Hometown Bancorp, Inc.

2013 ANNUAL REPORT

President's Message

Dear Stockholders and Customers:

On behalf of the Officers and Directors of Hometown Bancorp, Inc. and everyone affiliated with its subsidiary, Hometown Bank of the Hudson Valley, I am presenting to you our 2013 Annual Report.

During 2013, Hometown Bank of the Hudson Valley faced challenges in the local economy which continued to adversely affect the Bank's financial condition. The Bank's level of nonperforming assets decreased in 2013 but the expenses associated with the non-performing assets increased contributing to our net loss. The allowance for loan losses increased to reflect changes in real estate values, market conditions and increased charge-offs. We are working to resolve the non-performing assets in order to stabilize the Bank's financial condition.

We also saw a substantial decline in mortgage banking income in 2013 as refinancing activity decreased as a result of increases in interest rates during the second half of 2013. Commercial loan demand improved during the fourth quarter of 2013.

Effective March 7, 2013, the Bank entered into a Formal Agreement with the Office of the Comptroller of the Currency. The Agreement requires the Bank to improve its risk management program and credit administration practices, including reducing the level of criticized assets. We have made substantial progress in complying with the agreement and continue to improve our policies and procedures. The Board and Senior Management remain committed to improving the financial performance of the Bank. The Agreement does not affect the Bank's ability to continue to conduct its banking business with customers in a normal fashion. Banking products and services, hours of operation, internet banking, ATM usage and FDIC deposit insurance coverage are unaffected. Customer deposits remain protected and insured by the FDIC up to $250,000 per depositor, for each account ownership category.

In light of the Bank's recent financial performance and market conditions, the Board of Directors has engaged FinPro Capital Advisors, Inc. to assist us in exploring strategic alternatives to enhance stockholder and depositor value. The Board of Directors is currently reviewing all possible strategic alternatives in order to consider the relative benefits of such alternatives to the stockholders, depositors and the communities we serve.

As we evaluate our options, we will continue to serve our customers with our focus on exceptional customer service and maintaining relationships that have endured the challenging times. We offer all the conveniences of larger banks but with a personal touch. We are involved in our community with many officers, directors and staff volunteering to support community initiatives. I am extremely proud of the difference that our Bank and our people make in the lives of our customers and the communities we touch.

On behalf of all of us at the Company and the Bank, we offer special thanks to Graham S. Jamison, 38 years and Gerald N. Jacobowitz, 48 years of service. We thank them for their dedication, contributions and accomplishments. We wish them well in their retirement.

In closing, I want to thank you, our stockholders, depositors, customers and community for the confidence you have placed in us as we face the current challenges. I want to thank the staff for their dedication to serving our customers with expert care and commitment to excellence.

Marjorie S. Rovereto
President and Chief Executive Officer

Selected Financial and Other Data

The information at December 31, 2013 and 2012 and for the years ended December 31, 2013 and 2012 is derived in part from the audited consolidated financial statements that appear in this Annual Report. The following is only a summary and you should read it in conjunction with the audited consolidated financial statements and notes beginning on page 14.

	At or for the Year Ended December 31,	
(Dollars in thousands)	**2013**	**2012**
Financial Condition Data:		
Total assets	**$135,941**	$154,802
Cash and cash equivalents	**7,140**	11,682
Federal funds	**-**	528
Investment securities	**3,758**	4,011
Loans held for sale	**150**	843
Loans receivable, net	**115,339**	123,828
Deposits	**122,733**	133,653
Total stockholders' equity	**11,233**	18,428
Operating Data:		
Interest income	**$ 5,741**	$ 6,780
Interest expense	**361**	540
Net interest income	**5,380**	6,240
Provision for loan losses	**3,175**	1,494
Net interest income after provision for loan losses	**2,205**	4,746
Non-interest income	**909**	2,089
Non-interest expenses	**9,150**	8,480
Loss before taxes	**(6,036)**	(1,645)
Income tax expense (benefit)	**1,130**	(653)
Net loss	**$ (7,166)**	$ (992)

	At or for the Year Ended December 31,	
	2013	**2012**
Performance Ratios:		
Return on average assets	**(4.82)%**	(0.62)%
Return on average equity	**(47.06)**	(5.12)
Interest rate spread (1)	**4.10**	4.44
Net interest margin (2)	**4.14**	4.51
Non-interest income to average assets	**0.61**	1.30
Non-interest expense to average assets	**6.15**	5.30
Efficiency ratio (3)	**145.49**	101.81
Average interest-earning assets to average interest-bearing liabilities	**115.36**	117.50
Equity to total assets	**8.26**	11.90
Average equity to average assets	**10.24**	12.09
Capital Ratios (4):		
Tier 1 leverage capital	**7.05**	9.37
Tier 1 risk-based capital	**9.36**	12.27
Total risk-based capital	**10.63**	13.54
Asset Quality Ratios:		
Allowance for loan losses as a percent of total loans	**2.32**	2.07
Allowance for loan losses as a percent of nonperforming loans	**29.26**	20.23
Net charge-offs to average outstanding loans during the year	**2.53**	0.50
Nonaccrual loans as a percent of total loans	**7.94**	10.22
Nonaccrual loans as a percent of total assets	**6.89**	8.34
Nonperforming assets as a percent of total assets	**7.43**	10.19
Per Share Related Data:		
Basic net loss per common share	**$ (3.17)**	$ (0.44)
Dividends per share	**-**	0.04
Book value per share (5)	**4.83**	7.92
Tangible book value per share (6)	**4.57**	7.63
Other Data:		
Number of Offices	**5**	6

(1) Represents the difference between the weighted average yield on average interest-earning assets and the weighted average cost of average interest-bearing liabilities.
(2) Represents net interest income as a percent of average interest-earning assets.
(3) Represents non-interest expense divided by the sum of net interest income and non-interest income.
(4) Capital ratios are for Hometown Bank of the Hudson Valley.
(5) Book value per share is based on total stockholders' equity divided by 2,326,939 outstanding common shares at December 31, 2013 and 2012.
(6) Tangible book value per share is based on total stockholders' equity minus core deposit intangible of $595,000 and $672,000 at December 31, 2013 and 2012, divided by 2,326,939 outstanding common shares at December 31, 2013 and 2012.

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Management's discussion and analysis of financial condition and results of operations is intended to assist in understanding our financial condition and results of operations. You should read this discussion in conjunction with the Consolidated Financial Statements and Notes to the Consolidated Financial Statements included in this Annual Report.

Overview

Our principal business is to acquire deposits from individuals and businesses in the communities surrounding our offices and to use these deposits to fund loans. We focus on providing our products and services to two segments of customers: individuals and small businesses.

Income. Our primary source of pre-tax income is net interest income. Net interest income is the difference between interest income, which is the income that we earn on our loans and investments, and interest expense, which is the interest that we pay on our deposits and borrowings. Changes in levels of interest rates affect our net interest income. Since the latter part of 2007, short-term interest rates (which influence the rates we earn on our loans and we pay on deposits) have remained at historical lows. The declining spread between the interest we earn on loans and investments and the interest we pay on deposits and borrowings has decreased our net interest income.

A secondary source of income is non-interest income, which is revenue that we receive from providing products and services. The majority of our non-interest income comes from service charges and fees on deposit accounts and loans and mortgage-banking income.

Provision for Loan Losses. The allowance for loan losses is a valuation allowance for probable losses inherent in the loan portfolio. We evaluate the need to establish allowances against losses on loans on a quarterly basis. When additional allowances are necessary, a provision for loan losses is charged to earnings.

Expenses. The non-interest expenses we incur in operating our business consists of salaries and employee benefit expenses, occupancy and equipment expenses, data processing expenses, FDIC insurance premiums, other real estate owned expense and other miscellaneous expenses, such as office supplies, telephone, postage, advertising and professional services.

Our largest non-interest expense is salaries and employee benefits, which consist primarily of salaries and wages paid to our employees, payroll taxes, and expenses for health insurance, retirement plans and other employee benefits.

Occupancy and equipment expenses, which are the fixed and variable costs of buildings and equipment, consist primarily of branch lease expense, depreciation charges, furniture and equipment expenses, maintenance, real estate taxes and costs of utilities.

Operating/Business Strategy

Our strategy is to operate as a well-capitalized and profitable local bank that seeks to differentiate itself from its competition by providing superior, personalized and prompt service, backed by knowledge and experience. As a local bank, we emphasize the local nature of our decision-making to respond effectively to the needs of our customers. We have a long tradition of focusing on the needs of the communities we serve and being an active corporate citizen and we intend to continue this focus.

Our business model and product offerings allow us to provide a full range of financial services to both individuals and businesses. Our traditional consumer products such as conforming single family residential mortgages, time deposits, checking and savings accounts appeal to a broad customer base. Additionally we offer a full range of financial products that are meeting the changing needs of today's

customer. Those products include, but are not limited to, internet banking, mobile banking (introduced in 2013), remote deposit capture, cash management, debit cards and merchant services. We believe that offering a full range of financial products and services deepens the relationships with our current customers and entices new customers to bank with us, which ultimately should increase fee income.

Our primary business is attracting retail deposits from the general public and using those deposits together with funds generated from operations, principal repayments on loans and investments, loan sales and to a lesser extent borrowed funds, for our lending and investing activities. We intend to continue to pursue lending opportunities as we have done in the past.

We intend to continue to maintain our strategy to increase our core deposits, which lowers our overall cost of funds, through internal growth as well as expanding our access channels as a result of new technologies that attract those deposits.

We will continue to offer exceptional customer service, cross-selling our loan and deposit products, insurance and investment services and increasing our commercial deposits from small and medium-size businesses through the various products and services we offer.

We view the historically low interest rate environment as an opportunity to gain noninterest income by leveraging our expertise in originating residential mortgages and selling such originations in the secondary market. This strategy enables us to have a lending capacity, provides for a comprehensive product offering and reduces the interest rate, prepayment and credit risks associated with originating longer-term residential mortgage loans for retention in our loan portfolio.

Average Balance Sheets and Related Yields and Rates

The following table presents information regarding average balances of assets and liabilities, the total dollar amounts of interest income and dividends from average interest-earning assets, the total dollar amounts of interest expense on average interest-bearing liabilities, and the resulting average yields and costs. The yields and costs for the years indicated are derived by dividing income or expense by the average balances of assets or liabilities, respectively, for the years presented. For purposes of this table, average balances have been calculated using daily average balances, and nonaccrual loans are included in average balances. Loan fees and costs are deferred and recognized as an adjustment to interest income on loans.

Average Balance Table

	Year Ended December 31,					
	2013			2012		
(Dollars in thousands)	Average Balance	Interest and Dividends	Yield/ Cost	Average Balance	Interest and Dividends	Yield/ Cost
Assets:						
Interest-earning assets:						
Loans receivable	**$120,669**	**$5,647**	**4.68%**	$131,155	$6,668	5.08%
Investment securities, taxable	**3,868**	**62**	**1.60**	4,307	79	1.83
Other interest-earning assets	**5,419**	**32**	**0.59**	2,793	33	1.18
Total interest-earning assets	**129,956**	**5,741**	**4.42**	138,255	6,780	4.90
Non-interest-earning assets	**18,798**			21,861		
Total assets	**$148,754**			$160,116		
Liabilities and stockholders' equity:						
Interest-bearing liabilities:						
Interest-bearing demand deposits	**$ 12,546**	**13**	**0.10**	$ 10,889	12	0.11
Money market accounts	**24,666**	**55**	**0.22**	22,787	74	0.32
Savings accounts	**23,098**	**34**	**0.15**	22,812	50	0.22
Certificates of deposit	**52,344**	**259**	**0.49**	61,173	404	0.66
Borrowings	**1**	**-**	**0.00**	-	-	0.00
Total interest-bearing liabilities	**112,655**	**361**	**0.32**	117,661	540	0.46
Non-interest-bearing demand deposits	**18,507**			21,046		
Other non-interest-bearing liabilities	**2,365**			2,049		
Total liabilities	**133,527**			140,756		
Stockholders' equity	**15,227**			19,360		
Total liabilities and stockholders' equity	**$148,754**			$160,116		
Net interest income		**$5,380**			$6,240	
Interest rate spread			**4.10**			4.44
Net interest margin			**4.14**			4.51
Average interest-earning assets to average interest-bearing liabilities	**115.36%**			117.50%		

Comparison of Financial Condition at December 31, 2013 and 2012

Total Assets. Total assets declined $18.9 million, or 12.2%, to $135.9 million at December 31, 2013 from $154.8 million at December 31, 2012. The decrease was due primarily to the decreases of $8.6 million in loans receivable, net, $4.5 million in cash and cash equivalents and $2.1 million in other real estate owned due to sales. In addition, there were decreases of investment securities of $253,000 as a result of principal pay downs on residential mortgage-backed securities.

Cash and cash equivalents. At December 31, 2013 cash and cash equivalents decreased $4.5 million to $7.1 million compared to $11.7 million at December 31, 2012. The primary reason for the decrease in cash and cash equivalents during 2013 was the result of allowing some higher cost certificates of deposit accounts to run off.

