

THE UPSTATE NATIONAL BANK
ROCHESTER, NEW YORK
AUDITED FINANCIAL STATEMENTS
AND
INDEPENDENT AUDITOR'S REPORT
DECEMBER 31, 2020 AND 2019



MENGEL METZGER BARR & CO. LLP

Certified Public Accountants

CONTENTS

<u>AUDITED FINANCIAL STATEMENTS</u>	<u>PAGE</u>
Independent Auditor's Report	3
Balance Sheets	5
Statements of Income	7
Statements of Comprehensive Income	8
Statements of Changes in Shareholders' Equity	9
Statements of Cash Flows	10
Notes to Financial Statements	12

INDEPENDENT AUDITOR'S REPORT

Board of Directors
The Upstate National Bank

We have audited the accompanying financial statements of The Upstate National Bank which comprise the balance sheets as of December 31, 2020 and 2019 and the related statements of income, comprehensive income, changes in shareholders' equity, and cash flows for the years then ended, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of The Upstate National Bank as of December 31, 2020 and 2019, and the results of its operations and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Mengel, Metzger, Barw & Co. LLP

Rochester, New York
March 12, 2021

THE UPSTATE NATIONAL BANK

BALANCE SHEETS

<u>ASSETS</u>	December 31,	
	<u>2020</u>	<u>2019</u>
Cash and due from banks	\$ 431,000	\$ 429,000
Interest bearing deposits with banks	10,731,000	7,918,000
Investment securities:		
Securities available for sale	13,471,000	14,804,000
Securities held to maturity	10,000	10,000
Restricted equity securities	<u>1,313,000</u>	<u>1,715,000</u>
INVESTMENT SECURITIES	14,794,000	16,529,000
Loans, net of allowance for loan losses of \$1,778,000 and \$1,354,000, respectively	175,154,000	136,136,000
Accrued interest receivable	797,000	509,000
Premises and equipment, net	279,000	316,000
Other assets	2,406,000	2,882,000
	<u>\$ 204,592,000</u>	<u>\$ 164,719,000</u>

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

<u>LIABILITIES AND SHAREHOLDERS' EQUITY</u>	<u>December 31,</u>	
	<u>2020</u>	<u>2019</u>
Liabilities:		
Deposits:		
Non-interest bearing	\$ 17,504,000	\$ 12,801,000
Interest-bearing savings, NOW and money market deposits	51,218,000	19,005,000
Interest-bearing time deposits of \$250,000 or more	15,768,000	8,681,000
Interest-bearing other time deposits	<u>89,540,000</u>	<u>84,624,000</u>
TOTAL DEPOSITS	174,030,000	125,111,000
Federal Home Loan Bank advances	11,000,000	22,000,000
Accrued interest payable	80,000	106,000
Other liabilities	<u>185,000</u>	<u>137,000</u>
TOTAL LIABILITIES	185,295,000	147,354,000
Shareholders' equity:		
Series A:		
Redeemable convertible preferred stock, \$2.50 par value:		
Authorized - 3,880 shares		
Issued and outstanding - 2,825 shares	7,000	7,000
Common stock:		
\$.01 par value: Authorized - 100,000,000 shares at December 31, 2020 and 2019		
Issued and outstanding - 26,068,848 shares at December 31, 2020 and 26,067,478 shares at December 31, 2019	262,000	261,000
Additional paid in capital	19,360,000	19,361,000
Accumulated deficit	(955,000)	(2,575,000)
Accumulated other comprehensive income	650,000	339,000
Less treasury stock at cost - 39,520 common shares at December 31, 2020 and 40,890 common shares at December 31, 2019	<u>(27,000)</u>	<u>(28,000)</u>
	<u>19,297,000</u>	<u>17,365,000</u>
	<u>\$ 204,592,000</u>	<u>\$ 164,719,000</u>

THE UPSTATE NATIONAL BANK

STATEMENTS OF INCOME

	<u>Year ended December 31,</u>	
	<u>2020</u>	<u>2019</u>
Interest income:		
Loans, including fees	\$ 7,387,000	\$ 6,349,000
Debt securities:		
U.S. obligations	382,000	455,000
Deposits with banks and other	178,000	273,000
Total interest income	<u>7,947,000</u>	<u>7,077,000</u>
Interest expense:		
Deposits	2,059,000	2,107,000
Borrowed funds	152,000	616,000
Total interest expense	<u>2,211,000</u>	<u>2,723,000</u>
NET INTEREST INCOME BEFORE PROVISION FOR LOAN LOSSES	5,736,000	4,354,000
Provision for loan losses	<u>423,000</u>	<u>140,000</u>
NET INTEREST INCOME AFTER PROVISION FOR LOAN LOSSES	5,313,000	4,214,000
Non-interest income:		
Service charges	16,000	17,000
Other income	42,000	32,000
Total non-interest income	<u>58,000</u>	<u>49,000</u>
Non-interest expenses:		
Salaries and employee benefits	1,855,000	1,850,000
Occupancy expenses	178,000	173,000
Depreciation	60,000	70,000
Professional fees	479,000	570,000
Data processing fees	313,000	284,000
Other loan expense	23,000	17,000
Marketing and advertising	4,000	4,000
FDIC assessments	80,000	46,000
Realized loss on sale of securities	-	400,000
Other operating expenses	269,000	272,000
Total non-interest expenses	<u>3,261,000</u>	<u>3,686,000</u>
INCOME BEFORE INCOME TAXES	2,110,000	577,000
(Expense) benefit from income taxes	<u>(490,000)</u>	<u>735,000</u>
NET INCOME	<u>\$ 1,620,000</u>	<u>\$ 1,312,000</u>
NET INCOME APPLICABLE TO COMMON SHAREHOLDERS	<u>\$ 1,620,000</u>	<u>\$ 1,312,000</u>
Earnings per common share:		
Basic	<u>\$ 0.06</u>	<u>\$ 0.05</u>
Diluted	<u>\$ 0.06</u>	<u>\$ 0.05</u>

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

THE UPSTATE NATIONAL BANK
STATEMENTS OF COMPREHENSIVE INCOME

	Year ended December 31,	
	<u>2020</u>	<u>2019</u>
Net income	\$ 1,620,000	\$ 1,312,000
Other comprehensive income:		
Change in net unrealized gain on available for sale securities	<u>311,000</u>	<u>710,000</u>
OTHER COMPREHENSIVE INCOME	<u>311,000</u>	<u>710,000</u>
COMPREHENSIVE INCOME	<u>\$ 1,931,000</u>	<u>\$ 2,022,000</u>

