2018 Annual Report

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Forward Looking Statements

When used in this annual report, or in any written or oral statement made by us or our officers, directors or employees, the words and phrases “will result,” “expect,” “will continue,” “anticipate,” “estimate,” “project,” or similar terms are intended to identify “forward-looking statements.” A variety of factors could cause our actual results and experiences to differ materially from the anticipated results or other expectations expressed in any forward-looking statements. Some of the risks and uncertainties that may affect our operations, performance, development and results, the interest rate sensitivity of our assets and liabilities, and the adequacy of our loan loss allowance, include, but are not limited to:

- deterioration in local, regional, national or global economic conditions which could result in, among other things, an increase in loan delinquencies, a decrease in property values, or a change in the real estate turnover rate;
- changes in market interest rates or changes in the speed at which market interest rates change;
- changes in laws and regulations affecting the financial service industry;
- changes in public policy initiatives and regulatory philosophy;
- adverse weather conditions or other severe climate occurrences;
- the acceptability of alternate quasi-currencies or other products that affect banks as financial intermediaries;
- technology developments and competition from alternate monetary systems based upon different technology;
- hacking, cyber-attacks and other computer intrusion threats;
- changes in the public’s perception of financial institutions in general and banks in particular;
- changes in competition; and
- changes in consumer preferences by our customers or the customers of our business borrowers.

Please do not place undue reliance on any forward-looking statement, which speaks only as of the date made. There are many factors, including those described above, that could affect our future business activities or financial performance and could cause our actual future results or circumstances to differ materially from those we anticipate or project. We do not undertake any obligation to update any forward-looking statement after it is made.

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To Our Stockholders

We are looking to broaden our presence in 2019 with the opening of our sixth branch on Staten Island. Our net income continued to rise in 2018, totaling $3.3 million, or $1.83 per common share, which is more than a 27% increase over 2017. We increased our quarterly cash dividend per share by 20% to $0.12 per share for the fourth quarter of 2018. Our loan portfolio did decrease by $9 million in 2018, due primarily to larger payoffs of our matured construction loans. We have shifted our focus towards longer term commercial real estate loans, but we will continue to seek construction loan opportunities. Our total assets rose by $24 million to $374 million, purely from organic growth. Our non-performing assets rose slightly to $862 thousand, which is only 0.23% of total assets. We have increased our capital base by a net of $2.5 million, while paying cash dividends of $787,320.

We are seeing signs that economic expansion that has lasted for ten years may be coming to a close in 2019. Inflation has remained consistently around the 2% level and has not demonstrated any significant upward pressure. The Federal Reserve has shifted to a more neutral policy on rates while leaving the possibility of up to two more rate hikes in 2019. The stock market and interest rate environment has shown increased volatility and we expect that trend to subside later in 2019. There is still increased competition for deposits, and we may be forced to raise our rates to retain and attract depositors.

The real estate market has softened in some parts of New York City, especially in the high-priced sector of the housing market. Average rental rates in New York City reportedly rose modestly in the fourth quarter of 2018. This change in is being reflected in our underwriting decisions as we take a more conservative stance.

The growth of our investment portfolio, the higher yields that we are seeing on new investment purchases and the low level of non-performing loans, has generated more interest income. We continue to employ our cost containment program, which has moderated general expense growth. We had a lower level of recoveries on loans previously charged off and a higher level of loan charge-offs which resulted in a larger loan loss provision expense. The lower federal tax rate in 2018 was also a factor in our growth of net income.

Total deposits, including escrow deposits, increased to $336 million, an increase of $21 million, or 7% during 2018. The increase was spread primarily among our demand and checking, NOW and jumbo time accounts. We converted to a new data processing system in August of 2018, and we experienced additional costs associate with that conversion. Our ability to foster strong customer relationships translates into a very high level of business checking accounts. We are ranked in the 97th percentile, in average demand deposits to average assets, in our peer group of banks between $300 million to $1 billion in assets. This is an interest free source of deposits that increases profitability in the current interest rate environment. We were built from inception to deliver the utmost level of customer service, and this has been one of greatest strategic assets.

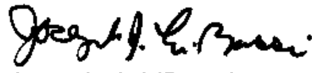
We have not been able to repurchase additional shares of our stock in 2018 at satisfactory prices as we now trade over our book value. We historically have been able to buy back our shares at an overall significant discount to our book value. We just announced our forty-sixth consecutive cash dividend, while maintaining our dividend payout ratio at 24% of net income, even with the increases in the dividend rate. Our book value per share rose to $19.13. Our regulatory capital base

remains well in excess of what is needed to be considered well capitalized by industry standards and regulatory requirements.

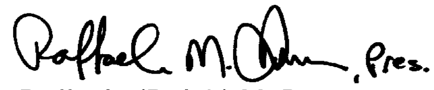
For 2018, our return on assets rose to 0.88% and our return on equity rose to 9.66%, which is a result of the growth of our investment portfolio, moderate interest and provision expense and the constrained growth of general expenses. We are confident that we will be able to add more loans and therefore increase our overall bottom-line.

In 2019, we anticipate that we will surpass our 2018 results. Our strategic program has generated strong stockholder value over our 21 years of existence. We are committed to this roadmap in 2019 and beyond.

March 29, 2019



Joseph J. LiBassi
Chairman of the Board



Raffaele (Ralph) M. Branca
President and Chief Executive Officer

Business Description

VSB Bancorp, Inc. (referred to using terms such as "we," "us," or the "Company") is the holding company for Victory State Bank (the "Bank"), a New York State chartered commercial bank. Our primary business is owning all of the issued and outstanding stock of the Bank. Victory State Bank is a New York State chartered commercial bank, founded in November 1997. The Bank is supervised by the New York State Department of Financial Services ("NYSDFS") and the Federal Deposit Insurance Corporation ("FDIC"). The Bank gathers deposits from individuals and businesses primarily in Staten Island and makes loans throughout that community. The Bank invests funds that are not used for lending primarily in government securities, mortgage backed securities and collateralized mortgage obligations. Customer deposits are insured, up to the applicable limit, by the FDIC. VSB Bancorp, Inc. common stock is quoted on the OTC Markets Group ("OTCQX") under the symbol "VSBN".

Our results of operations are dependent primarily on net interest income, which is the difference between the income we earn on our loan and investment portfolios and our costs of funds, consisting primarily of interest paid on our deposits. Our operating expenses principally consist of employee compensation and benefits, occupancy expenses, professional fees, advertising and marketing expenses and other general and administrative expenses. Our results of operations are significantly affected by general economic and competitive conditions, particularly the general strength of the local economy, changes in market interest rates, government policies and actions of regulatory authorities.

Since the Bank opened for business in 1997, the Board of Directors and management have pursued a strategy of growth and expansion in order to enhance the long-term value of our banking franchise. The Board of Directors and management anticipate that an increase in customer deposits, and the resulting increase in funds we would have available to fund asset growth, will generate an increase in net interest income.

In order to support branch expansion and asset growth, we initially did not pay cash dividends. Our Board of Directors approved our first $0.06 cash dividend during the fourth quarter of 2007, and we have paid dividends to stockholders every quarter since then. We have periodically increased our quarterly cash dividend, with our cash dividend reaching $0.12 per share for the fourth quarter of 2018. In 2018, we paid $787,320 of dividends out of net income of $3,256,563, for a dividend payout ratio of 24% and in 2017 we paid $605,219 of dividends out of net income of $2,558,122, for a dividend payout ratio of 24%. Thus, we retained the majority of our net income to increase our capital base to support our efforts to expand our franchise in the future.

During 2018, our non-accrual loans increased slightly, and totaled $861,727, or 0.68% of total loans, at December 31, 2018. Our loans 90 days past due and still accruing deceased to $248,619 in 2018, from $4.8 million in 2017. These are primarily matured constructions loans with interest being paid monthly, and we expect them to be repaid, modified, or extended without any concessions.

Commentators generally expect that deposit interest rates will rise in 2019, albeit at a slower pace than 2018, as the Federal Reserve is expected to continue increasing short term rates. This causes us to anticipate an increase in deposit costs in 2019. The local real estate market has shown some signs of softening. This may curtail demand for new loans.

Management intends to exert efforts to continue growing our company in the future. However, both internal and external factors could adversely affect our future growth. We have expanded our lending market outside of Staten Island to originate some new loans that meet our underwriting standards. This may increase our level of loans which have higher interest rates than other investments. This may result in a shift away from lower-yielding asset categories.

Regulatory capital requirements could have a negative effect on our ability to grow as we need to support that growth with increased capital. However, our current capital levels are such that we anticipate that existing capital plus retained

earnings will be sufficient to support growth without the need to choose between raising additional capital or reigning in anticipated growth.

Management's Discussion and Analysis of Financial Condition and Results of Operations

Since Victory State Bank opened for business, management has worked to grow its franchise. From no deposits, no loans and less than $7.0 million of assets on the day it opened for business in 1997, the bank has grown to total assets of $373.8 million, net loans of $126.6 million, total deposits of $336.4 million and capital of $35.0 million by December 31, 2018.

Economic Conditions

In the past few years, the local and national economy has been growing but recent events may dampen future performance. However, many factors, including those of a local, national and international nature, create uncertainties. The intermediate and long-term effect of the administration in Washington on economic growth, asset values, and other important economic factors is not yet known. The Federal Reserve has raised interest rates from their historical lows, but both the speed and magnitude of future interest rate increases are uncertain. These issues all contribute to the creation of uncertainty not only in the pace of economic growth, but its sustainability.

We draw a substantial portion of our customer base from local businesses, especially those in the building trades and related industries. If the local economy suffers due to any of these uncertainties, or as they are gradually resolved, it would become more difficult for us to conduct prudent and profitable business in our community.

Possible Adverse Effects on Our Net Income Due to Fluctuations in Market Rates

Our principal source of income is the difference between the interest income we earn on interest-earning assets, such as loans and securities, and our cost of funds, principally interest paid on deposits. These rates of interest change from time to time, depending upon a number of factors, including general market interest rates. However, the frequency of the changes varies among different types of assets and liabilities. For example, for a loan with an interest rate based upon the prime rate, the interest rate may change every time the prime rate changes. In contrast, the rate of interest we pay on a five-year certificate of deposit adjusts only every five years, based upon changes in market interest rates.

In general, the interest rates we pay on deposits adjust more slowly than the interest rates we earn on loans because our loan portfolio consists primarily of loans with interest rates that fluctuate based upon the prime rate. In contrast, although many of our deposit categories have interest rates that could adjust immediately, such as interest checking accounts and savings accounts, changes in the interest rates on those accounts are at our discretion. Thus, the rates on those accounts, as well as the rates we pay on certificates of deposit, tend to adjust more slowly. The prime rate began to rise at the end of 2015 from its long-term low of 3.25% and reached 5.50% by the end of 2018. Deposit rates have fluctuated within a narrower band during this time frame but are likely to rise if the Federal Reserve continues to increase short term rates.

In the past, we originated prime-based loans with minimum interest rates, or floors. The floors were normally set at a rate equal to the prime rate at that time plus a fixed margin. Thus, when the minimum rate remained below the prime rate plus that fixed margin, the rate on the loan stayed the same, and the interest rate did not decline with decreases in the prime rate. This helped stabilize our loan yields in a period of declining interest rates, but it limited the positive effect of market rate increases as the prime rate began to increase in 2015. In recent years, we have reduced reliance on interest rate floors as we anticipated that market rates would not decline, and thus a larger portion of our loan portfolio is immediately responsive to market interest rate increases. However, customer preferences and competitive pressures may negate this positive effect because customers may choose to move funds into higher-earning

deposit types as higher interest rates make them more attractive, or competitors offer premium rates to attract deposits.

However, our efforts to increase loans as a percentage of total interest-earning assets may have an adverse effect on our average loan yields if competitive pressures necessitate loan offerings at lower rates or if we purchase participations at current market yields.

We have a substantial amount of investment securities with fixed rates of interest, most of which are mortgage-backed securities with an estimated average life of not more than 7 years. We receive regular cash flows from the repayment of our securities portfolios. These repayments were in excess of $36.6 million in 2018 and $41.7 million in 2017. Consistent and predictable securities repayments should allow us to invest in new securities at higher yields as market rates increase, thus mitigating the effect of the delay in repricing our loans with interest rate floors.

The Company Is Exposed to Cyber-Security Risks

Cyber-security risks include the possibility of wrongful intrusions into or disruptions of the Bank's computer systems. These may be in the form of denial of service attacks, hacking, the insertion of malware or crypto-locker attacks and identity theft, which could result in the disclosure, theft, wrongful encryption or destruction of critical internal information necessary for the operation of the company, or the release of private information about customers.

The Bank relies heavily on communications and information systems to conduct its business. This includes the use of networks, the internet, digital applications, and the telecommunications and computer systems of its own and of third parties to perform business activities. Additionally, customers interact with the Bank using electronic means, which increases the risk of information security breaches. Criminal elements are constantly attempting to find weaknesses and flaws in software or hardware that could allow them to criminally access the Bank's systems. Any failure, interruption or breach in security of these systems could result in disruptions to the Bank's accounting, deposit, loan and other systems, or result in the wrongful access to sensitive customer information, all of which could adversely affect its customer relationships. While the Bank has implemented software and hardware systems to reduce the probability of adverse access to its systems and has adopted policies and procedures designed to prevent or limit the effect of these possible events, there can be no assurance that any such failure, interruption or security breach will not occur or, if any does occur, that it can be sufficiently remediated.

Comparative Results for the Years Ended December 31, 2018 and December 31, 2017

Our results of operations depend primarily on net interest income, which is the difference between the income we earn on our loan and investment portfolios and our cost of funds, consisting primarily of interest we pay on customer deposits. Our operating expenses principally consist of employee compensation and benefits, occupancy expenses, professional fees, advertising and marketing expenses and other general and administrative expenses. Our results of operations are significantly affected by general economic and competitive conditions, particularly changes in market interest rates, government policies and actions of regulatory authorities.

General. We had net income of $3,256,563 for the year ended December 31, 2018, compared to net income of $2,558,122 for the comparable period in 2017. The principal categories which make up the 2018 net income are:

- Interest income of $13,243,847
- Reduced by interest expense of $1,188,588
- Reduced by a provision for loan losses of $125,000
- Increased by non-interest income of $2,520,461
- Reduced by non-interest expense of $10,076,601
- Reduced by income tax expense of $1,117,556

We discuss each of these categories individually and the reasons for the differences

between the years ended December 31, 2018 and 2017 in the following paragraphs.

Interest Income. Interest income was $13,243,847 for the year ended December 31, 2018, compared to $12,389,414 for the year ended December 31, 2017, an increase of $854,433 or 6.9%. The main reason for the increase was a $26,787,160 or 15.2% increase in the average balance of investment securities. Interest from loans and other interest earning assets were relatively stable due to some offsetting volume and rate conditions.