Securities. The investment securities portfolio was $3.8 million, or 2.8% of total assets, at December 31, 2013 compared to $4.0 million or 2.6% of total assets at December 31, 2012. The decrease in the portfolio was the result of pay downs in the residential mortgage-backed securities portfolio. Our investment securities portfolio consisted primarily of U.S. government agency, municipal, corporate and residential mortgage-backed securities at December 31, 2013.

Loans. At December 31, 2013, total loans, net, excluding loans held for sale, were $115.3 million, or 84.8% of total assets at December 31, 2013 compared to $123.8 million, or 80.0% of total assets at December 31, 2012. During the year ended December 31, 2013, the loan portfolio declined primarily as a result of decreases of $2.8 million in commercial real estate mortgages, $2.0 million in commercial business loans, $1.9 million in land loans, $1.5 million in home equity loans and $1.3 million in construction loans. The decreases were a result of paydowns and charge-offs exceeding new volume during the year. The decrease was partially offset by increases of $867,000 in residential mortgages and $362,000 in multi-family loans. Loans held for sale decreased by $693,000 to $150,000 at December 31, 2013.

Premises and Equipment. At December 31, 2013, premises and equipment was $4.7 million, or 3.5% of total assets compared to $5.0 million, or 3.2% of total assets at December 31, 2012.

Other real estate owned. At December 31, 2013, other real estate owned was $729,000, or 0.5% of total assets compared to $2.9 million, or 1.8% of total assets at December 31, 2012. Other real estate owned at December 31, 2013 consisted of three residential properties and three properties for residential development. During the year ended December 31, 2013, we foreclosed on two residential properties totaling $338,000. During the year ended December 31, 2013, we sold six residential properties for $980,000, two properties for residential development for $234,000, three residential building lots for $63,000 and two commercial real estate buildings for $70,000, which resulted in an aggregate loss of $875,000 as compared to a $129,000 loss on other real estate owned during 2012.

Deposits. Our primary source of funds is retail deposit accounts, which are comprised of non-interest-bearing demand accounts, interest-bearing demand accounts, money market accounts, savings accounts and certificates of deposit. During the year ended December 31, 2013, deposits decreased $10.9 million, or 8.2% to $122.7 million at December 31, 2013 from $133.7 million at December 31, 2012. Deposits decreased in the following categories: certificates of deposit decreased by $8.1 million, money market and interest-bearing demand accounts, decreased by $1.2 million, savings accounts, decreased by $1.0 million and non-interest-bearing demand accounts decreased by $633,000. The decreases in all deposit categories were partially the result of the deposit run-off from closing and consolidating our Wal Mart branch in Monroe, N.Y. The decrease in certificates of deposit was the result of management allowing higher interest rate accounts to mature.

Borrowings. We utilize borrowings from the Federal Home Loan Bank of New York to supplement our source of funds for loans and investments. We are able to utilize borrowings when necessary or advantageous as an alternative to deposits when a pricing advantage exists, as a temporary source of funds to meet liquidity needs or to manage our asset and liability position. We had no borrowings at December 31, 2013 and 2012.

Stockholders' Equity. Total stockholders' equity decreased $7.3 million from $18.4 million at December 31, 2012 to $11.2 million at December 31, 2013. Equity decreased primarily due to a net loss of $7.2 million for the year ended December 31, 2013.

Results of Operations for the Years Ended December 31, 2013 and 2012

Overview. For the year ended December 31, 2013, we reported a net loss of $7.2 million, compared to a net loss of $992,000 for the year ended December 31, 2012. The primary reasons for the increase in net loss for the year ended December 31, 2013 were increases of $1.8 million in income tax expense, $1.7 million in the provision for loan losses, $670,000 in non-interest expenses and decreases of $1.2 million in non-interest income and $860,000 in net interest income. The establishment of a 100% valuation allowance for federal and state deferred tax assets led to the increase in income tax expense. Our provision for loan losses increased as a result of the increase to the general allowance due to elevated levels of nonperforming loans and management's consideration for continued economic weakness in the Bank's market area during 2013. Non-interest expenses increased due to increases in the expenses related to our non-performing loans and assets. Non-interest income decreased due to the loss on the sale of other real estate owned of $746,000 and a decrease in mortgage banking income, net of $312,000 as a result of the

increase in interest rates during the second half of 2013. Net interest income declined as result of decreases in average loan balances and average yields on loans during 2013.

Net Interest Income. Net interest income decreased $860,000, or 13.8% to $5.4 million for the year ended December 31, 2013 from $6.2 million for the year ended December 31, 2012. The decrease was primarily as a result of a reduction in interest income on loans, partially offset by a decrease in interest expense on deposits. As a result of the low interest rate environment, the average yield of interest-earning assets decreased by 48 basis points to 4.42% and was partially offset by the decline in the average cost of interest-bearing liabilities which decreased by 14 basis points to 0.32% for the year ended December 31, 2013 as compared to the year ended December 31, 2012. The interest rate spread decreased by 34 basis points to 4.10% for the year ended December 31, 2013 from 4.44% for the year ended December 31, 2012. The net interest margin decreased by 37 basis points to 4.14% for the year ended December 31, 2013 as compared to 4.51% for the year ended December 31, 2012. In a rising interest rate environment, if rates on deposits reprice higher faster than rates on our loans, we could experience compression of our net interest margin which could have a negative effect on our profitability.

Interest income on loans decreased $1.0 million, or 15.3% to $5.6 million during the year ended December 31, 2013 due to a decrease in the average balance of the loan portfolio of $10.5 million, to $120.7 million for the year ended December 31, 2013. In addition, the average yield on the loan portfolio decreased by 40 basis points to 4.68% for the year ended December 31, 2013. The decline in the average balance of loans was primarily the result of decreases in the average balances of nearly all loan categories, as a result of loan refinancing and less new loan production at lower interest rates. The decrease in the average yield on loans was primarily the result of the continued low market interest rates and the interest income not recognized on nonaccrual loans.

Interest income on investment securities decreased $17,000, or 21.5% to $62,000 for the year ended December 31, 2013 from $79,000 for the year ended December 31, 2012. The decrease in interest income on investment securities was due to a decrease in the average balance of investment securities to $3.9 million for the year ended December 31, 2013 from $4.3 million for the year ended December 31, 2012 and a decrease in the average yield of investment securities of 23 basis points to 1.60% for 2013 as compared to 1.83% in 2012. The decrease in the average yield on investments was due to pay-downs of higher rate mortgage-backed securities.

Interest income on other interest-earning assets decreased $1,000, or 3.0%, to $32,000 for the year ended December 31, 2013 from $33,000 for the year ended December 31, 2012. The decrease in interest income on other interest-earning assets was due to a decrease in the average yield of 59 basis points to 0.59% for 2013 as compared to 1.18% in 2012, offset by an increase in the average balance to $5.4 million for the year ended December 31, 2013 from $2.8 million for the year ended December 31, 2012.

Interest expense on deposits decreased 33.1%, to $361,000 for the year ended December 31, 2013 compared to $540,000 for the year ended December 31, 2012. The primary reasons for the decrease were maturing certificates of deposit repricing to lower interest rates during 2013 and a decrease in the average balance of certificates of deposit. The average cost of certificates of deposit decreased 17 basis points to 0.49% during 2013. Historically low market interest rates since 2007, combined with the shift in the deposit mix of a greater concentration of core deposit accounts led to the decrease in the average cost of deposits to 0.32% for the year ended December 31, 2013 compared to 0.46% for the year ended December 31, 2012. Core deposits as a percentage of total deposits increased 2.9% to 61.1% at December 31, 2013 compared to December 31, 2012. The average balance of interest-bearing deposits decreased during the year ended December 31, 2013 by $5.0 million, or 4.3% to $112.7 million, compared with $117.7 million for the prior year. The decrease in the average balance of interest bearing deposits was due primarily to a decrease in the average balance of certificates of deposit of $8.8 million during 2013, offset by increases in the average balances of money market, interest-bearing demand deposit and savings accounts of $1.9 million, $1.7 million and $286,000, respectively.

Provision for Loan Losses. The provision for loan losses increased $1.8 million to $3.2 million for the year ended December 31, 2013 compared to $1.5 million for the year ended December 31, 2012. The increase in the provision for loan losses during the year ended December 31, 2013 was the result of an

increase to the general allowance due to elevated levels of nonperforming loans and management's consideration for continued economic weakness in the Bank's market area during 2013 and net charge-offs of approximately $3.0 million during 2013 compared to net charge-offs of $661,000 during the prior year.

Nonperforming loans totaled $9.4 million, or 7.9%, of total loans at December 31, 2013 compared to $12.9 million, or 10.2%, of total loans at December 31, 2012. The $9.4 million in nonperforming loans at December 31, 2013 were comprised of $3.6 million in land loans, $3.0 million in one-to four-family residential loans, five construction loans totaling $1.3 million, two commercial real estate loans totaling $806,000, five commercial business loans totaling $410,000 and seven home equity loans totaling $265,000.

The allowance for loan losses was $2.7 million, or 2.32% of total loans outstanding as of December 31, 2013, as compared with $2.6 million, or 2.07% of total loans outstanding as of December 31, 2012.

Non-interest Income. Non-interest income decreased $1.2 million, or 56.5% to $909,000 for the year ended December 31, 2013 compared to $2.1 million for the year ended December 31, 2012. The primary reasons for the decrease in non-interest income for the year ended December 31, 2013, were the loss on the sale of other real estate owned by $746,000 and mortgage banking income, net, which decreased by $312,000. The decrease in mortgage banking income was a result of the decreased volume of loans sold during 2013 as compared to 2012 as interest rates rose during the second half of 2013. In addition, investment brokerage fees decreased by $38,000 and banking fees and service charges decreased by $80,000. The banking fees and service charges decreased as a result of less overdraft fee income during 2013.

Non-interest Expenses. Non-interest expenses increased $670,000, or 7.9% to $9.2 million for the year ended December 31, 2013 compared to $8.5 million for 2012. Non-interest expenses increased primarily due to delinquent loan related expenses such as real estate taxes and collection expenses, which increased by $396,000. Additional non-interest expense increases during the year ended December 31, 2013 included professional fees of $127,000, data processing expenses of $55,000 and FDIC premiums of $49,000. Professional fees and data processing expenses increased as a result of our actions to comply with the Formal Agreement with the OCC. FDIC premiums increased due to our regulatory classification. These increases were partially offset by a decrease of $179,000 in other real estate owned expense, as result of the sale of properties during 2013 and a decrease of $12,000 in telephone and postage expense.

Income Taxes. Income tax expense was $1.1 million for the year ended December 31, 2013 as compared to tax benefit of $653,000 for the year ended December 31, 2012. The increase in taxes was primarily due to the establishment of a 100% valuation allowance of $3.3 million for federal and state deferred tax assets.

Interest Rate Risk Management. Our earnings and the market value of our assets and liabilities are subject to fluctuations caused by changes in the level of interest rates. We manage the interest rate sensitivity of our interest-bearing liabilities and interest-earning assets in an effort to minimize the adverse effects of changes in the interest rate environment. Deposit accounts typically react more quickly to changes in market interest rates than mortgage loans because of the shorter maturities of deposits. As a result, sharp increases in interest rates may adversely affect our earnings while decreases in interest rates may beneficially affect our earnings. To reduce the potential volatility of our earnings, we have sought to improve the match between asset and liability maturities and rates, while maintaining an acceptable interest rate spread. Our strategy for managing interest rate risk emphasizes: originating loans with adjustable interest rates; selling residential real estate fixed-rate loans with terms greater than 10 years; and promoting core deposit products and short-term time deposits.

We have an Asset/Liability Management Committee to coordinate all aspects involving asset/liability management. The committee establishes and monitors the volume, maturities, pricing and mix of assets and funding sources with the objective of managing assets and funding sources to provide results that are consistent with liquidity, growth, risk limits and profitability goals.

Liquidity Management. Liquidity is the ability to meet current and future financial obligations of a short-term nature. Our primary sources of funds consist of deposit inflows, loan repayments, maturities of and payments on investment securities and borrowings from the Federal Home Loan Bank of New York. While maturities and scheduled amortization of loans and securities are predictable sources of funds, deposit flows and mortgage prepayments are greatly influenced by general interest rates, economic conditions and competition.

We regularly adjust our investments in liquid assets based upon our assessment of (1) expected loan demand, (2) expected deposit flows, (3) yields available on interest-earning deposits and securities and (4) the objectives of our asset/liability management policy.

Our most liquid assets are cash and cash equivalents. The levels of these assets depend on our operating, financing, lending and investing activities during any given period. At December 31, 2013, cash and cash equivalents totaled $7.1 million. In addition, at December 31, 2013, we had borrowing capacity up to $8.8 million from the Federal Home Loan Bank of New York. On December 31, 2013, we had no borrowings outstanding from the Federal Home Loan Bank.

