—	(7,000)	—	—
Net income	—	—	—	1,784,000	—	1,784,000
Other comprehensive income	—	—	—	—	2,175,000	2,175,000
Balance -- September 30, 2014	\$ 14,981,000	6,029,301	\$ 41,102,000	\$ 2,790,000	\$(1,615,000)	\$ 57,258,000

See notes to unaudited consolidated financial statements.

Index

Stewardship Financial Corporation and Subsidiary

Consolidated Statements of Cash Flows

(Unaudited)

	Nine Months Ended	
	September 30,	
	2015	2014
Cash flows from operating activities:		
Net income	\$3,139,000	\$1,784,000
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization of premises and equipment	290,000	320,000
Amortization of premiums and accretion of discounts, net	514,000	725,000
Amortization of restricted stock	80,000	48,000
Amortization of subordinated debenture issuance costs	6,000	—
Accretion (amortization) of deferred loan fees	66,000	37,000
Provision for loan losses	(1,100,000)	250,000
Originations of mortgage loans held for sale	(9,037,000)	(3,346,000)
Proceeds from sale of mortgage loans	7,584,000	3,028,000
Proceeds from sale of loans	—	2,559,000
Gain on sales of mortgage loans	(117,000)	(46,000)
Loss on sale of loans	—	241,000
Gain on calls and sales of securities	(152,000)	—
Gain on sale of other real estate owned	(53,000)	(54,000)
Deferred income tax expense	331,000	(154,000)
Decrease in accrued interest receivable	133,000	214,000
Increase (decrease) in accrued interest payable	179,000	(127,000)
Earnings on bank owned life insurance	(300,000)	(302,000)
Decrease in other assets	718,000	907,000
Decrease in other liabilities	(2,172,000)	1,785,000
Net cash provided by operating activities	109,000	7,869,000
Cash flows from investing activities:		
Purchase of securities available-for-sale	(85,000)	(7,835,000)
Proceeds from maturities and principal repayments on securities available-for-sale	9,451,000	14,086,000
Proceeds from sales and calls on securities available-for-sale	28,845,000	1,000,000
Purchase of securities held to maturity	(18,462,000)	(8,799,000)
Proceeds from maturities and principal repayments on securities held to maturity	7,397,000	6,083,000
Proceeds from calls on securities held to maturity	6,000,000	—
Sale (purchase) of FHLB-NY stock	742,000	(749,000)
Net increase in loans	(41,014,000)	(11,187,000)
Proceeds from sale of other real estate owned	1,149,000	594,000
Additions to premises and equipment	(596,000)	(1,109,000)
Net cash used in investing activities	(6,573,000)	(7,916,000)

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Cash flows from financing activities:		
Net increase in noninterest-bearing deposits	14,357,000	6,780,000
Net increase (decrease) in interest-bearing deposits	15,035,000	(27,360,000)
Net increase in long term borrowings	—	5,000,000
Repurchase of SBLF preferred stock	(15,000,000)	—
Proceeds from issuance of subordinated notes	15,953,000	—
Net increase in securities sold under agreements to repurchase	—	(7,200,000)
Net increase (decrease) in short term borrowings	(17,200,000)	16,800,000
Cash dividends paid on common stock	(364,000)	(179,000)
Cash dividends paid on preferred stock	(456,000)	(512,000)
Payment of discount on dividend reinvestment plan	(2,000)	(1,000)
Issuance of common stock	77,000	164,000
Tax benefit from restricted stock vesting	3,000	—
Net cash provided by (used in) financing activities	12,403,000	(6,508,000)
Net increase (decrease) in cash and cash equivalents	5,939,000	(6,555,000)
Cash and cash equivalents - beginning	10,086,000	17,405,000
Cash and cash equivalents - ending	\$16,025,000	\$10,850,000

Index

Stewardship Financial Corporation and Subsidiary

Consolidated Statements of Cash Flows (continued)

(Unaudited)

	Nine Months Ended September 30,	
	2015	2014
Supplemental disclosures of cash flow information:		
Cash paid during the period for interest	\$2,449,000	\$2,567,000
Cash paid during the period for income taxes	1,736,000	183,000
Reclassification of securities available-for-sale to held to maturity	—	24,022,000
Transfers from loans to other real estate owned	477,000	2,267,000

See notes to unaudited consolidated financial statements.

Index

Stewardship Financial Corporation and Subsidiary

Notes to Consolidated Financial Statements

September 30, 2015

(Unaudited)

Note 1. Summary of Significant Accounting Policies

Certain information and note disclosures normally included in the unaudited consolidated financial statements prepared in accordance with U.S. generally accepted accounting principles (“GAAP”) have been omitted pursuant to the rules and regulations of the Securities and Exchange Commission (the “SEC”). These unaudited consolidated financial statements should be read in conjunction with the audited consolidated financial statements and notes thereto included in the Stewardship Financial Corporation Annual Report on Form 10-K for the fiscal year ended December 31, 2014, filed with the SEC on March 27, 2015 (the “2014 Annual Report”).

The interim unaudited consolidated financial statements included herein have been prepared in accordance with instructions for Form 10-Q and the rules and regulations of the SEC and, therefore, do not include information or footnotes necessary for a complete presentation of consolidated financial condition, results of operations, and cash flows in conformity with GAAP. However, all adjustments, consisting only of normal recurring adjustments, which in the opinion of management are necessary for a fair presentation of the interim consolidated financial statements, have been included. The results of operations for the nine months ended September 30, 2015 are not necessarily indicative of the results which may be expected for the entire year.

Principles of consolidation

The consolidated financial statements include the accounts of Stewardship Financial Corporation and its wholly-owned subsidiary, Atlantic Stewardship Bank (the “Bank”), together referred to as “the Corporation”. The Bank includes its wholly-owned subsidiaries, Stewardship Investment Corporation, Stewardship Realty LLC, Atlantic Stewardship Insurance Company, LLC and several other subsidiaries formed to hold title to properties acquired through foreclosure or deed in lieu of foreclosure. The Bank’s subsidiaries have an insignificant impact on the Bank’s daily operations. All intercompany accounts and transactions have been eliminated in the consolidated financial statements. Certain amounts included in the prior period consolidated financial statements have been reclassified to conform to the current period presentation.

The consolidated financial statements of the Corporation have been prepared in conformity with GAAP. In preparing the consolidated financial statements, management is required to make estimates and assumptions, based on available information, that affect the amounts reported in the consolidated financial statements and disclosures provided. Actual results could differ significantly from those estimates.

Material estimates

Material estimates that are particularly susceptible to significant changes relate to the determination of the allowance for loan losses and deferred income taxes. Management believes the Corporation's policies with respect to the methodology for the determination of the allowance for loan losses and the evaluation of deferred income taxes involves a higher degree of complexity and requires management to make difficult and subjective judgments, which often require assumptions or estimates about highly uncertain matters. Changes in these judgments, assumptions or estimates could materially impact results of operations. These critical policies and their application are periodically reviewed with the Audit Committee and the Board of Directors.

Adoption of New Accounting Standards

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

Index

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

Note 2. Securities – Available-for-Sale and Held to Maturity

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

	September 30, 2015			
	Amortized Cost	Gross Gains	Unrealized Losses	Fair Value
U.S. government-sponsored agencies Obligations of state and political subdivisions	\$23,110,000	\$106,000	\$155,000	\$23,061,000
Mortgage-backed securities - residential	1,412,000	4,000	9,000	1,407,000
Asset-backed securities (a)	45,982,000	437,000	269,000	46,150,000
Corporate debt	9,876,000	—	137,000	9,739,000
	3,001,000	4,000	8,000	2,997,000
Total debt securities	83,381,000	551,000	578,000	83,354,000
Other equity investments	3,750,000	—	110,000	3,640,000
	\$87,131,000	\$551,000	\$688,000	\$86,994,000
	December 31, 2014			
	Amortized Cost	Gross Gains	Unrealized Losses	Fair Value
U.S. government-sponsored agencies Obligations of state and political subdivisions	\$30,701,000	\$94,000	\$521,000	\$30,274,000
Mortgage-backed securities - residential	1,420,000	2,000	22,000	1,400,000
Asset-backed securities (a)	76,894,000	521,000	672,000	76,743,000
Corporate debt	9,874,000	57,000	16,000	9,915,000
	2,998,000	6,000	7,000	2,997,000
Total debt securities	121,887,000	680,000	1,238,000	121,329,000

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Other equity investments	3,664,000	—	75,000	3,589,000
	\$125,551,000	\$680,000	\$1,313,000	\$124,918,000

(a) Collateralized by student loans

Cash proceeds realized from sales and calls of securities available-for-sale for the three and nine months ended September 30, 2015 were \$1,000,000 and \$28,845,000, respectively. For the three and nine months ended September 30, 2014, cash proceeds realized from sales and calls of securities available-for-sale were \$1,000,000. While there were no gross gains and no gross losses realized on sales or calls during the three months ended September 30, 2015, gross gains and gross losses realized on sales and calls during the nine months ended September 30, 2015 totaled \$213,000 and \$61,000, respectively. There were no gross gains and no gross losses realized on sales or calls during the three and nine months ended September 30, 2014.

Index

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

	September 30, 2015			Fair Value
	Amortized Cost	Gross Gains	Unrealized Losses	
U.S. Treasury	\$998,000	\$5,000	\$—	\$1,003,000
U.S. government-sponsored agencies	12,601,000	228,000	—	12,829,000
Obligations of state and political subdivisions	11,871,000	341,000	—	12,212,000
Mortgage-backed securities - residential	34,782,000	580,000	26,000	35,336,000
	\$60,252,000	\$1,154,000	\$26,000	\$61,380,000

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

Cash proceeds realized from calls of securities held to maturity for the three and nine months ended September 30, 2015 were \$900,000 and \$6,000,000, respectively. There were no cash proceeds realized from calls of securities held to maturity for the three and nine months ended September 30, 2014. There were no gross gains and no gross losses realized on calls during the three and nine months ended September 30, 2015 or 2014.