Interest income on loans decreased by $35,050 as a result of the decrease of $1.7 million in the average balance of loans from the year ended December 31, 2017 to the year ended December 31, 2018 offset by a 5 basis point increase in the average yield. We experienced a large level of payoffs on our construction loan portfolio as the collateral was sold or they were converted to permanent loans at other institutions. They have been replaced by new construction loans that are gradually funded over time. The loan portfolio represented 36.3% of average interest earning assets in 2018 compared to 37.7% in 2017.

Our non-performing loans increased from $592,757 at December 31, 2017 to $861,727 at December 31, 2018. Non-performing loans continue to be included in the calculation of average loan yield, but with an effective yield of zero. We estimate that if all non-performing loans were performing according to their contractual terms during the year ended December 31, 2018, our average loan yield would have been approximately 5 basis points higher. In contrast, we estimate that the comparable effect in 2017 would have been approximately a 4 basis point increase in average loan yield. Substantially all of the non-accrual loans are secured by mortgages on real estate.

Interest income on investment securities was $4,757,342 for the year ended December 31, 2018, compared to $3,901,097 for the year ended December 31, 2017, an increase of $856,245 or 21.9%. The average balance of our investment portfolio increased by $26.8 million or 15.2%, between the periods. This occurred as we invested available funds from our increase in deposits into investment securities pending our efforts to increase our average balance of loans. We also experienced a 13 basis point increase in the average yield on our investment securities portfolios, from 2.21% to 2.34%, due to the purchase of new investment securities, primarily CMOs with an average life of 5 years or less and balloon securities with stated maturities of primarily seven years or less. These securities were purchased at higher market rates than the rates we had been earning on the investment securities previously purchased that were gradually being repaid. The investment securities portfolios represented 56.9% of average interest earning assets in 2018 compared to 50.6% in 2017.

Interest income from other interest earning assets (principally overnight investments) increased by $33,238 due to an 86 basis point increase in the average rates we earned on our overnight investments from 2017 to 2018, partially offset by a decrease of $16,467,517 in the average balance of other interest earning assets. The average yield increase corresponded to the Federal Reserve's increase in the target federal funds rate between the periods. Other interest earning assets represented 6.8% of average interest earning assets in 2018 compared to 11.7% in 2017. We seek to maintain relatively lower levels of overnight investments, subject to anticipated liquidity needs, because those investments have low average yields.

Interest Expense. Interest expense was $1,188,588 for the year ended December 31, 2018, compared to $925,033 for the year ended December 31, 2017, an increase of $263,555 or 28.5%. The increase in interest expense was principally driven by an increase in the rates we paid on interest-bearing deposits. Although our deposit mix among interest-bearing deposit categories shifted from 2017 to 2018, the overall increase in deposits during 2018 was entirely in the no cost demand deposit category. We had a $244,790 increase in interest expense on time accounts as the average cost increased by 45 basis points and the average balance between periods increased by $451,248. We also experienced a $124,323 increase in interest expense on NOW accounts due to a $9.8 million increase in average balance and a 16 basis point

increase in average cost. These were partially offset by a $100,997 decrease in interest expense on money market accounts as the average cost decreased by 6 basis points and the average balance decreased by $8.9 million. This resulted from some of our existing customers moving into other deposit products.

Average interest-bearing deposits decreased by $407,146, and average demand deposits, an interest free source of funds for us to invest, increased $7.5 million, or 5.4%. This resulted in a combined $7.2 million increase in average total deposits from 2017 to 2018. Demand deposits represented approximately 44% of average total deposits in 2018.

Net Interest Income Before Provision for Loan Losses. Net interest income before the provision for loan losses was $12,055,259 for the year ended December 31, 2018, compared to $11,464,381 for the year ended December 31, 2017, an increase of $590,878, or 5.2%. The increase in our interest income as detailed above, was the principal cause of the rise in net interest income.

The average yield on interest earning assets increased by 15 basis points and the average cost of funds increased by 14 basis points. Overall, our interest rate spread increased 1 basis point, from 3.05% to 3.06% between the periods. Our net interest margin increased to 3.37% for the year ended December 31, 2018 from 3.29% in the same period of 2017. The margin is higher than the spread because it takes into account the effect of interest free demand deposits and capital.

The margin increased by 8 basis points, compared to a one basis point increase in spread, principally because the gradual, across the board increase in earning asset yields makes our capital and non-interest bearing demand deposits progressively more valuable as zero cost funding sources. Average noninterest-bearing demand deposits as a percentage of total deposits increased from 42.7% in 2017 to 44.1% in 2018. Our average cost of interest-bearing deposits increased 14 basis points, while our average overall deposit cost, including non-interest bearing demand and escrow deposits increased only 8 basis points. This positive effect of zero interest deposits was amplified by the increased earnings on that portion of our capital that was used to fund earning assets. The ratio of interest-earning assets to interest bearing liabilities improved from 187% to 192% as management's strategy of seeking demand deposits and maintaining a strong capital base bears fruit as market interest rate conditions increase

Provision for Loan Losses. The provision for loan losses in any period depends upon the amount necessary to bring the allowance for loan losses to the level management believes is appropriate, after taking into account charge offs and recoveries. We took a provision for loan losses of $125,000 for the year ended December 31, 2018 compared to a provision for loan losses of $15,000 for the same period in 2017. The $110,000 increase in the provision was due to a higher level of loans charged-off and a lower level of recoveries when comparing 2017 to 2018.

Our non-performing loans increased from $592,757 million at December 31, 2017 to $861,727 at December 31, 2018. All of those loans are secured by real estate. We individually evaluated the non-performing mortgage loans based primarily upon updated appraisals as part of our analysis of the appropriate level of our allowance for loan and lease losses. We charged off $290,000 of loans in 2018 as compared to $32,252 in 2017. We also had recoveries (which are added back to the allowance for loan losses) of $72,493 for the year ended December 31, 2018 as compared to $207,383 in the same period of 2017.

After considering available information, we determined that the level of our allowance at December 31, 2018 was appropriate to address probable incurred losses. Our allowance for loan losses was $1,564,698 or 1.14% of total loans, at December 31, 2017, compared to $1,472,191 or 1.15% of total loans, at December 31, 2018. There can be no assurance that a higher level, or a higher provision for loan losses, will not be necessary in the future.

Non-interest Income. Non-interest income was $2,520,461 for the year ended December 31, 2018, compared to $2,576,052 during the same period last year. The $55,591, or 2.2% decrease in

non-interest income was a direct result of three principal factors. Net rental income declined by $96,650 because we repurposed one of our rental properties into a business service center for the Bank's own use. Service charges on deposits consisting mainly of insufficient fund fees, declined by $66,500. Those fees are inherently volatile and are based upon the number of items being presented for payment against insufficient funds. These declines were partially offset by an increase in loan fees of $106,705 in 2018, due to a higher level of loan prepayments.

Non-interest Expense. Non-interest expense was $10,076,601 for the year ended December 31, 2018, compared to $9,375,796 for the year ended December 31, 2017, an increase of $700,805 or 7.5%. The principal shifts in the individual categories were:

- a $350,547 increase in salaries and benefits due to a higher level of staff, a minimum wage increase, and overtime expense associated with the core system conversion;
- a $303,842 increase in data processing service fees due to charges associated with the core system conversion in August 2018;
- a $148,746 increase in occupancy expense due primarily to rental expense on our new branch that is under construction; partially offset by
- a $49,525 decrease in professional fees due primarily to the recruitment fees incurred in 2017 that were not repeated in 2018, and
- a $36,000 decrease in FDIC and NYSDFS assessments, due to lower assessment rates.

In addition to these changes, we also experienced changes in the various other non-interest expense categories due to normal fluctuations in operations.

Income Tax Expense. Income tax expense was $1,117,556 for the year ended December 31, 2018, compared to income tax expense of $2,091,515 for the same period ended 2017. The decrease in income tax expense was due to the $275,518 decrease in income before taxes in the 2018 period and a 23 basis point decrease in the effective tax rate in 2018. Also, in 2017, we recorded a $423,318 federal tax valuation allowance related to our deferred tax asset due to the 2017 federal tax law change. The law dropped the corporate tax rate beginning in 2018, which made our deferred asset for future tax deductions less valuable. This adjustment, a component of tax expense, also resulted in a one-time effective tax rate increase in 2017. Our effective tax rate for 2018 was 22.0% and 2017 was 45.0%.

Changes in Financial Condition

Total assets were $373,838,638 at December 31, 2018, an increase of $24,030,672, or 6.9%, from December 31, 2017. The principal changes resulting in the increase in assets can be summarized as follows:

- a $16,262,334 increase in cash and cash equivalents
- a $14,634,962 increase in investment securities, partially offset by
- a $8,999,729 decrease in loans receivable, net.

In addition to these changes in major asset categories, we also experienced changes in other asset categories due to normal fluctuations in operations.

Our deposits (including escrow deposits) were $336,392,084 at December 31, 2018, an increase of $20,832,116 or 6.6%, from December 31, 2017. The principal components of this increase were increases of $22,010,524 in non-interest demand deposits, $5,456,596 in NOW accounts and $3,969,690 in time deposits, partially offset by decreases of $9,178,959 in money market accounts and $1,553,492 in savings accounts. We exert special efforts to maintain and increase the level of non-interest-bearing demand (checking) deposits as a source of low-cost funds.

Total stockholders' equity was $35,033,170 at December 31, 2018, an increase of $2,432,830, or 7.5%, from December 31, 2017. The increase reflected: (i) a $2,526,344 increase in retained earnings due to net income of $3,256,563 for the

year ended December 31, 2018, partially offset by $787,320 of dividends paid in 2018; (ii) a reduction of $100,125 in Unearned ESOP shares reflecting the gradual payment of the loan we made to fund the ESOP's purchase of our stock; and (iii) an increase in the net unrealized loss on available for sale securities of $375,401.

The unrealized gain or loss on the available for sale and held to maturity securities portfolios are excluded from the calculation of regulatory capital. Management does not anticipate selling securities in these portfolios, but changes in market interest rates or in the demand for funds may change management's plans with respect to the securities portfolios. If there is a material increase in interest rates, the market value of the securities portfolios may decline.

Liquidity and Capital Resources

Our primary sources of funds are increases in deposits, proceeds from the repayment of investment securities, and the repayment of loans. We use these funds to purchase new investment securities and to fund new and renewing loans in our loan portfolio. Remaining funds are invested in short-term liquid assets such as overnight federal funds loans and bank deposits.

During the year ended December 31, 2018, we had a net increase in total deposits of $20,832,116 due to increases of $22,010,524 in non-interest demand deposits, $5,456,596 in NOW accounts, $3,969,690 in time deposits, and $127,757 in escrow deposits, partially offset by decreases of $9,178,959 in money market accounts and $1,553,492 in savings accounts. These are all what are commonly known as "retail" deposits that we obtain through the efforts of our branch network rather than "wholesale" deposits that some banks obtain from deposit brokers or deposit listing services. We also received proceeds from repayment of investment securities of $36,596,886. We used $52,175,292 of available funds to purchase new investment securities and we had a net loan decrease of $8,998,550. These changes resulted in an overall increase in cash and cash equivalents of $16,262,334. Total cash and cash equivalents at December 31, 2018 were $29,182,881.

In contrast, in 2017, we had a net increase in total deposits of $14,686,574 due to increases of $11,580,907 in NOW accounts, $7,728,243 in non-interest demand deposits, $940,961 in savings accounts and $36,721 in escrow deposits, partially offset by decreases of $4,849,735 in time deposits and $750,523 in money market accounts. These are also all "retail" deposits. We also received proceeds from repayment of investment securities of $41,694,453. We used $72,963,433 of available funds to purchase new investment securities and we had a net loan increase of $10,635,373. These changes resulted in an overall decrease in cash and cash equivalents of $24,319,814. Total cash and cash equivalents at December 31, 2017 were $12,920,547.

At December 31, 2018, cash and cash equivalents represented 7.8% of total assets. Our cash and cash equivalents increased during the year. We deployed a portion of the funds received from maturing securities, paid off loans and our increase in deposits into new investment securities, at higher market yields, with the remainder into overnight liquid investments. We anticipate, based upon historical experience that cash and cash equivalents, combined with cash inflows we anticipate from payments on our loan and investment securities portfolios, will be sufficient to fund loan growth and unanticipated deposit outflows. Depending upon competitive pressures, we may need to implement interest-paying business checking in order to maintain demand deposits at historical levels or to increase such deposits.

As a secondary source of liquidity, at December 31, 2018 we had $38.3 million of investment securities classified available for sale. The disposition of these securities prior to maturity is an option available to us in the event, which we believe is unlikely, that our primary sources of liquidity and expected cash flows are insufficient to meet our need for funds. Additionally, we have the ability to borrow funds at the Federal Home Loan Bank of New York and the Federal Reserve Bank of New York using the securities in our investment portfolios as collateral if the need arises. Based upon our asset size and the amount of our

securities portfolios that qualifies as eligible collateral, we had more than $117 million of unused borrowing capability from the FHLBNY at December 31, 2018. Victory State Bank also has a $5 million unsecured credit facility with Atlantic Central Bankers Bank, which the Bank has not drawn upon. We do not anticipate a need for additional capital resources and do not expect to raise funds through a stock offering in the near future. Based upon past experience, we believe that we have sufficient resources to allow us to continue to make loans as appropriate opportunities arise to support our lending activities.

Victory State Bank satisfied all capital ratio requirements of the Federal Deposit Insurance Corporation at December 31, 2018, with a Tier I Leverage Capital ratio of 9.28%, a Common Equity Tier I to Risk Weighted Assets ratio of 20.79%, a Tier I Capital to Risk-Weighted Assets ratio of 20.79%, and a Total Capital to Risk-Weighted Assets ratio of 21.66%.

VSB Bancorp, Inc. satisfied all capital ratio requirements of the Federal Reserve Bank of New York at December 31, 2018, with a Tier I Leverage Capital ratio of 9.41%, a Common Equity Tier I to Risk Weighted Assets ratio of 20.83%, a Tier I Capital to Risk-Weighted Assets ratio of 21.01%, and a Total Capital to Risk-Weighted Assets ratio of 21.88%.

Non-Performing Loans

Our largest non-performing loan, with a principal balance of $645,000 represented 74.8% of our non-performing loans at December 31, 2018. Management believes it has taken appropriate steps with a view towards maximizing recovery and minimizing loss, if any, on these loans.

- The loan is a commercial construction loan secured by a first mortgage on residential property in Staten Island, NY. The loan is guaranteed personally by the principals of the borrower. Construction of the property is substantially complete, and the borrower has listed the property for sale. It is in the process of foreclosure. Management believes it has taken appropriate steps with a view towards maximizing recovery and minimizing loss, if any, on this loan.