A significant use of our liquidity is the funding of loan originations. At December 31, 2013, we had $13.6 million in loan commitments outstanding, which primarily consisted of $814,000 in unadvanced portions of construction loans, $2.0 million in commitments to fund one- to four-family residential real estate loans, $1.1 million in unused home equity lines of credit, $6.6 million in unused commercial lines of credit and $2.6 million in commitments to fund commercial real estate loans. Historically, many of the commitments expire without being fully drawn; therefore, the total amount of commitments does not necessarily represent future cash requirements. Another significant use of our liquidity is the funding of deposit withdrawals. Certificates of deposit due within one year of December 31, 2013 totaled $41.8 million, or 87.5% of certificates of deposit. The large percentage of certificates of deposit that mature within one year reflects customers' hesitancy to invest their funds for long periods in the recent low interest rate environment. If these maturing deposits do not remain with us, we will be required to seek other sources of funds, including other certificates of deposit and borrowings. Depending on market conditions, we may be required to pay higher than market rates on such deposits or other borrowings. We believe, however, based on past experience that a significant portion of our certificates of deposit will remain with us. We have the ability to attract and retain deposits by adjusting the interest rates offered.

Capital Management. We are subject to various regulatory capital requirements administered by the Office of the Comptroller of the Currency ("OCC"), including a risk-based capital measure. The risk-based capital guidelines include both a definition of capital and a framework for calculating risk-weighted assets by assigning balance sheet assets and off-balance sheet items to broad risk categories. At December 31, 2013, we exceeded all of our regulatory capital requirements and we were considered "well-capitalized" under OCC regulation.

We paid dividends for the first two quarters of 2012. We have ceased paying dividends and do not expect to pay dividends in the near term. Future dividend payments will depend on our profitability, approval by our Board of Directors, prevailing Federal Reserve regulations and approval of the Federal Reserve.

Formal Written Agreement. On March 7, 2013, Hometown Bank of the Hudson Valley (the "Bank") entered into a Formal Written Agreement (the "Agreement") with the Office of the Comptroller of the Currency. The Agreement sought to address OCC findings of unsafe and unsound practices by the Bank relating to management, credit risk management and asset quality. The Agreement required that the board of directors of the Bank take specific actions to address the deficiencies noted by the OCC. Among other things, specifically, the Agreement required the board of directors to:

- review the organizational structure of the Bank to ensure that full-time management was in place to carry out the board's policies, ensure compliance with the Agreement and manage the day-to-day operations of the Bank;
- hire qualified senior personnel where necessary and/or provide enhanced training for existing personnel;

- prepare, adopt and implement a written program for obtaining and analyzing credit and collateral information to monitor credit risk;
- follow a specific protocol before originating, reviewing or restructuring any loan, lease or other extension of credit;
- adopt and implement a written program to identify risk in the loan portfolio and ensure that the Bank does not improperly recognize income from the loan portfolio;
- adopt and adhere to written policies and procedures to maintain an adequate allowance for loan and lease losses;
- establish a revised and written Capital Plan that establishes internal capital ratios that identify and evaluate all material risks;
- adopt and implement a loan review system to assure the timely identification and categorization of problem loans;
- develop and implement a written profit plan to improve and sustain the earnings of the Bank; and
- revise and ensure Bank adherence to a written program of policies and procedures to provide compliance with the Bank Secrecy Act.

Concurrent with entering into the Agreement, the Bank was deemed by the OCC to be in "troubled condition" under the OCC's prompt corrective action rules. Consequently, the Bank is subject to additional regulatory restrictions that require it to:

- obtain the prior written approval of the OCC before appointing any new director or senior executive officer;
- obtain the prior written approval of the OCC before making or entering into any "golden parachute" payments or agreements;
- obtain the prior written approval of the OCC before declaring or paying any dividends or any other capital distributions; and
- provide advance notice to and receive a written notice of non-objection from the OCC before entering into or amending any contractual arrangements for compensation or benefits with any director or senior executive officer of the Bank.

The Agreement requires that we make periodic reports to the OCC as to our compliance with the requirements of the Agreement. In order to comply with the Agreement, we conducted an organizational review which resulted in the hiring of a new Chief Lending Officer, enhanced our training for existing personnel and initiated annual performance evaluations. We revised our classification of assets and appraisal policies to require updated financial information from borrowers and updated collateral valuations before originating, reviewing or restructuring any loan or extension of credit. In addition, we have revised our loan servicing and classification of assets policies to enhance our risk rating system for loans and follow the OCC guidance for maintaining an adequate allowance for loan losses.

The Bank's compliance committee monitors and coordinates compliance with the Agreement. The committee consists of six members of the Bank’s Board of Directors and meets at least monthly to receive written progress reports from management on the results and status of actions needed to achieve full compliance with each article of the Agreement. Management believes that it has made substantial progress in complying with the requirements of the Agreement. The requirements of the Agreement will remain in effect until the OCC suspends or terminates the Agreement.

Notice by the Federal Reserve Bank of Philadelphia. The Federal Reserve Bank of Philadelphia (“FRB Phil”) on February 12, 2014, gave formal notice that Hometown Bancorp, Inc. (the “Company”) and Hometown Bancorp MHC (the “Holding Companies”) are designated to be in “troubled condition”. The Holding Companies are required to provide 30 day’s prior written notice to the FRB Phil before adding or replacing any member of the board or any senior executive officers. The Holding Companies are prohibited from entering into and or making any payments that are deemed to be golden parachute payments, without prior written approval. We cannot determine when the Company will no longer be subject to the conditions of the FRB Phil.

The Agreements do not affect the Bank's ability to continue to conduct its banking business with customers in a normal fashion. Banking products and services, hours of operation, internet banking, ATM usage, and FDIC deposit insurance coverage will all be unaffected. Customer deposits remain protected and insured by the FDIC up to $250,000 per depositor.

Off-Balance Sheet Arrangements. In the normal course of operations, we engage in a variety of financial transactions that, in accordance with accounting principles generally accepted in the United States of America, are not recorded in our consolidated financial statements. These transactions involve, to varying degrees, elements of credit, interest rate and liquidity risk. Such transactions are used primarily to manage customers' requests for funding and take the form of loan commitments and lines of credit.

For the year ended December 31, 2013, we did not engage in any off-balance sheet transactions reasonably likely to have a material effect on our consolidated financial condition, results of operations or cash flows.

This Annual Report contains certain forward-looking statements that are based on assumptions and may describe future plans, strategies and expectations of the Company. Forward-looking statements can be identified by the fact that they do not relate strictly to historical or current facts. They often include words like "believe," "expect," "anticipate," "estimate" and "intend" or future or conditional verbs such as "will," "would," "should," "could" or "may." Certain factors that could cause actual results to differ materially from expected results include changes in the interest rate environment, changes in general economic conditions, legislative and regulatory changes that adversely affect the business of the Company and the Bank, and changes in the securities markets. Except as required by law, the Company does not undertake any obligation to update any forward-looking statements to reflect changes in belief, expectations or events.

For more information on Hometown Bancorp, Inc. and Hometown Bank of the Hudson Valley go to our website www.hometownbankhv.com.

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Bonadio & Co., LLP
Certified Public Accountants

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

April 2, 2014

To the Board of Directors and Stockholders of
Hometown Bancorp, Inc.

We have audited the accompanying consolidated balance sheet of Hometown Bancorp, Inc. and subsidiary (the “Company”) as of December 31, 2013, and the related consolidated statements of operations, comprehensive loss, stockholders’ equity and cash flows for the year then ended. Hometown Bancorp, Inc.’s management is responsible for these consolidated financial statements. Our responsibility is to express an opinion on these consolidated financial statements based on our audit.

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

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

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Certified Public Accountants

INDEPENDENT AUDITOR'S REPORT

April 10, 2013

To the Board of Directors and Stockholders of
Hometown Bancorp, Inc.:

Report on the Financial Statements
We have audited the accompanying consolidated financial statements of Hometown Bancorp, Inc. and subsidiary, which comprise the consolidated balance sheet as of December 31, 2012, and the related consolidated statements of operations, comprehensive loss, stockholders' equity, and cash flows for the year then ended, and the related notes to the financial statements.

Management's Responsibility for the Consolidated 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 audit. We conducted our audit 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 of 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 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 Hometown Bancorp Inc. and subsidiary as of December 31, 2012, and the results of their operations and their cash flows for the year then ended in accordance with accounting principles generally accepted in the United States of America.

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Consolidated Balance Sheets

	December 31, 2013	December 31, 2012
	(Dollars in Thousands, Except Share Data)	
Assets		
Cash and due from banks	**$ 5,241**	$ 9,796
Interest earning demand deposits with banks	**1,899**	1,886
Cash and Cash Equivalents	**7,140**	11,682
Federal Funds	**-**	528
Certificates of deposit	**275**	275
Securities available for sale	**2,704**	2,934
Securities held to maturity (fair value 2013 $1,063; 2012 $1,092)	**1,054**	1,077
Loans held for sale	**150**	843
Loans receivable, net of allowance for loan losses (2013 $2,741; 2012 $2,613)	**115,339**	123,828
Premises and equipment, net	**4,744**	5,006
Restricted investments in bank stocks, at cost	**476**	514
Other real estate owned	**729**	2,850
Accrued interest receivable and other assets	**3,330**	5,265
Total Assets	**$135,941**	$154,802
Liabilities and Stockholders' Equity		
Liabilities		
Deposits:		
Non-interest bearing	**$ 17,886**	$ 18,519
Interest bearing	**104,847**	115,134
Total Deposits	**122,733**	133,653
Advances from borrowers for taxes and insurance	**683**	685
Accrued interest payable	**3**	6
Other liabilities	**1,289**	2,030
Total Liabilities	**124,708**	136,374
Stockholders' Equity		
Preferred stock, $0.01 par value; 3,000,000 shares authorized and unissued	**-**	-
Common stock, $0.01 par value; 7,000,000 shares authorized; 2,380,500 shares issued	**24**	24
Paid-in capital	**9,997**	10,023
Retained earnings	**2,161**	9,327
Unearned ESOP shares, at cost	**(607)**	(653)
Treasury stock, at cost, 53,561 shares at December 31, 2013 and 2012	**(311)**	(311)
Accumulated other comprehensive (loss) income	**(31)**	18
Total Stockholders' Equity	**11,233**	18,428
Total Liabilities and Stockholders' Equity	**$135,941**	$154,802

See notes to consolidated financial statements.

Hometown Bancorp, Inc.

Consolidated Statements of Operations

	Years Ended December 31,	
	2013	2012
	(In Thousands Except Per Share Data)	
Interest Income		
Loans receivable, including fees	**$5,647**	$6,668
Securities, taxable	**62**	79
Other	**32**	33
Total Interest Income	**5,741**	6,780
Interest Expense		
Deposits	**361**	540
Federal Home Loan Bank advances	**-**	-
Total Interest Expense	**361**	540
Net Interest Income	**5,380**	6,240
Provision for Loan Losses	**3,175**	1,494
Net Interest Income after Provision for Loan Losses	**2,205**	4,746
Non-interest Income		
Banking fees and service charges	**811**	891
Mortgage banking income, net	**783**	1,095
Investment brokerage fees	**64**	102
Realized loss on sale of other real estate owned	**(875)**	(129)
Other	**126**	130
Total Non-interest Income	**909**	2,089
Non-interest Expenses		
Salaries and employee benefits	**4,326**	4,307
Occupancy and equipment	**816**	789
Professional fees	**477**	350
Advertising and marketing	**299**	268
Data processing	**763**	708
Telephone and postage	**144**	156
FDIC premiums	**192**	143
Other real estate owned expense	**712**	891
Delinquent loan expense	**574**	178
Other	**847**	690
Total Non-interest Expenses	**9,150**	8,480
Loss before Income Taxes	**(6,036)**	(1,645)
Income Tax Expense (Benefit)	**1,130**	(653)
Net loss	**$ (7,166)**	$ (992)
Net loss per common share - basic	**$ (3.17)**	$ (0.44)
Weighted average number of common shares outstanding – basic	**2,263**	2,259

See notes to consolidated financial statements.

Consolidated Statements of Comprehensive Loss

Years Ended December 31, 2013 and 2012

	Years Ended December 31,	
	2013	**2012**
	(In Thousands)	
Net Loss	**$ (7,166)**	$ (992)
Other comprehensive income (loss), before tax:		
Unrealized gains (losses) on available-for-sale securities:		
Unrealized holding gains (losses) arising during the year	**(71)**	24
Net unrealized gains (losses)	**(71)**	24
Directors' retirement plan:		
Pension gains	**10**	2
Reclassification adjustment for pension losses and prior service cost recognized in pension expense	**-**	2
Net change in directors' retirement plan liability	**10**	4
Other comprehensive income (loss), before tax	**(61)**	28
Income tax expense (benefit), net	**(12)**	11
Other comprehensive income (loss), net of tax	**(49)**	17
Comprehensive loss	**$ (7,215)**	$ (975)

See notes to consolidated financial statements.

Consolidated Statements of Stockholders' Equity
Years Ended December 31, 2013 and 2012
(In Thousands Except Share Data)

	Common Stock	Paid-In Capital	Retained Earnings	Unearned ESOP Shares	Treasury Stock	Accumulated Other Comprehensive Income (Loss)	Total
Balance - December 31, 2011	$ 24	$ 10,044	$ 10,360	$ (700)	$ (311)	$ 1	$ 19,418
Net loss	-	-	(992)	-	-	-	(992)
Other comprehensive income	-	-	-	-	-	17	17
Cash dividends declared ($0.04 per share)	-	-	(41)	-	-	-	(41)
ESOP shares committed to be released (4,666 shares)	-	(21)	-	47	-	-	26
Balance - December 31, 2012	24	10,023	9,327	(653)	(311)	18	18,428
Net loss	**-**	**-**	**(7,166)**	**-**	**-**	**-**	**(7,166)**
Other comprehensive loss	**-**	**-**	**-**	**-**	**-**	**(49)**	**(49)**
ESOP shares committed to be released (4,666 shares)	**-**	**(26)**	**-**	**46**	**-**	**-**	**20**
Balance - December 31, 2013	**$ 24**	**$ 9,997**	**$ 2,161**	**$ (607)**	**$ (311)**	**$ (31)**	**$ 11,233**

See notes to consolidated financial statements.