Mortgage-backed securities are a type of asset-backed security secured by a mortgage or collection of mortgages, purchased by government agencies such as the Government National Mortgage Association and government sponsored agencies such as the Federal National Mortgage Association ("FNMA") and the Federal Home Loan Mortgage Corporation, which then issue securities that represent claims on the principal and interest payments made by borrowers on the loans in the pool.

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

Index

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

	September 30, 2015	
	Amortized Cost	Fair Value
Available-for-sale		
Within one year	\$ 500,000	\$ 500,000
After one year, but within five years	12,987,000	12,988,000
After five years, but within ten years	6,792,000	6,878,000
After ten years	7,244,000	7,099,000
Mortgage-backed securities - residential	45,982,000	46,150,000
Asset-backed securities	9,876,000	9,739,000
Total	\$83,381,000	\$83,354,000
Held to maturity		
Within one year	\$3,100,000	\$3,159,000
After one year, but within five years	12,446,000	12,743,000
After five years, but within ten years	8,979,000	9,161,000
After ten years	945,000	981,000
Mortgage-backed securities - residential	34,782,000	35,336,000
Total	\$60,252,000	\$61,380,000

The following tables summarize the fair value and unrealized losses of those investment securities which reported an unrealized loss at September 30, 2015 and December 31, 2014, and if the unrealized loss position was continuous for the twelve months prior to September 30, 2015 and December 31, 2014.

Index

Available-for-Sale September 30, 2015	Less than 12 Months		12 Months or Longer		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
U.S. government-sponsored agencies	\$2,080,000	\$(3,000)	\$9,592,000	\$(152,000)	\$11,672,000	\$(155,000)
Obligations of state and political subdivisions	999,000	(9,000)	—	—	999,000	(9,000)
Mortgage-backed securities - residential	2,058,000	(7,000)	17,122,000	(262,000)	19,180,000	(269,000)
Asset-backed securities	9,738,000	(137,000)	—	—	9,738,000	(137,000)
Corporate debt	—	—	1,492,000	(8,000)	1,492,000	(8,000)
Other equity investments	—	—	3,580,000	(110,000)	3,580,000	(110,000)
Total temporarily impaired securities	\$14,875,000	\$(156,000)	\$31,786,000	\$(532,000)	\$46,661,000	\$(688,000)
December 31, 2014	Less than 12 Months		12 Months or Longer		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
U.S. government-sponsored agencies	\$—	\$—	\$23,750,000	\$(521,000)	\$23,750,000	\$(521,000)
Obligations of state and political subdivisions	—	—	992,000	(22,000)	992,000	(22,000)
Mortgage-backed securities - residential	5,985,000	(22,000)	30,445,000	(650,000)	36,430,000	(672,000)
Asset-backed securities	3,022,000	(16,000)	—	—	3,022,000	(16,000)
Corporate debt	—	—	1,494,000	(7,000)	1,494,000	(7,000)
Other equity investments	—	—	3,529,000	(75,000)	3,529,000	(75,000)
Total temporarily impaired securities	\$9,007,000	\$(38,000)	\$60,210,000	\$(1,275,000)	\$69,217,000	\$(1,313,000)
Held to Maturity September 30, 2015	Less than 12 Months		12 Months or Longer		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Mortgage-backed securities - residential	\$2,067,000	\$(5,000)	\$1,129,000	\$(21,000)	\$3,196,000	\$(26,000)
Total temporarily impaired securities	\$2,067,000	\$(5,000)	\$1,129,000	\$(21,000)	\$3,196,000	\$(26,000)

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December 31, 2014	Less than 12 Months		12 Months or Longer		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Mortgage-backed securities - residential	\$8,788,000	\$ (66,000)	\$ —	\$ —	\$8,788,000	\$ (66,000)
Total temporarily impaired securities	\$8,788,000	\$ (66,000)	\$ —	\$ —	\$8,788,000	\$ (66,000)

Other-Than-Temporary-Impairment

At September 30, 2015, there were available-for-sale investments comprising seven U.S. government-sponsored agency securities, seventeen mortgage-backed securities, two corporate debt securities, and an other equity investments security in a continuous loss position for twelve months or longer. There were held to maturity investments consisting of two mortgage-backed securities in a continuous loss position for twelve months or longer at September 30, 2015. Management has assessed the securities that were in an unrealized loss position at September 30, 2015 and December 31, 2014 and has determined that any decline in fair value below amortized cost primarily relate to changes in interest rates and market spreads and was temporary.

Index

In making this determination management considered the following factors in estimating the cash flows expected to be collected from the security: the period of time the securities were in an unrealized loss position; the percentage decline in comparison to the securities' amortized cost; any adverse conditions specifically related to the security, an industry or a geographic area; the rating or changes to the rating by a credit rating agency; the financial condition of the issuer and guarantor and any recoveries or additional declines in fair value subsequent to the balance sheet date. Management expects to collect all amounts contractually due and none of the debt securities can be prepaid at less than the par values.

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

Note 3. Loans and Allowance for Loan Losses

At September 30, 2015 and December 31, 2014, respectively, the loan portfolio consisted of the following:

	September 30, 2015	December 31, 2014
Commercial:		
Secured by real estate	\$41,225,000	\$46,545,000
Other	25,874,000	29,307,000
Commercial real estate	328,500,000	286,063,000
Commercial construction	2,653,000	4,215,000
Residential real estate	81,414,000	77,836,000
Consumer:		
Secured by real estate	28,750,000	27,319,000
Other	637,000	939,000
Government Guaranteed Loans - guaranteed portion	8,944,000	5,000,000
Other	171,000	96,000
Total gross loans	518,168,000	477,320,000
Less: Deferred loan fees, net of costs	93,000	19,000
Allowance for loan losses	8,805,000	9,602,000
	8,898,000	9,621,000
Loans, net	\$ 509,270,000	\$467,699,000

The Corporation has purchased the guaranteed portion of several government guaranteed loans. Due to the guarantee of the principal amount of these loans, no allowance for loan losses is established for these government guaranteed loans.

At September 30, 2015 and December 31, 2014, loan participations sold by the Corporation to other lending institutions totaled approximately \$8,663,000 and \$12,948,000, respectively. These amounts are not included in the totals presented above.

Index

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

	For the three months ended September 30, 2015				
	Balance, beginning of period	Provision charged to operations	Loans charged off	Recoveries of loans charged off	Balance, end of period
Commercial	\$3,317,000	\$ (360,000)	\$ (323,000)	\$ 194,000	\$2,828,000
Commercial real estate	5,289,000	148,000	—	23,000	5,460,000
Commercial construction	14,000	(15,000)	—	12,000	11,000
Residential real estate	140,000	(2,000)	—	—	138,000
Consumer	139,000	12,000	—	1,000	152,000
Other loans	3,000	1,000	(1,000)	—	3,000
Unallocated	397,000	(184,000)	—	—	213,000
Total	\$9,299,000	\$ (400,000)	\$ (324,000)	\$ 230,000	\$8,805,000

	For the nine months ended September 30, 2015				
	Balance, beginning of period	Provision charged to operations	Loans charged off	Recoveries of loans charged off	Balance, end of period
Commercial	\$3,704,000	\$ (701,000)	\$ (595,000)	\$ 420,000	\$2,828,000
Commercial real estate	5,017,000	319,000	—	124,000	5,460,000
Commercial construction	150,000	(492,000)	—	353,000	11,000
Residential real estate	142,000	(4,000)	—	—	138,000
Consumer	189,000	(40,000)	—	3,000	152,000
Other loans	2,000	3,000	(2,000)	—	3,000
Unallocated	398,000	(185,000)	—	—	213,000
Total	\$9,602,000	\$ (1,100,000)	\$ (597,000)	\$ 900,000	\$8,805,000

	For the three months ended September 30, 2014				
	Balance, beginning of period	Provision charged to operations	Loans charged off	Recoveries of loans charged off	Balance, end of period
Commercial	\$3,068,000	\$ 94,000	\$ (76,000)	\$ 23,000	\$3,109,000
Commercial real estate	5,448,000	559,000	(3,000)	75,000	6,079,000
Commercial construction	120,000	54,000	—	—	174,000
Residential real estate	452,000	(121,000)	—	—	331,000
Consumer	259,000	(33,000)	—	1,000	227,000

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Other loans	—	1,000	(1,000)	—	—
Unallocated	478,000	(304,000)	—	—	174,000
Total	\$9,825,000	\$ 250,000	\$ (80,000)	\$ 99,000	\$10,094,000

Index

	For the nine months ended September 30, 2014				
	Balance, beginning of period	Provision charged to operations	Loans charged off	Recoveries of loans charged off	Balance, end of period
Commercial	\$3,373,000	\$ (156,000)	\$ (259,000)	\$ 151,000	\$3,109,000
Commercial real estate	5,665,000	363,000	(89,000)	140,000	6,079,000
Commercial construction	117,000	57,000	—	—	174,000
Residential real estate	460,000	(121,000)	(8,000)	—	331,000
Consumer	288,000	(56,000)	(6,000)	1,000	227,000
Other loans	3,000	(2,000)	(1,000)	—	—
Unallocated	9,000	165,000	—	—	174,000
Total	\$9,915,000	\$ 250,000	\$ (363,000)	\$ 292,000	\$10,094,000

The following table presents the balance in the allowance for loan losses and the recorded investment in loans by portfolio segment and based on the impairment method as of September 30, 2015 and December 31, 2014.