From time to time, the Bank will enter into agreements with borrowers to modify the terms of their loans when we believe that a modification will maximize our recovery. In most cases, we do not agree to reduce the rate of interest or forgive the repayment of principal when we agree to the loan modification, and we did not do so in any of the modifications described above. Instead, we seek to modify terms on an interim basis to allow the borrower to reduce payments for a short duration and thus give the borrower an opportunity to get back on its feet. We prefer to develop repayment plans for our borrowers that provide them with cash flow relief while requiring that they ultimately pay all amounts that they owe. However, we are not averse to commencing legal action to foreclose on mortgages or obtain personal judgments against obligors when we perceive that as the appropriate strategy.

Average Balance Sheet

The following table sets forth certain information relating to our consolidated statements of financial condition and the consolidated statements of earnings for the fiscal years ended December 31, 2018 and 2017 and reflects the average yield on assets and average cost of liabilities for the periods indicated. Such yields and costs are derived by dividing income or expense by the average balance of assets or liabilities, respectively, for the periods shown. Average balances are derived from average daily balances. The average balance of loans receivable include loans on which we have discontinued accruing interest. The yields and costs include net fees, which are considered adjustments to yields. No tax equivalent adjustments have been made.

	Year Ended December 31, 2018			Year Ended December 31, 2017		
	Average Balance	Interest	Yield/ Cost	Average Balance	Interest	Yield/ Cost
Assets:						
Interest-earning assets:						
Loans receivable	$ 129,859,234	$ 8,012,432	6.17 %	$ 131,565,761	$ 8,047,482	6.12 %
Other interest earning assets	24,375,163	474,073	1.94	40,842,680	440,835	1.08
Investment securities	203,340,375	4,757,342	2.34	176,553,215	3,901,097	2.21
Total interest-earning assets	357,574,772	13,243,847	3.70	348,961,656	12,389,414	3.55
Non-interest earning assets	11,889,393			11,388,549		
Total assets	$ 369,464,165			$ 360,350,205		
Liabilities and equity:						
Interest-bearing liabilities:						
Savings accounts	$ 23,173,212	48,969	0.21	$ 24,868,152	53,505	0.22
Time accounts	54,517,960	544,134	1.00	54,066,712	299,344	0.55
Money market accounts	48,098,036	345,976	0.72	57,021,384	446,973	0.78
Now accounts	60,214,699	249,506	0.41	50,454,805	125,183	0.25
Short term borrow ings	137	3	2.47	2,055	28	1.36
Total interest-bearing liabilities	186,004,044	1,188,588	0.64	186,413,108	925,033	0.50
Checking accounts	147,024,844			139,502,132		
Escrow Deposits	731,930			604,954		
Total	333,760,818			326,520,194		
Other liabilities	2,000,776			1,705,507		
Total liabilities	335,761,594			328,225,701		
Equity	33,702,571			32,124,504		
Total liabilities and equity	$ 369,464,165			$ 360,350,205		
Net interest income/net interest rate spread		$ 12,055,259	3.06 %		$ 11,464,381	3.05 %
Net interest earning assets/net interest margin	$ 171,570,728		3.37 %	$ 162,548,548		3.29 %
Ratio of interest-earning assets to to interest-bearing liabilities	1.92 x			1.87 x		
Return On Average Equity:			9.66 %			7.96 %
Equity To Assets:			9.37 %			9.32 %
Dividend Payout Ratio			24.18 %			23.66 %

Market for Common Equity and Related Stockholder Matters.

Our common stock has been quoted on the OTC Marketplace under the symbol "VSBN" since December 23, 2013. Since February 9, 2015 our common stock has been quoted on the OTCQX Best Market, continuing under the symbol “VSBN”. Prior to December 23, 2013, we were listed on the NASDAQ Global Market under the same symbol.

The following table reflects the high and low sales prices for our common stock during each calendar quarter of the last two fiscal years.

	2018			
	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
High Price	$20.35	$22.00	$20.80	$21.50
Low Price	$19.00	$19.50	$20.00	$19.71

	2017			
	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
High Price	$16.20	$16.25	$18.84	$19.75
Low Price	$14.35	$14.45	$16.25	$18.00

We have approximately 119 stockholders of record. We paid our first cash dividend of $0.06 per common share on January 2, 2008 to stockholders of record on November 29, 2007, and we paid quarterly dividends of $0.06 per share with respect to each calendar quarter thereafter through the end of 2015. In the first quarter of 2016, we increased our cash dividend rate, by $0.01 per a share, to $0.07 per a share. In the fourth quarter of 2016, we again increased our cash dividend rate, by $0.01 per a share, to $0.08 per a share. In the fourth quarter of 2017, we again increased our cash dividend rate, by $0.02 per a share, to $0.10 per a share. In the second quarter of 2018, we again increased our cash dividend rate, by $0.01 per a share, to $0.11 per a share. In the fourth quarter of 2018, we again increased our cash dividend rate, by $0.01 per a share, to $0.12 per a share.

INDEPENDENT AUDITOR'S REPORT

Board of Directors and Stockholders
VSB Bancorp, Inc.
Staten Island, New York

Report on the Financial Statements

We have audited the accompanying consolidated financial statements of VSB Bancorp, Inc. (the "Company"), which comprise the consolidated statements of financial condition as of December 31, 2018 and 2017, and the related consolidated statements of earnings, comprehensive income, stockholders' equity and cash flows for the years then ended, and the related notes to the consolidated financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these consolidated 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 consolidated 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 consolidated 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 consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated 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 consolidated 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 consolidated 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 consolidated financial statements referred to above present fairly, in all material respects, the financial position of the Company as of December 31, 2018 and 2017, 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.

/s/Crowe LLP

Livingston, New Jersey
March 14, 2019

VSB BANCORP, INC.
CONSOLIDATED STATEMENTS OF FINANCIAL CONDITION
DECEMBER 31, 2018 AND 2017

ASSETS	2018	2017
Cash and cash equivalents	$ 29,182,881	$ 12,920,547
Investment securities, available for sale	38,296,615	46,080,113
Investment securities, held to maturity		
(fair value of $165,694,423 at 2018 and $144,168,074 at 2017)	168,272,336	145,853,876
Loans receivable (net of allowance for loan losses		
of $1,472,191 at 2018 and $1,564,698 at 2017, respectively)	126,615,957	135,615,686
Accrued interest receivable	973,057	888,936
Premises and equipment, net	2,622,898	1,086,569
Restricted equity securities	347,100	294,100
Deferred income taxes, net	878,730	792,272
Bank owned life insurance	5,543,958	5,433,064
Prepaid and other assets	1,105,106	842,803
Total assets	$ 373,838,638	$ 349,807,966
LIABILITIES AND STOCKHOLDERS' EQUITY		
LIABILITIES:		
Deposits		
Non-interest bearing	$ 153,720,497	$ 131,582,216
Interest bearing	182,671,587	183,977,752
Total deposits	336,392,084	315,559,968
Accounts payable, accrued expenses and other liabilities	2,413,384	1,647,658
Total liabilities	338,805,468	317,207,626
Commitments and contigent liabilities (Note 14)	-	-
STOCKHOLDERS' EQUITY		
Common stock ($.0001 par value, 10,000,000 shares authorized,		
2,094,676 issued, 1,831,215 outstanding at December 31, 2018		
and 2,092,926 issued, 1,829,465 outstanding at December 31, 2017)	209	209
Additional paid-in capital	10,829,420	10,590,557
Retained earnings	28,248,811	25,722,467
Treasury stock, at cost (263,461 shares at December 31, 2018		
and at December 31, 2017)	(2,813,653)	(2,813,653)
Unearned Employee Stock Ownership Plan shares	(534,000)	(634,125)
Accumulated other comprehensive loss, net of taxes		
of $196,764 and $85,652, respectively	(697,617)	(265,115)
Total stockholders' equity	35,033,170	32,600,340
Total liabilities and stockholders' equity	$ 373,838,638	$ 349,807,966

VSB BANCORP, INC.

CONSOLIDATED STATEMENTS OF EARNINGS FOR THE YEARS ENDED DECEMBER 31, 2018 AND 2017

	2018	2017
INTEREST INCOME:		
Loans receivable	$ 8,012,432	$ 8,047,482
Investment securities	4,757,342	3,901,097
Other interest income	474,073	440,835
Total interest income	13,243,847	12,389,414
INTEREST EXPENSE:		
Deposits	1,188,588	925,033
Total interest expense	1,188,588	925,033
Net interest income	12,055,259	11,464,381
PROVISION FOR LOAN LOSSES	125,000	15,000
Net interest income after provision for loan losses	11,930,259	11,449,381
NON-INTEREST INCOME:		
Deposit service fees	1,854,288	1,920,788
Other income	666,173	655,264
Total non-interest income	2,520,461	2,576,052
NON-INTEREST EXPENSES:		
Salaries and employee benefits	5,181,234	4,830,687
Occupancy and equipment	1,562,642	1,413,896
Data processing service fees	726,013	422,171
Legal fees	308,650	312,728
Professional fees	433,821	483,346
Director fees	252,061	240,001
FDIC and NYDFS assessments	146,000	182,000
Supplies and service	384,639	305,762
Checkbook charges	149,575	168,729
Other	931,966	1,016,476
Total non-interest expenses	10,076,601	9,375,796
INCOME BEFORE INCOME TAXES	4,374,119	4,649,637
Income tax expense	1,117,556	2,091,515
NET INCOME	$ 3,256,563	$ 2,558,122
Earnings per share:		
Basic	$ 1.83	$ 1.44
Diluted	$ 1.81	$ 1.43
Comprehensive income	$ 2,881,162	$ 2,308,501

See notes to consolidated financial statements.

VSB BANCORP, INC.

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME FOR THE YEARS ENDED DECEMBER 31, 2018 AND 2017

	2018	2017
Net Income	$ 3,256,563	$ 2,558,122
Other comprehensive income/(loss):		
Unrealized gains on securities, AFS:		
Change in unrealized gain (loss) on securties , AFS	(430,063)	(273,583)
Amortization on unrealized gains on HTM securities	(56,450)	(110,449)
Tax benefit/(expense)	111,112	134,411
Net of tax	(375,401)	(249,621)
Comprehensive income	$ 2,881,162	$ 2,308,501

See notes to consolidated financial statements.

VSB BANCORP, INC.

CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY FOR THE YEARS ENDED DECEMBER 31, 2018 AND 2017

	Number of Common Shares	Common Stock	Additional Paid-in Capital	Retained Earnings	Treasury Stock, at cost	Unearned ESOP Shares	Accumulated Other Comprehensive (Loss)	Total Stockholders' Equity
Balance at January 1, 2017	1,828,298	$ 209	$ 10,269,454	$ 23,769,564	$ (2,717,128)	$ (734,250)	$ (15,494)	$ 30,572,355
Exercise of stock options	6,417		77,658					77,658
Stock-based compensation			202,942					202,942
Amortization of earned portion of ESOP common stock			40,503			100,125		140,628
Cash dividends declared ($0.34 per share)				(605,219)				(605,219)
Purchase of treasury stock, at cost	(5,250)				(96,525)			(96,525)
Net income				2,558,122				2,558,122
Other comprehensive loss	-	-	-	-	-	-	(249,621)	(249,621)
Balance at December 31, 2017	1,829,465	209	10,590,557	25,722,467	(2,813,653)	(634,125)	(265,115)	32,600,340
Adoption of ASU 2018-02				57,101			(57,101)	-
Exercise of stock options	1,750		19,757					19,757
Stock-based compensation			152,757					152,757
Amortization of earned portion of ESOP common stock			66,349			100,125		166,474
Cash dividends declared ($0.44 per share)				(787,320)				(787,320)
Net income				3,256,563				3,256,563
Other comprehensive loss	-	-	-	-	-	-	(375,401)	(375,401)
Balance at December 31, 2018	1,831,215	$ 209	$ 10,829,420	$ 28,248,811	$ (2,813,653)	$ (534,000)	$ (697,617)	$ 35,033,170

See notes to consolidated financial statements.

VSB BANCORP, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS FOR THE YEARS ENDED DECEMBER 31, 2018 and 2017

	2018	2017
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income	$ 3,256,563	$ 2,558,122
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	396,620	464,620
Premium amortization, net of discount accretion	333,110	346,288
ESOP compensation expense	166,474	140,628
Stock-based compensation expense	152,757	202,942
Provision for loan losses	125,000	15,000
Changes in operating assets and liabilities:		
Increase in cash surrender value of BOLI	(110,894)	(116,865)
Increase in prepaid and other assets	(259,613)	(247,273)
Increase in accrued interest receivable	(84,121)	(132,659)
Provision for deferred income taxes	24,655	372,029
Increase in accrued expenses, income tax payable and other liabilities	713,035	2,854
Net cash provided by operating activities	4,713,586	3,605,686
CASH FLOWS FROM INVESTING ACTIVITIES:		
Net change in loans receivable	8,998,550	(10,635,373)
Available-for-sale securities:		
Proceeds from repayments and calls of investment securities	7,233,860	12,550,830
Purchase of investment securities	-	(16,444,949)
Held-to-maturity securities:		
Proceeds from repayments and calls of investment securities	29,363,026	29,143,623
Purchase of investment securities	(52,175,292)	(56,518,484)
Restricted equity securities:		
Proceeds from redemption of restricted equity securities	2,300	64,100
Purchase of restricted equity securities	(55,300)	(14,600)
Proceeds from sale of other real estate	50,000	-
Purchases of premises and equipment, net	(1,932,949)	(133,135)
Net cash used in investing activities	(8,515,805)	(41,987,988)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Net increase in deposits	20,832,116	14,686,574
Cash dividends paid	(787,320)	(605,219)
Exercise of stock options	19,757	77,658
Purchase of treasury stock, at cost	-	(96,525)
Net cash provided by financing activities	20,064,553	14,062,488
NET (DECREASE)/INCREASE CASH AND CASH EQUIVALENTS	16,262,334	(24,319,814)
CASH AND CASH EQUIVALENTS, BEGINNING OF YEAR	12,920,547	37,240,361
CASH AND CASH EQUIVALENTS, END OF YEAR	$ 29,182,881	$ 12,920,547
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION:		
Cash paid during the period for:		
Interest	$ 937,176	$ 926,924
Income taxes	$ 1,005,905	$ 1,564,411

VSB BANCORP, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEARS ENDED DECEMBER 31, 2018 and 2017

1. GENERAL

VSB Bancorp, Inc. (referred to using terms such as "we," "us," or the "Company") is the holding company for Victory State Bank (the "Bank"), a New York chartered commercial bank. Our primary business is owning all of the issued and outstanding stock of the Bank. Our common stock is quoted on the OTCQX Best Market. We trade under the symbol "VSBN".

Through the Bank, the Company is primarily engaged in the business of commercial banking, and to a lesser extent retail banking. The Bank gathers deposits from individuals and businesses primarily in Staten Island, New York and makes loans primarily throughout that community. Therefore, the Company's exposure to credit risk is significantly affected by changes in the local Staten Island economic and real estate markets. The Bank invests funds that are not used for lending primarily in government securities, mortgage backed securities and collateralized mortgage obligations. Customer deposits are insured, up to the applicable limit, by the Federal Deposit Insurance Corporation ("FDIC"). The Bank is supervised by the New York State Department of Financial Services ("NYDFS") and the FDIC.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The following is a description of the significant accounting and reporting policies followed in preparing and presenting the accompanying consolidated financial statements. These policies conform with accounting principles generally accepted in the United States of America ("GAAP").