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

THE UPSTATE NATIONAL BANK

STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY

YEARS ENDED DECEMBER 31, 2020 AND 2019

	Series A Redeemable Convertible Preferred Stock	Common Stock	Additional Paid-in Capital	Accumulated deficit	Accumulated other comprehensive (loss) income	Treasury stock	Total
Balance at January 1, 2019	\$ 7,000	\$ 260,000	\$19,362,000	\$(3,887,000)	\$ (371,000)	\$ (32,000)	\$ 15,339,000
Net income	-	-	-	1,312,000	-	-	1,312,000
Sale of treasury stock	-	1,000	(1,000)	-	-	4,000	4,000
Other comprehensive income	-	-	-	-	710,000	-	710,000
 BALANCE AT DECEMBER 31, 2019	 7,000	 \$ 261,000	 \$19,361,000	 (2,575,000)	 339,000	 \$ (28,000)	 \$ 17,365,000
Net income	-	-	-	1,620,000	-	-	1,620,000
Sale of treasury stock	-	1,000	(1,000)	-	-	1,000	1,000
Other comprehensive income	-	-	-	-	311,000	-	311,000
 BALANCE AT DECEMBER 31, 2020	 <u>\$ 7,000</u>	 <u>\$ 262,000</u>	 <u>\$19,360,000</u>	 <u>\$ (955,000)</u>	 <u>\$ 650,000</u>	 <u>\$ (27,000)</u>	 <u>\$ 19,297,000</u>

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

THE UPSTATE NATIONAL BANK

STATEMENTS OF CASH FLOWS

	Year ended December 31,	
	2020	2019
<u>CASH FLOWS - OPERATING ACTIVITIES</u>		
Net income	\$ 1,620,000	\$ 1,312,000
Adjustments to reconcile net income to net cash provided from operating activities:		
Provision for loan losses	423,000	140,000
Depreciation	60,000	70,000
Net amortization of securities	73,000	39,000
Realized loss on sale of securities	-	400,000
Amortization on loans, net	(63,000)	59,000
Deferred income tax expense (benefit)	484,000	(746,000)
Changes in certain assets and liabilities affecting operations:		
Accrued interest receivable	(288,000)	12,000
Other assets	(8,000)	44,000
Accrued interest payable	(26,000)	32,000
Other liabilities	48,000	91,000
NET CASH PROVIDED FROM OPERATING ACTIVITIES	2,323,000	1,453,000
<u>CASH FLOWS - INVESTING ACTIVITIES</u>		
Increase in loans, net	(39,378,000)	(27,016,000)
Proceeds from available for sale securities	4,576,000	16,197,000
Proceeds from restricted equity securities	3,254,000	2,046,000
Purchase of available for sale securities	(3,005,000)	(16,518,000)
Purchase of restricted equity securities	(2,852,000)	(2,042,000)
Purchases of premises and equipment	(23,000)	(27,000)
(Increase) decrease in interest bearing deposits with banks, net	(2,813,000)	2,901,000
NET CASH USED FOR INVESTING ACTIVITIES	(40,241,000)	(24,459,000)
<u>CASH FLOWS - FINANCING ACTIVITIES</u>		
Net increase in deposits	48,919,000	24,977,000
Decrease in Federal Home Loan Bank advances	(11,000,000)	(2,200,000)
Proceeds from sale of treasury stock	1,000	4,000
NET CASH PROVIDED FROM FINANCING ACTIVITIES	37,920,000	22,781,000
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	2,000	(225,000)
Cash and cash equivalents at beginning of year	429,000	654,000
CASH AND CASH EQUIVALENTS AT END OF YEAR	<u>\$ 431,000</u>	<u>\$ 429,000</u>

THE UPSTATE NATIONAL BANK
STATEMENTS OF CASH FLOWS, Cont'd

	Year ended December 31,	
	2020	2019
<u>SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION</u>		
Cash paid during the period for:		
Interest	<u>\$ 2,237,000</u>	<u>\$ 2,691,000</u>
Income taxes	<u>\$ 5,000</u>	<u>\$ 8,000</u>

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

THE UPSTATE NATIONAL BANK

NOTES TO FINANCIAL STATEMENTS

DECEMBER 31, 2020 AND 2019

1. ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Organization

The Upstate National Bank (the Bank), a national bank with offices in New York State, provides lending, deposit, and other financial services to consumers and businesses located within its service area.

Cash and cash equivalents

For purposes of reporting cash flows, cash and cash equivalents include cash, due from banks, federal funds sold, and short-term investments, with original terms to maturity of 90 days or less.

Investment securities

Debt securities that management has the positive intent and ability to hold to maturity are classified as “held to maturity” and recorded at amortized cost. Securities not classified as held to maturity are classified as “available for sale”. Effective January 1, 2019, unrealized holding losses and gains for debt securities are reported in other comprehensive income (loss), whereas unrealized holding gains and losses for equity securities are reported in net income. Previous to this date, all unrealized holding gains and losses were reported in other comprehensive income (loss). Restricted equity securities consist primarily of Federal Reserve Bank and Federal Home Loan Bank stock.

Purchase premiums and discounts are recognized in interest income using the interest method over the terms of the securities. Declines in the fair value of held to maturity and available for sale securities below their cost that are deemed to be other than temporary are reflected in earnings as realized losses. In estimating other than temporary impairment losses, management considers (1) the length of time and the extent to which the fair value has been less than cost, (2) the financial condition and near-term prospects of the issuer, and (3) the intent and ability of the Bank to retain its investment in the issuer for a period of time sufficient to allow for any anticipated recovery in fair value. Gains and losses on the sale of securities are recorded on the trade date and are determined using the specific identification method.

Loans

The Bank grants mortgage, commercial, and consumer loans to customers. A substantial portion of the loan portfolio is represented by residential and commercial mortgage loans throughout New York State. The ability of the Bank’s debtors to honor their contracts is dependent upon the real estate and general economic conditions in this area.

Loans that management has the intent and ability to hold for the foreseeable future or until maturity or pay-off generally are reported at their outstanding principal balances adjusted for the allowance for loan losses and any deferred fees or costs on originated loans. Interest income is accrued on the unpaid principal balance. Loan origination fees (net of certain direct origination costs), premiums, and discounts are deferred and recognized as an adjustment of the related loan yield using the interest method over the contractual life of the loan.

The accrual of interest on residential mortgage, commercial mortgage and commercial loans is discontinued at the time the loan is 90 days delinquent unless the credit is well-secured and in the process of collection. Loans are placed on nonaccrual status or charged-off at an earlier date if collection of principal or interest is considered doubtful.

THE UPSTATE NATIONAL BANK

NOTES TO FINANCIAL STATEMENTS, Cont'd

DECEMBER 31, 2020 AND 2019

1. ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES, Cont'd

All interest income accrued but not collected for loans that are placed on nonaccrual or charged off is generally reversed against interest income. Interest received on nonaccrual loans, including impaired loans, generally is applied against principal or reported as interest income, according to management's judgment as to the collectability of principal. Generally, loans are restored to accrual status when the obligation is brought current, has performed in accordance with the contractual terms for a reasonable period of time and the ultimate collectability of the total contractual principal and interest is no longer in doubt.

Allowance for loan losses

The allowance for loan losses is established through a provision for loan losses charged to expense. Loans, or portions of loans, which are determined to be uncollectible are charged against the allowance account and subsequent recoveries, if any, are credited to the account. The allowance for loan losses is based on management's ongoing assessment of the Bank's credit exposure, given its judgment about a number of relevant variables. These variables include prevailing and anticipated domestic economic conditions, assigned risk ratings, the diversification and size of the loan portfolio, the results of the most recent regulatory examinations available to the Bank, off-balance sheet credit risks, the nature and level of non-performing loans that have been identified as potential problems, the adequacy of collateral, past and expected loss experience and other factors deemed relevant by management. This evaluation is inherently subjective as it requires estimates that are susceptible to significant revision as more information becomes available.