Consolidated Statements of Cash Flows

	Years Ended December 31,	
	2013	2012
	(In Thousands)	
Cash Flows from Operating Activities		
Net loss	$ (7,166)	$ (992)
Adjustments to reconcile net loss to net cash flow from operating activities:		
Depreciation and amortization	286	260
Provision for loan losses	3,175	1,494
Deferred income tax expense (benefit)	1,308	(185)
Amortization of deposit premium	78	77
Amortization of mortgage servicing rights	212	223
Net amortization of securities premiums and discounts	21	28
Net gain on sale of loans	(422)	(684)
Loans originated for sale	(32,176)	(48,284)
Proceeds from sale of loans	33,291	48,924
Loss on sale of other real estate owned	875	129
ESOP expense	20	26
Valuation write-down of other real estate owned	421	403
Decrease (increase) in accrued interest receivable and other assets	333	(531)
Increase (decrease) in accrued interest payable and other liabilities	(719)	1,220
Net Cash Flow From Operating Activities	(463)	2,108
Cash Flows from Investing Activities		
Maturity of certificates of deposit	-	250
Net change in federal funds	528	1,149
Activity in available for sale securities:		
Purchases	-	(1,750)
Maturities, calls and principal repayments	145	2,414
Activity in held to maturity securities:		
Purchases	-	(255)
Maturities, calls and principal repayments	16	207
Net decrease in loans receivable	4,976	7,594
Proceeds from sale of other real estate owned	1,164	1,360
Net decrease in restricted investment in bank stocks	38	5
Purchases of bank premises and equipment	(24)	(232)
Net Cash Flow From Investing Activities	6,843	10,742
Cash Flows from Financing Activities		
Net decrease in deposits	(10,920)	(11,217)
Net decrease in advances from borrowers for taxes and insurance	(2)	(65)
Dividends paid	-	(41)
Net Cash Flow From Financing Activities	(10,922)	(11,323)
Net Change in Cash and Cash Equivalents	(4,542)	1,527
Cash and Cash Equivalents - Beginning	11,682	10,155
Cash and Cash Equivalents - Ending	$ 7,140	$ 11,682
Supplementary Cash Flows Information		
Interest paid	$ 364	$ 548
Income taxes (refunded) paid	$ (935)	$ 82
Supplemental Schedule of Noncash Investing Activities		
Loans transferred to other real estate owned	$ 338	$ 1,200

See notes to consolidated financial statements.

Note 1 - Significant Accounting Policies

Organization and Nature of Operations

Hometown Bancorp, Inc. (the "Company"), is a federally chartered mid-tier stock holding company, and a subsidiary of Hometown Bancorp, MHC (the "Mutual Holding Company"), a federally chartered mutual holding company. The Mutual Holding Company owns 1,309,275 shares, or 56.3%, of the Company's issued stock, and the remaining Company stock is held by the public or has been repurchased by the Company. The Mutual Holding Company activity is not included in the accompanying consolidated financial statements. Hometown Bank of the Hudson Valley formerly known as Walden Federal Savings and Loan Association (the "Bank") is a wholly owned subsidiary of the Company. The same directors and officers, who manage the Bank, also manage the Company and the Mutual Holding Company.

The Bank maintains its executive offices and main branch in Walden, New York, with branches in Montgomery, Monroe, Newburgh and Otisville, New York. The Bank is a community-oriented savings institution whose business primarily consists of accepting deposits from customers within its market area and investing those funds principally in mortgage loans secured by one- to four-family residences, multi-family and commercial properties, land loans, commercial loans, consumer loans and investment securities.

The Bank has three wholly-owned subsidiaries, Ever-Green Financial Services, Inc., which holds a 50% interest in Evergreen Title Agency, LP, Valley Services, Inc. and Balsam Realty Inc., which lease certain premises used by the Bank and hold other real estate owned.

Principles of Consolidation

The consolidated financial statements include the accounts of the Company, the Bank and the Bank's wholly-owned subsidiaries, Ever-Green Financial Services, Inc., Valley Services, Inc. and Balsam Realty Inc. All significant intercompany transactions and balances have been eliminated in consolidation.

Estimates

The preparation of consolidated financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of income and expenses during the reporting period. Actual results could differ from those estimates. Material estimates that are particularly susceptible to significant change in the near term relate to the determination of the allowance for loan losses and the valuation of other real estate owned.

Concentrations of Credit Risk

Most of the Company's activities are with customers located within Orange County, New York and to a lesser extent the adjacent counties of Ulster and Sullivan. Note 2 discusses the types of securities that the Bank invests in. Note 3 discusses the types of lending that the Bank engages in. Although the Bank has a diversified loan portfolio, its debtors' ability to honor their contracts is influenced by the region's economy. The Bank does not have any significant concentrations in any one industry or customer.

Presentation of Cash Flows

For purposes of reporting cash flows, cash and cash equivalents include cash on hand, amounts due from banks and interest-bearing deposits with an original maturity of three months or less.

Securities

Management determines the appropriate classification of debt securities at the time of purchase.

Securities classified as available for sale are those securities that the Bank intends to hold for an indefinite period of time but not necessarily to maturity. Any decision to sell a security classified as available for sale would be based on various factors, including significant movement in interest rates, changes in maturity mix of the Bank's assets and liabilities, liquidity needs, regulatory capital considerations, and other similar factors. Securities available for sale are carried at fair value. Unrealized gains and losses are reported in other comprehensive income (loss), net of the related deferred tax

Note 1 - Significant Accounting Policies (Continued)

effect. Realized gains or losses, determined on the basis of the cost of the specific securities sold, are included in earnings. Premiums and discounts are recognized in interest income using the effective interest method over the terms of the securities.

Securities classified as held to maturity are those debt securities the Bank has both the intent and ability to hold to maturity regardless of changes in market conditions, liquidity needs or changes in general economic conditions. These securities are carried at cost adjusted for the amortization of premium and accretion of discount, recognized in interest income using the effective interest method over the terms of the securities.

On a quarterly basis, the Bank performs an assessment to determine whether there have been any events or economic circumstances indicating that a security with an unrealized loss has suffered other-than-temporary impairment. A security is considered impaired if the fair value is less than its amortized cost basis at the reporting date. If impaired, the Bank then assesses whether the unrealized loss is other-than-temporary. The assessment considers (i) whether the Bank intends to sell the security prior to recovery and/or maturity, (ii) whether it is more likely than not that the Bank will have to sell the security prior to recovery and/or maturity and (iii) if the present value of the expected cash flows is not sufficient to recover the entire amortized cost basis. If a debt security is deemed to be other-than-temporarily impaired, the credit loss component of an other-than-temporary impairment write-down is recorded in earnings while the remaining portion of the impairment loss is recognized, net of tax, in other comprehensive income provided that the Bank does not intend to sell the underlying security and it is more-likely-than not that the Bank would not have to sell the security prior to recovery. For held-to-maturity debt securities, the amount of an other-than-temporary impairment recorded in other comprehensive income for the noncredit portion of a previous other-than-temporary impairment is amortized prospectively over the remaining life of the security on the basis of the timing of future estimated cash flows of the security. There were no other-than-temporary impairments recorded in the years ended December 31, 2013 or 2012.

Securities are exposed to various risks such as interest rate, market and credit risks. Due to the level of risk associated with certain securities, it is at least reasonably possible that changes in the values of securities will occur in the near term and that such changes could materially affect the amounts reported in the accompanying consolidated financial statements.

Federal law requires a member institution of the Federal Home Loan Bank (FHLB) system to hold restricted stock of its district FHLB according to a predetermined formula, which amounted to approximately $416,000 and $454,000 at December 31, 2013 and 2012, respectively. The restricted stock is carried at cost. Management reviews impairment based on the ultimate recoverability of the cost basis in the FHLB stock.

The Bank owns $60,000 of restricted stock from its correspondent bank Atlantic Central Bankers Bank (ACBB). The purchase was required in order to access credit lines and other services. The restricted stock is carried at cost. Management reviews impairment based on the ultimate recoverability of the cost basis in the ACBB stock.

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 their outstanding unpaid principal balances, net of an allowance for loan losses and any deferred fees and costs. Interest income is accrued on the unpaid principal balance. Loan origination fees and costs are deferred and recognized as an adjustment of interest income on the related loans. The Bank is amortizing these amounts over the expected life of the loan.

For all classes of loans receivable, the accrual of interest is generally discontinued when the contractual payment of principal or interest has become 90 days past due or management has serious doubts about further collectability of principal or interest, even though the loan is currently performing. A loan may remain on accrual status if it is in the process of collection and is either guaranteed or well secured. When a loan is placed on nonaccrual status, unpaid interest is reversed against interest income. Interest received on nonaccrual loans generally is either applied against principal or reported as interest income, according to management's judgment as to the collectability of principal. Generally, loans are restored to accrual status when the obligation is brought current, has performed in accordance with the contractual

Note 1 - Significant Accounting Policies (Continued)

terms for a reasonable period of time and the ultimate collectability of the total contractual principal and interest is no longer in doubt.

The Bank has issued letters of credit on behalf of customers primarily to secure construction or land development projects that involve public improvements. The letters of credit are fully secured by a note and a mortgage placed on the related property. The note contains provisions that waive any interest payments provided there are no drawdowns on the letter of credit. Funds equal to the full amount of the letters of credit are advanced and placed in a non-interest bearing deposit account in order to enhance the Bank's collateral position under New York State Lien Law. These loans and deposits are reported gross in the consolidated balance sheets as the Bank does not intend to offset them. Interest is not imputed on these loans and deposits as it is a customary lending and deposit activity of the Bank.

Allowance for Loan Losses

The allowance for loan losses is established through provisions for loan losses charged against income. Loans deemed to be uncollectible are charged against the allowance for loan losses, and subsequent recoveries, if any, are credited to the allowance.

The allowance for loan losses is maintained at a level considered adequate to provide for losses that can be reasonably anticipated. Management's periodic evaluation of the adequacy of the allowance is based on the Bank's past loan loss experience, known and inherent risks in the portfolio, adverse situations that may affect the borrower's ability to repay, the estimated value of any underlying collateral, composition of the loan portfolio, current economic conditions, and other relevant factors. This evaluation is inherently subjective as it requires material estimates that may be susceptible to significant revision as more information becomes available.

The Bank periodically may agree to modify the contractual terms of loans. When a loan is modified and a concession is made to a borrower experiencing financial difficulty, the modification is considered a troubled debt restructuring (TDR). All TDR's are classified as impaired.

The allowance consists of specific, general and unallocated components. The specific component relates to loans that are classified as impaired. For loans that are classified as impaired, an allowance is established when the discounted cash flows (or collateral value or observable market price) of the impaired loan are lower than the carrying amount of that loan. The general component covers non-classified loans and is based on historical loss experience adjusted for the following qualitative factors:

- Trends in past due and problem loans
- Trends in volume and nature of the portfolio
- Changes in lending policy
- Changes in lending management
- Economic trends in lending
- Concentrations of credit
- Changes in loan review
- External factors (regulatory and competition)

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

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

Note 1 - Significant Accounting Policies (Continued)

for commercial, commercial real estate, construction and land loans by either the present value of expected future cash flows discounted at the loan's effective interest rate, the loan's observable market price, or the fair value of the collateral if the loan is collateral dependent.

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

Loans Held for Sale and Loan Servicing

Loans held for sale represent residential mortgage loans originated for sale on a whole-loan basis. These loans are carried at the lower of cost or estimated fair value, as determined on an aggregate basis. Net unrealized losses are recognized in a valuation allowance by charges to operations. Premiums and discounts and origination fees and costs on loans held for sale are deferred and recognized as a component of the gain or loss on sale. Commitments to originate loans that will be held for sale and forward commitments to sell such loans are derivative instruments which are required to be recognized as assets or liabilities at fair value. Fair value is determined based solely on the effect of changes in secondary market interest rates and yield requirements from the commitment date to the date of the financial statements. The fair values of these commitments have had an immaterial effect on the Company's consolidated balance sheets and income statements.

The Bank sells residential mortgage loans to third parties. The Bank, as transferor, must surrender control over the transferred assets (i.e., the loans sold) in order to record a sale. The criteria specify that (i) the transferred assets have been isolated from the transferor (put presumptively beyond the reach of the transferor and its creditors, even in bankruptcy or other receivership); (ii) each transferee has the right to pledge or exchange the assets it received; and (iii) the transferor does not maintain effective control over the transferred assets through an agreement to repurchase the assets or an ability to unilaterally cause the holder to return specific assets.

Gains and losses on sales of loans are recognized when the sales proceeds are received (including consideration of assets obtained and liabilities incurred in the transfer, if any, such as servicing rights and recourse obligations). Recourse liabilities on loan sales through December 31, 2013 and 2012 are not material to the Company's consolidated balance sheets and income statement. Loan servicing income is reported in mortgage banking income, net.