Principles of Consolidation - The consolidated financial statements of the Company include the accounts of the Company, including its subsidiary Victory State Bank. All significant inter-company accounts and transactions between the Company and Bank have been eliminated in consolidation.

Subsequent Events - The Company has evaluated subsequent events for recognition and disclosure through March 14, 2019, which is the day the financial statements were available to be issued.

Use of Estimates - The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the financial statements and the amounts of revenues and expenses during the reporting period. Actual results can differ from those estimates.

Reclassifications – Some items in the prior year financial statements were reclassified to conform to the current presentation.

Cash and Cash Equivalents – Cash and cash equivalents consist of cash on hand, due from banks and interest-bearing deposits. Interest-bearing deposits with original maturities of 90 days or less are included in this category. Customer loan and deposit transactions are reported on a net cash basis. Regulation D of the Board of Governors of the Federal Reserve System requires that Victory State Bank maintain interest-bearing deposits or cash on hand as reserves against its demand deposits. The amount of reserves which Victory State Bank is required to maintain depends upon its level of transaction accounts. During the fourteen-day period from December 20, 2018 through January 2, 2019, Victory State Bank was required to maintain reserves, after deducting vault cash, of $10,966,000. Reserves are required to be maintained on a fourteen-day basis, so, from time to time, Victory State Bank may use

available cash reserves on a day to day basis, so long as the fourteen-day average reserves satisfy Regulation D requirements. Victory State Bank is required to report transaction account levels to the Federal Reserve on a weekly basis.

Interest-bearing bank balances – Interest-bearing bank balances mature overnight and are carried at cost.

Investment Securities - Investment securities, available for sale, are to be held for an unspecified period of time and include securities that management intends to use as part of its asset/liability strategy. Investment securities held to maturity are carried at amortized cost when management has the positive intent and ability to hold them to maturity. Investment securities, available for sale may be sold in response to changes in interest rates, prepayments or other factors and are carried at estimated fair value. Gains or losses on the sale of such securities are determined by the specific identification method. Interest income includes amortization of purchase premium and accretion of purchase discount. Premiums and discounts are recognized in interest income using a method that approximates the level yield method without anticipating prepayments, except for mortgage-backed securities where prepayments are estimated. Unrealized holding gains or losses, net of deferred income taxes, are excluded from earnings and reported as other comprehensive income in a separate component of stockholders' equity until realized.

For debt securities with other than temporary impairment (OTTI) that management does not intend to sell or expect to be required to sell, the amount of impairment is split into two components as follows: 1) OTTI related to credit loss, which must be recognized in the income statement and 2) OTTI related to other factors, which is recognized in other comprehensive income. The credit loss is defined as the difference between the present value of the cash flows expected to be collected and the amortized cost basis.

The Company invests primarily in agency collateralized mortgage-Backed obligations ("CMOs") with estimated average lives primarily under 7 Years and mortgage-backed securities. These securities are primarily issued by the Federal National Mortgage Association ("FNMA"), the Government National Mortgage Association ("GNMA") or the Federal Home Loan Mortgage Corporation ("FHLMC") and are primarily comprised of mortgage pools guaranteed by FNMA, GNMA or FHLMC. The Company also invests in whole loan CMOs, collateralized loan obligations ("CLO") and asset backed securities, all of which are AAA rated at the time of purchase, as well as corporate bonds, which are typically rated A or better at the time of purchase. These securities expose the Company to risks such as interest rate, prepayment and credit risk and thus pay a higher rate of return than comparable treasury issues.

Loans Receivable - Loans receivable, that management has the intent and ability to hold for the foreseeable future or until maturity or payoff, are stated at unpaid principal balances, adjusted for deferred net origination and commitment fees and the allowance for loan losses. Interest income on loans is credited as earned.

It is the policy of the Company to provide a valuation allowance for probable incurred losses on loans based on the Company's past loan loss experience, known and inherent risks in the portfolio, adverse situations which may affect the borrower's ability to repay, estimated value of underlying collateral and current economic conditions in the Company's lending area. The allowance is increased by provisions for loan losses charged to earnings and is reduced by charge-offs, net of recoveries. While management uses available information to estimate losses on loans, future additions to the allowance may be necessary based upon the expected growth of the loan portfolio and any changes in economic conditions beyond management's control. In addition, various 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 judgments different from those of

management. Management believes, based upon all relevant and available information, that the allowance for loan losses is appropriate.

The allowance consists of specific and general components. The specific component relates to loans that are individually classified as impaired. The general component covers non-impaired loans and is based for all portfolio segments on historical loss experience adjusted for current factors. The historical loss experience is determined by portfolio segment and is based on the actual loss history experienced by the Company. This actual loss experience is supplemented with other economic factors based on the risks present for each portfolio segment. These economic factors include consideration of the following: levels of and trends in delinquencies and impaired loans; levels of and trends in charge-offs and recoveries; trends in volume and terms of loans; effects of any changes in risk selection and underwriting standards; other changes in lending policies, procedures, and practices; experience, ability, and depth of lending management and other relevant staff; national and local economic trends and conditions; industry conditions; and effects of changes in credit concentrations.

The Company has a policy that all loans 90 days past due are place on non-accrual status unless there are specific circumstances that would preclude classification. From time to time, due to the Bank's underwriting loan renewals, a loan may be pushed past due 90 days, but would not need to be placed on non-accrual because there is no doubt of collectability. It is the Company's policy to cease the accrual of interest on loans to borrowers past due less than 90 days where a probable loss is estimated and to reverse out of income all interest that is due but has not been paid. Past due status is based on the contractual terms of the loan. The Company applies payments received on non-accrual loans to the outstanding principal balance due before applying any amount to interest, until the loan is restored to an accruing status. On a limited basis, the Company may apply a payment to interest on a non-accrual loan if there is no impairment or no estimated loss on these assets. The Company continues to accrue interest on construction loans that are 90 days past contractual maturity date if the loan is expected to be paid in full in the next 60 days and all interest is paid up to date.

Loans are returned to accrual status when all the principal and interest amounts contractually due are brought current, there has been a history of prompt payments and future payments are reasonably assured.

Loan origination fees and certain direct loan origination costs are deferred, and the net amount recognized over the contractual loan terms using the level-yield method, adjusted for periodic prepayments in certain circumstances.

The Company considers a loan to be impaired when, when full payment under the loan terms is not expected. Commercial and commercial real estate loans are individually evaluated for impairment. Loans that experience insignificant payment delays and payment shortfalls generally are not classified as impaired. Impairment is measured on a loan by loan basis for commercial and commercial real estate loans. Impaired loans are measured based on the present value of expected future cash flows discounted at the loan's effective interest rate or, as a practical expedient, at the loan's observable market price or the fair value of the collateral. The fair value of the collateral, as reduced by costs to sell, is utilized if a loan is collateral dependent. The fair value of the collateral is estimated by obtaining a new appraisal, if the loan amount exceeds $100,000, or by adjusting the most recent appraisal to reflect the current market if the loan is less than $100,000 or a more recent appraisal has yet to be received. Loans with modified terms that the Company would not normally consider, and for which the borrower is experiencing financial difficulties, are considered troubled debt restructurings and classified as impaired. Large groups of homogeneous loans are collectively evaluated for impairment.

Long-Lived Assets - The Company periodically evaluates the recoverability of long-lived assets, such as premises and equipment, to ensure the carrying value has not been impaired. In performing the

review for recoverability, the Company would estimate the future cash flows expected to result from the use of the asset. If the sum of the expected future cash flows is less than the carrying amount, an impairment will be recognized. The Company reports these assets at the lower of the carrying value or fair value.

Premises and Equipment - Premises, leasehold improvements, and furniture and equipment are stated at cost less accumulated depreciation and amortization. Depreciation and amortization are accumulated by the straight-line method over the estimated useful lives of the respective assets, which range from three to fifteen years. Leasehold improvements are amortized at the lesser of their useful life or the term of the lease.

Federal Home Loan Bank (FHLB) Stock - The Bank is a member of the FHLB system. Members are required to own a certain amount of stock based on the level of borrowings and other factors and may invest in additional amounts. FHLB stock is carried at cost, classified as a restricted security, and periodically evaluated for impairment. Because this stock is viewed as a long-term investment, impairment is based on ultimate recovery of par value, which is the price the Bank pays for the FHLB Stock. Both cash and stock dividends are reported as income.

Bank-Owned Life Insurance - The Company has purchased life insurance policies on certain employees. These bank-owned life insurance policies ("BOLI") policies are recorded in the Consolidated Statements of Condition at their cash surrender value. Income from these policies and changes in the cash surrender value are recorded in "Non-interest income" in the Consolidated Statements of Earnings. The Company's investment in BOLI was $5,543,958 at December 31, 2018 and $5,433,064 at December 31, 2017. The company's initial purchase of BOLI was recorded on July 1, 2014. The Company's investment in BOLI generated income of $110,894 and $116,965 during the years ended December 31, 2018 and 2017.

Income Taxes - The Company utilizes the liability method to account for income taxes. Under this method, deferred tax assets and liabilities are determined on differences between financial reporting and the tax bases of assets and liabilities and are measured using the enacted tax rates and laws expected to be in effect when the differences are expected to reverse. As changes in tax laws or rates are enacted, deferred tax assets and liabilities are adjusted through the provision for income taxes. As such, a tax position is recognized as a benefit only if it is "more likely than not" that the tax position would be sustained in a tax examination, with a tax examination being presumed to occur. The amount recognized is the largest amount of tax benefit that is greater than 50% likely of being realized on examination. For tax positions not meeting the "more likely than not" test, no tax benefit is recorded.

The Company recognizes interest and/or penalties related to income tax matters in income tax expense.

Financial Instruments - In the ordinary course of business, the Company has entered into off-balance sheet financial instruments, primarily consisting of commitments to extend credit. The face amount for these items represents the exposure to loss, before considering customer collateral or ability to repay. Such financial instruments are recorded when they are funded.

Basic and Diluted Net Income Per Common Share - The Company has stock compensation awards with non-forfeitable dividend rights which are considered participating securities. As such, earnings per share is computed using the two-class method. Basic earnings per common share is computed by dividing net income allocated to common stock by the weighted average number of common shares outstanding during the period which excludes the participating securities. Diluted earnings per common share includes the dilutive effect of additional potential common shares from stock-based compensation plans, but excludes awards considered participating securities. Earnings and dividends per share are restated for all stock splits and stock dividends through the date of issuance of the financial statements.

Basic net income per share of common stock is based on 1,745,161 shares and 1,734,552 shares, the weighted average number of common shares outstanding for the years ended December 31, 2018 and 2017, respectively. Diluted net income per share of common stock is based on 1,767,665 and 1,752,039, the weighted average number of common shares outstanding plus potentially dilutive common shares for the years ended December 31, 2018 and 2017, respectively. The weighted average number of potentially dilutive common shares excluded in calculating diluted net income per common share due to the anti-dilutive effect is 0 and 0 shares for the years ended December 31, 2018 and 2017, respectively. Common stock equivalents were calculated using the treasury stock method.

The reconciliation of the numerators and the denominators of the basic and diluted per share computations for the years ended December 31, are as follows:

Reconciliation of EPS

	Year ended December 31, 2018	Year ended December 31, 2017
Basic		
Net Income allocated to common stock	$ 3,256,563	$ 2,558,122
Undistributed earnings allocated to participating securities	(65,353)	(53,619)
Net earnings allocated to common stock	$ 3,191,210	$ 2,504,503
Weighted common shares outstanding including participating securities	1,780,873	1,771,687
Less: Unvested RRP shares	(35,712)	(37,135)
Weighted average shares	1,745,161	1,734,552
Basic EPS	$ 1.83	$ 1.44
Diluted		
Net earnings allocated to common stock	$ 3,191,210	$ 2,504,503
Weighted average shares for basic	1,745,161	1,734,552
Dilutive effects of:		
Stock Options	22,504	17,487
Unvested shares not considered particpating securities	-	-
	1,767,665	1,752,039
Diluted EPS	$ 1.81	$ 1.43

Net earnings allocated to common stock for the period are distributed earnings during the period, such as dividends on common shares outstanding, plus a proportional amount of retained income for the period based on restricted shares granted but unvested compared to the total common shares outstanding.

Stock Based Compensation - The Company records compensation expense for stock options provided to employees in return for employment service. The cost is measured at the fair value of the options when granted, and this cost is expensed over the employment service period, which is normally the vesting period of the options.

Employee Stock Ownership Plan ("ESOP") - The cost of shares issued to the ESOP, but not yet allocated to participants, is shown as a reduction of stockholders' equity. Compensation expense is based on the market price of shares as they are committed to be released to participant accounts. Cash dividends on allocated ESOP shares reduce retained earnings; cash dividends on unearned ESOP shares reduce debt and accrued interest.

Stock Repurchase Programs – On September 8, 2008, the Company announced that its Board of Directors had authorized a Rule 10b5-1 stock repurchase program for the repurchase of up to 100,000 shares of the Company's common stock. On April 21, 2009, the Company announced that its Board of Directors had authorized a second Rule 10b5-1 stock repurchase program for the repurchase of up to an additional 100,000 shares of the Company's common stock. On September 14, 2011, the Company announced that its Board of Directors had authorized a third Rule 10b5-1 stock repurchase program for the repurchase of up to an additional 100,000 shares of the Company's common stock. On June 11, 2015, the Company announced that its Board of Directors had authorized a fourth Rule 10b5-1 stock repurchase program for the repurchase of up to an additional 100,000 shares of the Company's common stock. At December 31, 2018, the Company had repurchased a total of 350,961 shares of its common stock under the stock repurchase programs. Stock repurchases under the programs have been accounted for using the cost method, in which the Company will reflect the entire cost of repurchased shares as a separate reduction of stockholders' equity on its balance sheet.

Retention and Recognition Plan – In 2010, the stockholders of VSB Bancorp, Inc. approved the 2010 Retention and Recognition Plan (the "RRP"). The RRP authorized the award of up to 50,000 shares of its common stock to directors, officers and employees. In April 2016, the stockholders approved the addition of 50,000 more shares to the RRP. The recipient of an award will not be required to make any payment to receive the award or the stock covered by the award. Upon the approval of the increase in 2016, each director with five years of service was awarded 5,000 shares for a total of 40,000 shares. These awards vest over three years and only after the Company's total assets exceed $400 million. The Company recognizes compensation expense for the shares awarded under the RRP gradually as the shares vest, based upon the market price of the shares on the date of the award.