The allowance consists of specific, general, and unallocated components. The specific component relates to loans that are classified as impaired. For loans that are classified as impaired, an allowance is established when the discounted cash flow (or collateral value or observable market price) of the impaired loan is lower than the carrying value of that loan. The general component covers pools of loans by loan class including commercial loans that are not considered impaired, as well as smaller balance homogeneous consumer loans. These pools of loans are evaluated for loss exposure based upon historical loss rates for each of these categories of loans, adjusted for qualitative risk factors.

Each of the qualitative risk factors is assigned a value to reflect improving, stable or declining conditions based on management's best judgment using relevant information at the time of the evaluation.

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

A loan is considered impaired when, based on current information and events, it is probable that the Bank will be unable to collect the scheduled payments of principal or interest when due according to the contractual terms of the loan agreement. Factors considered by management in determining impairment include payment status, collateral value, and the probability of collecting scheduled principal and interest payments when due. Loans that experience insignificant payment delays and payment shortfalls generally are not classified as impaired. Management determines the significance of payment delays and payment shortfalls on a case-by-case basis, taking into consideration all of the circumstances surrounding the loan and the borrower including the length of the delay, the reasons for the delay, the borrower's prior payment record, and the amount of the shortfall in relation to the principal and interest owed. Impairment is measured on a loan by loan basis by either the present value of expected future cash flows discounted at the loan's effective interest rate or the fair value of the collateral if the loan is collateral dependent.

THE UPSTATE NATIONAL BANK

NOTES TO FINANCIAL STATEMENTS, Cont'd

DECEMBER 31, 2020 AND 2019

1. ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES, Cont'd

An allowance for loan losses is established for an impaired loan if its carrying amount exceeds its estimated fair value. The estimated fair values of substantially all of the Bank's impaired loans are measured based on the estimated fair value of the loan's collateral.

Large groups of smaller balance homogeneous loans are collectively evaluated for impairment. Accordingly, the Bank does not separately identify individual consumer loans for impairment disclosures, unless such loans are the subject of a troubled debt restructuring agreement.

Loans whose terms are modified are classified as troubled debt restructurings if the Bank grants such borrowers concessions and it is deemed that those borrowers are experiencing financial difficulty. Concessions granted under a troubled debt restructuring generally involve a temporary reduction in interest rate or an extension of a loan's stated maturity date. Nonaccrual troubled debt restructurings are restored to accrual status if principal and interest payments, under the modified terms, are current for six consecutive months after modification. Loans classified as troubled restructurings are designated as impaired.

The direct and indirect effects of the COVID-19 pandemic resulted in a dramatic reduction in the economic activity that severely hampered the ability for businesses and consumers to meet their repayment obligations. The Coronavirus Aid, Relief, and Economic Security Act and the Consolidated Appropriations Act, 2021 (collectively "CARES Act"), in addition to providing financial assistance to both businesses and consumers, creates a forbearance program for federally-backed mortgage loans, protects borrowers from negative credit reporting due to loan accommodations related to the national emergency, and provides financial institutions the option to temporarily suspend certain requirements under GAAP related to troubled debt restructurings to account for the effects of COVID-19. The bank regulatory agencies likewise issued guidance encouraging financial institutions to work prudently with borrowers who are, or may be, unable to meet their contractual payment obligations because of the effects of COVID-19. The guidance, with concurrence of the Financial Accounting Standards Board, and provisions of the CARES Act allow modifications made on a good faith basis in response to COVID-19 to borrowers who were current with their payments prior to any relief, to not be treated as troubled debt restructurings nor be reported as past due. Modifications may include payment deferrals (including maturity extensions), covenant waivers and fee waivers. The Bank worked with its customers affected by COVID-19 and granted modifications across many of its loan portfolios. To the extent that such modifications meet the criteria described, the modified loans have not been classified as troubled debt restructurings nor reported as past due. As of December 31, 2020, the Bank had outstanding loan balances of \$1,638,000 for which COVID-19 payment deferral has been granted.

The allowance calculation methodology includes further segregation of loan classes into risk rating categories. The borrower's overall financial condition, repayment sources, guarantors and value of collateral, if appropriate, are evaluated annually for commercial loans or when credit deficiencies arise, such as delinquent loan payments, for commercial and consumer loans.

THE UPSTATE NATIONAL BANK

NOTES TO FINANCIAL STATEMENTS, Cont'd

DECEMBER 31, 2020 AND 2019

1. ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES, Cont'd

Credit quality risk ratings include regulatory classifications of special mention, substandard, doubtful and loss. Loans criticized special mention have potential weaknesses that deserve management's close attention. If uncorrected, the potential weaknesses may result in deterioration of the repayment prospects. Loans classified substandard have a well-defined weakness or weaknesses that jeopardize the liquidation of the debt. They include loans that are inadequately protected by the current sound net worth and paying capacity of the obligor or of the collateral pledge, if any. Loans classified doubtful have all the weaknesses inherent in loans classified substandard with the added characteristic that collection or liquidation in full, or the basis of current conditions and facts, is highly improbable. Loans classified as a loss are considered uncollectible and are charged to the allowance for loans losses. Loans not classified are rated pass.

Management believes the allowance for loan losses is adequate. While management uses available information in establishing the allowance for loan losses, future additions to the allowance may be necessary if conditions differ substantially from the assumptions used in making the evaluations. In addition, regulatory agencies, as an integral part of their examination process, periodically review the Bank's allowance for loan losses. Such agencies may require the Bank to recognize additions to the allowance based on their judgments about information available to them at the time of their examination.

Premises and equipment

Premises and equipment are stated at cost less accumulated depreciation. Depreciation is computed by the straight-line method over the estimated useful lives of the assets, which range from 3 to 40 years.

Foreclosed real estate

Assets acquired through, or in lieu of, loan foreclosure are held for sale and are initially recorded at fair value less costs to sell at the date of foreclosure, establishing a new cost basis. Subsequent to foreclosure, valuations are periodically performed by management, and any subsequent write-downs are recorded as a charge to operations, if necessary, to reduce the carrying value of the property to the lower of its cost or fair value less costs to sell. There was no foreclosed real estate at December 31, 2020 or 2019.

Common stock

In 2018, the Board of Directors approved a proposal to amend the Certificate of Incorporation to increase the number of authorized shares of common stock from 50,000,000 shares to 100,000,000 shares. The amendment had no effect on the par value of the common stock.

Treasury stock

Treasury stock is recorded at cost.

Income taxes

Deferred tax assets and liabilities arise from temporary differences between the financial statement and tax basis of assets and liabilities, as measured by the enacted tax rates which are expected to be in effect when these differences reverse. Deferred tax expense (benefit) is a result of the changes in deferred tax assets and liabilities, except for the change in deferred taxes related to unrealized gains (losses) on debt securities available for sale which is reflected in other comprehensive income. The principal types of temporary differences between assets and liabilities for financial statement and tax return purposes are detailed in Note 8.