Originated mortgage servicing rights are recorded at their fair value when loans are sold and are amortized in proportion to and over the period of estimated net servicing income or loss. The carrying value of originated mortgage servicing rights is periodically evaluated for impairment.

Premises and Equipment

Premises and equipment are recorded at cost. Depreciation is computed using the straight-line method over the expected useful lives of the related assets, which is generally 15 to 40 years for buildings and building improvements and 3 to 10 years for furniture, equipment, computers and software. Leasehold improvements are amortized over the related terms of the leases or their useful life if shorter.

Other Real Estate Owned

Real estate acquired in settlement of loans is recorded at the fair value of the property at the date of acquisition. Write-downs from cost to fair value less estimated selling costs which are required at the time of foreclosure are charged to the allowance for loan losses. Subsequent write-downs to fair value, net of estimated selling costs, are charged to other real estate owned expense.

Intangible Assets

Intangible assets include a core deposit intangible (CDI) arising from the acquisition of the Monroe branch on September 9, 2011. The CDI is amortized on a straight-line basis over 10 years. CDI, which is recorded in other assets, has a net carrying amount of $595,000 and $673,000 at December 31, 2013 and 2012, respectively. The gross carrying amount and accumulated amortization of the CDI amounted to $776,000 and $181,000, respectively, at December 31, 2013 and $776,000 and $103,000, respectively, at December 31, 2012. The estimated amortization expense is $77,000 for each of the next five years ending December 31, 2018 and $210,000 thereafter.

Note 1 - Significant Accounting Policies (Continued)

Advertising Costs

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

Income Taxes

Deferred taxes are provided on the liability method whereby deferred tax assets are recognized for deductible temporary differences and net operating losses and deferred tax liabilities are recognized for taxable temporary differences. Temporary differences are the differences between the reported amounts of assets and liabilities and their tax basis. Deferred tax assets are reduced by a valuation allowance when, in the opinion of management, it is more likely than not that some portion of the deferred tax assets will not be realized. Deferred tax assets and liabilities are adjusted for the effects of changes in tax laws and rates on the date of enactment. The Company and its subsidiary file a consolidated federal income tax return.

Net Income Per Common Share

Basic net income per common share is calculated by dividing net income by the weighted-average number of common shares outstanding during the period. The Company has a simple capital structure as it has not granted any restricted stock awards or stock options and, during the years ended December 31, 2013 and 2012, had no potentially dilutive common stock equivalents. Unallocated common shares held by the ESOP are not included in the weighted-average number of common shares outstanding for purposes of calculating earnings per common share until they are committed to be released.

Comprehensive Income (Loss)

Accounting principles generally accepted in the United States of America require that recognized revenue, expenses, gains, and losses be included in net income (loss). Although certain changes in assets and liabilities, such as unrealized gains and losses on available for sale securities and unrecognized pension losses and past service liability are reported as a separate component of the equity section of the consolidated balance sheet, such items, along with net income (loss), are components of comprehensive income (loss).

The amounts of income tax expense (benefit) allocated to each component of other comprehensive income (loss) are as follows for the years ended December 31, 2013 and 2012:

	2013	2012
	(In Thousands)	
Unrealized holding gains on securities available for sale:		
Change in unrealized holding gains (losses) arising during the year	$ (16)	$ 9
Directors' retirement plan:		
Pension gains	4	1
Reclassification adjustment for pension losses and prior service cost recognized in pension expense	-	1
Net Change in Director's retirement plan liability	4	2
	$ (12)	$ 11

Note 1 - Significant Accounting Policies (Continued)

Comprehensive Income (Loss) (Continued)

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

	Unrealized Gains on Available-for-Sale Securities	Directors Retirement Plan	Accumulated Other Comprehensive Income (loss)
Balance, December 31, 2011	$ 9	$ (8)	$ 1
Other comprehensive income for 2012	15	2	17
Balance, December 31, 2012	24	(6)	18
Other comprehensive income (loss) for 2013	**(53)**	**4**	**(49)**
Balance, December 31, 2013	**$ (29)**	**$ (2)**	**$ (31)**

Note 2 - Securities

The amortized cost of securities and their approximate fair values are summarized as follows:

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
		(In Thousands)		
Available For Sale:				
December 31, 2013:				
U. S. Government agency securities	**$ 1,750**	**$ -**	**$ 42**	**$ 1,708**
Municipal securities	**548**	**15**	**2**	**561**
Residential mortgage-backed securities	**435**	**-**	**-**	**435**
Total	**$ 2,733**	**$ 15**	**$ 44**	**$ 2,704**
December 31, 2012:				
U. S. Government agency securities	$ 1,750	$ 4	$ 1	$ 1,753
Municipal securities	557	30	-	587
Residential mortgage-backed securities	585	9	-	594
Total	$ 2,892	$ 43	$ 1	$ 2,934

Note 2 – Securities (Continued)

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
		(In Thousands)		
Held to Maturity:				
December 31, 2013:				
Corporate securities	**$ 1,012**	**$ 8**	**$ -**	**$ 1,020**
Residential mortgage-backed securities	**42**	**1**	**-**	**43**
Total	**$ 1,054**	**$ 9**	**$ -**	**$ 1,063**
December 31, 2012:				
Corporate securities	$ 1,020	$ 14	$ 1	$ 1,033
Residential mortgage-backed securities	57	2	-	59
Total	$ 1,077	$ 16	$ 1	$ 1,092

All residential mortgage-backed securities are issued by U.S. Government agencies or sponsored enterprises.

There were no sales of investments in 2013 and 2012. At December 31, 2013 and 2012, no securities were pledged.

The following table shows the Bank's investments' gross unrealized losses and fair value, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position, at December 31, 2013 and 2012:

	Less than 12 Months		12 Months or More		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
			(In Thousands)			
December 31, 2013:						
U. S. Government agency securities	**$ 1,708**	**$ 42**	**$ -**	**$ -**	**$ 1,708**	**$ 42**
Municipal securities	**124**	**2**	**-**	**-**	**124**	**2**
Total	**$ 1,832**	**$ 44**	**$ -**	**$ -**	**$ 1,832**	**$ 44**
December 31, 2012:						
U. S. Government agency securities	$ 999	$ 1	$ -	$ -	$ 999	$ 1
Corporate securities	249	1	-	-	249	1
Total	$ 1,248	$ 2	$ -	$ -	$ 1,248	$ 2

At December 31, 2013, there were 3 securities in a continuous loss position for 12 months or less and no securities in a continuous loss position for more than 12 months. All of the securities are of high credit quality and the decline in fair value is primarily due to the effects of changes in market interest rates. The fair values are expected to recover as the securities approach their maturity date and/or market interest rates change. Because the Bank does not intend to sell the securities and it is not more likely than not that the Bank will be required to sell the securities before recovery of their amortized cost basis, which may be maturity, the Bank does not consider the securities to be other-than-temporarily impaired at December 31, 2013.

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

Note 2 – Securities (Continued)

	Available for Sale		Held to Maturity	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
	(In Thousands)		(In Thousands)	
Due in one year or less	$ -	$ -	$ 1,012	$ 1,020
Due after one year through five years	1,750	1,708	-	-
Due after five years through ten years	-	-	-	-
Due after ten years	548	561	-	-
Residential Mortgage-backed securities	435	435	42	43
	$ 2,733	$ 2,704	$ 1,054	$ 1,063

Note 3 - Loans Receivable and Allowance for Loan Losses

The composition of loans receivable at December 31, 2013 and 2012 is as follows:

	2013	2012
	(In Thousands)	
Real estate mortgages:		
Residential	$ 61,004	$ 60,137
Construction	2,542	3,830
Multi-family	2,239	1,877
Commercial	23,987	26,829
Land	10,394	12,321
Total Real Estate Mortgages	100,166	104,994
Other loans:		
Commercial	8,876	10,874
Home equity loans and credit lines	8,498	10,026
Consumer	428	466
Total Loans	117,968	126,360
Deferred loan origination costs, net	112	81
Allowance for loan losses	(2,741)	(2,613)
Net Loans	$ 115,339	$ 123,828

The Bank grants loans to customers primarily within Orange County, New York, and to a lesser extent, portions of the adjacent counties of Ulster and Sullivan. A large portion of the loan portfolio is secured by real estate. Although the Bank has a diversified loan portfolio, its debtors' ability to honor their contracts is influenced by the region's economy.

The allowance for loan losses is established through a provision for loan losses based on management's evaluation of the losses inherent in the loan portfolio, the composition of the loan portfolio, specific impaired loans and current economic conditions. Such evaluation, which includes a review of all loans on which full collectability may not be reasonably assured, considers among other matters, the estimated net realizable value or the fair value of the underlying collateral, economic conditions, historical loan loss experience and other factors that warrant recognition in providing for the loan loss allowance. 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 their judgment about information available to them at the time of their examination. The Bank considers residential mortgages, home equity loans, which include credit lines and consumer loans to customers as small, homogeneous loans, which are evaluated for impairment collectively based on historical loss experience, except that such loans subject to a troubled debt restructuring are individually evaluated for impairment. Commercial mortgage, construction, multi-family, land and

Note 3 - Loans Receivable and Allowance for Loan Losses (Continued)

commercial loans are evaluated individually and considered impaired if it is probable that the Bank will not be able to collect scheduled payments of principal and interest when due, according to the contractual terms of the loan agreements. The measurement of impaired loans is primarily based on the fair value of the underlying collateral. The allowance for loan losses is increased by a provision for loan losses (which results in a charge to expense) and recoveries of loans previously charged off and is reduced by loan charge-offs.

The following tables present changes in the allowance for loan losses for the years ended December 31, 2013 and 2012 (In Thousands):

Note 3 - Loans Receivable and Allowance for Loan Losses (Continued)

For the Year Ended December 31, 2013

	Residential mortgage	Construction	Multi-family	Commercial real estate	Land	Commercial	Home equity	Consumer	Unallocated	Total
Allowance for loan losses:										
Beginning Balance	$ 722	$ 113	$ 16	$ 493	$ 644	$ 307	$ 253	$ 14	$ 51	$ 2,613
Charge-offs	(752)	(339)	-	(68)	(1,078)	(439)	(483)	(37)	-	(3,196)
Recoveries	136	-	-	-	-	2	-	11	-	149
Provisions	982	338	3	150	823	483	421	18	(43)	3,175
Ending balance	$ 1,088	$ 112	$ 19	$ 575	$ 389	$ 353	$ 191	$ 6	$ 8	$ 2,741
Ending balance: related to loans individually evaluated for impairment	$ 42	$ 42	$ -	$ 301	$ -	$ 84	$ 28	$ -	$ -	$ 497
Ending balance: related to loans collectively evaluated for impairment	$ 1,046	$ 70	$ 19	$ 274	$ 389	$ 269	$ 163	$ 6	$ 8	$ 2,224
Loans receivable:										
Ending balance	$ 61,004	$ 2,542	$ 2,239	$ 23,987	$ 10,394	$ 8,876	$ 8,498	$ 428		$ 117,968
Ending balance: individually evaluated for impairment	$ 6,011	$ 1,262	$ -	$ 5,711	$ 2,850	$ 458	$ 334	$ -		$ 16,626
Ending balance: collectively evaluated for impairment	$ 54,993	$ 1,280	$ 2,239	$ 18,276	$ 7,544	$ 8,418	$ 8,164	$ 428		$ 101,342

Note 3 - Loans Receivable and Allowance for Loan Losses (Continued)

For the Year Ended December 31, 2012

	Residential mortgage	Construction	Multi-family	Commercial real estate	Land	Commercial	Home equity	Consumer	Unallocated	Total
Allowance for loan losses:										
Beginning Balance	$ 564	$ 101	$ 10	$ 288	$ 419	$ 162	$ 221	$ 10	$ 5	$ 1,780
Charge-offs	(201)	-	-	(148)	(468)	(73)	-	(12)	-	(902)
Recoveries	61	-	-	37	-	-	141	2	-	241
Provisions	298	12	6	316	693	218	(109)	14	46	1,494
Ending balance	$ 722	$ 113	$ 16	$ 493	$ 644	$ 307	$ 253	$ 14	$ 51	$ 2,613
Ending balance: related to loans individually evaluated for impairment	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -
Ending balance: related to loans collectively evaluated for impairment	$ 722	$ 113	$ 16	$ 493	$ 644	$ 307	$ 253	$ 14	$ 51	$ 2,613
Loans receivable:										
Ending balance	$ 60,137	$ 3,830	$ 1,877	$ 26,829	$ 12,321	$ 10,874	$ 10,026	$ 466		$ 126,360
Ending balance: individually evaluated for impairment	$ 2,874	$ 261	$ -	$ 3,167	$ 3,080	$ 50	$ 13	$ -		$ 9,445
Ending balance: collectively evaluated for impairment	$ 57,263	$ 3,569	$ 1,877	$ 23,662	$ 9,241	$ 10,824	$ 10,013	$ 466		$ 116,915

Note 3 - Loans Receivable and Allowance for Loan Losses (Continued)

Nonperforming Assets and Loan Delinquencies

Management places loans on nonaccrual status once the loans have become 90 days or more delinquent. Nonaccrual is defined as a loan in which collectability is questionable and therefore interest on the loan will no longer be recognized on an accrual basis. A loan is not placed back on accrual status until the borrower has demonstrated the ability and willingness to make timely payments on the loan. A loan does not have to be 90 days delinquent in order to be classified as nonaccrual. Nonaccrual loans consisted primarily of loans secured by real estate at December 31, 2013. While the Bank makes every reasonable effort to work with the borrowers to collect amounts due, the number of loans in process of foreclosure has grown substantially over the past several years. This growth has been the result of adverse changes within the economy and increases in local unemployment. The growth is also due in part to the extended length of time required to meet all of the legal requirements mandated by New York State law prior to a foreclosure sale, which may be in excess of three years. At December 31, 2013, nonaccrual loans totaling $2.2 million were in the process of foreclosure.