Comprehensive Income - Comprehensive income consists of net income and other comprehensive income. Other comprehensive income includes unrealized gains and losses, net of taxes, on our securities' portfolios which are also recognized as separate components of equity. Amortization of unrealized gains on HTM securities is a separate component.

Adoption of New Accounting Standards and Newly Issued Not Yet Effective Accounting Standards - In May 2014, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") 2014-09 "Revenue from Contracts with Customers." The amendments in ASU 2014-09 provide a comprehensive framework for addressing revenue recognition issues that can be applied to all contracts with customers. The amendments in ASU 2014-09 also include improved disclosures to enable users of financial statements to better understand the nature, amount, timing and uncertainty of revenue that is recognized. For public entities, ASU 2014-09, as amended, is effective for interim and annual reporting periods beginning after December 15, 2017. While the guidance in ASU 2014-09 supersedes most existing industry-specific revenue recognition accounting guidance, much of the Bank's revenue comes from financial instruments such as debt securities and loans that are outside the scope of the guidance. The Company adopted ASU 2014-09 on January 1, 2018 and it did not have a material impact on the Company's consolidated financial position, results of operations or disclosures. Refer to Footnote 7 for further disclosure.

In January 2016, the FASB issued ASU 2016-01 "Financial Instruments – Overall." The amendments in ASU 2016-01 are intended to improve the recognition, measurement, presentation and disclosure of financial assets and liabilities to provide users of financial statements with information that is more useful for decision-making purposes. Among other changes, ASU 2016-01 would require equity securities to be measured at fair value with changes in fair value recognized through net income but would allow equity securities that do not have readily determinable fair values to be re-measured at fair value either upon the occurrence of an observable price change or upon identification of an impairment. The amendments would simplify the impairment assessment of such equity securities and would require enhanced

disclosure about these investments. ASU 2016-01 would also require separate presentation of financial assets and liabilities by measurement category and type of instrument, such as securities or loans, on the balance sheet or in the notes, and would eliminate certain other disclosures relating to the methods and assumptions used to estimate fair value. For public entities, the amendments in ASU 2016-01 are effective for interim and annual reporting periods beginning after December 15, 2017. Early adoption is not permitted. The Company adopted ASU 2016-01 on January 1, 2018 and as a result, the fair value of loans is now presented at exit price.

In February 2016, the FASB issued ASU 2016-02 "Leases." ASU 2016-02 affects any entity that enters a lease and is intended to increase the transparency and comparability of financial statements among organizations. The ASU requires, among other changes, a lessee to recognize on its balance sheet a lease asset and a lease liability for those leases previously classified as operating leases. The lease asset would represent the right to use the underlying asset for the lease term and the lease liability would represent the discounted value of the required lease payments to the lessor. The ASU would also require entities to disclose key information about leasing arrangements. ASU 2016-02 is effective for interim and annual reporting periods beginning after December 15, 2018. Early adoption is permitted. The Company currently leases six branches. ASU 2016-02 will result in the establishment of a right to use asset and corresponding lease obligation of approximately $5.4 million, which will increase the balance sheet by that amount.

In June 2016, the FASB issued ASU 2016-13 "Measurement of Credit Losses on Financial Instruments." ASU 2016-13 affects entities holding financial assets that are not accounted for at fair value through net income, including loans, debt securities, and other financial assets. The ASU requires financial assets measured at amortized cost basis to be presented at the net amount expected to be collected by recording an allowance for current expected credit losses. ASU 2016-13 is effective for interim and annual reporting periods beginning after December 15, 2020. Early adoption is permitted beginning after December 15, 2019, including interim periods within those fiscal years. Management is currently evaluating the impact that ASU 2016-13 will have on the Company's consolidated financial position, results of operations and disclosures.

In February 2018, the FASB amended existing guidance to allow a reclassification from accumulated other comprehensive income to retained earnings for stranded tax effects resulting from the Tax Cuts and Jobs Act ("Tax Act"). Consequently, the amendments eliminate the stranded tax effects resulting from the Tax Act and will improve the usefulness of information reported to financial statement users. However, because the amendments only relate to the reclassification of the income tax effects of the Tax Act, the underlying guidance that requires that the effect of a change in tax laws or rates be included in income from continuing operations is not affected. The amendments in this Update are effective for all entities for fiscal years beginning after December 15, 2018, and interim periods within those fiscal years, with early adoption, including adoption in an interim period, permitted. The Company adopted ASU 2018-02 at the beginning of the first quarter 2018 and reclassified $57,101 from accumulated other comprehensive income to retained earnings.

3. INVESTMENT SECURITIES

The following table summarizes the amortized cost and fair value of securities available-for-sale and securities held-to-maturity at December 31, 2018 and December 31, 2017 and the corresponding amounts of unrealized and unrecognized gains and losses herein:

	December 31, 2018			
	Amortized Cost	Unrealized Gains	Unrealized Losses	Fair Value
Available-for-Sale				
FNMA MBS - Residential	$ 127,623	$ 5,891	$ -	$ 133,514
Collateralized mortgage obligations	28,323,590	1,109	(696,869)	27,627,830
Corporate bonds	9,515,818	4,182	(253,264)	9,266,736
Other debt securities	1,250,905	17,630	-	1,268,535
Total Available-for-Sale	$ 39,217,936	$ 28,812	$ (950,133)	$ 38,296,615

	December 31, 2018			
	Amortized Cost	Unrecognized Gains	Unrecognized Losses	Fair Value
Held-to-Maturity				
FNMA MBS - Residential	$ 71,493,974	$ 88,806	$ (1,268,532)	$ 70,314,248
GNMA MBS - Residential	837,823	-	(13,698)	824,125
FHLMC MBS - Residential	7,447,565	76,257	(52,597)	7,471,225
Collateralized mortgage obligations	63,034,836	28,358	(1,058,588)	62,004,606
Corporate Notes	21,515,627	9,029	(365,701)	21,158,955
Other debt securities	3,942,511	-	(21,247)	3,921,264
Total Held-to-Maturity	$ 168,272,336	$ 202,450	$ (2,780,363)	$ 165,694,423

	December 31, 2017			
	Amortized Cost	Unrealized Gains	Unrealized Losses	Fair Value
Available-for-Sale				
FNMA MBS - Residential	$ 198,738	$ 8,328	$ -	$ 207,066
Whole Loan MBS - Residential	129	-	-	129
Collateralized mortgage obligations	35,295,870	13,174	(544,679)	34,764,365
Corporate bonds	9,524,259	33,231	(15,674)	9,541,816
Other debt securities	1,552,375	14,362	-	1,566,737
Total Available-for-Sale	$ 46,571,371	$ 69,095	$ (560,353)	$ 46,080,113

	December 31, 2017			
	Amortized Cost	Unrecognized Gains	Unrecognized Losses	Fair Value
Held-to-Maturity				
FNMA MBS - Residential	$ 73,118,530	$ 108,548	$ (750,463)	$ 72,476,615
GNMA MBS - Residential	1,131,505	4,654	(11,379)	1,124,780
FHLMC MBS - Residential	1,975,370	-	(40,722)	1,934,648
Collateralized mortgage obligations	49,086,462	20,192	(939,597)	48,167,057
Corporate Notes	20,542,009	39,240	(116,275)	20,464,974
Total Held-to-Maturity	$ 145,853,876	$ 172,634	$ (1,858,436)	$ 144,168,074

There were no sales of investment securities for the years ended December 31, 2018 and 2017.

The amortized cost and fair value of the investment securities portfolio are shown by expected maturity.

Expected maturities may differ from contractual maturities, especially for collateralized mortgage obligations, if borrowers have the right to call or prepay obligations with or without call or prepayment penalties.

	December 31, 2018	
Available-for-Sale	Amortized Cost	Fair Value
Less than one year	$ -	$ -
Due after one year through five years	7,552,398	7,311,611
Due after five years through ten years	9,249,820	9,055,193
Due after ten years	22,415,718	21,929,811
Available-for-Sale	$ 39,217,936	$ 38,296,615

	December 31, 2018	
Held-to-maturity	Amortized Cost	Fair Value
Less than one year	$ 15,005,651	$ 14,940,661
Due after one year through five years	70,665,868	69,900,205
Due after five years through ten years	22,407,969	21,693,377
Due after ten years	60,192,848	59,160,180
Held-to-maturity	$ 168,272,336	$ 165,694,423

The following table summarizes the investment securities with unrealized and unrecognized losses at December 31, 2018 and December 31, 2017 by aggregated major security type and length of time in a continuous unrealized loss position:

December 31, 2018	Less than 12 months		More than 12 months		Total	
Available-for-Sale	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss
Collateralized mortgage obligations	$ 257,761	$ (213)	$ 26,995,212	$ (696,656)	$ 27,252,973	$ (696,869)
Corporate bonds	4,755,120	(244,880)	1,991,616	(8,384)	6,746,736	(253,264)
Available-for-Sale	$ 5,012,881	$ (245,093)	$ 28,986,828	$ (705,040)	$ 33,999,709	$ (950,133)

December 31, 2018	Less than 12 months		More than 12 months		Total	
Held-to-Maturity	Fair Value	Unrecognized Loss	Fair Value	Unrecognized Loss	Fair Value	Unrecognized Loss
FNMA MBS	$ 8,523,976	$ (37,475)	$ 54,622,261	$ (1,231,057)	$ 63,146,237	$ (1,268,532)
GNMA MBS	798,769	(13,698)	-	-	798,769	(13,698)
FHLMC MBS	-	-	1,498,066	(52,597)	1,498,066	(52,597)
Collateralized mortgage obligations	19,622,934	(104,149)	35,407,135	(954,439)	55,030,069	(1,058,588)
Corporate notes	10,924,725	(101,279)	6,238,786	(264,422)	17,163,511	(365,701)
Other debt securities	3,921,264	(21,247)	-	-	3,921,264	(21,247)
Held-to-Maturity	$ 43,791,668	$ (277,848)	$ 97,766,248	$ (2,502,515)	$ 141,557,916	$ (2,780,363)

December 31, 2017	Less than 12 months		More than 12 months		Total	
Available-for-Sale	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss
Collateralized mortgage obligations	$ 22,251,526	$ (299,184)	$ 10,084,265	$ (245,495)	$ 32,335,791	$ (544,679)
Corporate bonds	1,991,586	(8,414)	2,492,740	(7,260)	4,484,326	(15,674)
Available-for-Sale	$ 24,243,112	$ (307,598)	$ 12,577,005	$ (252,755)	$ 36,820,117	$ (560,353)

December 31, 2017	Less than 12 months		More than 12 months		Total	
Held-to-Maturity	Fair Value	Unrecognized Loss	Fair Value	Unrecognized Loss	Fair Value	Unrecognized Loss
FNMA MBS	$ 52,187,529	$ (575,923)	$ 14,487,193	$ (174,540)	$ 66,674,722	$ (750,463)
GNMA MBS	-	-	615,190	(11,379)	615,190	(11,379)
FHLMC MBS	-	-	1,934,648	(40,722)	1,934,648	(40,722)
Collateralized mortgage obligations	16,758,292	(322,954)	28,435,519	(616,643)	45,193,811	(939,597)
Corporate notes	6,004,692	(3,025)	2,386,750	(113,250)	8,391,442	(116,275)
Held-to-Maturity	$ 74,950,513	$ (901,902)	$ 47,859,300	$ (956,534)	$ 122,809,813	$ (1,858,436)

The Company evaluates securities for other-than-temporary impairment at least on a quarterly basis, and more frequently when economic or market concerns warrant such evaluation. Consideration is given to the length of time and the extent to which the fair value has been less than cost, the financial condition and near-term prospects of the issuer, and the intent and ability of the Company to retain its investment in the issuer for a period of time sufficient to allow for any anticipated recovery in fair value. In analyzing an issuer's financial condition, the Company may consider whether the securities are issued by the federal government or its agencies, whether downgrades by bond rating agencies have occurred, and the results of reviews of the issuer's financial condition.

At December 31, 2018, the unrealized and unrecognized loss on investment securities were caused by a rise in intermediate and long-term market interest rates generally. We expect that these securities, at maturity, will be settled for the amortized cost of the investment. Because the decline in fair value is attributable to changes in interest rates and not credit quality, and because the Company does not intend to sell the securities and it is not more likely than not that the Company will be required to sell the securities before recovery of the amortized cost basis less any current-period loss, these investments are not considered other-than-temporarily impaired. At December 31, 2018, there were three debt securities with unrealized losses with aggregate depreciation of 5% or more from the Company's amortized cost basis.

Securities pledged had a fair value of $62,285,865 and $62,460,840 at December 31, 2018 and 2017, respectively and were pledged to secure public deposits and balances in excess of the deposit insurance limit on certain customer accounts.

During the second quarter of 2013, $74,540,643 of securities was transferred from the available for sale portfolio to the held to maturity portfolio. These securities were transferred at fair value with the unrealized gain/loss remaining in accumulated other comprehensive income to be accreted or amortized through other comprehensive income over the remaining life of the securities. As of December 31, 2018, and 2017, the unrealized gain on the transferred securities was $26,940 and $83,390, respectively.

4. LOANS RECEIVABLE, NET

Loans receivable, net at December 31, 2018 and 2017 are summarized as follows:

	2018	2017
Commercial loans (principally variable rate):		
Secured	$ 1,158,887	$ 1,159,567
Unsecured	16,412,190	16,964,651
Total commercial loans	17,571,077	18,124,218
Real estate loans:		
Commercial	89,922,766	90,359,444
Residential	1,603,140	1,956,499
Total real estate loans	91,525,906	92,315,943
Construction loans (net of undisbursed funds of $13,616,942 and $11,545,128, respectively)	18,267,210	25,676,057
Consumer loans	402,375	475,877
Other loans	545,364	744,966
	947,739	1,220,843
Total loans receivable	128,311,932	137,337,061
Less:		
Unearned loans fees, net	(223,784)	(156,677)
Allowance for loan losses	(1,472,191)	(1,564,698)
Total	$ 126,615,957	$ 135,615,686

Lending Risk

The principal business of the Bank is lending, primarily in commercial real estate mortgage loans and commercial and industrial loans. The Bank considers its primary lending area to be Staten Island, New York, and a substantial portion of the Bank's loans are secured by real estate in this area. Accordingly, the ultimate collectability of such a loan portfolio is susceptible to changes in market and economic conditions in this region. A weakened economy and resultant decreased consumer and/or business spending will have an adverse effect on credit quality in all classes of loans.

Commercial Real Estate

Loans in this classification include income producing investment properties and owner-occupied real estate used for business purposes. The underlying properties are generally located largely in our primary market area. The cash flows of the income producing investment properties are adversely impacted by a downturn in the economy as evidenced by increased vacancy rates, which in turn, will have an effect on credit quality. Generally, management seeks to obtain annual financial information for borrowers in this category.