THE UPSTATE NATIONAL BANK

NOTES TO FINANCIAL STATEMENTS, Cont'd

DECEMBER 31, 2020 AND 2019

1. ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES, Cont'd

The Bank is taxed under the provisions of the Internal Revenue Code and applicable state tax laws. The Bank files tax returns in the U.S. federal jurisdiction and in New York State. With few exceptions, as of December 31, 2020, the Bank is no longer subject to U.S. federal or state income tax examinations by tax authorities for years ended before December 31, 2017. The tax returns for the years ended December 31, 2017 through 2020 are still subject to potential audit by the IRS and the taxing authorities in New York State. Management of the Bank believes it has no material uncertain tax positions and, accordingly, it has not recognized any liability for unrecognized tax benefits.

Off-balance sheet financial instruments

In the ordinary course of business, the Bank has originated off-balance sheet financial instruments consisting of commitments to extend credit, unused portions of consumer credit lines, commercial letters of credit, and municipal letters of credit. Such financial instruments are recorded in the financial statements when they are funded.

Use of estimates in the preparation of financial statements

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reporting period. Actual results could differ from those estimates.

Comprehensive income

Comprehensive income consists of net income and other comprehensive income. Other comprehensive income consists of the change in net unrealized gains (losses) on available for sale debt securities.

New accounting pronouncements

Leases

In February 2016, the FASB issued a new standard related to leases to increase transparency and comparability among entities by requiring the recognition of right-of-use ("ROU") assets and lease liabilities on the balance sheet. Most prominent among the changes in the standard is the recognition of ROU assets and lease liabilities by lessees for those leases classified as operating leases under current U.S. GAAP. For nonpublic entities, the guidance in this new standard is effective for fiscal years beginning after December 15, 2021, and interim periods within fiscal years beginning after December 15, 2022. The Bank is currently evaluating the provisions of this standard to determine the impact the new standard will have on the Bank's financial position or results of operations.

THE UPSTATE NATIONAL BANK

NOTES TO FINANCIAL STATEMENTS, Cont'd

DECEMBER 31, 2020 AND 2019

1. ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES, Cont'd

Credit losses

In June 2016, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2016-13, *Financial Instruments – Credit Losses (Topic 326)*. The ASU amends the guidance on the impairment of financial instruments. The ASU adds an impairment model known as the current expected credit loss (CECL) model that is based on expected losses rather than incurred losses. Under the new guidance, the Bank recognizes as an allowance its estimate of expected credit losses, which FASB believes will result in more timely recognition of losses when compared to the current model. For nonpublic business entities, the guidance in this ASU is effective for annual periods, and interim periods within those annual periods, beginning after December 15, 2022. The Bank is currently evaluating the provisions of this ASU to determine the impact the new standard will have on the Bank's financial condition or results of operations.

Revenue recognition

The majority of the Bank's revenue-generating transactions are not subject to ASC 606, including revenue generated from financial instruments, such as loans and investment securities which are presented in the statements of income as components of net interest income. All of the Bank's revenue from contracts with customers in the scope of ASC 606 is recognized within non-interest income.

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

COVID-19

On January 30, 2020, the World Health Organization ("WHO") announced a global health emergency because of a new strain of coronavirus originating in Wuhan, China (the "COVID-19 outbreak") and the risks to the international community as the virus spreads globally beyond its point of origin. In March 2020, the WHO classified the COVID-19 outbreak as a pandemic, based on the rapid increase in exposure globally. The full impact of the COVID-19 outbreak continues to evolve as of the date of this report. As such, it is uncertain as to the full magnitude that the pandemic will have on the Bank's financial condition, liquidity, and future results of operations. Management is actively monitoring the global situation on its financial condition, liquidity, operations, suppliers, industry, and workforce. Given the daily evolution of the COVID-19 outbreak and the global responses to curb its spread, the Bank is not able to estimate the effects of the COVID-19 outbreak on its results of operations, financial condition, or liquidity for 2021.

Subsequent events

The Bank has conducted an evaluation of potential subsequent events occurring after the balance sheet date through March 12, 2021, which is the date the financial statements are available to be issued. No subsequent events requiring disclosure were noted.

THE UPSTATE NATIONAL BANK

NOTES TO FINANCIAL STATEMENTS, Cont'd

DECEMBER 31, 2020 AND 2019

2. EARNINGS PER COMMON SHARE

Basic earnings per common share is computed by dividing net income applicable to common shareholders by the weighted average number of common shares outstanding during the period. Diluted earnings per share is computed by dividing net income by the weighted-average number of common shares and dilutive potential common shares outstanding during the period. Treasury shares are not deemed outstanding for earnings per share calculations.

The factors used in the calculation of basic earnings per share and diluted earnings per share for the years ended December 31, 2020 and 2019 are as follows:

	December 31,	
	2020	2019
Net income	<u>\$ 1,620,000</u>	<u>\$ 1,312,000</u>
Basic weighted-average shares	26,067,494	26,064,701
Effect of dilutive securities:		
Convertible preferred stock - Series A	<u>14,125</u>	<u>14,125</u>
Dilutive potential common shares	<u>26,081,619</u>	<u>26,078,826</u>
Net earnings per share:		
Basic	<u>\$ 0.06</u>	<u>\$ 0.05</u>
Diluted	<u>\$ 0.06</u>	<u>\$ 0.05</u>

THE UPSTATE NATIONAL BANK

NOTES TO FINANCIAL STATEMENTS, Cont'd

DECEMBER 31, 2020 AND 2019

3. INVESTMENT SECURITIES

The amortized cost and fair value of investment securities with gross unrealized gains and losses are as follows:

	<u>Amortized cost</u>	<u>Gross unrealized gains</u>	<u>Gross unrealized losses</u>	<u>Fair value</u>
<u>December 31, 2020</u>				
Available for sale:				
Mortgage Backed Securities -				
Government issued or guaranteed	\$ 8,924,000	\$ 357,000	\$ -	\$ 9,281,000
Municipal bonds	2,706,000	227,000	-	2,933,000
Other	1,191,000	66,000	-	1,257,000
Total securities available for sale	<u>\$ 12,821,000</u>	<u>\$ 650,000</u>	<u>\$ -</u>	<u>\$ 13,471,000</u>
Held to maturity:				
State and municipal securities	\$ 10,000	\$ -	\$ -	\$ 10,000
Total held to maturity securities	<u>\$ 10,000</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 10,000</u>
Restricted equity securities	<u>\$ 1,313,000</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 1,313,000</u>
<u>December 31, 2019</u>				
Available for sale:				
Mortgage Backed Securities -				
Government issued or guaranteed	\$ 11,894,000	\$ 223,000	\$ 6,000	\$ 12,111,000
Other	2,571,000	122,000	-	2,693,000
Total securities available for sale	<u>\$ 14,465,000</u>	<u>\$ 345,000</u>	<u>\$ 6,000</u>	<u>\$ 14,804,000</u>
Held to maturity:				
State and municipal securities	\$ 10,000	\$ -	\$ -	\$ 10,000
Total held to maturity securities	<u>\$ 10,000</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 10,000</u>
Restricted equity securities	<u>\$ 1,715,000</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 1,715,000</u>

THE UPSTATE NATIONAL BANK

NOTES TO FINANCIAL STATEMENTS, Cont'd

DECEMBER 31, 2020 AND 2019

3. INVESTMENT SECURITIES, Cont'd

The above restricted equity securities primarily include non-marketable Federal Home Loan Bank New York (FHLBNY) stock and non-marketable Federal Reserve Bank (FRB) stock, both of which are required to be held for regulatory purposes and for borrowing availability. The required investment in FHLBNY stock is tied to the Banks's borrowing levels with the FHLB. Holdings of FHLBNY stock and FRB stock totaled \$661,000 and \$572,000 at December 31, 2020, respectively and \$1,121,000 and \$514,000 at December 31, 2019, respectively. The Bank has an investment in a banker's bank of \$80,000 at December 31, 2020 and 2019. These securities are carried at par, which is also cost.