	September 30, 2015							
	Commercial	Commercial Real Estate	Commercial Construction	Residential Real Estate	Consumer	Government Guaranteed	Other Loans	Unall
Allowance for loan losses:								
Ending allowance balance attributable to loans								
Individually evaluated for impairment	\$72,000	\$658,000	\$—	\$—	\$—	\$—	\$—	\$—
Collectively evaluated for impairment	2,756,000	4,802,000	11,000	138,000	152,000	—	3,000	213
Total ending allowance balance	\$2,828,000	\$5,460,000	\$11,000	\$138,000	\$152,000	\$—	\$3,000	\$213
Loans:								
Loans individually evaluated for impairment	\$3,985,000	\$8,153,000	\$250,000	\$89,000	\$200,000	\$—	\$—	\$—
Loans collectively								

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evaluated for impairment	63,114,000	320,347,000	2,403,000	81,325,000	29,187,000	8,944,000	171,000	—
Total ending loan balance	\$67,099,000	\$328,500,000	\$2,653,000	\$81,414,000	\$29,387,000	\$8,944,000	\$171,000	\$—

Index

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

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

	September 30, 2015	December 31, 2014
Commercial:		
Secured by real estate	\$ 1,775,000	\$ 1,923,000
Other	14,000	—
Commercial real estate	496,000	1,284,000
Residential real estate	89,000	96,000
Consumer:		
Secured by real estate	200,000	325,000

Total nonaccrual loans \$ 2,574,000 \$ 3,628,000

At September 30, 2015 and December 31, 2014, there were no loans that were past due 90 days and still accruing.

Index

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

	At and for the nine months ended September 30, 2015				
	Unpaid Principal Balance	Recorded Investment	Allowance for Loan Losses Allocated	Average Recorded Investment	Interest Income Recognized
With no related allowance recorded:					
Commercial:					
Secured by real estate	\$3,662,000	\$3,246,000		\$3,921,000	\$ 133,000
Other	—	—		42,000	2,000
Commercial real estate	3,705,000	2,566,000		2,890,000	91,000
Commercial construction	289,000	250,000		269,000	—
Residential real estate	129,000	89,000		93,000	—
Consumer:					
Secured by real estate	200,000	200,000		262,000	—
With an allowance recorded:					
Commercial:					
Secured by real estate	402,000	310,000	\$ 71,000	430,000	11,000
Other	429,000	429,000	1,000	535,000	24,000
Commercial real estate	5,596,000	5,587,000	658,000	5,610,000	154,000
	\$14,412,000	\$12,677,000	\$ 730,000	\$14,052,000	\$ 415,000

During the nine months ended September 30, 2015, no interest income was recognized on a cash basis.

	At and for the year ended December 31, 2014				
	Unpaid Principal Balance	Recorded Investment	Allowance for Loan Losses Allocated	Average Recorded Investment	Interest Income Recognized
With no related allowance recorded:					
Commercial:					
Secured by real estate	\$5,997,000	\$4,838,000		\$5,443,000	\$ 225,000
Other	66,000	58,000		65,000	3,000
Commercial real estate	4,609,000	3,279,000		6,755,000	155,000
Commercial construction	652,000	288,000		517,000	71,000
Residential real estate	132,000	96,000		526,000	—
Consumer:					
Secured by real estate	333,000	326,000		506,000	—
With an allowance recorded:					
Commercial:					

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Secured by real estate	458,000	436,000	\$ 213,000	437,000	16,000
Other	713,000	710,000	10,000	750,000	44,000
Commercial real estate	5,643,000	5,634,000	697,000	3,922,000	233,000
Commercial construction	—	—	—	420,000	—
	\$18,603,000	\$15,665,000	\$ 920,000	\$19,341,000	\$ 747,000

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

Index

The following table presents the aging of the recorded investment in past due loans by class of loans as of September 30, 2015 and December 31, 2014. Nonaccrual loans are included in the disclosure by payment status.

	September 30, 2015					
	30-59 Days Past Due	60-89 Days Past Due	Greater than		Loans	
			90 Days Past Due	Total Past Due	Not Past Due	Total
Commercial:						
Secured by real estate	\$—	\$ —	\$ 1,479,000	\$ 1,479,000	\$ 39,746,000	\$ 41,225,000
Other	—	—	—	—	25,874,000	25,874,000
Commercial real estate	—	—	350,000	350,000	328,150,000	328,500,000
Commercial construction	—	—	—	—	2,653,000	2,653,000
Residential real estate	—	—	89,000	89,000	81,325,000	81,414,000
Consumer:						
Secured by real estate	41,000	—	200,000	241,000	28,509,000	28,750,000
Other	—	—	—	—	637,000	637,000
Government Guaranteed Loans	—	—	—	—	8,944,000	8,944,000
Other	—	—	—	—	171,000	171,000
Total	\$41,000	\$ —	\$ 2,118,000	\$ 2,159,000	\$ 516,009,000	\$ 518,168,000
	December 31, 2014					
	30-59 Days Past Due	60-89 Days Past Due	Greater than		Loans	
			90 Days Past Due	Total Past Due	Not Past Due	Total
Commercial:						
Secured by real estate	\$546,000	\$ —	\$ 1,508,000	\$ 2,054,000	\$ 44,491,000	\$ 46,545,000
Other	225,000	—	—	225,000	29,082,000	29,307,000
Commercial real estate	—	330,000	836,000	1,166,000	284,897,000	286,063,000
Commercial construction	—	—	—	—	4,215,000	4,215,000
Residential real estate	—	—	—	—	77,836,000	77,836,000
Consumer:						
Secured by real estate	—	—	249,000	249,000	27,070,000	27,319,000
Other	—	—	—	—	939,000	939,000
Government Guaranteed Loans	—	—	—	—	5,000,000	5,000,000
Other	—	—	—	—	96,000	96,000
Total	\$771,000	\$ 330,000	\$ 2,593,000	\$ 3,694,000	\$ 473,626,000	\$ 477,320,000

Troubled Debt Restructurings

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

At September 30, 2015 and December 31, 2014, the Corporation had \$10.7 million and \$12.9 million, respectively, of loans whose terms have been modified in troubled debt restructurings. Of these loans, \$10.1 million and \$12.0 million were performing in accordance with their new terms at September 30, 2015 and December 31, 2014, respectively. The remaining troubled debt restructurings are reported as nonaccrual loans. Specific reserves of \$730,000 and \$868,000 have been allocated for the troubled debt restructurings at September 30, 2015 and December 31, 2014, respectively. As of September 30, 2015 and December 31, 2014, the Corporation has committed \$25,000 and \$0, respectively, of additional funds to a single customer with an outstanding line of credit that is classified as a troubled debt restructuring.

There are no troubled debt restructurings for which there was a payment default within twelve months following the modification.

Index

There were no new loans classified as a troubled debt restructuring during the three and nine months ended September 30, 2015 or September 30, 2014.

Credit Quality Indicators

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

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

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

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

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

Index

Loans not meeting the criteria above that are analyzed individually as part of the above described process are considered to be pass rated loans. As of September 30, 2015 and December 31, 2014, and based on the most recent analysis performed at those times, the risk category of loans by class is as follows:

	September 30, 2015					Total
	Pass	Special Mention	Substandard	Doubtful	Loss	
Commercial:						
Secured by real estate	\$36,792,000	\$2,658,000	\$1,775,000	\$ —	\$ —	\$41,225,000
Other	24,937,000	239,000	698,000	—	—	25,874,000
Commercial real estate	320,507,000	3,136,000	4,857,000	—	—	328,500,000
Commercial construction	2,653,000	—	—	—	—	2,653,000
Total	\$384,889,000	\$6,033,000	\$7,330,000	\$ —	\$ —	\$398,252,000

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

The Corporation considers the performance of the loan portfolio and its impact on the allowance for loans losses. For residential real estate and consumer loan segments, the Corporation also evaluates credit quality based on payment activity. The following table presents the recorded investment in residential real estate and consumer loans based on payment activity as of September 30, 2015 and December 31, 2014.

	September 30, 2015		
	Current	Past Due and Nonaccrual	Total
Residential real estate	\$81,105,000	\$309,000	\$81,414,000
Consumer:			
Secured by real estate	26,666,000	2,084,000	28,750,000
Other	632,000	5,000	637,000
Total	\$108,403,000	\$2,398,000	\$110,801,000

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December 31, 2014

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

19

Index

Note 4. Fair Value of Financial Instruments

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

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

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

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

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

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

The Corporation measures impairment of collateralized loans and other real estate owned ("OREO") based on the estimated fair value of the collateral less estimated costs to sell the collateral, incorporating assumptions that experienced parties might use in estimating the value of such collateral (Level 3 inputs). At the time a loan or OREO is considered impaired, it is valued at the lower of cost or fair value. Generally, impaired loans carried at fair value have been partially charged-off or receive specific allocations of the allowance for loan losses. OREO is initially

recorded at fair value less estimated selling costs. For collateral dependent loans and OREO, fair value is commonly based on real estate appraisals. These appraisals may utilize a single valuation approach or a combination of approaches including comparable sales and the income approach. Adjustments are routinely made in the appraisal process by the independent appraisers to adjust for differences between the comparable sales and income data available. Such adjustments typically result in a Level 3 classification of the inputs for determining fair value. Non-real estate collateral may be valued using an appraisal, the net book value recorded for the collateral on the borrower's financial statements, or aging reports. Collateral is then adjusted or discounted based on management's historical knowledge, changes in market conditions from the time of the valuation, and management's expertise and knowledge of the borrower and borrower's business, resulting in a Level 3 fair value classification. Impaired loans are evaluated on a quarterly basis for additional impairment and adjusted accordingly.

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

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

IndexAssets and Liabilities Measured on a Recurring Basis

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

	Carrying Value At September 30, 2015	Fair Value Measurements Using:		
		Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets:				
Available-for-sale securities				
U.S. government - sponsored agencies	\$23,061,000	\$—	\$23,061,000	\$—
Obligations of state and political subdivisions	1,407,000	—	1,407,000	—
Mortgage-backed securities - residential	46,150,000	—	46,150,000	—
Asset-backed securities	9,739,000	—	9,739,000	—
Corporate debt	2,997,000	—	2,997,000	—
Other equity investments	3,640,000	3,580,000	60,000	—
Total available-for- sale securities	\$86,994,000	\$3,580,000	\$83,414,000	\$—
Liabilities:				
Interest rate swap	\$130,000	\$—	\$130,000	\$—
At December 31, 2014				
Assets:				
Available-for-sale securities				
U.S. government - sponsored agencies	\$30,274,000	\$—	\$30,274,000	\$—
Obligations of state and political subdivisions	1,400,000	—	1,400,000	—
Mortgage-backed securities - residential	76,743,000	—	76,743,000	—
Asset-backed securities	9,915,000	—	9,915,000	—
Corporate debt	2,997,000	—	2,997,000	—
Other equity investments	3,589,000	3,529,000	60,000	—
Total available-for-				

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sale securities	\$124,918,000	\$3,529,000	\$121,389,000	\$—
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Liabilities:

Interest rate swap	\$314,000	\$—	\$314,000	\$—
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There were no transfers of assets between Level 1 and Level 2 during the nine months ended September 30, 2015 or during the year ended December 31, 2014. There were no changes to the valuation techniques for fair value measurements as of September 30, 2015 and December 31, 2014.