Construction

Loans in this classification include investment properties and owner-occupied real estate that are being developed for business and residential purposes. The underlying properties are generally located largely in Bank's primary market area. Repayment on construction loans is expected to come from the sale of the underlying collateral, or from permanent financing once the property is stabilized. The sales of the

underlying properties, and the ability to rent the completed buildings, could be adversely impacted by a downturn in the economy as evidenced by lack of qualified borrowers, tightening of credit terms and increased vacancy rates, which in turn, will have an effect on credit quality. Generally, management seeks to obtain annual financial information for borrowers in this category.

Commercial & Industrial

Loans in this classification are made to businesses. Generally, these loans are unsecured, and repayment is expected from the cash flows of the business.

Nonaccrual loans outstanding at December 31, 2018 and 2017 are summarized as follows:

	2018	2017
Nonaccrual loans:		
Commercial real estate	$ 39,691	$ 592,757
Commercial	113,682	-
Residential real estate	63,354	-
Construction	645,000	-
Total nonaccrual loans	$ 861,727	$ 592,757

	2018	2017
Interest income that would have been recorded during the period on nonaccrual loans outstanding in accordance with original terms	$124,000	$ 53,679

At December 31, 2018, there were eight loans totaling $248,619 that were 90 days past due and still accruing interest and at December 31, 2017, there were six loans totaling $4,825,134 that were 90 days past due and still accruing interest.

The following table presents the aging of the past due loan balances as of December 31, 2018 and 2017 by class of loans:

December 31, 2018	Total	30-59 Days Past Due	60-89 Days Past Due	Greater than 90 Days Past Due	Total Past Due	Loans Not Past Due
Commercial loans:						
Unsecured	$16,412,190	$ 587,470	$ 528,484	$ 334,680	$ 1,450,634	$14,961,556
Secured	1,158,887	-	-	-	-	1,158,887
Real Estate loans						
Commercial	89,922,766	1,474,683	966,094	60,812	2,501,589	87,421,177
Residential	1,603,140	-	-	63,354	63,354	1,539,786
Construction loans	18,267,210	495,000	-	645,000	1,140,000	17,127,210
Consumer loans	402,375	4,116	-	6,500	10,616	391,759
Other loans	545,364	14,510	3,945	-	18,455	526,909
Total loans	$128,311,932	$2,575,779	$1,498,523	$1,110,346	$5,184,648	$123,127,284

December 31, 2017	Total	30-59 Days Past Due	60-89 Days Past Due	Greater than 90 Days Past Due	Total Past Due	Loans Not Past Due
Commercial loans:						
Unsecured	$16,964,651	$ 178,042	$ 9,750	$ -	$ 187,792	$16,776,859
Secured	1,159,567	35,000	-	-	35,000	1,124,567
Real Estate loans						
Commercial	90,359,444	1,021,474	-	1,145,691	2,167,165	88,192,279
Residential	1,956,499	-	68,490	385,000	453,490	1,503,009
Construction loans	25,676,057	-	-	3,887,200	3,887,200	21,788,857
Consumer loans	475,877	-	-	-	-	475,877
Other loans	744,966	-	-	-	-	744,966
Total loans	$137,337,061	$1,234,516	$78,240	$5,417,891	$6,730,647	$130,606,414

Nonaccrual loans include smaller balance homogeneous loans that are collectively evaluated for impairment and individually classified impaired loans.

Loans individually evaluated for impairment were as follows:

	December 31, 2018	December 31, 2017
Loans with no allocated allowance for loan losses:		
Commercial real estate	$ 2,135,692	$ 2,764,228
Residential real estate	63,354	-
Construction	645,000	-
	$ 2,844,046	$ 2,764,228

The following table sets forth certain information about impaired loans with a measured impairment:

	Year Ended December 31, 2018	Year Ended December 31, 2017
Average of individually impaired loans during period:		
Commercial real estate	$ 344,246	$ 3,578,307
Residential real estate	42,352	-
Construction	431,178	-
Commercial unsecured	191,855	21,222
Consumer	-	105
	$ 1,009,631	$ 3,599,634
Interest income recognized during time period that loans were impaired, either using accrual or cash-basis method of accounting	$ 275,392	$ 147,940

Troubled Debt Restructurings:

The Company has not allocated specific reserves to customers whose loan terms have been modified in troubled debt restructurings ("TDRs") as of December 31, 2018 and 2017, respectively. The Company has not committed to lend any additional amounts to customers with outstanding loans that are classified as TDRs.

The outstanding principal balance of trouble debt restructurings at December 31, 2018 was $2,135,692 and at December 31, 2017 was $2,576,964. None of the loans currently classified as TDRs have defaulted during the 2018 period. These TDRs are all current and are paying under the modified arrangements.

There were no loans that were modified during the years ended December 31, 2018 and 2017 that met the definition of a TDR. Modification of loans that do not meet the definition of a TDR involve either a modification of the terms of a loan to borrowers who were not experiencing financial difficulties or a delay in a payment that was considered to be insignificant.

In order to determine whether a borrower is experiencing financial difficulty, 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.

Credit Quality Indicators:

The Company categorizes loans into risk categories based on relevant information about the ability of borrowers to service their debts such as: current financial information, historical payment experience, credit documentation, public information, and current economic trends, among other factors. The Company analyzes loans individually by classifying the loans as to credit risk. This analysis is performed on a quarterly basis. The Company uses the following definitions for risk ratings:

Special Mention. Loans categorized as special mention have a potential weakness that deserves management's close attention. If left uncorrected, these potential weaknesses may result in deterioration of the repayment prospects for the loan or of the institution's credit position as some future date.

Substandard. Loans classified as substandard are inadequately protected by the current net worth and paying capacity of the obligor or of the collateral pledged, if any. Loans so classified have a well-defined weakness or weaknesses that jeopardize the liquidation of the debt. They are characterized by the distinct possibility that the institution will sustain some loss if the deficiencies are not corrected.

Doubtful. Loans classified as doubtful have all the weaknesses inherent in those classified as substandard, with the added characteristics that the weaknesses make collection or liquidation in full, on the basis of currently existing facts, conditions and values, highly questionable and improbable.

The following table sets forth at December 31, 2018 and 2017, the aggregate carrying value of our assets categorized as Special Mention, Substandard and Doubtful according to asset type:

	At December 31, 2018				
	Special Mention	Substandard	Doubtful	Not Classified	Total
Commercial Loans:					
Secured	$ -	$ -	$ -	$ 1,158,887	$ 1,158,887
Unsecured	512,688	756,617	-	15,142,885	16,412,190
Commercial Real Estate	6,037,378	4,959,573	-	78,925,815	89,922,766
Residential Real Estate	-	1,603,140	-	-	1,603,140
Construction	495,000	645,000	-	17,127,210	18,267,210
Consumer	-	-	-	402,375	402,375
Other	-	-	-	545,364	545,364
Total loans	$ 7,045,066	$ 7,964,330	$ -	$ 113,302,536	$ 128,311,932
Real estate owned	-	-	-	-	-
Total assets	$ 7,045,066	$ 7,964,330	$ -	$ 113,302,536	$ 128,311,932

	At December 31, 2017				
	Special Mention	Substandard	Doubtful	Not Classified	Total
Commercial Loans:					
Secured	$ -	$ -	$ -	$ 1,159,567	$ 1,159,567
Unsecured	615,071	556,322	-	15,793,258	16,964,651
Commercial Real Estate	4,644,960	3,239,081	-	82,475,403	90,359,444
Residential Real Estate	-	1,888,009	-	68,490	1,956,499
Construction	-	-	-	25,676,057	25,676,057
Consumer	-	-	-	475,877	475,877
Other	-	-	-	744,966	744,966
Total loans	$ 5,260,031	$ 5,683,412	$ -	$ 126,393,618	$ 137,337,061
Real estate owned	-	43,351	-	-	43,351
Total assets	$ 5,260,031	$ 5,726,763	$ -	$ 126,393,618	$ 137,380,412

The following table presents the balance in the allowance for loan losses and the recorded balance in loans, by portfolio segment, and based on impairment method as of December 31, 2018 and 2017:

December 31, 2018

	Commercial Unsecured	Commercial Secured	Construction	Commerical Real Estate	Residential Real Estate	Other Loans	Total
Allowance for loan losses:							
Ending allowance balance attributable to loans							
Individually evaluated for impairment	$ -	$ -	$ -	$ -	$ -	$ -	$ -
Collectively evaluated for impairment	470,314	9,328	154,988	774,295	36,709	26,557	1,472,191
Total ending allowance balance	$ 470,314	$ 9,328	$ 154,988	$ 774,295	$ 36,709	$ 26,557	$ 1,472,191
Loans:							
Individually evaluated for impairment	$ -	$ -	$ 645,000	$ 2,135,692	$ 63,354	$ -	$ 2,844,046
Collectively evaluated for impairment	16,412,190	1,158,887	17,622,210	87,787,074	1,539,786	947,739	125,467,886
Total ending loans balance	$ 16,412,190	$ 1,158,887	$ 18,267,210	$ 89,922,766	$ 1,603,140	$ 947,739	$ 128,311,932

December 31, 2017

	Commercial Unsecured	Commercial Secured	Construction	Commerical Real Estate	Residential Real Estate	Other Loans	Total
Allowance for loan losses:							
Ending allowance balance attributable to loans							
Individually evaluated for impairment	$ -	$ -	$ -	$ -	$ -	$ -	$ -
Collectively evaluated for impairment	373,928	10,839	265,673	839,648	37,251	37,359	1,564,698
Total ending allowance balance	$ 373,928	$ 10,839	$ 265,673	$ 839,648	$ 37,251	$ 37,359	$ 1,564,698
Loans:							
Individually evaluated for impairment	$ -	$ -	$ -	$ 2,764,228	$ -	$ -	$ 2,764,228
Collectively evaluated for impairment	16,964,651	1,159,567	25,676,057	87,595,216	1,956,499	1,220,843	134,572,833
Total ending loans balance	$ 16,964,651	$ 1,159,567	$ 25,676,057	$ 90,359,444	$ 1,956,499	$ 1,220,843	$ 137,337,061

The following table presents the activity in the allowance for loan losses by portfolio segment for the years ended December 31, 2018 and 2017.

Year ended December 31, 2018

	Commercial Unsecured	Commercial Secured	Construction	Commerical Real Estate	Residential Real Estate	Other Loans	Total
Allowance for loan losses:							
Beginning balance	$ 373,928	$ 10,839	$ 265,673	$ 839,648	$ 37,251	$ 37,359	$ 1,564,698
Provision for loan losses	350,145	(1,511)	(110,685)	(79,926)	(542)	(32,481)	125,000
Loans charged-off	(290,000)	-	-	-	-	-	(290,000)
Recoveries	36,241	-	-	14,573	-	21,679	72,493
Total ending allowance balance	$ 470,314	$ 9,328	$ 154,988	$ 774,295	$ 36,709	$ 26,557	$ 1,472,191

Year ended December 31, 2017

	Commercial Unsecured	Commercial Secured	Construction	Commerical Real Estate	Residential Real Estate	Other Loans	Total
Allowance for loan losses:							
Beginning balance	$ 438,261	$ 13,810	$ 191,409	$ 666,339	$ 38,679	$ 26,069	$ 1,374,567
Provision for loan losses	(188,876)	(2,971)	74,264	121,295	(1,428)	12,716	15,000
Loans charged-off	(30,826)	-	-	-	-	(1,426)	(32,252)
Recoveries	155,369	-	-	52,014	-	-	207,383
Total ending allowance balance	$ 373,928	$ 10,839	$ 265,673	$ 839,648	$ 37,251	$ 37,359	$ 1,564,698

5. PREMISES AND EQUIPMENT

Premises and equipment at December 31, 2018 and 2017 are summarized as follows:

	2018	2017
Leasehold improvements	$ 2,812,852	$ 2,595,122
Construction in progress	1,327,179	-
Computer equipment and software	248,322	270,811
Furniture, fixtures and equipment	465,469	372,901
Other	84,643	84,643
	4,938,465	3,323,477
Less accumulated depreciation and amortization	(2,315,567)	(2,236,908)
Total	$ 2,622,898	$ 1,086,569

Depreciation and amortization expense amounted to $396,620 and $464,620 for the years ended December 31, 2018 and 2017, respectively.

At December 31, 2018 and 2017, the Company was obligated under six non-cancelable operating leases on property used for banking purposes. Rental expense under these leases was $594,222 for the year ended December 31, 2018 and $515,784 for the year ended December 31, 2017.

The projected minimum rental payments under the terms of the leases at December 31, 2018 are summarized as follows:

Year Ending December 31,	Amount
2019	$ 609,343
2020	480,240
2021	317,478
2022	189,263
2023	196,297
Thereafter	1,334,667
Total	$ 3,127,288

6. DEPOSITS

Deposits are summarized, according to their original terms, at December 31, 2018 and 2017 as follows:

	2018	2017
	Amount	Amount
Checking	$ 153,311,235	$ 131,300,711
Variable-rate money market	45,715,279	54,894,238
Statement savings	22,162,400	23,715,892
Interest-bearing checking	58,527,067	53,070,471
	279,715,981	262,981,312
Time deposits:		
Less than six months	6,053,377	5,732,668
Six months to one year	29,112,937	29,872,326
More than one year	21,100,527	16,692,157
	56,266,841	52,297,151
Other deposits	409,262	281,505
Total	$ 336,392,084	$ 315,559,968

Scheduled maturities of time deposits at December 31, 2018 are as follows:

	Amount
Within six months	$ 34,597,170
Six months to one year	4,620,542
Over one year to two years	2,766,026
Over two years to three years	2,985,076
Over three years to four years	4,128,856
Over four years to five years	7,169,171
Total	$ 56,266,841

Time deposits that meet or exceed the FDIC Insurance limit of $250,000 at year end 2018 and 2017 were $41,028,595 and $38,010,017, respectively.

The bank has two customers with large deposit concentrations in the amount of $20,000,000 and $30,020,433 at December 31, 2018.

7. REVENUE FROM CONTRACTS WITH CUSTOMERS

All of the Company's revenue from contracts with customers in the scope of ASC 606 is recognized within Non-Interest Income. The following table presents the Company's sources of Non-Interest Income for the twelve months ended December 31, 2018 and 2017. Items outside the scope of ASC 606 are noted as such.

	For the years ended	
	December 31, 2018	December 31, 2017
Non-interest income:		
Service charges on deposits		
Overdraft fees	$ 1,742,364	$ 1,791,996
Other	111,924	128,792
ATM/debit card surcharge	94,614	139,093
Service fees on loans (a)	339,338	232,633
Income from BOLI (a)	110,894	116,865
Other income (b)	121,327	166,673
Total non-interest income	$ 2,520,461	$ 2,576,052

(a) Not within the scope of ASC 606.
(b) The Other income category includes safe deposit rental fees and official check fees totaling $13,121 and $13,426, for the year ended December 31, 2018 and 2017, respectively, which is within the scope of ASC 606; the remaining balance of $108,206 and $153,247, for the years ended December 31, 2018 and 2017, respectively, represents dividends on restricted stock, net rental income and other miscellaneous income, which is outside the scope of ASC 606.