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

Management evaluates securities for other than temporary impairment at least on a quarterly basis, and more frequently when economic or market conditions warrant such evaluation. Consideration is given to (1) the length of time and the extent to which the fair value has been less than cost, (2) the financial condition and near-term prospects of the issuer, and (3) the intent and ability of the Bank to retain its investment in the security for a period of time sufficient to allow for any anticipated recovery in fair value.

At December 31, 2020, no securities have been in a continuous unrealized loss position for less than 12 months.

The amortized cost and fair value of debt securities by contractual maturities at December 31, 2020 are as follows:

	<u>Available for sale</u>		<u>Held to maturity</u>	
	<u>Amortized cost</u>	<u>Fair value</u>	<u>Amortized cost</u>	<u>Fair value</u>
Due in one year or less	\$ -	\$ -	\$ -	\$ -
Due after one year through five years	55,000	57,000	10,000	10,000
Due after five years through ten years	475,000	486,000	-	-
Due after ten years or more	12,291,000	12,928,000	-	-
	<u>\$ 12,821,000</u>	<u>\$ 13,471,000</u>	<u>\$ 10,000</u>	<u>\$ 10,000</u>

No securities were pledged at December 31, 2020.

THE UPSTATE NATIONAL BANK
NOTES TO FINANCIAL STATEMENTS, Cont'd
DECEMBER 31, 2020 AND 2019

4. LOANS

Loans receivable, net are summarized as follows:

	<u>30-59 Days Past Due</u>	<u>60-89 Days Past Due</u>	<u>90 Days or More Past Due (Nonaccrual)</u>	<u>Total Past Due</u>	<u>Current</u>	<u>Total</u>
<u>December 31, 2020</u>						
Construction and Land Development	\$ -	\$ -	\$ -	\$ -	\$ 4,730,000	\$ 4,730,000
Residential Mortgages	-	-	-	-	73,504,000	73,504,000
Multi - Family	-	-	-	-	24,774,000	24,774,000
Commercial Real Estate	-	-	-	-	63,406,000	63,406,000
Commercial and Industrial	-	-	-	-	10,373,000	10,373,000
Loans to Individuals	-	-	-	-	33,000	33,000
Municipals	-	-	-	-	103,000	103,000
All Other Loans	-	-	-	-	9,000	9,000
	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 176,932,000</u>	<u>\$ 176,932,000</u>
					Allowance for loan losses	<u>(1,778,000)</u>
					Total loans receivable	<u>\$ 175,154,000</u>

THE UPSTATE NATIONAL BANK

NOTES TO FINANCIAL STATEMENTS, Cont'd

DECEMBER 31, 2020 AND 2019

4. LOANS, Cont'd

	30-59 Days Past Due	60-89 Days Past Due	90 Days or More Past Due (Nonaccrual)	Total Past Due	Current	Total
<u>December 31, 2019</u>						
Construction and Land Development	\$ -	\$ -	\$ -	\$ -	\$ 9,106,000	\$ 9,106,000
Residential Mortgages	-	-	-	-	47,686,000	47,686,000
Multi - Family	-	-	-	-	19,483,000	19,483,000
Commercial Real Estate	-	-	-	-	53,663,000	53,663,000
Commercial and Industrial	-	-	-	-	7,299,000	7,299,000
Loans to Individuals	-	-	-	-	33,000	33,000
Municipals	-	-	-	-	152,000	152,000
All Other Loans	-	-	-	-	68,000	68,000
	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 137,490,000</u>	<u>\$ 137,490,000</u>
					Allowance for loan losses	(1,354,000)
					Total loans receivable	<u>\$ 136,136,000</u>

THE UPSTATE NATIONAL BANK

NOTES TO FINANCIAL STATEMENTS

DECEMBER 31, 2020 AND 2019

4. LOANS, Cont'd

All loans 90 days or more past due shown in the tables, if any, above are in nonaccrual status. There were no loans in nonaccrual status for the years ended December 31, 2020 and 2019. The Bank had no loans 90 days or more delinquent and still accruing interest at December 31, 2020 or 2019.

Activity in the allowance for loan losses is summarized below:

	Construction and Land Development	Residential Mortgages	Multi- Family	Commercial Real Estate	Commercial and Industrial	Loans to Individuals	Municipals	All Other Loans	Unallocated	Total
2020:										
Beginning balance	\$ 31,000	\$ 86,000	\$ 79,000	\$ 422,000	\$ 504,000	\$ -	\$ 1,000	\$ 3,000	\$ 228,000	\$ 1,354,000
Provision for loan losses	-	-	-	-	-	-	-	-	423,000	423,000
Charge-offs	-	-	-	-	-	-	-	-	-	-
Recoveries	-	-	-	-	1,000	-	-	-	-	1,000
Ending balance	<u>\$ 31,000</u>	<u>\$ 86,000</u>	<u>\$ 79,000</u>	<u>\$ 422,000</u>	<u>\$ 505,000</u>	<u>\$ -</u>	<u>\$ 1,000</u>	<u>\$ 3,000</u>	<u>\$ 651,000</u>	<u>\$ 1,778,000</u>
2019:										
Beginning balance	\$ 31,000	\$ 86,000	\$ 79,000	\$ 422,000	\$ 499,000	\$ -	\$ 1,000	\$ 3,000	\$ 88,000	\$ 1,209,000
Provision for loan losses	-	-	-	-	-	-	-	-	140,000	140,000
Charge-offs	-	-	-	-	-	-	-	-	-	-
Recoveries	-	-	-	-	5,000	-	-	-	-	5,000
Ending balance	<u>\$ 31,000</u>	<u>\$ 86,000</u>	<u>\$ 79,000</u>	<u>\$ 422,000</u>	<u>\$ 504,000</u>	<u>\$ -</u>	<u>\$ 1,000</u>	<u>\$ 3,000</u>	<u>\$ 228,000</u>	<u>\$ 1,354,000</u>