IndexAssets and Liabilities Measured on a Non-Recurring Basis

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

	Fair Value Measurements Using:			
	Carrying Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
At September 30, 2015				
Assets:				
Impaired loans				
Commercial:				
Secured by real estate	\$ 382,000	\$ —	\$ —	\$ 382,000
Other Real Estate Owned	587,000	—	—	587,000
	\$ 969,000	\$ —	\$ —	\$ 969,000

At December 31, 2014

Assets:				
Impaired loans				
Commercial:				
Secured by real estate	\$ 1,348,000	\$—	\$—	\$ 1,348,000
Commercial real estate	205,000	—	—	205,000
Consumer				
Secured by real estate	49,000	—	—	49,000
Other Real Estate Owned	1,117,000	—	—	1,117,000
	\$ 2,719,000	\$—	\$—	\$ 2,719,000

Collateral-dependent impaired loans measured for impairment using the fair value of the collateral had a recorded investment value of \$382,000, with no valuation allowance, resulting in an increase of the provision for loan losses of \$6,000 for the nine months ended September 30, 2015.

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

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OREO had a recorded investment value of \$757,000 with a \$170,000 valuation allowance at September 30, 2015. At December 31, 2014, OREO had a recorded investment value of \$1,375,000 with a \$67,000 valuation allowance. Additional valuation allowances of \$170,000 were recorded during the nine months ended September 30, 2015. Additional valuation allowances of \$143,000 were recorded during the nine months ended September 30, 2014.

For the Level 3 assets measured at fair value on a non-recurring basis at September 30, 2015 and December 31, 2014, the significant unobservable inputs used in the fair value measurements were as follows:

22

Index

September 30, 2015

Assets	Fair Value	Valuation Technique	Unobservable Inputs	Range
Impaired loans	\$382,000	Comparable real estate sales and / or the income approach.	Adjustments for differences between comparable sales and income data available. Estimated selling costs.	0% - 5% 7%
Other real estate owned	\$587,000	Comparable real estate sales and / or the income approach.	Adjustments for differences between comparable sales and income data available. Estimated selling costs.	0% - 61% 7%

December 31, 2014

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

Index

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

	Carrying Value At September 30, 2015	Fair Value Measurements Using:		
		Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Financial assets:				
Cash and cash equivalents	\$ 16,025,000	\$ 16,025,000	\$—	\$—
Securities available-for-sale	86,994,000	3,580,000	83,414,000	—
Securities held to maturity	60,252,000	—	61,380,000	—
FHLB-NY stock	3,035,000	N/A	N/A	N/A
Mortgage loans held for sale	1,570,000	—	—	1,570,000
Loans, net	509,270,000	—	—	513,014,000
Accrued interest receivable	1,861,000	—	465,000	1,396,000
Financial liabilities:				
Deposits	585,868,000	443,009,000	143,487,000	—
FHLB-NY advances	49,500,000	—	49,972,000	—
Subordinated debentures and subordinated notes	23,176,000	—	—	23,159,000
Accrued interest payable	487,000	1,000	365,000	121,000
Interest rate swap	130,000	—	130,000	—

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

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

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

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

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

Index

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

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

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

Accrued interest receivable – The carrying amount approximates fair value.

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

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

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

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

Accrued interest payable – The carrying amount approximates fair value.

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

Commitments to extend credit – The fair value of commitments is estimated using the fees currently charged to enter into similar agreements, taking into account the remaining terms of the agreements and the present credit worthiness of the counter parties. At September 30, 2015 and December 31, 2014 the fair value of such commitments were not material.

Limitations

The preceding fair value estimates were made at September 30, 2015 and December 31, 2014 based on pertinent market data and relevant information concerning the financial instruments. These estimates do not include any premiums or discounts that could result from an offer to sell at one time the Corporation's entire holdings of a particular financial instrument or category thereof. Since no market exists for a substantial portion of the Corporation's financial instruments, fair value estimates were necessarily based on judgments with respect to future expected loss experience, current economic conditions, risk assessments of various financial instruments, and other factors. Given the subjective nature of these estimates, the uncertainties surrounding them and the matters of significant judgment that must be applied, these fair value estimates cannot be calculated with precision. Modifications in such assumptions could meaningfully alter these estimates.

Since these fair value approximations were made solely for on- and off-balance sheet financial instruments at September 30, 2015 and December 31, 2014, no attempt was made to estimate the value of anticipated future business. Furthermore, certain tax implications related to the realization of unrealized gains and losses could have a substantial impact on these fair value estimates and have not been incorporated into the estimates.

Index**Note 5. Earnings Per Share**

Basic earnings per share is calculated by dividing net income available to common shareholders by the weighted average number of common shares outstanding during the period. Common stock equivalents are not included in the calculation. Diluted earnings per share is computed similar to that of basic earnings per share except that the denominator is increased to include the number of additional common shares that would have been outstanding if all potential dilutive common shares were issued.

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2015	2014	2015	2014
Net income	\$1,000,000	\$552,000	\$3,139,000	\$1,784,000
Dividends on preferred stock	114,000	170,000	456,000	512,000
Net income available to common stockholders	\$886,000	\$382,000	\$2,683,000	\$1,272,000
Weighted average common shares outstanding - basic	6,091,627	6,026,848	6,074,763	5,994,800
Effect of dilutive securities - stock options	N/A	N/A	N/A	N/A
Weighted average common shares outstanding - diluted	6,091,627	6,026,848	6,074,763	5,994,800
Basic earnings per common share	\$0.15	\$0.06	\$0.44	\$0.21
Diluted earnings per common share	\$0.15	\$0.06	\$0.44	\$0.21

There were no stock options to purchase shares of common stock for the three and nine months ended September 30, 2015.

Index**Note 6. Subordinated Debt**

Issue	Maturity	Rate	Carrying Amount	
			September 30, 2015	December 31, 2014
9/17/2003	9/17/2033	Fixed / Floating Rate Junior Subordinated Debentures	\$7,217,000	\$ 7,217,000
8/28/2015	8/25/2025	Fixed Rate Subordinated Notes	15,959,000	—
			\$23,176,000	\$ 7,217,000

In 2003, the Corporation formed Stewardship Statutory Trust I (the “Trust”), a statutory business trust, which on September 17, 2003 issued \$7.0 million Fixed/Floating Rate Capital Securities (“Capital Securities”). The Trust used the proceeds to purchase from the Corporation, \$7,217,000 of Fixed/Floating Rate Junior Subordinated Deferrable Interest Debentures (the “Subordinated Debentures”) maturing September 17, 2033. The Trust is obligated to distribute all proceeds of a redemption whether voluntary or upon maturity, to holders of the Capital Securities. The Corporation’s obligation with respect to the Capital Securities, and the Debentures, when taken together, provide a full and unconditional guarantee on a subordinated basis by the Corporation of the Trust’s obligations to pay amounts when due on the Capital Securities. The Corporation is not considered the primary beneficiary of this Trust (variable interest entity); therefore, the Trust is not consolidated in the Corporation’s consolidated financial statements, but rather the Subordinated Debentures are shown as a liability. Prior to September 17, 2008, the Capital Securities and the Subordinated Debentures both had a fixed interest rate of 6.75%. Beginning September 17, 2008, the rate floats quarterly at a rate of three month LIBOR plus 2.95%. At September 30, 2015 and December 31, 2014, the rate on both the Capital Securities and the Subordinated Debentures was 3.28% and 3.19%, respectively. The Corporation has the right to defer payments of interest on the Subordinated Debentures by extending the interest payment period for up to 20 consecutive quarterly periods. The Subordinated Debentures may be included in Tier 1 capital (with certain limitations applicable) under current regulatory guidelines and interpretations.

On August 28, 2015, the Corporation completed a private placement of \$16.6 million in aggregate principal amount of fixed rate subordinated notes (the “Subordinated Notes”) to certain institutional accredited investors pursuant to a Subordinated Note Purchase Agreement dated August 28, 2015 between the Corporation and such investors. The Subordinated Notes have a maturity date of August 28, 2025 and bear interest at the rate of 6.75% per annum, payable semi-annually, in arrears, on March 1 and September 1 of each year during the time that the Subordinated Notes remain outstanding. The Subordinated Notes include a right of prepayment, without penalty, on or after August 28, 2020 and, in certain limited circumstances, before that date. The indebtedness evidenced by the Subordinated Notes, including principal and interest, is unsecured and subordinate and junior in right of the Company's payment to general and secured creditors and depositors of the Bank. The Subordinated Notes have been structured to qualify as Tier 2 capital for regulatory purposes. The Subordinated Notes totaled \$16.0 million at September 30, 2015, which includes \$641,000 of remaining unamortized debt issuance costs. The debt issuance costs are being amortized over the expected life of the issue. The net cash proceeds of the Subordinated Notes were used to redeem the Series B Preferred Shares as discussed in Note 7.