Service Charges on Deposit Accounts: The Company earns fees from its deposit customers for transaction-based, account maintenance and overdraft services. Transaction-based fees, which include services such as stop payment charges, statement rendering, and ACH fees, are recognized at the time the transaction is executed as that is the point in time the Company fulfills the customer's request. Account maintenance fees, which relate to monthly maintenance, are earned over the course of a month, representing the period over which the Company satisfies the performance obligation. 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.

ATM/Debit Card Surcharge: The Company earns fees from its deposit customers for transaction-based services. Transaction-based fees, which include ATM/debit card surcharges are recognized at the time the transaction is executed as that is the point in time the Company fulfills the customer's request.

8. INCOME TAXES

The Company files consolidated federal, state and local income tax returns on a calendar-year basis. For federal, state and local income tax purposes, the Company uses the Internal Revenue Code Section 585 reserve method in computing its federal, state and local tax bad debt deduction.

The basis for the determination of New York and New York City tax is the greater of a calculated income tax liability, a tax liability based upon average equity capital or a minimum filing fee. Federal and New Jersey income tax provisions were determined based on the tax computed on book taxable income for the years ended December 31, 2018 and 2017.

The components of the income tax expense/(benefit) for the years ended December 31, 2018 and 2017 are summarized as follows:

	2018	2017
Current:		
Federal	$ 894,569	$ 1,711,941
State and local	198,332	7,545
	1,092,901	1,719,486
Deferred:		
Federal	25,053	331,654
State and local	40,782	(44,897)
	65,835	286,757
Valuation Allowance	(41,180)	85,272
	$ 1,117,556	$ 2,091,515

The components of the deferred income tax asset/(liability), net as of December 31, 2018 and 2017 are summarized as follows:

	2018	2017
Deferred tax assets:		
Excess book depreciation	$ 268,555	$ 382,100
Deferred loan fees	123,143	125,527
Excess book allowance for loan losses	346,983	313,013
Nonaccrual loan interest income	36,948	85,269
Unrealized loss on investment securities	196,764	85,652
Other	202,726	138,280
Valuation allowance	(296,389)	(337,569)
Net deferred tax asset:	$ 878,730	$ 792,272

Effective January 1, 2015, New York and New York City enacted comprehensive tax reform provisions with significant impact on financial institutions. As a result of this legislation, beginning in 2015, the Bank calculates its tax obligation to New York and New York City based upon the largest of a calculated income tax liability, a tax liability based upon average equity capital or a minimum filing fee. Also, effective January 1, 2015, banks under $8 billion in total assets are permitted to claim a subtraction from New York and New York City taxable income equal to 50% of the net interest income on loans secured by residential real estate located within these respective jurisdictions. Based upon the forecasted impact of this subtraction on the Bank's state and city taxable income, it is more likely than not that the Bank will generate income tax losses in future years and therefore calculate its New York and New York City tax liability on the basis of average equity capital or a fixed minimum fee. Consequently, the Bank recorded a valuation allowance against its New York and New York City deferred tax assets as of January 1, 2015 as it is unlikely these deferred tax assets will impact the Bank's tax liability in future years.

At December 31, 2018 and December 31, 2017, the Company had no unrecognized tax benefits recorded. The Company does not expect the total amount of unrecognized tax benefits to significantly increase in the next twelve months. The Company recognizes interest and penalties on unrecognized tax benefits as a component of income tax expense.

The Company is subject to United States federal income tax, New York, New Jersey and New York City income tax. The Company is no longer subject to examination by taxing authorities for years before 2015.

On December 22, 2017, H.R.1, commonly known as the Tax Cuts and Jobs Act (the "Act"), was signed into law. The Act includes many provisions that will affect our income tax expense, including reducing our federal tax rate from 34% to 21% effective January 1, 2018. As a result of the rate reduction, we were required to re-measure, through income tax expense in the period of enactment, our deferred tax assets and liabilities using the enacted rate at which we expect them to be recovered or settled. The re-measurement of our net deferred tax asset resulted in additional 2017 income tax expense of $423,318.

The Company's effective tax rates differ from the statutory Federal tax rate for the years ended December 31, 2018 and 2017 are as follows:

	2018			2017		
Federal income tax provision at statutory rates	$ 918,565	21.00	%	$ 1,580,877	34.00	%
Enactment of Tax Reform	-	0.00		423,318	9.10	
State and local taxes, net of Federal income tax benefit	188,901	4.32		(80,204)	(1.72)	
Valuation allowance	(41,180)	(0.94)		85,272	1.83	
Other	51,270	1.17		82,252	1.77	
	$ 1,117,556	25.55	%	$ 2,091,515	44.98	%

9. REGULATORY MATTERS

The Bank is a New York State chartered stock form commercial bank. The Bank's deposits are insured by the Federal Deposit Insurance Corporation ("FDIC"). The Bank is subject to certain FDIC capital requirements. Failure to meet minimum capital requirements can initiate certain mandatory and possibly discretionary actions by the regulators that, if undertaken, could have a direct material effect on the Bank's financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, the Bank must meet certain specific capital guidelines that involve quantitative measures of the Bank's assets, liabilities and certain off-balance sheet items 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. The final rules implementing the Basel Committee on Banking Supervision's capital guidelines for U.S. banks (Basel III rules) became effective for the Company on January 1, 2015 with full compliance with requirements being phased in over a multi-year schedule, and fully phased in by January 1, 2019. The net unrealized gain or loss on available for sale securities is not included in computing regulatory capital.

Beginning January 1, 2016, financial institutions are required to maintain a capital conservation buffer on Common Equity Tier 1 capital under Basel III in order to avoid restrictions on capital distributions and other payments. The buffer is .625% in 2016, 1.25% in 2017, 1.875% in 2018 and 2.5% in 2019. The Bank is currently well above the required buffer level.

As of the latest notification from the FDIC, the Bank was classified as "well capitalized" under the regulatory framework for prompt corrective action. To be categorized as "well capitalized," the Bank must maintain Tier 1 Leverage, Common Equity Tier 1, Risk-Based, Tier 1 Risk-Based and minimum Total Risk-based ratios as set forth in the table below. There are no conditions or events since that notification that management believes would have changed the Bank's category. Management believes, as of December 31, 2018, that the Bank meets all capital adequacy requirements to which it is subject.

The Bank is subject to certain restrictions on the availability of its undistributed earnings for payment of dividends to stockholders.

In accordance with the New York State Banking Law and the New York State Superintendent of Financial Services Regulations, the Bank credits 10% of quarterly net income to regulatory surplus and is required to do so until such time as shareholders' equity is equal to 10% of amounts due to depositors. As of December 31, 2018, regulatory surplus equals 10% of deposits.

The following table is the Bank's actual capital amounts and ratios, as well as the minimum required levels for both "capital adequacy purposes" and to be considered "well capitalized". No deductions were made for qualitative judgments by regulators:

	Actual		For capital adequacy purposes		To be well-capitalized under prompt corrective action provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
As of December 31, 2018:						
Tier 1 Capital (to Average Assets)	$ 35,262,562	9.28 %	$ 15,203,724	4.00 %	$ 19,004,656	5.00 %
Common Equity Tier 1 (to Risk Weighted Assets)	35,262,562	20.79	7,714,370	4.50	11,142,979	6.50
Tier 1 Capital (to Risk Weighted Assets)	35,262,562	20.79	10,285,827	6.00	13,714,436	8.00
Total Capital (to Risk Weighted Assets)	36,734,753	21.66	13,714,436	8.00	17,143,045	10.00

	Actual		For capital adequacy purposes		To be well-capitalized under prompt corrective action provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
As of December 31, 2017:						
Tier 1 Capital (to Average Assets)	$ 32,522,000	9.02 %	$ 14,427,247	4.00 %	$ 18,034,059	5.00 %
Common Equity Tier 1 (to Risk Weighted Assets)	32,522,000	18.05	8,105,850	4.50	11,708,450	6.50
Tier 1 Capital (to Risk Weighted Assets)	32,522,000	18.05	10,807,800	6.00	14,410,400	8.00
Total Capital (to Risk Weighted Assets)	34,087,000	18.92	14,410,400	8.00	18,013,000	10.00

10. EMPLOYEE BENEFITS

The Company sponsors an incentive savings plan (401(k) plan) which started March 1, 1999. All eligible employees, who have reached the age of 21, have at least one year of service and work a minimum of 1,000 hours per year are permitted to make tax deferred contributions up to certain limits. The Bank may reduce or cease matching contributions if it determines that the current or accumulated net earnings or undivided profits of the Bank are insufficient to pay the full contributions in a plan year. The Bank contributed $151,751 to the 401(k) plan in 2018 and $139,525 in 2017.

Stock Options

Stockholders have approved six different stock option plans. Options may no longer be granted under four of those plans and options to purchase 19,927 shares remain available to be granted under the two remaining plans, subject to increase in the event of forfeitures. Options to buy stock are granted to directors, officers and employees under the VSB Bancorp, Inc. 2010 Incentive Plan, the 2000 Incentive Plan, the 1998 Incentive Plan, the 2004 Directors' Plan, the 2000 Directors' Plan and the 1998 Directors' Plan which, in the aggregate, provide for issue up to 293,750 options. The exercise price of all options is the market price at the date of grant, and compensation expense is recognized in the income statement over the vesting period. The maximum option term is ten years, and the options vesting period is up to five years.

The Company granted no stock options in 2018 or 2017. Total compensation expense for the stock option plans charged against income for 2018 and 2017 was $0 and $2,138, respectively.

The fair value of each option award is estimated on the date of grant using a closed form option valuation (Black-Scholes) model. Expected volatilities are based on historical volatilities of the Company's common stock. The Company uses historical data to estimate option exercise and post-vesting termination behavior. Employee and management options are tracked separately. The expected term of options granted is based on historical data and represents the period of time that options granted are expected to be outstanding, which takes into account that the options are not transferable. The risk-free interest rate for the expected term of the option is based on the U.S. Treasury yield curve in effect at the time of the grant.

The unrecognized compensation expense at December 31, 2018 was $0.

The changes in stock options outstanding under the plans during 2018 are as follows:

	2018		
	Shares	Weighted Average Exercise Price	Aggregate Intrinsic Value
Options outstanding at the beginning of the year	76,050	$11.43	$ 558,627
Exercised	(1,750)	11.29	
Forfeited	-	-	
Options outstanding at the end of the year	74,300	$11.44	$ 614,461
Options exercisable at the end of the year	74,300	$11.44	$ 614,461
Weighted average remaining contractual life of options outstanding at the end of the year		3.3 Years	

Information related to the stock option plan during each year follows:

	2018	2017
Intrinsic value of options exercised	$ 16,643	$ 28,620
Cash received from option exercises	19,757	77,658
Tax benefit from option exercises	3,495	9,731

Described below is the range of exercise prices for options granted and outstanding at December 31, 2018:

Plan Description	Number of Exercisable Shares	Weighted Average Exercise Price	Weighted Average Contractual Life
2000 Incentive Stock Option Plan	3,927	$ 11.10	1.08
2004 Director Stock Option Plan	48,250	11.46	4.34
2010 Incentive Stock Option Plan	22,123	11.45	1.50
All Plans	74,300	$ 11.44	3.32

Post-Retirement Benefits

The Company offers post-retirement benefits related to its Bank-owned life insurance plan to certain employees. At December 31, 2018and 2017, the post retirement benefit obligation was $41,475 and $36,930, respectively. The costs of such benefits are accrued during the years that an employee renders the service. The associated expense for the liability for the year ended December 31, 2018 and 2017 were $4,545 and $7,800 respectively.

11. EMPLOYEE STOCK OWNERSHIP PLAN

Employees participate in an Employee Stock Ownership Plan ("ESOP"). VSB Bancorp, Inc. ESOP Trust was formed on May 1, 2004. The ESOP borrowed from the Company to purchase 92,900 shares of stock at $18.20 per share. The ESOP completed the repayment of this loan on April 30, 2014. On May 5, 2014, the ESOP borrowed from the Company to purchase 89,000 shares of stock at $11.25 per share. The Company makes discretionary contributions to the ESOP and pays dividends on unallocated shares to the ESOP. The ESOP uses these funds to repay the loan. When loan payments are made, a pro rata portion of ESOP shares that had been pledged as collateral for the loan are released and are then allocated to participants based on their relative compensation. The Company then records compensation expense. Dividends on allocated shares increase participant accounts.

Shares allocated to each participant and the earnings thereon, to the extent vested, are distributed to the participant upon termination of employment. As required by federal law, a participant may require the Company to repurchase shares so distributed unless the stock is traded on an established market. Since the Company shares are traded on the OTCQX, which is considered an established market, the Company does not now have such a repurchase obligation.

The contribution to the ESOP was $100,125 for the year ended December 31, 2018 and for the year ended December 31, 2017. ESOP expense was $166,474 and $140,628 for the years ended December 31, 2018 and 2017, respectively.

Shares held by the ESOP at December 31, 2018 and 2017 were as follows:

	2018	2017
Shares allocated to participants	137,493	128,384
Shares released to participants	(43,135)	(35,686)
Unearned shares	44,407	53,516
Total ESOP Shares	138,765	146,214
Fair value of unearned shares	$ 875,262	$ 1,025,902

12. RETENTION AND RECOGNITION PLAN

The stockholders of VSB Bancorp, Inc. approved the adoption of the 2010 Retention and Recognition Plan (the "RRP"). The RRP authorizes the award of up to 50,000 shares of its common stock to directors, officers and employees. On November 10, 2015, 500 shares were awarded to each of five key Vice Presidents of the Bank who each have tenure over 10 years. The awards will vest over three years. At the April 26, 2016 Annual Meeting, the stockholders of VSB Bancorp, Inc. approved the addition of 50,000 shares of our common stock to our 2010 Retention and Recognition Plan and approved the grant of 5,000 of those shares to each of the eight directors who has at least five years of service. These new awards will vest over three years, provided that vesting will be delayed until Victory State Bank's total assets exceed $400 million at quarter end.

The recipient of an award will not be required to make any payment to receive the award or the stock covered by the award. The Company recognizes compensation expense for the shares awarded under the RRP gradually as the shares vest, based upon the market price of the shares on the date of the award. For the years ended December 31, 2018 and 2017, the Company recognized $152,757 and $200,804 of compensation expense related to the shares awarded. The income tax benefit resulting from this expense was $33,607 and $44,177 for the years ended December 31, 2018 and 2017. As of December 31, 2018, there was approximately $36,021 of unrecognized compensation costs related to the shares awarded. These costs are expected to be recognized over the next 3 months. The total fair value of the shares vested during the years ended December 31, 2018 and 2017 was $16,359 and $111,857.