THE UPSTATE NATIONAL BANK

NOTES TO FINANCIAL STATEMENTS, Cont'd

DECEMBER 31, 2020 AND 2019

4. LOANS, Cont'd

Information pertaining to the allocation and balance of the allowance for loan losses and loans receivable based on individual and collective impairment evaluation by loan portfolio class as of December 31, 2020 and 2019 follows:

	Allowance for Loan Loss			Loans Receivable		
	Balance	Balances related to loans individually evaluated for impairment	Balances related to loans collectively evaluated for impairment	Balance	Balance Individually evaluated for impairment	Balance Collectively evaluated for impairment
<u>December 31, 2020</u>						
Construction and Land Development	\$ 31,000	\$ -	\$ 31,000	\$ 4,730,000	\$ -	4,730,000
Residential Mortgages	86,000	-	86,000	73,504,000	-	73,504,000
Multi - Family	79,000	-	79,000	24,774,000	-	24,774,000
Commercial Real Estate	422,000	-	422,000	63,406,000	-	63,406,000
Commercial and Industrial	505,000	-	505,000	10,373,000	175,000	10,198,000
Loans to Individuals	-	-	-	33,000	-	33,000
Municipals	1,000	-	1,000	103,000	-	103,000
All Other Loans	3,000	-	3,000	9,000	-	9,000
Unallocated	651,000	-	651,000	-	-	-
Total	<u>\$ 1,778,000</u>	<u>\$ -</u>	<u>\$ 1,778,000</u>	<u>\$ 176,932,000</u>	<u>\$ 175,000</u>	<u>\$ 176,757,000</u>
<u>December 31, 2019</u>						
Construction and Land Development	\$ 31,000	\$ -	\$ 31,000	\$ 9,106,000	\$ -	9,106,000
Residential Mortgages	86,000	-	86,000	47,686,000	-	47,686,000
Multi - Family	79,000	-	79,000	19,483,000	-	19,483,000
Commercial Real Estate	422,000	-	422,000	53,663,000	-	53,663,000
Commercial and Industrial	504,000	-	504,000	7,299,000	187,000	7,112,000
Loans to Individuals	-	-	-	33,000	-	33,000
Municipals	1,000	-	1,000	152,000	-	152,000
All Other Loans	3,000	-	3,000	68,000	-	68,000
Unallocated	228,000	-	228,000	-	-	-
Total	<u>\$ 1,354,000</u>	<u>\$ -</u>	<u>\$ 1,354,000</u>	<u>\$ 137,490,000</u>	<u>\$ 187,000</u>	<u>\$ 137,303,000</u>

THE UPSTATE NATIONAL BANK
NOTES TO FINANCIAL STATEMENTS, Cont'd
DECEMBER 31, 2020 AND 2019

4. LOANS, Cont'd

The following is information pertaining to impaired loans at December 31, 2020 and 2019:

	<u>Recorded Investment</u>	<u>Unpaid Principal Balance</u>	<u>Related Allowance</u>	<u>Interest Income Recognized</u>
2020:				
With no related allowance recorded:				
Commercial and Industrial	<u>\$ 175,000</u>	<u>\$ 175,000</u>	<u>\$ -</u>	<u>\$ 9,000</u>
Total	<u>\$ 175,000</u>	<u>\$ 175,000</u>	<u>\$ -</u>	<u>\$ 9,000</u>
2019:				
With no related allowance recorded:				
Commercial and Industrial	<u>187,000</u>	<u>187,000</u>	<u>-</u>	<u>\$ 9,000</u>
Total	<u>\$ 187,000</u>	<u>\$ 187,000</u>	<u>\$ -</u>	<u>\$ 9,000</u>

THE UPSTATE NATIONAL BANK

NOTES TO FINANCIAL STATEMENTS, Cont'd

DECEMBER 31, 2020 AND 2019

4. LOANS, Cont'd

The following table presents the classes of the loan portfolio summarized by the pass rating and the classified ratings of special mention, substandard, and doubtful within the Bank's internal risk rating system as of December 31, 2020 and 2019:

	<u>Pass</u>	<u>Special Mention</u>	<u>Substandard</u>	<u>Doubtful</u>	<u>Total</u>
<u>December 31, 2020</u>					
Construction and Land Development	\$ 4,730,000	\$ -	\$ -	\$ -	\$ 4,730,000
Residential Mortgages	73,504,000	-	-	-	73,504,000
Multi - Family	24,774,000	-	-	-	24,774,000
Commercial Real Estate	63,271,000	135,000	-	-	63,406,000
Commercial and Industrial	10,373,000	-	-	-	10,373,000
Loans to Individuals	33,000	-	-	-	33,000
Municipals	103,000	-	-	-	103,000
All Other Loans	<u>9,000</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>9,000</u>
	<u>\$ 176,797,000</u>	<u>\$ 135,000</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 176,932,000</u>
<u>December 31, 2019</u>					
Construction and Land Development	\$ 8,555,000	\$ -	\$ 551,000	\$ -	\$ 9,106,000
Residential Mortgages	47,380,000	306,000	-	-	47,686,000
Multi - Family	19,483,000	-	-	-	19,483,000
Commercial Real Estate	53,663,000	-	-	-	53,663,000
Commercial and Industrial	7,225,000	-	74,000	-	7,299,000
Loans to Individuals	33,000	-	-	-	33,000
Municipals	152,000	-	-	-	152,000
All Other Loans	<u>68,000</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>68,000</u>
	<u>\$ 136,559,000</u>	<u>\$ 306,000</u>	<u>\$ 625,000</u>	<u>\$ -</u>	<u>\$ 137,490,000</u>

THE UPSTATE NATIONAL BANK
NOTES TO FINANCIAL STATEMENTS, Cont'd
DECEMBER 31, 2020 AND 2019

5. PREMISES AND EQUIPMENT

Premises and equipment at December 31, 2020 and 2019 by major classification are summarized as follows:

	December 31,	
	2020	2019
Buildings and improvements	\$ 594,000	\$ 592,000
Furniture, fixtures and equipment	340,000	319,000
Land	91,000	91,000
	<u>1,025,000</u>	<u>1,002,000</u>
Accumulated depreciation	746,000	686,000
Net book value	<u>\$ 279,000</u>	<u>\$ 316,000</u>

6. DEPOSITS

The aggregate amount of time deposits in denominations of \$250,000 or more at December 31, 2020 and 2019 was \$15,768,000 and \$8,681,000 respectively. Brokered deposits, including non-reciprocal CDARS and ICS deposits, totaled approximately \$11,000,000 and \$17,001,000 at December 31, 2020 and 2019, respectively.

At December 31, 2020, the scheduled maturities of time deposits are as follows:

2021	\$ 70,003,000
2022	28,917,000
2023	4,812,000
2024	541,000
2025	1,035,000
	<u>\$ 105,308,000</u>

7. FEDERAL HOME LOAN BANK ADVANCES

The Bank pledges assets to the FHLB as collateral for the ability to borrow from the FHLB and for letters of credit to collateralize certain municipal deposits. At December 31, 2020, the Bank had pledged approximately \$148,248,000 of mortgage loans receivable for a total eligible collateral value of approximately \$124,972,000. There was \$11,000,000 in advances from the FHLB at December 31, 2020. The Bank had the capacity to borrow an additional amount of approximately \$26,416,000 from the FHLB against this collateral at December 31, 2020. At December 31, 2019, the Bank had pledged approximately \$109,422,000 of mortgage loans receivable for a total eligible collateral value of approximately \$89,151,000. There was \$22,000,000 in advances from the FHLB at December 31, 2019. The Bank had the capacity to borrow an additional amount of approximately \$42,300,000 from the FHLB against this collateral at December 31, 2019.