Note 7. Preferred Stock

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

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

Index**Note 8. Accumulated Other Comprehensive Income (Loss)**

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

	Three Months Ended September 30, 2015			September 30, 2014		
	Gross	Tax Effect	Net	Gross	Tax Effect	Net
Net income	\$1,532,000	\$(532,000)	\$1,000,000	\$803,000	\$(251,000)	\$552,000
Other comprehensive (loss) income:						
Change in unrealized holding gains (losses) on securities available-for-sale	422,000	(157,000)	265,000	(303,000)	116,000	(187,000)
Accretion of loss on securities reclassified to held to maturity	48,000	(19,000)	29,000	58,000	(22,000)	36,000
Change in fair value of interest rate swap	64,000	(25,000)	39,000	73,000	(29,000)	44,000
Total other comprehensive income (loss)	534,000	(201,000)	333,000	(172,000)	65,000	(107,000)
Total comprehensive income (loss)	\$2,066,000	\$(733,000)	\$1,333,000	\$631,000	\$(186,000)	\$445,000
	Nine Months Ended September 30, 2015			September 30, 2014		
	Gross	Tax Effect	Net	Gross	Tax Effect	Net
Net income	\$4,797,000	\$(1,658,000)	\$3,139,000	\$2,491,000	\$(707,000)	\$1,784,000
Other comprehensive (loss) income:						
Change in unrealized holding gains (losses) on securities available-for-sale	648,000	(245,000)	403,000	4,040,000	(1,567,000)	2,473,000
Reclassification adjustment for gains in net income	(152,000)	61,000	(91,000)	—	—	—
Loss on securities reclassified from available-for-sale to held to maturity	—	—	—	(742,000)	285,000	(457,000)
Accretion of loss on securities						

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reclassified to held to maturity	243,000	(93,000)	150,000	76,000	(29,000)	47,000
Change in fair value of interest rate swap	183,000	(73,000)	110,000	187,000	(75,000)	112,000
Total other comprehensive income (loss)	922,000	(350,000)	572,000	3,561,000	(1,386,000)	2,175,000
Total comprehensive income (loss)	\$5,719,000	\$(2,008,000)	\$3,711,000	\$6,052,000	\$(2,093,000)	\$3,959,000

Index

The following table presents the after-tax changes in the balances of each component of accumulated other comprehensive income for the three and nine months ended September 30, 2015 and 2014.

	Three Months Ended September 30, 2015			
	Components of Accumulated Other Comprehensive Income (Loss)			Total
	Unrealized Gains and (Losses) on Available-for-Sale Securities	Loss on securities reclassified from Available-for-Sale to Held to Maturity	Unrealized Gains and (Losses) on Derivatives	Accumulated Other Comprehensive Income (Loss)
Balance at June 30, 2015	\$ (345,000)	\$ (256,000)	) \$ (117,000)	) \$ (718,000)
Other comprehensive income (loss) before reclassifications	265,000	29,000	39,000	333,000
Other comprehensive income (loss), net	265,000	29,000	39,000	333,000
Balance at September 30, 2015	\$ (80,000)	) \$ (227,000)	) \$ (78,000)	) \$ (385,000)

	Nine Months Ended September 30, 2015			
	Components of Accumulated Other Comprehensive Income (Loss)			Total
	Unrealized Gains and (Losses) on Available-for-Sale Securities	Loss on securities reclassified from Available-for-Sale to Held to Maturity	Unrealized Gains and (Losses) on Derivatives	Accumulated Other Comprehensive Income (Loss)
Balance at December 31, 2014	\$ (392,000)	\$ (377,000)	) \$ (188,000)	) \$ (957,000)
Other comprehensive income (loss) before reclassifications	403,000	150,000	110,000	663,000
Amounts reclassified from other comprehensive income	(91,000)	—	—	(91,000)
Other comprehensive income (loss), net	312,000	150,000	110,000	572,000
Balance at September 30, 2015	\$ (80,000)	) \$ (227,000)	) \$ (78,000)	) \$ (385,000)

Index

	Three Months Ended September 30, 2014			
	Components of Accumulated			Total
	Other Comprehensive Income (Loss)			
	Unrealized	Loss on securities	Unrealized	Accumulated
	Gains		Gains and	Other
	and	reclassified from	(Losses) on	Comprehensive
	(Losses)	Available-for-Sale	Derivatives	Income (Loss)
	on	to Held to Maturity		
	Available-for-Sale			
	(AFS)			
	Securities			
Balance at June 30, 2014	\$ (795,000)	\$ (446,000)	) \$ (267,000)	) \$ (1,508,000)
Other comprehensive income (loss) before reclassifications	(187,000)	36,000	44,000	(107,000)
Other comprehensive income (loss), net	(187,000)	36,000	44,000	(107,000)
Balance at September 30, 2014	\$ (982,000)	\$ (410,000)	) \$ (223,000)	) \$ (1,615,000)

	Nine Months Ended September 30, 2014			
	Components of Accumulated			Total
	Other Comprehensive Income (Loss)			
	Unrealized	Loss on securities	Unrealized	Accumulated
	Gains		Gains and	Other
	and	reclassified from	(Losses) on	Comprehensive
	(Losses) on	Available-for-Sale	Derivatives	Income (Loss)
	on	to Held to Maturity		
	Available-for-Sale			
	(AFS)			
	Securities			
Balance at December 31, 2013	\$ (3,455,000)	\$ —	) \$ (335,000)	) \$ (3,790,000)
Other comprehensive income (loss) before reclassifications	2,473,000	(410,000)	) 112,000	2,175,000
Other comprehensive income (loss), net	2,473,000	(410,000)	) 112,000	2,175,000
Balance at September 30, 2014	\$ (982,000)	) \$ (410,000)	) \$ (223,000)	) \$ (1,615,000)

The following table presents amounts reclassified from each component of accumulated other comprehensive income on a gross and net of tax basis for the three and nine months ended September 30, 2015 and 2014.

	Three and	Income
	Nine Months Ended	Statement
	September 30,	Line Item
	2015	2014
Components of Accumulated Other Comprehensive Income (Loss)		

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Unrealized gains on AFS securities before tax	\$ 152,000	\$ —	Gains on securities transactions, net
Tax effect	(61,000)	—	
Total net of tax	91,000	—	
Total reclassifications, net of tax	\$ 91,000	\$ —	

30

Index

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

Cautionary Note Regarding Forward-Looking Statements

This Quarterly Report on Form 10-Q contains certain "forward-looking statements" with respect to Stewardship Financial Corporation (the "Corporation") within the meaning of the Private Securities Litigation Reform Act of 1995, which forward looking statements may be identified by the use of such words as "expect," "believe," "anticipate," "should," "plan," "estimate," and "potential." Examples of forward-looking statements include, but are not limited to, estimates with respect to the financial condition, results of operations and business of the Corporation that are subject to various factors which could cause actual results to differ materially from these estimates. These factors include: changes in general, economic and market conditions, legislative and regulatory conditions, or the development of an interest rate environment that adversely affects the Corporation's interest rate spread or other income anticipated from operations and investments. As used in this Form 10-Q, "we", "us" and "our" refer to the Corporation and its consolidated subsidiary, Atlantic Stewardship Bank (the "Bank"), depending on the context.

Critical Accounting Policies and Estimates

"Management's Discussion and Analysis of Financial Condition and Results of Operations," as well as disclosures found elsewhere in this Quarterly Report on Form 10-Q, are based upon the Corporation's consolidated financial statements, which have been prepared in conformity with U.S. generally accepted accounting principles ("GAAP"). The preparation of these financial statements requires the Corporation to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses. Note 1 to the Corporation's Audited Consolidated Financial Statements for the year ended December 31, 2014 included in the Corporation's 2014 Annual Report contains a summary of the Corporation's significant accounting policies. Management believes the Corporation's policy with respect to the methodology for the determination of the allowance for loan losses and the evaluation of deferred income taxes involves a higher degree of complexity and requires management to make difficult and subjective judgments, which often require assumptions or estimates about highly uncertain matters. Changes in these judgments, assumptions or estimates could materially impact results of operations. This critical accounting policy and its application are periodically reviewed with the Audit Committee and the Board of Directors.

Allowance for Loan Losses. The allowance for loan losses is based upon management's evaluation of the adequacy of the allowance, including an assessment of known and inherent risks in the loan portfolio, giving consideration to the size and composition of the loan portfolio, actual loan loss experience, level of delinquencies, detailed analysis of individual loans for which full collectability may not be assured, the existence and estimated net realizable value of any underlying collateral and guarantees securing the loans, and current economic and market conditions. Although management uses the best information available, the level of the allowance for loan losses remains an estimate, which is subject to significant judgment and short-term change. Various regulatory agencies, as an integral part of their

examination process, periodically review the Corporation's allowance for loan losses. Such agencies may require the Corporation to make additional provisions for loan losses based upon information available to them at the time of their examination. Furthermore, the majority of the Corporation's loans are secured by real estate in the State of New Jersey. Accordingly, the collectability of a substantial portion of the carrying value of the Corporation's loan portfolio is susceptible to changes in local market conditions and may be adversely affected should real estate values decline or the northern New Jersey area experience adverse economic changes. Future adjustments to the allowance for loan losses may be necessary due to economic, operating, regulatory and other conditions beyond the Corporation's control.

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

Financial Condition

Total assets increased \$14.1 million to \$707.6 million at September 30, 2015 from \$693.6 million at December 31, 2014. Cash and cash equivalents increased \$5.9 million to \$16.0 million at September 30, 2015 from \$10.1 million at December 31, 2014, reflecting some additional liquidity at quarter end. Securities available-for-sale decreased \$37.9 million to \$87.0 million while securities held to maturity increased \$5.2 million to \$60.3 million. In order to manage the growth in assets while still assisting in the funding of the loan growth, in early 2015, the Corporation identified and sold approximately \$27.8 million of available-for-sale securities with high price volatility. Net loans increased \$41.6 million to \$509.3 million at September 30, 2015 compared to \$467.7 million at December 31, 2014, reflecting improved loan demand. Loans held for sale totaled \$1.6 million at September 30, 2015 compared to no loans held for sale at December 31, 2014. Other real estate owned (OREO) decreased \$721,000 to \$587,000 at September 30, 2015 compared to \$1.3 million at December 31, 2014 reflecting the sale of several properties partially offset by an additional foreclosure.

Index

Deposits totaled \$585.9 million at September 30, 2015, an increase of \$29.4 million from \$556.5 million at December 31, 2014. The growth in deposits consisted of a \$14.4 million increase in noninterest-bearing accounts and a \$15.0 million increase in interest-bearing accounts.