A summary of the status of the Company's non-vested plan shares as of December 31, 2018 is as follows:

For the Year Ended December 31, 2018:

	Shares	Weighted Average Grant Date Fair Value
Non vested at beginning of period	35,830	$ 12.35
Granted	-	-
Vested	830	12.49
Non vested at end of period	35,000	$ 12.35

13. COMMITMENTS, CONTINGENCIES AND FINANCIAL INSTRUMENTS WITH OFF-BALANCE SHEET RISK

The Company is a party to financial instruments with off-balance sheet risk in the normal course of business in order to meet the financing needs of its customers. Such financial instruments primarily include commitments to extend credit.

A summary of these commitments and contingent liabilities, all of which are variable rate commitments tied to prime, at December 31:

	2018 Amount	2017 Amount
Commitments to fund secured construction loans	$ 13,616,942	$ 11,545,128
Commitments to fund all other commercial loans	26,933,991	32,144,045
	$ 40,550,933	$ 43,689,173

Commitments to extend credit are legally binding agreements to lend to a customer. Commitments are issued following the Company's evaluation of each applicant's creditworthiness on a case-by-case basis. The Company's exposure to credit loss in the event of nonperformance by the other party to the financial instrument is represented by the contractual notional amount of those instruments.

Victory State Bank currently has a $5 million unsecured credit facility with Atlantic Central Bankers Bank which the Bank has not drawn upon.

VSB Bancorp, Inc. is not involved in any material pending legal proceedings. The Bank, from time to time, is involved in routine collection proceedings in the ordinary course of business on loans in default. Management believes that such other routine legal proceedings in the aggregate are immaterial to our financial condition or results of operations.

14. FAIR VALUE

The following disclosure of the estimated fair value of financial instruments is made in accordance with the requirements of FASB ASC 820, “Financial Instruments”. The estimated fair value amounts have been determined by the Company using available market information and appropriate valuation methodologies. However, considerable judgment is necessarily required to interpret market data to develop the estimates of fair value. Accordingly, the estimates presented herein are not necessarily indicative of the amounts the Company could realize in a current market exchange. The use of different market assumptions and/or estimation methodologies may have a material effect on the estimated fair value amounts.

The following methods and assumptions were used by the Company in estimating fair values of financial instruments:

Investment Securities, Available For Sale and Held To Maturity – The estimated fair value of these securities is determined by using available market information and appropriate valuation methodologies. The estimates presented herein are not necessarily indicative of the amounts that the Company could realize in a current market exchange.

Loans Receivable - The Company has adopted ASU 2016-01, and therefore is measuring the fair value of loans receivable under the exit price notion rather than the previous method of entry price notion. Under the entry price notion, the fair value estimate of loans receivable was based on discounted cash flow. At December 31, 2018, the exit price notion used to estimate the fair value of loans receivable was based on similar techniques, with the addition of current origination spreads, liquidity premiums, or credit adjustments.

The carrying amounts and estimated fair values of financial instruments, at December 31, 2018 and December 31, 2017 are:

	Fair Value Measurements at December 31, 2018 Using				
	Carrying Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total
Financial Assets:					
Cash and cash equivalents	$ 29,182,881	$ 1,651,559	$ 27,531,322	$ -	$ 29,182,881
Investment securities, available for sale	38,296,615	-	38,296,615	-	38,296,615
Investment securities, held to maturity	168,272,336	-	165,694,423	-	165,694,423
Loans receivable	128,088,148	-	-	127,186,000	127,186,000
Accrued interest receivable	973,057	-	596,020	377,037	973,057
Total Financial Assets	$ 364,813,037	$ 1,651,559	$ 232,118,380	$ 127,563,037	$ 361,332,976
Financial Liabilities:					
Deposits	$ 336,392,084	$ 153,720,497	$ 182,665,587	$ -	$ 336,386,084
Accrued interest payable	391,005	-	391,005	-	391,005
Total Financial Liabilities	$ 336,783,089	$ 153,720,497	$ 183,056,592	$ -	$ 336,777,089

	Fair Value Measurements at December 31, 2017 Using				
	Carrying Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total
Financial Assets:					
Cash and cash equivalents	$ 12,920,547	$ 3,146,218	$ 9,774,329	$ -	$ 12,920,547
Investment securities, available for sale	46,080,113	-	46,080,113	-	46,080,113
Investment securities, held to maturity	145,853,876	-	144,168,074	-	144,168,074
Loans receivable	137,180,384	-	-	136,076,329	136,076,329
Accrued interest receivable	888,936	-	488,382	400,554	888,936
Total Financial Assets	$ 342,923,856	$ 3,146,218	$ 200,510,898	$ 136,476,883	$ 340,133,999
Financial Liabilities:					
Deposits	$ 315,559,968	$ 131,582,216	$ 183,722,818	$ -	$ 315,305,034
Accrued interest payable	139,594	-	139,594	-	139,594
Total Financial Liabilities	$ 315,699,562	$ 131,582,216	$ 183,862,412	$ -	$ 315,444,628

ASC 820 establishes a fair value hierarchy which requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. The standard describes 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 and asset or liability.

The fair value of securities available for sale and held to maturity is determined by obtaining quoted prices on nationally recognized securities exchanges (Level 1 inputs) or using 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). For securities where, quoted prices or market prices of similar securities are not available, fair values are calculated using discounted cash flows or other market indicators (Level 3).

The tables below present a reconciliation of all assets measured at fair value on a recurring basis using significant observable inputs (Level 2) for the years ended December 31, 2018 and 2017:

	Fair Value Measurements at December 31, 2018 Using			
	Total	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:				
FNMA MBS - Residential	$ 133,514	$ -	$ 133,514	$ -
Collateralized mortgage obligations	27,627,830	-	27,627,830	-
Corporate bonds	9,266,736	-	9,266,736	-
Other debt securities	1,268,535	-	1,268,535	-
Total Available for sale Securities	$ 38,296,615	$ -	$ 38,296,615	$ -

	Fair Value Measurements at December 31, 2017 Using			
	Total	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:				
FNMA MBS - Residential	$ 207,066	$ -	$ 207,066	$ -
Whole Loan MBS-Residential	129	-	129	-
Collateralized mortgage obligations	34,764,365	-	34,764,365	-
Corporate bonds	9,541,816	-	9,541,816	-
Other debt securities	1,566,737	-	1,566,737	-
Total Available for sale Securities	$ 46,080,113	$ -	$ 46,080,113	$ -

During the years-ended December 31, 2018 and 2017, there were no transfers between levels.

Assets Measured on a Non-Recurring Basis

Certain financial assets are measured at fair value on a nonrecurring basis, that is, the instruments are not measured at fair value on an ongoing basis but are subject to fair value adjustments in certain circumstances (for example, when there is evidence of impairment).

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

Impaired Loans: The fair value of impaired loans with specific allocations of the allowance for loan losses is generally based on recent 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 are usually significant and typically result in a Level 3 classification of the inputs for determining fair value.

Real Estate Owned: Assets acquired through or instead of loan foreclosure are initially recorded at fair value less costs to sell when acquired, establishing a new cost basis. These assets are subsequently accounted for at lower of cost or fair value less estimated costs to sell. Fair value is commonly based on recent real estate appraisals which are updated no less frequently than annually, or bona fide purchase offers that are accepted. (which would be level 2). 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 are usually significant and typically result in a Level 3 classification of the inputs for determining fair value.

	Fair Value Measurements at December 31, 2018 Using			
	Total	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets:				
Other real estate owned	$ -	-	$ -	-

	Fair Value Measurements at December 31, 2017 Using			
	Total	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets:				
Other real estate owned	$ 43,351	-	$ 43,351	-

As of December 31, 2018, and 2017, we had no impaired loans with specific reserves that were collateral dependent.

15. RELATED PARTIES

The Bank at times has had loans, and other financial transactions, with its executive officers and directors. At December 31, 2018, the aggregate amount of loans outstanding to directors and director affiliated companies was $1,396,185. There were no loans granted to executive officers.

The change in aggregate amount of loans outstanding to directors as of December 31, 2018 and 2017 is as follows:

	2018	**2017**
Beginning balance	$ 2,479,036	$ 550,000
Originations	962,356	3,660,456
Payments	(2,045,207)	(1,731,420)
Ending balance	$ 1,396,185	$ 2,479,036

The interest income that was paid on these loans was $105,354 and $84,559 for 2018 and 2017, respectively.

Executive officers and directors own, in the aggregate, 29.0% and 29.1% of the common shares outstanding, calculated in accordance with SEC beneficial ownership rules, at December 31, 2018 and 2017, respectively.

A related party law firm provides legal services to the Bank. Fees paid to that firm for legal services were $264,367 in 2018 and $198,244 in 2017, and out of pocket disbursements incurred for the Bank, in the amount of $5,397 in 2018 and $5,019 in 2017.

16. CONDENSED FINANCIAL STATEMENTS OF THE PARENT COMPANY ONLY

VSB BANCORP, INC.

STATEMENTS OF FINANCIAL CONDITION
DECEMBER 31, 2018 and 2017

	2018	2017
ASSETS		
Cash and cash equivalents	$ 1,100	$ 1,100
Money market	424,338	330,403
Investment in subsidiaries	34,564,945	32,256,591
Deferred taxes	102,968	66,121
Other assets	27,357	26,287
Total assets	$ 35,120,708	$ 32,680,502
LIABILITIES AND STOCKHOLDERS' EQUITY		
LIABILITIES:		
Accounts payable, accrued expenses and other liabilities	$ 87,538	$ 80,162
Total liabilities	87,538	80,162
COMMITMENTS AND CONTINGENT LIABILITIES		
STOCKHOLDERS' EQUITY		
Common stock ($.0001 par value, 10,000,000 shares authorized, 2,094,676 issued, 1,831,215 outstanding at December 31, 2018 and 2,092,926 issued, 1,829,465 outstanding at December 31, 2017)	209	209
Additional paid-in capital	10,829,420	10,590,557
Retained earnings	28,248,811	25,722,467
Treasury stock, at cost (263,461 shares at December 31, 2018 and at December 31, 2017)	(2,813,653)	(2,813,653)
Unearned Employee Stock Ownership Plan shares	(534,000)	(634,125)
Accumulated other comprehensive loss, net of taxes of $196,764 and $142,754, respectively	(697,617)	(265,115)
Total stockholders' equity	35,033,170	32,600,340
Total liabilities and stockholders' equity	$ 35,120,708	$ 32,680,502

VSB BANCORP, INC.

STATEMENTS OF OPERATIONS
FOR THE YEARS ENDED DECEMBER 31, 2018 AND 2017

	2018	2017
INTEREST INCOME:		
Loans receivable	$ 20,600	$ 23,854
Other interest income	3,091	2,479
Total interest income	23,691	26,333
INTEREST EXPENSE:		
Total interest expense	-	-
Net interest income	23,691	26,333
NON-INTEREST INCOME:		
Dividend income	750,000	500,000
Other	-	-
	750,000	500,000
NON-INTEREST EXPENSES:		
Salaries and benefits	152,757	202,942
Legal fees	12,000	36,000
Other	65,569	58,910
Total non-interest expenses	230,326	297,852
INCOME BEFORE INCOME TAXES	543,365	228,481
Income tax expense	(50,043)	(62,730)
EQUITY IN UNDISTRIBUTED EARNINGS, NET OF TAXES	2,663,155	2,266,911
NET INCOME	$ 3,256,563	$ 2,558,122

VSB BANCORP, INC.

STATEMENTS OF CASH FLOWS FOR THE YEARS ENDED DECEMBER 31, 2018 AND 2017

	2018	2017
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income	$ 3,256,563	$ 2,558,122
Adjustments to reconcile net income to net cash used in operating activities:		
Changes in operating assets and liabilities:		
ESOP compensation expense	66,350	40,503
Stock-based compensation expense	152,757	202,942
Undistributed income of subsidiaries	(2,663,155)	(2,266,911)
Increase in other assets	(1,070)	(5,417)
Provision for deferred income taxes	(36,847)	(13,496)
(Decrease)/increase in accounts payable, accrued expenses, and other liabilities	(13,225)	25,468
Net cash provided by operating activities	761,373	541,211
CASH FLOWS FROM INVESTING ACTIVITIES:		
Net decrease in loan receivable	100,125	100,125
Net increase in money market deposit	(93,935)	(17,250)
Net cash provided by investing activities	6,190	82,875
CASH FLOWS FROM FINANCING ACTIVITIES:		
Exercise of stock options	19,757	77,658
Purchase of treasury stock, at cost	-	(96,525)
Payment of dividends	(787,320)	(605,219)
Net cash used in financing activities	(767,563)	(624,086)
NET INCREASE/(DECREASE) IN CASH AND CASH EQUIVALENTS	-	-
CASH AND CASH EQUIVALENTS, BEGINNING OF YEAR	1,100	1,100
CASH AND CASH EQUIVALENTS, END OF YEAR	$ 1,100	$ 1,100
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION:		
Cash paid during the period for:		
Interest	$ -	$ -
Income taxes	$ -	$ -

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BOARD OF DIRECTORS

Joseph J. LiBassi
Chairman of the Board
Private Investor

Raffaele M. Branca
President & CEO
VSB Bancorp, Inc. and
Victory State Bank

Joan Nerlino Caddell
Attorney, Owner
Joan Nerlino Caddell &
Associates, PLLC

Hon. Robert J. Gigante
Retired Judge
Surrogate Court
Richmond County

Alfred C. Johnsen, CPA
Private Practice
Alfred C. Johnsen, CPA

Robert P. Moore
Retired Vice President
KeySpan

Dr. Carlos M. Perez
Medical Doctor

Bruno Savo
Builder/Developer
Savo Brothers, Inc.

DIRECTORS EMERITI

Savino Savo
Builder/Developer

Robert S. Cutrona, Sr.
President
Maintenance Company
Project One Services, Inc.

VICTORY STATE BANK SENIOR OFFICERS

Raffaele M. Branca
President &
Chief Executive Officer

Richard P. Boyle
Senior Vice President
Chief Lending Officer

Elizabeth Scarano
Senior Vice President
Chief Operations Officer

David J. Onderko
Senior Vice President
Chief Financial Officer

Philip Stropoli
1st Vice President
Branch Administrator

Anna Williams
1st Vice President
Compliance

Brahim Bacha
Vice President
Business Development

Kathleen Cassiliano
Vice President
Branch Manager

Johnny Reyes
Vice President
Business Development

Toni Scarito
Vice President
Human Resources

Isaac Zahavi
Vice President
IT Manager

INDEPENDENT AUDITOR

Crowe LLP

TRANSFER AGENT AND REGISTRAR

Computershare Trust
Company, N.A.
250 Royall Street
Canton, MA 02021

STOCKHOLDER INFORMATION

Raffaele M. Branca
(718) 979-1100

STOCK QUOTATION

OTC Market Place OTCQX
Symbol: VSBN

BRANCHES

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1762 Hylan Boulevard
Dongan Hills
(718) 979-2300

1065 Bay Street
Rosebank
(718) 981-1200

Loan Department
Dongan Hills
1762 Hylan Boulevard
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