THE UPSTATE NATIONAL BANK
NOTES TO FINANCIAL STATEMENTS, Cont'd
DECEMBER 31, 2020 AND 2019

8. INCOME TAXES

The expense (benefit) from income taxes for the years ended December 31, 2020 and 2019 is summarized as follows:

	<u>2020</u>	<u>2019</u>
Current:		
Federal	\$ -	\$ -
State	6,000	11,000
Deferred	<u>484,000</u>	<u>(746,000)</u>
	<u>\$ 490,000</u>	<u>\$ (735,000)</u>

State income tax expense consists of current state capital base taxes payable.

The Bank's 2020 and 2019 effective tax rates differ from the statutory U.S. Federal income tax rate due primarily to the effects of state taxes and certain nondeductible expenses for Federal tax purposes.

	<u>December 31,</u>	<u>2019</u>
	<u>2020</u>	<u>2019</u>
Deferred tax assets:		
Federal net operating loss carryforwards	\$ 1,230,000	\$ 1,743,000
State net operating loss carryforwards	987,000	1,093,000
Other	<u>19,000</u>	<u>18,000</u>
Total deferred tax assets	2,236,000	2,854,000
Deferred tax liabilities:		
Allowance for loan losses	111,000	1,000
Other	<u>(41,000)</u>	<u>(65,000)</u>
Total deferred tax liabilities	<u>70,000</u>	<u>(64,000)</u>
Net deferred tax assets	<u>\$ 2,306,000</u>	<u>\$ 2,790,000</u>

At December 31, 2020, the Bank has Federal net operating loss carryforwards of approximately \$5,856,000 to offset future taxable income. Loss carryforwards of \$5,655,000 expire in varying amounts through December 2031. Loss carryforwards of \$201,000 do not expire. In addition, the Bank also has available for carryforward \$15,183,000 of New York State net operating loss carryforwards expiring at various dates through 2038.

Accounting principles generally accepted in the United States of America prescribe minimum recognition thresholds for evaluating uncertain income tax positions, and provide guidance on derecognition, measurement, classification, interest and penalties, and disclosure.

THE UPSTATE NATIONAL BANK

NOTES TO FINANCIAL STATEMENTS, Cont'd

DECEMBER 31, 2020 AND 2019

9. EMPLOYEE BENEFIT PLAN

The Bank has a salary savings profit sharing plan. The plan provides for matching contributions by the Bank up to 3% of each eligible employee's salary. Expense for the plan, which is included in salaries and employee benefits, aggregated \$63,000 and \$48,000 for the years ended December 31, 2020 and 2019, respectively.

10. OFF-BALANCE SHEET ACTIVITIES

The Bank is a party to credit related financial instruments with off-balance sheet risk in the normal course of business to meet the financing needs of its customers. These financial instruments include commitments to extend credit, consumer lines of credit and commercial letters of credit. Such commitments involve, to varying degrees, elements of credit and interest rate risk in excess of the amount recognized in the balance sheets.

The Bank's exposure to credit loss is represented by the contractual amount of these commitments. The Bank follows the same credit policies in making commitments as it does for on-balance sheet instruments.

At December 31, 2020 and 2019, commitments of \$25,402,000 and \$14,369,000, respectively, were outstanding whose contract amounts represent credit risk. Of these amounts, commitments to extend new money totaled \$13,535,000 and \$4,635,000 at December 31, 2020 and 2019, respectively. The unused portion of lines of credit and construction loans totaled \$11,819,000 and \$9,686,000 at December 31, 2020 and 2019, respectively. Conditional letters of credit totaled \$48,000 at December 31, 2020 and 2019.

Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee.

The commitments may expire without being drawn upon. Therefore, the total commitment amounts do not necessarily represent future cash requirements. The amount of collateral obtained, if it is deemed necessary by the Bank, is based on management's credit evaluation of the customer.

Commercial and municipal letters of credit are conditional commitments issued by the Bank to guarantee the performance of a customer to a third party. Those letters of credit are primarily issued to support public and private borrowing arrangements. Essentially all letters of credit issued have expiration dates within one year. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loan facilities to customers. The Bank generally holds collateral supporting those commitments if deemed necessary. Management believes that the proceeds through a liquidation of such collateral would be sufficient to cover the maximum potential amount of future payments required under the corresponding commitments. No liability was required to be recorded on the balance sheets as December 31, 2020 and 2019 under letters of credit.

THE UPSTATE NATIONAL BANK

NOTES TO FINANCIAL STATEMENTS, Cont'd

DECEMBER 31, 2020 AND 2019

11. REGULATORY CAPITAL

The Bank, as a national bank, is subject to the dividend restrictions set forth by The Office of the Comptroller of the Currency (OCC). Under such restrictions, the Bank may not, without prior approval of the OCC, declare dividends, either common or preferred, that would exceed its net profits for the current year combined with retained net profits (net profits minus dividends paid during that period) of the two prior years. There were no dividends declared or paid during 2020 or 2019.

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

In addition to setting minimum capital ratios, the requirements introduce a capital conservation buffer, which must be added to each of the minimum capital ratios and is designed to absorb losses during period of economic stress. The implementation of the capital conservation buffer began on January 1, 2016 and reached 2.5% on January 1, 2019. If the Bank fails to hold capital above minimum capital ratios, including the capital conservation buffer, it will be subject to certain restrictions on capital distributions and discretionary bonus payments.

Quantitative measures established by regulation to ensure capital adequacy require the Bank to maintain required amounts and ratios as set forth in the table below.

THE UPSTATE NATIONAL BANK

NOTES TO FINANCIAL STATEMENTS, Cont'd

DECEMBER 31, 2020 AND 2019

11. REGULATORY CAPITAL, Cont'd

As of December 31, 2020, the most recent notification categorized the Bank as well capitalized under the regulatory framework for prompt corrective action. To be categorized as well capitalized, the Bank must maintain minimum total risk-based, Tier 1 risk-based, Common Equity Tier 1 risk-based, and Tier 1 leverage ratios as set forth in the following table:

	Actual		To be adequately capitalized under prompt corrective action provisions		To be well capitalized under prompt corrective action provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
As of December 31, 2020:						
Total capital (to risk-weighted assets)	\$ 18,112,000	12.78%	\$ 11,338,000	8.00%	\$ 14,172,000	10.00%
Tier 1 capital (to risk-weighted assets)	16,340,000	11.53%	8,503,000	6.00%	11,338,000	8.00%
Tier 1 capital (leveraged) (to adjusted total assets)	16,340,000	8.26%	7,908,000	4.00%	9,886,000	6.00%
Common Equity Tier 1 (to risk-weighted assets)	16,321,000	11.52%	6,377,000	4.50%	9,212,000	6.50%
As of December 31, 2019:						
Total capital (to risk-based assets)	\$ 15,590,000	13.00%	\$ 9,594,000	8.00%	\$ 11,992,000	10.00%
Tier 1 capital (to risk-weighted assets)	14,236,000	11.87%	7,195,000	6.00%	9,594,000	8.00%
Tier 1 capital (leveraged) (to adjusted total assets)	14,236,000	9.17%	6,209,000	4.00%	7,762,000	6.00%
Common Equity Tier 1 (to risk-weighted assets)	14,236,000	11.87%	5,397,000	4.50%	7,795,000	6.50%

THE UPSTATE NATIONAL BANK

NOTES TO FINANCIAL STATEMENTS, Cont'd

DECEMBER 31, 2020 AND 2019

12. FAIR VALUE MEASUREMENTS

The definition of fair value is clarified by accounting principles generally accepted in the United States of America ("GAAP") to be the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. GAAP established a three-level hierarchy for fair value measurements based upon the inputs to the valuation of an asset or liability.