The following table represents nonaccrual loans by classes of the loan portfolio as of December 31, 2013 and 2012.

	December 31,	
(Dollars in thousands)	**2013**	**2012**
Nonaccrual loans:		
Residential mortgage	**$ 3,025**	$ 4,282
Construction	**1,262**	513
Multi-family	**—**	—
Commercial real estate	**1,812**	4,649
Land	**2,594**	3,073
Commercial	**410**	50
Home equity loans and credit lines	**265**	351
Consumer	**—**	—
Total nonaccrual loans	**9,368**	12,918
Total nonaccrual loans to total loans	**7.94%**	10.22%
Total nonaccrual loans to total assets	**6.89**	8.34

Interest not recognized on nonaccrual loans was $660,000 and $303,000 for the years ended December 31, 2013 and 2012, respectively. There were no loans past due 90 days or more and still accruing interest at December 31, 2013 and 2012.

The performance and credit quality of the loan portfolio is also monitored by analyzing the age of the loans receivable as determined by the length of time a recorded payment is past due. The following table presents the classes of the loan portfolio summarized by the past due status as of December 31, 2013 (In Thousands):

Note 3 - Loans Receivable and Allowance for Loan Losses (Continued)

	30-59 Days Past Due	60-89 Days Past Due	Greater than 90 Days	Total Past Due	Current	Total Loans Receivable
Residential mortgage	**$ 1,831**	**$ 188**	**$ 2,263**	**$ 4,282**	**$ 56,722**	**$ 61,004**
Construction	**171**	**-**	**1,262**	**1,433**	**1,109**	**2,542**
Multi-family	**-**	**-**	**-**	**-**	**2,239**	**2,239**
Commercial real estate	**73**	**-**	**86**	**159**	**23,828**	**23,987**
Land	**126**	**-**	**2,594**	**2,720**	**7,674**	**10,394**
Commercial	**230**	**22**	**295**	**547**	**8,329**	**8,876**
Home equity	**258**	**-**	**125**	**383**	**8,115**	**8,498**
Consumer	**-**	**-**	**-**	**-**	**428**	**428**
Total	**$ 2,689**	**$ 210**	**$ 6,625**	**$ 9,524**	**$ 108,444**	**$ 117,968**

The following table presents the classes of the loan portfolio summarized by the past due status as of December 31, 2012 (In Thousands):

	30-59 Days Past Due	60-89 Days Past Due	Greater than 90 Days	Total Past Due	Current	Total Loans Receivable
Residential mortgage	$ 660	$ 1,067	$ 2,430	$ 4,157	$ 55,980	$ 60,137
Construction	-	30	485	515	3,315	3,830
Multi-family	-	-	-	-	1,877	1,877
Commercial real estate	82	-	193	275	26,554	26,829
Land	-	-	3,080	3,080	9,241	12,321
Commercial	46	-	40	86	10,788	10,874
Home equity	75	65	359	499	9,527	10,026
Consumer	-	-	-	-	466	466
Total	$ 863	$ 1,162	$ 6,587	$ 8,612	$ 117,748	$ 126,360

Management closely monitors the quality of the loan portfolio and has established a loan review process designed to help grade the quality and profitability of the Bank's loan portfolio. The credit quality grade helps management make a consistent assessment of each loan relationship's credit risk. Consistent with regulatory guidelines, the Bank provides for the classification of loans considered being of lesser quality. Such ratings coincide with the "Substandard," "Doubtful" and "Loss" classifications used by federal regulators in their examination of financial institutions. Generally, an asset is considered Substandard if it is inadequately protected by the current net worth and paying capacity of the obligors and/or the collateral pledged. Substandard assets include those characterized by the distinct possibility that the insured financial institution will sustain some loss if the deficiencies are not corrected. Assets classified as Doubtful have all the weaknesses inherent in assets classified Substandard with the added characteristic that the weaknesses present make collection or liquidation in full, on the basis of currently existing facts, highly questionable and improbable. Assets classified as Loss are those considered uncollectible and of such little value that their continuance as assets without the establishment of a full loss allowance and/or charge-off is not warranted. Assets that do not currently expose the insured financial institutions to sufficient risk to warrant classification in one of the aforementioned categories but otherwise possess weaknesses are designated "Special Mention." These loans represent borrowers with declining earnings, strained cash flow, increasing leverage and/or weakening market fundamentals that indicate above average risk. When the Bank classifies problem assets as either Substandard or Doubtful, it generally establishes a valuation allowance or "loss reserve" in an amount deemed prudent by management. General allowances represent loss allowances that have been established to recognize the inherent risk associated with lending activities, but which, unlike specific allowances, have not been allocated to particular problem assets. When the Bank identifies problem assets as being impaired, it is required either to establish a specific allowance for losses equal to the amount of impairment of the assets, or to charge-off such amount. The Bank's determination as to the classification of its assets and the amount of its valuation allowance is subject to review by its regulatory agencies, which can

Note 3 - Loans Receivable and Allowance for Loan Losses (Continued)

order the establishment of additional general or specific loss allowances. The Bank reviews its portfolio monthly to determine whether any assets require classification in accordance with applicable regulations.

The inherent risk within the loan portfolio varies depending upon the loan type. The Bank’s primary lending activity is the origination of residential mortgage loans, including home equity loans, which are collateralized by residences. Generally, residential mortgage loans are made in amounts up to 85.0% of the appraised value of the property. However, the Bank will originate residential mortgage loans with loan-to-value ratios of up to 95.0%, with private mortgage insurance. In the event of default by the borrower, the Bank will acquire and liquidate the underlying collateral. By originating the loan at a loan-to-value ratio of 85% or less, the Bank limits its risk of loss in the event of default. However, the market values of the collateral may be adversely impacted by declines in the economy. Home equity loans may have an additional inherent risk if the Bank does not hold the first mortgage. The Bank may stand in a secondary position in the event of collateral liquidation resulting in a greater chance of insufficiency to meet all obligations.

Construction lending generally involves a greater degree of risk than other residential mortgage lending. The repayment of the construction loan is, to a great degree, dependent upon the successful and timely completion of the construction of the subject property. The Bank completes inspections during the construction phase prior to any disbursements. The Bank limits its risk during the construction as disbursements are not made until the required work for each advance has been completed. Construction delays may further impair the borrower's ability to repay the loan.

Loans collateralized by commercial real estate, and multi-family loans, such as apartment buildings generally are larger than residential loans and involve a greater degree of risk. Commercial mortgage loans often involve large loan balances to single borrowers or groups of related borrowers. Payments on these loans depend to a large degree on the results of operations and management of the properties or underlying businesses, and may be affected to a greater extent by adverse conditions in the real estate market or the economy in general. Accordingly, the nature of commercial real estate loans makes them more difficult for management to monitor and evaluate.

Loans collateralized by land generally are larger than residential loans and involve a greater degree of risk. Payments on these loans depend to a large degree on the results of operations and sales of the properties, and may be affected to a greater extent by adverse conditions in the real estate market or the economy in general. Accordingly, the nature of land loans makes them more difficult for management to monitor and evaluate.

Consumer loans generally have shorter terms and higher interest rates than residential mortgage loans. In addition, consumer loans expand the products and services offered by the Bank to better meet the financial services needs of its customers. Consumer loans generally involve greater credit risk than residential mortgage loans because of the difference in the underlying collateral. Repossessed collateral for a defaulted consumer loan may not provide an adequate source of repayment of the outstanding loan balance because of the greater likelihood of damage, loss or depreciation in the underlying collateral. The remaining deficiency often does not warrant further substantial collection efforts against the borrower beyond obtaining a deficiency judgment. In addition, consumer loan collections depend on the borrower's personal financial stability. Furthermore, the application of various federal and state laws, including federal and state bankruptcy and insolvency laws, may limit the amount that can be recovered on such loans.

Commercial lending generally involves greater risk than residential mortgage lending and involves risks that are different from those associated with residential and commercial real estate lending. Real estate lending is generally considered to be collateral based, with loan amounts based on fixed-rate loan-to-collateral values, and liquidation of the underlying real estate collateral is viewed as the primary source of repayment in the event of borrower default. Although commercial loans may be collateralized by equipment or other business assets, the liquidation of collateral in the event of a borrower default is often an insufficient source of repayment because equipment and other business assets may be obsolete or of limited use, among other things. Accordingly, the repayment of a commercial loan depends primarily on the creditworthiness of the borrower (and any guarantors), while liquidation of collateral is a secondary and often insufficient source of repayment.

Note 3 - Loans Receivable and Allowance for Loan Losses (Continued)

Credit Quality Indicators

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

2013	Pass	Special Mention	Substandard	Total
Residential mortgage	**$ 55,299**	**$ 845**	**$ 4,860**	**$ 61,004**
Construction	**1,108**	**-**	**1,434**	**2,542**
Multi-family	**2,239**	**-**	**-**	**2,239**
Commercial real estate	**17,118**	**2,835**	**4,034**	**23,987**
Land	**6,401**	**154**	**3,839**	**10,394**
Commercial	**7,623**	**253**	**1,000**	**8,876**
Home equity	**8,090**	**105**	**303**	**8,498**
Consumer	**428**	**-**	**-**	**428**
Total	**$ 98,306**	**$ 4,192**	**$ 15,470**	**$ 117,968**

2012	Pass	Special Mention	Substandard	Total
Residential mortgage	$ 53,804	$ 894	$ 5,439	$ 60,137
Construction	3,144	171	515	3,830
Multi-family	877	-	1,000	1,877
Commercial real estate	20,584	1,841	4,404	26,829
Land	7,175	1,234	3,912	12,321
Commercial	9,770	406	698	10,874
Home equity	9,579	75	372	10,026
Consumer	466	-	-	466
Total	$ 105,399	$ 4,621	$ 16,340	$ 126,360

The Bank had no loans classified as Doubtful or Loss at December 31, 2013 and 2012.

A loan is considered impaired when it is probable that the borrower will be unable to repay the loan according to the original contractual terms of the loan agreement or the loan is restructured in a troubled debt restructuring. Loans are reviewed on a regular basis to assess collectability of all principal and interest payments due. Management determines that a loan is impaired or nonperforming when it is probable at least a portion of the loan will not be collected due to an irreversible deterioration in the financial condition of the borrower or the value of the underlying collateral. When a loan is determined to be impaired, the measurement of the loan is based on present value of estimated future cash flows, except that all collateral dependent loans are measured for impairment based on the fair value of the collateral. The following table summarizes information in regards to impaired loans by loan portfolio class as of December 31, 2013 and 2012 (In Thousands):

Note 3 - Loans Receivable and Allowance for Loan Losses (Continued)

Impaired Loans

December 31, 2013	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Interest Income Recognized
With no related allowance recorded:					
Residential mortgage	$ 4,296	$ 5,118	$ -	$ 3,760	$ 45
Construction	916	1,243	-	786	-
Commercial real estate	2,629	2,978	-	2,598	46
Land	2,850	4,448	-	3,066	-
Commercial	343	343	-	1	-
Home equity	295	303	-	176	3
Total	$ 11,329	$ 14,433	$ -	$ 10,387	$ 94
With an allowance recorded:					
Residential mortgage	1,715	1,715	42	1,589	60
Construction	346	346	42	-	-
Commercial real estate	3,082	3,082	301	1,928	79
Commercial	115	119	84	35	-
Home equity	39	39	28	10	-
Total	$ 5,297	$ 5,301	$ 497	$ 3,562	$ 139
Total:					
Residential mortgage	$ 6,011	$ 6,833	$ 42	$ 5,349	$ 105
Construction	1,262	1,589	42	786	-
Commercial real estate	5,711	6,060	301	4,526	125
Land	2,850	4,448	-	3,066	-
Commercial	458	462	84	36	-
Home equity	334	342	28	186	3
Total	$ 16,626	$ 19,734	$ 497	$ 13,949	$ 233

December 31, 2012	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Interest Income Recognized
With no related allowance recorded:					
Residential mortgage	$ 2,874	$ 3,079	$ -	$ 3,262	$ 94
Construction	261	263	-	1,068	-
Commercial real estate	3,167	3,278	-	4,609	122
Land	3,080	3,600	-	2,375	23
Commercial	50	50	-	36	1
Home equity	13	13	-	43	-
Total	**$ 9,445**	**$ 10,283**	**$ -**	**$ 11,393**	**$ 240**

The Bank generally does not separately identify individual residential mortgages, home equity and consumer loans for impairment unless the loan is restructured in a troubled debt restructuring.