On August 28, 2015, the Corporation completed a private placement of \$16.6 million in aggregate principal amount of fixed rate subordinated notes (the "Subordinated Notes") to certain institutional accredited investors pursuant to a Subordinated Note Purchase Agreement dated August 28, 2015 between the Corporation and such investors. The subordinated notes have a maturity date of August 28, 2025 and bear interest at the rate of 6.75% per annum, payable semi-annually, in arrears, on March 1 and September 1 of each year during the time that the Subordinated Notes remain outstanding. The Subordinated Notes include a right of prepayment, without penalty, on or after August 28, 2020 and, in certain limited circumstances, before that date. The indebtedness evidenced by the Subordinated Notes, including principal and interest, is unsecured and subordinate and junior in right of the Company's payment to general and secured creditors and depositors of the Bank. The Subordinated Notes have been structured to qualify as Tier 2 capital for regulatory purposes. The Subordinated Notes totaled \$16.0 million at September 30, 2015, which includes \$641,000 of remaining unamortized debt issuance costs. The debt issuance costs are being amortized over the expected life of the issue.

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

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

FHLB – NY advances were \$49.5 million at September 30, 2015 compared to \$66.7 million at December 31, 2014. The decrease in these borrowings was the result of maturities and the payoff of the borrowings made possible by the growth in deposits as well as by funds provided from the sale of securities reported above.

Results of Operations

General

The Corporation reported net income of \$1.0 million, or \$0.15 diluted earnings per common share for the three months ended September 30, 2015, compared to net income of \$552,000, or \$0.06 diluted earnings per common share for the comparable prior year period. For the nine months ended September 30, 2015, the Corporation reported net income of \$3.1 million, or \$0.44 diluted earnings per common share compared to net income of \$1.8 million, or \$0.21 per diluted common share, for the comparable prior year period.

Net Interest Income

Net interest income, on a tax equivalent basis, for the three and nine months ended September 30, 2015 was \$5.5 million and \$16.6 million, respectively, compared to \$5.4 million and \$16.3 million recorded in the prior year periods. The net interest rate spread and net yield on interest-earning assets for the three months ended September 30, 2015 were 3.01% and 3.21%, respectively, compared to 3.17% and 3.36% for the three months ended September 30, 2014. For the nine months ended September 30, 2015, the net interest rate spread and net yield on interest-earning assets were 3.15% and 3.34%, respectively, compared to 3.25% and 3.42% for the nine months ended September 30, 2014.

Index

The declines in both the net interest rate spread and net yield on interest-earning assets reflect the impact of the new \$16.6 million of Subordinated Notes issued on August 28, 2015. While the cost of the Subordinated Notes reduces net interest income, the increased interest expense for the quarter, on an after tax basis, is approximately offset by the dividends that would have accrued at a rate of 4.56% on the Series B Preferred Shares for the quarter resulting in an overall neutral effect on net income available to common shareholders for the quarter. Furthermore, beginning on March 1, 2016, and for all dividend periods thereafter, the dividend rate would have increased and fixed at 9% per annum, making the issuance of the Subordinated Notes a positive impact to net income available to common shareholders in the future.

In addition, in general, the net interest rate spread and net yield on interest-earning assets for the current year periods also reflect a decline in loan interest rates as well as a flat to slight decline in the interest rates on deposits and borrowings. The reduced loan yields primarily reflect the historically low market rates in the current environment.

The following table reflects the components of the Corporation's net interest income for the three and nine months ended September 30, 2015 and 2014 including: (1) average assets, liabilities and shareholders' equity based on average daily balances, (2) interest income earned on interest-earning assets and interest expense paid on interest-bearing liabilities, (3) average yields earned on interest-earning assets and average rates paid on interest-bearing liabilities and (4) net yield on interest-earning assets. Nontaxable income from investment securities and loans is presented on a tax-equivalent basis assuming a statutory tax rate of 34% for the periods presented. This was accomplished by adjusting non-taxable income upward to make it equivalent to the level of taxable income required to earn the same amount after taxes.

Index

Analysis of Net Interest Income (Unaudited)

For the Three Months Ended September 30,

	2015			2014			
	Average	Interest	Average	Average	Interest	Average	
	Balance	Income/ Expense	Rates Earned/ Paid	Balance	Income/ Expense	Rates Earned/ Paid	
	(Dollars in thousands)			(Dollars in thousands)			
Assets							
Interest-earning assets:							
Loans (1) (2)	\$512,411	\$ 5,699	4.41 %	\$434,849	\$ 5,136	4.69 %	
Taxable investment securities (1)	138,978	593	1.69	178,290	780	1.74	
Tax-exempt investment securities (1) (2)	13,568	180	5.26	18,649	240	5.11	
Other interest-earning assets	12,574	10	0.32	2,662	4	0.60	
Total interest-earning assets	677,531	6,482	3.80	634,450	6,160	3.85	
Non-interest-earning assets:							
Allowance for loan losses	(9,372)			(9,906)			
Other assets	41,459			43,004			
Total assets	\$709,618			\$667,548			
Liabilities and Stockholders' Equity							
Interest-bearing liabilities:							
Interest-bearing demand deposits	\$217,039	\$ 145	0.27 %	\$214,765	\$ 156	0.29 %	
Savings deposits	79,234	21	0.11	79,141	21	0.11	
Time deposits	144,183	379	1.04	124,950	256	0.81	
Repurchase agreements	—	—	—	5,887	72	4.85	
FHLB-NY borrowing	45,789	213	1.85	32,321	159	1.95	
Subordinated debentures and subordinated notes	13,146	235	7.09	7,217	127	6.98	
Total interest-bearing liabilities	499,391	993	0.79	464,281	791	0.68	
Non-interest-bearing liabilities:							
Demand deposits	151,226			143,098			
Other liabilities	2,538			2,909			
Stockholders' equity	56,463			57,260			
Total liabilities and stockholders' equity	\$709,618			\$667,548			
Net interest income (taxable equivalent basis)		5,489			5,369		
Tax equivalent adjustment		(70)			(91)		
Net interest income		\$ 5,419			\$ 5,278		

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Net interest spread (taxable equivalent basis)	3.01 %	3.17 %
Net yield on interest-earning assets (taxable equivalent basis) (3)	3.21 %	3.36 %

(1) For purpose of these calculations, nonaccruing loans are included in the average balance. Loans and total interest-earning assets are net of unearned income. Securities are included at amortized cost.

(2) The tax equivalent adjustments are based on a marginal tax rate of 34%.

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

Index

Analysis of Net Interest Income (Unaudited)

For the Nine Months Ended September 30,

	2015				2014			
	Average	Interest	Average		Average	Interest	Average	
	Balance	Income/ Expense	Rates Earned/ Paid		Balance	Income/ Expense	Rates Earned/ Paid	
	(Dollars in thousands)				(Dollars in thousands)			
Assets								
Interest-earning assets:								
Loans (1) (2)	\$497,238	\$16,787	4.51	%	\$430,020	\$15,509	4.82	%
Taxable investment securities (1)	139,750	1,801	1.72		177,830	2,385	1.79	
Tax-exempt investment securities (1) (2)	14,331	571	5.33		20,307	778	5.12	
Other interest-earning assets	11,711	27	0.31		6,758	18	0.36	
Total interest-earning assets	663,030	19,186	3.87		634,915	18,690	3.94	
Non-interest-earning assets:								
Allowance for loan losses	(9,716)				(9,974)			
Other assets	41,749				43,177			
Total assets	\$695,063				\$668,118			
Liabilities and Stockholders' Equity								
Interest-bearing liabilities:								
Interest-bearing demand deposits	\$211,413	\$427	0.27	%	\$220,203	\$472	0.29	%
Savings deposits	78,568	63	0.11		79,094	64	0.11	
Time deposits	139,696	1,013	0.97		128,768	816	0.85	
Repurchase agreements	—	—	—		6,993	254	4.86	
FHLB-NY borrowing	49,025	640	1.75		27,951	457	2.19	
Subordinated debentures and subordinated notes	9,215	485	7.04		7,217	377	6.98	
Total interest-bearing liabilities	487,917	2,628	0.72		470,226	2,440	0.69	
Non-interest-bearing liabilities:								
Demand deposits	145,711				139,169			
Other liabilities	2,548				2,648			
Stockholders' equity	58,887				56,075			
Total liabilities and stockholders' equity	\$695,063				\$668,118			
Net interest income (taxable equivalent basis)		16,558				16,250		
Tax equivalent adjustment		(220)				(290)		
Net interest income		\$16,338				\$15,960		

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Net interest spread (taxable equivalent basis)	3.15 %	3.25 %
Net yield on interest-earning assets (taxable equivalent basis) (3)	3.34 %	3.42 %

(1) For purpose of these calculations, nonaccruing loans are included in the average balance. Loans and total interest-earning assets are net of unearned income. Securities are included at amortized cost.

(2) The tax equivalent adjustments are based on a marginal tax rate of 34%.

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

Index

For the three and nine months ended September 30, 2015, total interest income, on a tax equivalent basis, was \$6.5 million and \$19.2 million, respectively, compared to \$6.2 million and \$18.7 million for the same prior year periods. The increases were due to increases in the average balances of interest-earning assets partially offset by decreases in yields on interest-earning assets. Average interest-earning assets increased \$43.1 million and \$28.1 million for the three and nine months ended September 30, 2015 compared to the prior year periods. The change in average interest-earning assets primarily reflects an increase from the comparable prior year periods in average loans offset by a decrease in securities reflective of the sale of available-for-sale securities with high price volatility and use of those proceeds to fund loan growth. Average loans increased \$77.6 million and \$67.2 million for the three and nine months ended September 30, 2015 while average securities decreased \$44.4 million and \$44.1 million when compared to the prior year averages. The average rate earned on interest-earning assets was 3.80% and 3.87% for the three and nine months ended September 30, 2015, respectively, compared to an average rate of 3.85% and 3.94% for the three and nine months ended September 30, 2014. The decline in the asset yields reflects the effect of a prolonged low interest rate environment.