Level 1 - Valuation is based on quoted prices in active markets for identical assets and liabilities.

Level 2 - Valuation is determined from quoted prices for similar assets or liabilities in active markets, quoted prices for identical or similar instruments in markets that are not active or by model-based techniques in which all significant inputs are observable in the market.

Level 3 - Valuation is derived from model-based techniques in which at least one significant input is unobservable and based on the Bank's own estimates about the assumptions that market participants would use to value the asset or liability.

The asset's fair value measurement level within the fair value hierarchy is based on the lowest level of any input that is significant to the fair value measurement. Valuation techniques used need to maximize the use of observable inputs and minimize the use of unobservable inputs.

Following is a description of the valuation methodologies used for assets measured at fair value. There have been no changes in the methodologies used at December 31, 2020 and 2019.

U.S. government agency securities, mortgage backed securities and other fixed income securities: Valued by reference to prices for similar securities or through model-based techniques in which all significant inputs are observable.

The preceding methods described may produce a fair value calculation that may not be indicative of net realizable value or reflective of future fair values. Furthermore, while the Bank believes its valuation methods are appropriate and consistent with other market participants, the use of different methodologies or assumptions to determine the fair value of certain financial instruments could result in a different fair value measurement at the reporting date.

THE UPSTATE NATIONAL BANK
NOTES TO FINANCIAL STATEMENTS, Cont'd
DECEMBER 31, 2020 AND 2019

12. FAIR VALUE MEASUREMENTS, Cont'd

Fair values of assets measured on a recurring basis at December 31, 2020 and 2019 are as follows:

	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	<u>Total</u>
<u>December 31, 2020</u>				
Mortgage backed securities -				
Government issued or guaranteed	\$ -	\$ 9,281,000	\$ -	\$ 9,281,000
Municipal bonds	-	2,933,000	-	2,933,000
Other	-	1,257,000	-	1,257,000
Total securities available for sale	<u>\$ -</u>	<u>\$ 13,471,000</u>	<u>\$ -</u>	<u>\$ 13,471,000</u>
 <u>December 31, 2019</u>				
Mortgage backed securities -				
Government issued or guaranteed	\$ -	\$ 12,111,000	\$ -	\$ 12,111,000
Other	-	2,693,000	-	2,693,000
Total securities available for sale	<u>\$ -</u>	<u>\$ 14,804,000</u>	<u>\$ -</u>	<u>\$ 14,804,000</u>

13. RELATED PARTY TRANSACTIONS

The Bank has entered into transactions with its directors, significant shareholders and their affiliates (related parties). There were no loans to related parties at December 31, 2020 and 2019. The aggregate amount of deposits from such related parties at December 31, 2020 and 2019 were \$3,116,000 and \$2,725,000, respectively.

14. REDEEMABLE CONVERTIBLE PREFERRED STOCK

Holders of the Series A redeemable convertible preferred stock will be entitled to receive dividends as declared by the Board of Directors, if any, out of assets of the Bank legally available for payment. Any Series A redeemable convertible preferred stock dividends, if declared, will be at the rate of 5.5% per annum, based on a \$10 per share purchase price, or \$0.55 per share per annum. This rate can be changed by the Board of Directors at any time. No preferred stock dividends were paid in 2020 and 2019. The preferred stock is non-cumulative, however, dividends in any year must be paid on the Series A redeemable convertible preferred stock prior to any payment of dividends on the common stock.

Each share of the Series A redeemable convertible preferred stock is convertible into 5 shares of common stock at the option of the holder. There were no preferred stock transactions during 2020 and 2019.

THE UPSTATE NATIONAL BANK
NOTES TO FINANCIAL STATEMENTS, Cont'd
DECEMBER 31, 2020 AND 2019

14. REDEEMABLE CONVERTIBLE PREFERRED STOCK, Cont'd

The holders of preferred stock will not have a vote in any matter, unless otherwise required by law.

In the event of a liquidation, dissolution or winding up of the Bank, each holder of preferred stock would be entitled to receive, after payment of all debts and liabilities of the Bank and prior to any liquidation rights of the holders of common stock, a pro rata portion of all assets of the Bank available for distribution to holders of preferred stock up to the amount of the preferred stock purchase price. Holders of preferred stock have no right to share in any other assets of the Bank upon liquidation.

Holders of shares of common stock are not entitled to preemptive rights with respect to any shares of preferred stock that may be issued. The shares of preferred stock will be redeemable at the option of the holder.

15. COMMITMENTS

The Bank leases one of its facilities under terms of an operating lease agreement which expires in September 2025. The lease agreement currently requires total monthly payments approximating \$6,000 per month.

Future minimum lease payments under the amended lease are as follows:

<u>Year</u>	<u>Amount</u>
2021	\$ 79,000
2022	80,000
2023	81,000
2024	82,000
2025	63,000
	<u>\$ 385,000</u>

Rent expense, including certain common area charges, under the lease was approximately \$78,000 and \$77,000 for the years ended December 31, 2020 and 2019, respectively.

The Bank has a master license maintenance and service agreement for data processing software which expires March 2021. The agreement currently requires total monthly payments of \$18,000 per month.

Future minimum payments are as follows:

<u>Year</u>	<u>Amount</u>
2021	<u>\$ 53,000</u>

Data processing expense was approximately \$313,000 and \$285,000 for the years ended December 31, 2020 and 2019, respectively.

THE UPSTATE NATIONAL BANK
NOTES TO FINANCIAL STATEMENTS, Cont'd
DECEMBER 31, 2020 AND 2019

16. COMPREHENSIVE INCOME (LOSS)

The following table displays the components of other comprehensive income (loss):

	<u>Unrealized (losses) gains</u>	<u>Accumulated other comprehensive (loss) income</u>
Balance at January 1, 2019	\$ (371,000)	\$ (371,000)
Net gain during 2019	<u>710,000</u>	<u>710,000</u>
Balance at December 31, 2019	339,000	339,000
Net gain during 2020	<u>311,000</u>	<u>311,000</u>
Balance at December 31, 2020	<u>\$ 650,000</u>	<u>\$ 650,000</u>