During the years ended December 31, 2013 and 2012, certain loan modifications were executed which were considered to be troubled debt restructurings. Substantially all of these modifications included one or a combination of the following: extension of the maturity date at a stated rate of interest lower than the current market rate for new debt with similar risk; temporary reduction in the interest rate; change in scheduled payment amount; permanent reduction of principal of the loan; or extension of additional credit for payment of delinquent real estate taxes.

Note 3 - Loans Receivable and Allowance for Loan Losses (Continued)

The following tables summarize troubled debt restructurings by loan classification that occurred during the year indicated (in thousands):

For the year ended December 31, 2013	Number of Contracts	Pre-Modification Outstanding Recorded Investments	Post-Modification Outstanding Recorded Investments
Residential mortgage	**1**	**$ 145**	**$ 145**
Commercial real estate	**1**	**$ 886**	**$ 886**
Home equity loans and credit lines	**1**	**$ 107**	**$ 107**
Commercial	**1**	**$ 36**	**$ 36**

For the year ended December 31, 2012	Number of Contracts	Pre-Modification Outstanding Recorded Investments	Post-Modification Outstanding Recorded Investments
Residential Mortgage	7	$ 1,815	$ 1,846

A loan is considered to be in payment default once it is greater than 90 days contractually past due under the modified terms. There were no significant troubled debt restructurings that defaulted in the first twelve months after restructure in 2013. One loan restructured in 2012, with a current balance of $141,000 defaulted and is currently in nonaccrual status.

Loans subject to a troubled debt restructuring are evaluated as impaired loans for the purpose of determining the specific component of allowance for loan losses.

At December 31, 2013 and 2012, one- to four-family residential mortgage loans serviced for others amounted to approximately $136.2 million and $125.7 million, respectively. Advances from borrowers for taxes and insurance related to loans serviced for others amounted to approximately $1.5 million at December 31, 2013 and 2012. These loans and related advances are not included in the accompanying consolidated balance sheets.

The following summarizes activity pertaining to mortgage servicing rights for the years ended December 31, 2013 and 2012:

	2013	**2012**
	(In Thousands)	
Balance, beginning	**$ 744**	$ 624
Capitalized during the year	**231**	343
Amortization	**(212)**	(223)
Balance, ending	**$ 763**	$ 744

Mortgage servicing rights are included in accrued interest receivable and other assets in the consolidated balance sheets.

Note 4 - Premises and Equipment

The components of premises and equipment at December 31, 2013 and 2012 are as follows:

	2013	2012
	(In Thousands)	
Land	**$ 1,801**	$ 1,801
Buildings and leasehold improvements	**3,946**	4,117
Furniture and equipment	**1,031**	1,087
Automobiles	**32**	61
	6,810	7,066
Accumulated depreciation	**2,066**	2,060
	$ 4,744	$ 5,006

Depreciation and amortization expense was $286,000 and $260,000 in 2013 and 2012, respectively.

Note 5 - Deposits

Deposits at December 31, 2013 and 2012 consist of the following major classifications:

	2013	2012
	(In Thousands)	
Non-interest bearing demand	**$ 17,886**	$ 18,519
NOW	**13,703**	11,943
Money market	**21,258**	24,202
Savings	**22,199**	23,184
Certificates of deposit	**47,687**	55,805
	$ 122,733	$ 133,653

A summary of certificates of deposit by maturity at December 31, 2013 is as follows (In Thousands):

Year ending December 31:	
2014	**$ 41,773**
2015	**3,360**
2016	**1,667**
2017	**548**
2018	**339**
	$ 47,687

The aggregate amount of certificates of deposit with a minimum denomination of $100,000 was $20.8 million and $23.9 million at December 31, 2013 and 2012, respectively. At December 31, 2013 and 2012, $7.5 million, respectively, of certificates of deposit consisted of one municipal deposit from the New York State Office of the Comptroller which is secured by a municipal letter of credit issued by the Federal Home Loan Bank (see Note 6).

A summary of interest expense on deposits for the years ended December 31, 2013 and 2012 is as follows:

	2013	2012
	(In Thousands)	
NOW and money market demand	**$ 68**	$ 87
Savings	**34**	50
Certificates of deposit	**259**	403
	$ 361	$ 540

Note 6 – Federal Home Loan Bank and Other Borrowings

As a member of the FHLB, the Bank may borrow in the form of term and overnight borrowing up to a portion of the amount of eligible residential mortgage loans and securities that have been pledged as collateral under a blanket security agreement. As of December 31, 2013, the Bank had pledged residential mortgage loans totaling $23.6 million. Based on no outstanding borrowings and a secured $7.5 million municipal letter of credit, the Bank had unused borrowing capacity with FHLB of approximately $8.8 million at December 31, 2013.

At December 31, 2013 and 2012, the Bank had no borrowings outstanding.

The Bank also had an unused $2.0 million federal funds line from its correspondent bank, Atlantic Central Bankers Bank at December 31, 2013 and 2012, which was terminated on February 28, 2014.

Note 7 - Legal Contingencies

Various legal claims arise from time to time in the normal course of business, which in the opinion of management will have no material effect on the Company's consolidated financial statements.

Note 8 - Restrictions on Dividends, Loans and Advances

Federal and state banking regulations place certain restrictions on dividends paid and loans or advances made by the Bank to the Company. The total amount of dividends which may be paid at any date is generally limited to retained net income of the Bank for the current and preceding two years. In addition, dividends paid by the Bank to the Company would be prohibited if the effect thereof would cause the Bank's capital to be reduced below minimum capital requirements. Loans or advances are limited to 10% of the Bank's capital and surplus on a secured basis.

At December 31, 2013, the Bank had no retained earnings available for the payment of dividends. Prior approval of the Bank's regulatory agency would be required for the payment of dividends or any loans or advances to the Company. The Company's ability to pay dividends is generally dependent on the Bank's ability to pay dividends to the Company.

Note 9 - Lease Commitments and Total Rental Expense

The Bank leases two branch locations under long-term operating leases. Future minimum lease payments by year and in the aggregate, under noncancellable operating leases with initial or remaining terms of one year or more, consisted of the following at December 31, 2013 (In Thousands):

Years ending December 31:	
2014	**$ 33**
2015	**21**
2016	**16**
	$ 70

The leases contain options to extend for periods up to ten years. The cost of such extensions is not included above. The total rental expense for all leases for the years ended December 31, 2013 and 2012 was approximately $76,000 and $83,000, respectively.

Note 10 - Income Taxes

The income tax expense (benefit) consists of the following for the years ended December 31, 2013 and 2012:

	2013	2012
	(In Thousands)	
Federal:		
Current	**$ (178)**	$ (469)
Deferred	**968**	(68)
	790	(537)
State		
Current	**-**	1
Deferred	**340**	(117)
	340	(116)
Income Tax Expense (Benefit)	**$ 1,130**	$ (653)

A reconciliation of the statutory federal income tax at a rate of 34% to the income tax expense (benefit) included in the consolidated statements of operations for the years ended December 31, 2013 and 2012 is as follows:

	2013		2012	
	Amount	% of Pretax Income	Amount	% of Pretax Income
	(Dollars in Thousands)			
Federal income tax at statutory rate	**$ (2,052)**	**(34.0) %**	$ (559)	(34.0) %
State income taxes, net of federal tax benefit	**224**	**3.7**	(77)	(4.6)
Valuation allowance for federal net deferred tax assets	**2,822**	**46.8**	-	-
Other	**136**	**2.2**	(17)	(1.1)
	$ 1,130	**18.7 %**	$ (653)	(39.7) %

Note 10 - Income Taxes (Continued)

Items that gave rise to significant portions of deferred taxes are as follows:

	December 31,	
	2013	2012
	(In Thousands)	
Deferred tax assets:		
Allowance for loan losses	**$ 974**	$ 1,045
Directors' retirement plan	**134**	133
Nonaccrual interest	**262**	119
Other real estate owned	**150**	138
Net operating losses	**2,348**	393
Other	**38**	24
	3,906	1,852
Deferred tax liabilities:		
Premises and equipment	**213**	217
Mortgage servicing rights	**303**	295
Deferred loan fees	**44**	32
	560	544
Valuation allowance	**(3,346)**	-
Net Deferred Tax Asset	**$ -**	$ 1,308

Net deferred tax assets are recorded in accrued interest receivable and other assets. Realization of deferred tax assets is dependent upon the generation of future taxable income or the existence of sufficient taxable income within the carryback period. A valuation allowance is provided when it is more likely than not that some portion or all of the deferred tax assets will not be realized. In assessing the need for a valuation allowance, management considers the scheduled reversal of the deferred tax liabilities, the level of historical taxable income, and the projected future level of taxable income over the periods in which the temporary differences or net operating losses related to the deferred tax assets will be deductible. The judgment about the level of future taxable income is inherently subjective and is reviewed on a continual basis as regulatory and business factors change. Due to the significant and continued operating losses in 2013, management reassessed the potential realization of the deferred tax assets and recorded a valuation allowance in the amount of $3,346,000, representing the full amount of the net deferred tax assets at December 31, 2013.

As a thrift institution, the Bank is subject to special provisions in the Federal tax laws regarding its allowable tax bad debt deductions and related tax bad debt reserves. These reserves consist primarily of a defined base-year amount for Federal income tax purposes. Deferred tax liabilities are recognized with respect to any portion of the base-year amount which is expected to become taxable (or "recaptured") in the foreseeable future.

Under current tax laws, Federal base-year reserves would be subject to recapture if the Bank pays a cash dividend in excess of earnings and profits or liquidates. The Bank expects that it will take no action in the foreseeable future which would require the establishment of a tax liability associated with these bad debt reserves. Deferred tax liabilities have not been recognized with respect to the base-year reserve of approximately $500,000 at December 31, 2013, since the Bank does not expect that these amounts will become taxable in the foreseeable future. The unrecognized deferred tax liability with respect to the base-year reserves was approximately $170,000 at December 31, 2013.

The Company recognized no adjustment for unrecognized income tax benefits for the years ended December 31, 2013 and 2012. The Company's policy is to recognize interest and penalties on unrecognized tax benefits in income tax expense in the consolidated statements of operations. No interest and penalties were recorded in 2013 and 2012. The Company's Federal

Note 10 - Income Taxes (Continued)

and New York tax returns, constituting the returns of the major taxing jurisdictions, are subject to examination by the taxing authorities for 2009 through 2013. As of December 31, 2013 and 2012, the Company has no uncertain tax positions.

The Company has net operating loss carry forwards for Federal income tax purposes of approximately $5.7 million which expire in 2033. In addition, the Company has net operating loss carry forwards for New York State income tax purposes of approximately $8.0 million which will begin to expire in 2031.

Note 11 - Employee Benefit Plans

401(k)

The Bank has a 401(k) savings plan, which is offered to all eligible employees, defined as those who are at least 21 years of age that have worked for the Bank for one year and work a minimum of 1,000 hours per Plan year. The Plan permits tax deferred employee contributions of up to 15% of compensation and provides for employer discretionary matching and additional contributions determined annually by the Board of Directors. Employer contributions are subject to the employee completing 1,000 hours of service during the Plan year and being employed on the last day of the Plan year. Employer contributions vest to the employee at the rate of 20% after completion of two years of service and 20% per year, thereafter, becoming 100% vested upon the completion of six years of service.

In 2013, the Board of Directors did not approve any matching or additional contributions. In 2012, the Board of Directors approved matching contributions of 100% of employee contributions up to 2% of the employee’s compensation. Matching contributions amounted to $45,000 in 2012. No additional contributions were approved for 2012.

Employee Stock Ownership Plan (“ESOP”)

In June 2007, the Bank established an ESOP which acquired 93,315 shares of the Company’s common stock in the stock offering with funds provided by a loan from the Company. The stock acquired by the ESOP but not yet released to participants is shown as a reduction of stockholders’ equity in the accompanying consolidated balance sheets. The ESOP loan will be repaid principally from the Bank’s contributions to the ESOP in annual payments through 2027 at a fixed interest rate of 8.25%. Shares are released to participants on a straight-line basis over the loan term and allocated based on participant compensation. The Bank recognizes compensation benefit expense as shares are committed for release at their current market price. The difference between the market price and the cost of shares committed to be released is recorded as an adjustment to additional paid-in capital. Dividends on allocated shares are recorded as a reduction of retained earnings and dividends on unallocated shares are recorded as a reduction of debt. The Company recognized $20,000 and $26,000 of compensation expense related to this plan for the years ended December 31, 2013 and 2012. At December 31, 2013, there were 60,653 shares not yet released having an aggregate market value of approximately $200,000. Participant eligibility requirements and vesting provisions for the ESOP are the same as the 401(k) savings plan outlined above.