Interest paid on deposits and borrowed money increased \$202,000 and \$188,000 for the three and nine months ended September 30, 2015, respectively, compared to the same periods for 2014. The issuance of the Subordinated Notes on August 28, 2015 had the effect of increasing average interest-bearing liabilities and added approximately \$108,000 to interest expense for the current three and nine month periods. An increase in the other components of average interest-bearing liabilities also contributed to the increase in interest expense for the three and nine months ended September 30, 2015. The average balance of interest-bearing deposits, repurchase agreements and FHLB-NY borrowings increased \$29.2 million and \$15.7 million for the three and nine months ended September 30, 2015, respectively, from the comparable 2014 periods. For the three months ended September 30, 2015, the \$21.6 million increase in average interest-bearing deposits accounted for the majority of the increase compared to the three months ended September 30, 2014. For the nine months ended September 30, 2015, a \$14.1 million increase in average interest-bearing repurchase agreements and FHLB-NY borrowings accounted for the majority of the increase in average interest-bearing liabilities. For the three and nine months ended September 30, 2015, the total cost for interest-bearing liabilities was 0.79% and 0.72%, respectively, compared to 0.68% and 0.69% for the comparable prior year periods. As noted previously, the issuance of the Subordinated Notes contributed to the overall increase in the current year periods. Excluding the Subordinated Debentures and the Subordinated Notes, the cost for interest-bearing deposits, repurchase agreements and FHLB-NY borrowings was 0.62% and 0.60%, respectively, compared to 0.58% and 0.60% for the comparable prior year periods, reflecting a slight increase in the cost for interest-bearing deposits and FHLB-NY borrowings.

Provision for Loan Losses

The Corporation maintains an allowance for loan losses at a level considered by management to be adequate to cover the probable losses to be incurred associated with its loan portfolio. The Corporation's policy with respect to the methodology for the determination of the allowance for loan losses involves a high degree of complexity and requires management to make difficult and subjective judgments. The adequacy of the allowance for loan losses is based upon management's evaluation of the known and inherent risks in the portfolio, consideration of the size and composition of the loan portfolio, actual loan loss experience, the level of delinquencies, detailed analysis of individual loans for which full collectability may not be assured, the existence and estimated net realizable value of any underlying collateral and guarantees securing the loans, and current economic and market conditions.

The allowance for loan losses contains an unallocated reserve amount to cover inherent losses which may not otherwise have been measured. Due to the complexity in determining the estimated amount of allowance for loan losses, these unallocated reserves reflect management's attempt to ensure that the overall allowance reflects an appropriate level of reserves. During the nine months ended September 30, 2015, the Corporation's unallocated reserves decreased by \$185,000. Management believes that the unallocated reserves at September 30, 2015 are appropriate and are expected to be further impacted as the Corporation continues to demonstrate a sustained level of performance in the loan portfolio.

For the three and nine months ended September 30, 2015, the Corporation recorded a \$400,000 and \$1.1 million negative loan loss provision, respectively, compared to a \$250,000 provision to loan losses for the three and nine months ended September 30, 2014. The negative provision for loan losses reflects the continued improvement in the credit quality of the portfolio. In addition, for the nine months ended September 30, 2015, the Corporation recorded net recoveries of \$303,000. For the three months ended September 30, 2015, the Corporation recorded net charge-offs of only \$94,000. Nonperforming loans of \$2.6 million at September 30, 2015, or 0.50% of total gross loans, reflected a \$1.1 million decrease from \$3.6 million of nonperforming loans, or 0.76% of total gross loans, at December 31, 2014.

The allowance for loan losses was \$8.8 million, or 1.70% of total gross loans, as of September 30, 2015 compared to \$9.6 million, or 2.01% of total gross loans, as of December 31, 2014. The allowance for loan losses related to impaired loans decreased from \$920,000 at December 31, 2014 to \$730,000 at September 30, 2015. During the nine months ended September 30, 2015, the Corporation charged-off \$597,000 of loan balances and recovered \$900,000 in previously charged-off loans compared to \$363,000 and \$292,000, respectively, during the same period in 2014.

Index

The Corporation monitors its loan portfolio and intends to continue to provide for loan loss reserves based on its ongoing periodic review of the loan portfolio, charge-off activity and general market conditions. There can be no assurances that the current level of no provision will continue in the future.

See “Asset Quality” section below for a summary of the allowance for loan losses and nonperforming assets.

Noninterest Income

Noninterest income was \$838,000 and \$2.6 million for the three and nine months ended September 30, 2015, respectively, compared to \$764,000 and \$2.0 million for the prior year periods. Noninterest income for the three and nine months ended September 30, 2015 includes year over year increases of \$31,000 and \$142,000 in fees and service charges as a result of changes to the standard amounts assessed on deposit accounts. In addition, gains on sales of mortgage loans reflected increases of \$20,000 and \$71,000 for the three and nine months ended September 30, 2015, respectively, as the Corporation returns to selling the majority of mortgage originations due to current market conditions and commercial loan demand. For the nine months ended September 30, 2015, noninterest income included \$152,000 of gains on calls and sales of securities. There were no gains on calls and sales of available-for-sale securities for the prior year nine months ended September 30, 2014. The prior year nine months ended September 30, 2014 included a \$241,000 loss from the sale of nonperforming loans.

Noninterest Expense

Noninterest expenses for the three and nine months ended September 30, 2015 was \$5.1 million and \$15.3 million, respectively, compared to \$5.0 million and \$15.2 million in the comparable prior year period. Increases in salaries and employee benefit costs, data processing expenses and contributions were partially offset by decreases in occupancy expense and FDIC insurance premiums. An increase in data processing expense is reflective of costs associated with the outsourcing and migration of the Corporation’s information technology environment/network, including disaster recovery/business continuity planning, to a third party hosted environment. An increase in contributions is reflective of an overall increase in profitability. When compared to the same prior year periods, occupancy expense decreased \$12,000 and \$197,000 for the three and nine months ended September 30, 2015, respectively, primarily due to the closing of a branch and a remote drive-up location.

Income Tax Expense

Income tax expense totaled \$532,000 and \$1.7 million for the three and nine months ended September 30, 2015, respectively, representing effective tax rates of 34.7% and 34.6%. For the three and nine months ended September 30,

2014, income tax expense totaled \$251,000 and \$707,000, respectively, equating to effective tax rates of 31.3% and 28.3%. For the 2014 periods, tax expense reflects a lower overall projected effective tax rate as a result of our tax exempt income representing a larger percentage of pretax income.

Asset Quality

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

Index

Risk elements include nonaccrual loans, past due and restructured loans, potential problem loans, loan concentrations and other real estate owned. The following table shows the composition of nonperforming assets at the end of each of the last four quarters:

	September 30, 2015	June 30, 2015	March 31, 2015	December 31, 2014
	(Dollars in thousands)			
Nonaccrual loans (1)	\$2,574	\$2,539	\$2,798	\$ 3,628
Loans past due 90 days or more and accruing (2)	—	—	—	—
Total nonperforming loans	2,574	2,539	2,798	3,628
Other real estate owned	587	219	320	1,308
Total nonperforming assets	\$3,161	\$2,758	\$3,118	\$ 4,936
Allowance for loan losses	\$8,805	\$9,299	\$9,600	\$ 9,602
Nonperforming loans to total gross loans	0.50%	0.50%	0.57%	0.76%
Nonperforming assets to total assets	0.45%	0.39%	0.45%	0.71%
Allowance for loan losses to total gross loans	1.70%	1.83%	1.96%	2.01%
Allowance for loan losses to nonperforming loans	342.07%	366.25%	343.10%	264.66%

(1) Generally represents loans as to which the payment of principal or interest is in arrears for a period of more than 90 days. Interest previously accrued on these loans and not yet paid is reversed and charged against income during the current period. Interest earned thereafter is only included in income to the extent that it is received in cash.

(2) Represents loans as to which payment of principal or interest is contractually past due 90 days or more but which are currently accruing income at the contractually stated rates. A determination is made to continue accruing income on those loans which are sufficiently collateralized and on which management believes all interest and principal owed will be collected.

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

At September 30, 2015, the nonaccrual loans were comprised of 13 loans, primarily commercial real estate loans, commercial loans and construction loans. While the Corporation maintains strong underwriting requirements, the number and amount of nonaccrual loans is a reflection of the prolonged weakened economic conditions and the corresponding effects it has had on our commercial borrowers and the current real estate environment. Certain loans, including restructured loans, are current, but in accordance with applicable guidance and other weakness concerns, management has continued to keep these loans on nonaccrual status.

During the nine months ended September 30, 2015, nonaccrual loans have decreased 29% to \$2.6 million. The decrease reflects payments received, payoffs, charge-offs and loans returned to an accrual status. The ratio of allowance for loan losses to nonperforming loans increased to 342.07% at September 30, 2015 from 264.66% at December 31, 2014. The ratio of allowance for loan losses to nonperforming loans is reflective of a detailed analysis and the probable losses to be incurred that we have identified with these nonperforming loans. This metric reflects the effect of the decrease in nonaccrual loans partially offset by a decline in the allowance for loan losses.

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

For loans not included in nonperforming loans, at September 30, 2015, the level of loans past due 30-89 days was \$41,000 compared to \$771,000 at December 31, 2014. We will continue to monitor delinquencies for early identification of new problem loans.

Index

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

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

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

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

For the nine months ended September 30, 2015, a negative loan loss provision was recorded in the amount of \$1,100,000 compared to a positive loan loss provision of \$250,000 recorded for the nine months ended September 30, 2014. The total allowance for loan losses of 1.70% of total loans was comparable to a ratio of 2.01% at December 31, 2014.

When management expects that some portion or all of a loan balance will not be collected, that amount is charged-off as a loss against the allowance for loan losses. For the three months ended September 30, 2015 net charge-offs of \$94,000 were recorded. For the nine months ended September 30, 2015 net recoveries of \$303,000 were recorded compared to a net recovery of \$19,000 and a net charge-off of \$71,000 for the three and nine months ended September 30, 2014. Recorded charge-offs reflect partial writedowns or full charge-offs on nonaccrual loans due to the initial and ongoing evaluations of market values of the underlying real estate collateral in accordance with Accounting Standards Codification ("ASC") 310-40. Regardless of our actions of recording partial and full charge-offs on loans, we continue to aggressively pursue collection, including legal action.

While regular monthly payments continue to be made on many of the nonaccrual loans, certain charge-offs result, nevertheless, from the borrowers' inability to provide adequate documentation evidencing their ability to continue to service their debt. Therefore, consideration has been given to any underlying collateral and appropriate charge-offs recorded based, in general, on the deficiency of such collateral. In general, the charge-offs reflect partial writedowns and full charge-offs on nonaccrual loans due to the initial evaluation of market values of the underlying real estate collateral in accordance with ASC 310-40. Management believes the charge-off of these reserves provides a clearer indication of the value of nonaccrual loans.

At September 30, 2015 and December 31, 2014, the Corporation had \$10.7 million and \$12.9 million, respectively, of loans the terms of which have been modified in troubled debt restructurings. Of these loans, \$10.1 million and \$12.0 million were performing in accordance with their new terms at September 30, 2015 and December 31, 2014, respectively. The remaining troubled debt restructurings are reported as nonaccrual loans. Specific reserves of \$730,000 and \$868,000 have been allocated for the troubled debt restructurings at September 30, 2015 and December 31, 2014, respectively. As of September 30, 2015 and December 31, 2014, the Corporation had \$25,000 and \$0, respectively, of additional committed funds to these borrowers.

As of September 30, 2015, there were \$7.6 million of other loans not included in the preceding table or discussion of troubled debt restructurings where credit conditions of borrowers, including real estate tax delinquencies, caused management to have concerns about the possibility of the borrowers not complying with the present terms and conditions of repayment and which may result in disclosure of such loans as nonperforming loans at a future date. These loans have been considered by management in conjunction with the analysis of the adequacy of the allowance for loan losses.

Index

The Corporation's lending activities are concentrated in loans secured by real estate located in northern New Jersey. Accordingly, the collectability of a substantial portion of the Corporation's loan portfolio is susceptible to changes in real estate market conditions in northern New Jersey.

Capital Adequacy

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

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

Guidelines for Banks

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

Among other things, the Basel Rules (a) establish a new common equity Tier 1 Capital ("CET1") to risk-weighted assets ratio minimum of 4.5% of risk-weighted assets, (b) raise the minimum Tier 1 Capital to risk-based assets requirement ("Tier 1 Capital Ratio) from 4% to 6% of risk-weighted assets and (c) assign a higher risk weight of 150% to exposures that are more than 90 days past due or are on nonaccrual status and to certain commercial real estate facilities. The minimum ratio of Total Capital to risk-weighted assets (including certain off-balance sheet activities, such as standby letters of credit) is 8%. At least 6% of the Total Capital is required to be "Tier 1 Capital", which consists of common shareholders' equity and certain preferred stock, less certain items and other intangible assets. The remainder, "Tier 2

Capital,” may consist of (a) the allowance for loan losses of up to 1.25% of risk-weighted assets, (b) excess of qualifying preferred stock, (c) hybrid capital instruments, (d) debt, (e) mandatory convertible securities and (f) qualifying subordinated debt. “Total Capital” is the sum of Tier 1 Capital and Tier 2 Capital less reciprocal holdings of other banking organizations’ capital instruments, investments in unconsolidated subsidiaries and any other deductions as determined by the federal banking regulatory agencies on a case-by-case basis or as a matter of policy after formal rule-making. A small bank holding company that has the highest regulatory examination rating and is not contemplating significant growth or expansion must maintain a minimum level of Tier 1 Capital to average total consolidated assets leverage ratio of at least 3%. All other bank holding companies are expected to maintain a leverage ratio of at least 100 to 200 basis points above the stated minimum.

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

Index

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

Guidelines for Small Bank Holding Companies

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

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

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

As of September 30, 2015, the Corporation and the Bank exceeded all regulatory capital requirements as follows:

41

Index

	Actual	Required for Capital Adequacy Purposes	To Be Well Capitalized Under Prompt Corrective Action Regulations
Tier 1 Leverage ratio			
Corporation	7.66%	4.00%	N/A
Bank	9.47%	4.00%	5.00%
Risk-based capital			
Common Equity Tier 1			
Corporation	N/A	N/A	N/A
Bank	12.53%	4.50%	6.50%
Tier 1			
Corporation	10.23%	4.00%	N/A
Bank	12.53%	6.00%	8.00%
Total			
Corporation	14.48%	8.00%	N/A
Bank	13.78%	8.00%	10.00%

As discussed above under the heading “Financial Condition” and in Note 6 to the unaudited consolidated financial statements, on August 28, 2015, the Corporation completed a private placement of \$16.6 million in aggregate principal amount of fixed rate subordinated notes (the “Subordinated Notes”) to certain institutional accredited investors. The Subordinated Notes have a maturity date of August 28, 2025 and bear interest at the rate of 6.75% per annum, payable semiannually, over their term. The Subordinated Notes have been structured to qualify as Tier 2 capital for regulatory purposes.

Using the net proceeds of the Subordinated Note issuance, on September 1, 2015, the Corporation repurchased from the U.S. Treasury all 15,000 shares of the Corporation’s Senior Non-Cumulative Perpetual Preferred Stock, Series B (the “Series B Preferred Shares”) for an aggregate purchase price of \$15 million, in cash, plus accrued dividends. The Series B Preferred Shares qualified as Tier 1 for regulatory purposes.

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

Liquidity and Capital Resources

The Corporation's primary sources of funds are deposits, amortization and prepayments of loans and mortgage-backed securities, maturities of investment securities and funds provided from operations. While scheduled loan and mortgage-backed securities amortization and maturities of investment securities are a relatively predictable source of funds, deposit flow and prepayments on loans and mortgage-backed securities are greatly influenced by market interest rates, economic conditions and competition. The Corporation's liquidity, represented by cash and cash equivalents, is a product of its operating, investing and financing activities.

The primary source of cash from operating activities is net income. Liquidity management is both a daily and long-term function of business management. Excess liquidity is generally invested in interest-earning cash accounts or short-term investments, such as federal funds sold.

Cash and cash equivalents increased \$5.9 million during the first nine months of 2015. Net operating and financing activities provided \$109,000 and \$12.4 million, respectively, while investing activities used \$6.6 million.

Index

We anticipate that the Corporation will have sufficient funds available to meet its current contractual commitments. Should we need temporary funding, the Corporation has the ability to borrow overnight with the Federal Home Loan Bank-NY (“FHLB-NY”). The Corporation’s overall borrowing capacity is contingent on available collateral to secure borrowings and the ability to purchase additional activity-based capital stock of the FHLB-NY. The Corporation may also borrow from the Discount Window of the Federal Reserve Bank of New York based on the market value of collateral pledged. In addition, the Corporation has available overnight variable repricing lines of credit with other correspondent banks totaling \$38 million on an unsecured basis.

With respect to the payment of dividends on common stock, the Corporation has historically paid a quarterly cash dividend; however, management recognizes that the payment of future dividends could be impacted by losses or reduced earnings and the Corporation cannot assure the payment of future dividends. On October 21, 2015, the Corporation announced that its Board of Directors had declared a \$0.02 per share cash dividend payable on its common stock to shareholders of record as of November 2, 2015. The dividend is to be paid on November 16, 2015.

Index

ITEM 3. Quantitative and Qualitative Disclosures about Market Risk

Not applicable to smaller reporting companies.

ITEM 4. Controls and Procedures

Evaluation of internal controls and procedures

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

Changes in Internal Controls over Financial Reporting

Pursuant to Rule 13a-15(d) under the Exchange Act, our management, with the participation of our principal executive officer and principal financial officer, has evaluated our internal controls over financial reporting and based upon such evaluation concluded that there were no changes in our internal control over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) during the quarter ended September 30, 2015 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

Index

Part II -- Other Information

Item 6. Exhibits

See Exhibit Index following this report.

Index

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

Stewardship Financial Corporation

Date: November 13, 2015 By: /s/ Paul Van Ostenbridge
Paul Van Ostenbridge
President and Chief Executive Officer
(Principal Executive Officer)

Date: November 13, 2015 By: /s/ Claire M. Chadwick
Claire M. Chadwick
Executive Vice President and Chief Financial Officer
(Principal Financial and Accounting Officer)

Index

EXHIBIT INDEX

Exhibit

Number Description of Exhibits

4.1	Form of 6.75% Subordinated Note dated as of August 28, 2015 issued by Stewardship Financial Corporation (incorporated by reference to Exhibit 4.1 to the Corporation’s Current Report on Form 8-K filed with the SEC on September 1, 2015)
10.1	Subordinated Note Purchase Agreement dated as of August 28, 2015 between the Corporation and the Purchasers identified therein (incorporated by reference to Exhibit 10.1 to the Corporation’s Current Report on Form 8-K filed with the SEC on September 1, 2015)
31.1	Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
31.2	Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
32.1	Certification of Chief Executive Officer and Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
101	The following material from Stewardship Financial Corporation’s Quarterly Report on Form 10-Q for the quarter ended September 30, 2015, formatted in XBRL (Extensible Business Reporting Language): (i) Consolidated Statements of Financial Condition, (ii) Consolidated Statements of Income, (iii) Consolidated Statements of Comprehensive Income, (iv) Consolidated Statement of Changes in Shareholders’ Equity, (v) Consolidated Statements of Cash Flows and (vi) Notes to Consolidated Financial Statements, tagged as blocks of text ^[1]

^[1] This exhibit shall not be deemed “filed” for purposes of Section 18 of the Securities Exchange Act of 1934, as amended, or otherwise subject to the liability of that section, nor shall it be deemed incorporated by reference into any filing under the Securities Act of 1933, as amended, or the Securities Exchange Act of 1934, as amended, whether made before or after the date hereof and irrespective of any general incorporation language in any filing, except to the extent the Corporation specifically incorporates it by reference.