Directors’ Retirement Plan

Effective March 2007, the Bank adopted an unfunded directors’ retirement plan for the benefit of non-employee directors. Under the plan, directors who have attained the normal retirement age of 65 receive a retirement benefit based on their length of service upon termination. Benefits vest at the rate of 20% per year over a five year period commencing on the date of adoption for existing directors or the initial date of service for directors who join the Board of Directors after the adoption date. The plan’s projected benefit obligation as of the December 31, 2013 and 2012 measurement date, activity in the plan and the amounts recognized in the accompanying consolidated financial statements follows:

Note 11 - Employee Benefit Plans (Continued)

Directors' Retirement Plan (Continued)

	Year Ended December 31, 2013	Year Ended December 31, 2012
	(In Thousands)	
Change in projected benefit obligation:		
Projected benefit obligation at beginning of year	**$ 335**	$ 320
Service cost	**1**	1
Interest cost	**13**	15
Gains	**(10)**	(1)
Projected benefit obligation at end of year	**$ 339**	$ 335

The discount rate used to determine the projected benefit obligation at December 31, 2013 and 2012 was 4.75% and 3.75%, respectively. The projected benefit obligation is recorded in the other liabilities in the consolidated balance sheets.

The components of net periodic pension expense follow (In Thousands):

	2013	2012
Service cost	**$ 1**	$ 1
Interest cost	**13**	14
Amortization of losses and prior service cost	**-**	2
Net periodic pension expense	**$ 14**	$ 17

Discount rates of 3.75% and 4.50% were used to determine net periodic pension expense for the years ended December 31, 2013 and 2012, respectively.

The following table shows the expected benefit payments to be paid to participants for the years indicated (In Thousands):

Years ending December 31,	
2014	**$ 8**
2015	**43**
2016	**43**
2017	**43**
2018	**43**
2019 - 2023	**210**

Hometown Bancorp, Inc. 2008 Equity Incentive Plan

In 2008, the stockholders approved the 2008 Equity Incentive Plan ("Equity Plan") the purpose of which is to promote the long-term financial success of the Company and the Bank, by providing a means to attract, retain and reward individuals who can and do contribute to such success and to further align their interests with those of our stockholders. The Compensation Committee determines which executives will receive stock awards as well as type, size and restrictions on the awards. Under the Equity Plan, the Compensation Committee may make grants of incentive stock options, nonqualified stock options, stock appreciation rights or restricted stock of up to 163,301 shares. Grants have not yet been made under the Equity Plan.

Note 12 - Transactions with Officers and Directors

The Bank has had, and may be expected to have in the future, banking transactions in the ordinary course of business with its executive officers, directors, their immediate families, and affiliated companies (commonly referred to as related parties), on substantially the same terms, including interest rates and collateral, as those prevailing at the time for comparable transactions with persons not related to the Bank. These persons were indebted to the Bank for loans totaling approximately

Note 12 - Transactions with Officers and Directors (Continued)

$1.5 million and $1.1 million at December 31, 2013 and 2012, respectively. During 2013, approximately $606,000 of new loans and approximately $132,000 of repayments were made.

Deposits from related parties held by the Bank at December 31, 2013 and 2012 amounted to approximately $743,000 and $1.1 million, respectively.

A director of the Company is associated with a law firm which provides legal services to the Bank and its subsidiaries. During 2013 and 2012, the law firm was paid approximately $347,000 and $417,000, respectively, for legal services of which $54,000 and $52,000, respectively, is included in professional fees in the accompanying consolidated statements of operations. The Bank paid legal fees to the law firm of approximately $115,000 during 2013 and $59,000 during 2012 that were recorded in other real estate owned expense and other expense. The balance was paid by customers of the Bank in connection with loan transactions.

Note 13 - Off-Balance Sheet Risk

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

The Bank's exposure to credit loss in the event of nonperformance by the other party to the financial instrument for commitments to extend credit is represented by the contractual amount of those instruments. The Bank uses the same credit policies in making commitments and conditional obligations as it does for on-balance sheet instruments.

A summary of the Bank's financial instruments with off-balance sheet risk at December 31, 2013 and 2012 is as follows:

	2013	2012
	(In Thousands)	
Commitments to grant loans	**$ 5,336**	$ 2,012
Unfunded commitments under lines of credit	**8,128**	9,522
Letters of credit	**172**	209
	$ 13,636	$ 11,743

Fixed rate commitments to grant loans amounted to approximately $3.8 million at December 31, 2013, and had interest rates that ranged from 4.25% to 7.00%.

Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Since many of the commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. The Bank evaluates each customer's credit worthiness on a case-by-case basis. The amount of collateral obtained, if deemed necessary by the Bank upon extension of credit, is based on management's credit evaluation. Collateral held varies, but includes principally residential or commercial real estate.

Standby letters of credit are conditional commitments issued by the Bank to guarantee the performance of a customer to a third party and generally expire within one year. Those guarantees are primarily issued to municipalities to ensure the completion of public improvements in residential subdivisions by contractors that are customers of the Bank. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loan facilities to customers. The Bank holds collateral supporting these commitments for which collateral is deemed necessary. The current amount of the liability as of December 31, 2013 and 2012 for guarantees under standby letters of credit issued is not material.

Note 14 - Regulatory Matters

The Bank is required to maintain a cash reserve balance in vault cash or with the Federal Reserve Bank. The total of this reserve balance was approximately $466,000 and $351,000 at December 31, 2013 and 2012, respectively.

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

Quantitative measures established by regulation to ensure capital adequacy require the Bank to maintain minimum amounts and ratios (set forth in the table below) of Tier 1 leverage, Tier 1 risk-based capital and total risk-based capital as defined in the regulations. As of December 31, 2013, the most recent notification from the FDIC categorized the Bank as "well capitalized" under the regulatory framework for prompt corrective action. To be categorized as well capitalized, the Bank must maintain minimum Tier 1 leverage, Tier 1 risk-based and total risk-based ratios as set forth in the table below. The Bank's actual capital amounts and ratios are presented below.

	Actual			For Capital Adequacy Purposes			To be Well Capitalized Under Prompt Corrective Action Provisions		
	Amount	Ratio		Amount	Ratio		Amount	Ratio	
				(Dollars in Thousands)					
As of December 31, 2013:									
Tier 1 leverage	**$ 9,532**	**7.05**	**%**	**$ ≥5,407**	**≥4.0**	**%**	**$ ≥6759**	**≥ 5.0**	**%**
Tier 1 risk-based	**9,532**	**9.36**		**≥4,073**	**≥4.0**		**≥6,110**	**≥ 6.0**	
Total risk-based	**10,823**	**10.63**		**≥8,146**	**≥8.0**		**≥10,183**	**≥10.0**	
As of December 31, 2012:									
Tier 1 leverage	$ 14,246	9.37	%	$ ≥6,079	≥4.0	%	$ ≥7,598	≥ 5.0	%
Tier 1 risk-based	14,246	12.27		≥4,643	≥4.0		≥6,964	≥ 6.0	
Total risk-based	15,711	13.54		≥9,285	≥8.0		≥11,607	≥10.0	

Formal Written Agreement. On March 7, 2013, the Bank entered into a Formal Written Agreement ("Agreement") with the Office of the Comptroller of the Currency ("OCC"). The Agreement seeks to address OCC findings of unsafe and unsound practices by the Bank relating primarily to management, credit risk management and asset quality. The Agreement requires that the board of directors of the Bank take specific actions to address the deficiencies noted by the OCC. The Agreement requires the Bank to improve its risk management program and credit administration practices, develop and implement a written program to reduce the level of credit risk in the Bank, including the level of criticized assets, develop and implement a written profit plan to improve and sustain the earnings of the Bank. The Agreement also requires the Bank to prepare a written capital plan for the Bank covering at least a three-year period and adhere to other compliance related matters.

The Agreement requires that the Bank make periodic reports to the OCC as to its compliance with the requirements of the Agreement. The Agreement will remain in effect until the OCC suspends or terminates it.

Notice by the Federal Reserve Bank of Philadelphia. The Federal Reserve Bank of Philadelphia ("FRB Phil") on February 12, 2014, gave formal notice that the Company and Mutual Holding Company are designated to be in "troubled condition", as defined by regulation. The Holding Companies are required to provide 30 day's prior written notice to the FRB Phil before

Note 14 - Regulatory Matters (Continued)

adding or replacing any member of the board or any senior executive officers. The Holding Companies are prohibited from entering into and or making any payments that are deemed to be golden parachute payments, without prior written approval. It cannot be determined when the Company will no longer be subject to the conditions of the FRB Phil.

The OCC Agreement and the FRB Phil formal notice do not affect the Bank's ability to continue to conduct its banking business with customers in a normal fashion. Banking products and services, hours of operation, internet banking, ATM usage, and FDIC deposit insurance coverage will all be unaffected. Customer deposits remain protected and insured by the FDIC up to $250,000 per depositor.

The Bank's regulators can require the Bank to maintain capital ratios in excess of the amounts set forth in the table above to be adequately or well capitalized. Failure to comply with increased capital requirements or the Agreement discussed above can result in further discretionary supervisory enforcement actions and possible legal proceedings. These actions could include the issuance of cease and desist orders, the imposition of civil money penalties and/or removal of directors and officers. The exercise of additional discretionary supervisory enforcement actions, if deemed necessary by the regulators, may have a material adverse impact on the Company's consolidated financial statements.

Note 15 - Fair Value Measurements and Fair Values of Financial Instruments

Management uses its best judgment in estimating the fair value of the Company's financial instruments; however, there are inherent weaknesses in any estimation technique. Therefore, for substantially all financial instruments, the fair value estimates herein are not necessarily indicative of the amounts the Company could have realized in a sales transaction on the dates indicated. The estimated fair value amounts have been measured as of December 31, 2013 and 2012 and have not been re-evaluated or updated for purposes of these financial statements subsequent to those respective dates. As such, the estimated fair values of these financial instruments subsequent to the respective reporting dates may be different than the amounts reported at each year-end.

A fair value hierarchy is used that prioritizes the inputs to valuation methods used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1 measurements) and the lowest priority to unobservable inputs (Level 3 measurements). The three levels of the fair value hierarchy are as follows:

Level 1: Unadjusted quoted prices in active markets that are accessible at the measurement date for identical, unrestricted assets or liabilities.

Level 2: Quoted prices in markets that are not active, or inputs that are observable either directly or indirectly, for substantially the full term of the asset or liability.

Level 3: Prices or valuation techniques that require inputs that are both significant to the fair value measurement and unobservable (i.e., supported with little or no market activity).

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

For financial assets measured at fair value on a recurring basis, the fair value measurements by level within the fair value hierarchy used at December 31, 2013 are as follows:

Note 15 - Fair Value of Financial Instruments (Continued)

Description	Carrying Amount	(Level 1) Quoted Prices in Active Markets for Identical Assets	(Level 2) Significant Other Observable Inputs	(Level 3) Significant Unobservable Inputs
		(In Thousands)		
U. S. Government agency securities	**$ 1,708**	**$ -**	**$ 1,708**	**$ -**
Municipal securities	**$ 561**	**$ -**	**$ 561**	**$ -**
Residential mortgage-backed securities	**$ 435**	**$ -**	**$ 435**	**$ -**
Forward sales contract	**$ 4**	**$ -**	**$ 4**	**$ -**

For financial assets measured at fair value on a recurring basis, the fair value measurements by level within the fair value hierarchy used at December 31, 2012 are as follows:

Description	Carrying Amount	(Level 1) Quoted Prices in Active Markets for Identical Assets	(Level 2) Significant Other Observable Inputs	(Level 3) Significant Unobservable Inputs
		(In Thousands)		
U. S. Government agency securities	$ 1,753	$ -	$ 1,753	$ -
Municipal securities	$ 587	$ -	$ 587	$ -
Residential mortgage-backed securities	$ 594	$ -	$ 594	$ -
Forward sales contract	$ 45	$ -	$ 45	$ -

The Company enters into forward sales contracts to sell certain residential real estate loans. Such commitments are considered to be derivative financial instruments and, therefore, are carried at estimated fair value in the other assets or other liabilities section of the consolidated balance sheets. The fair value of these forward sales contracts is primarily measured by obtaining pricing from certain government-sponsored entities. The pricing is derived from market observable inputs that can generally be verified and do not typically involve significant judgment by the Company and therefore, are classified as Level 2 in the fair value hierarchy.

For financial assets measured at fair value on a nonrecurring basis, the fair value measurements by level within the fair value hierarchy used at December 31, 2013 are as follows:

Description	Carrying Amount	(Level 1) Quoted Prices in Active Markets for Identical Assets	(Level 2) Significant Other Observable Inputs	(Level 3) Significant Unobservable Inputs
		(In Thousands)		
Impaired loans	**$ 4,491**	**$ -**	**$ -**	**$ 4,491**
Other real estate owned	**$ 502**	**$ -**	**$ -**	**$ 502**

Note 15 - Fair Value of Financial Instruments (Continued)

For financial assets measured at fair value on a nonrecurring basis, the fair value measurements by level within the fair value hierarchy used at December 31, 2012 are as follows:

Description	Carrying Amount	(Level 1) Quoted Prices in Active Markets for Identical Assets	(Level 2) Significant Other Observable Inputs	(Level 3) Significant Unobservable Inputs
		(In Thousands)		
Impaired loans	$ 2,170	$ -	$ -	$ 2,170
Other real estate owned	$ 971	$ -	$ -	$ 971

The valuation techniques and significant unobservable inputs in the determination of fair value of assets classified as level 3 on a nonrecurring basis at December 31, 2013 and 2012 are as follows:

December 31, 2013	Valuation Technique	Unobservable Input	Range
Impaired loans	Appraisal of collateral	Management appraisal adjustments and estimated costs to sell	7.0% - 40.0%
Foreclosed assets	Appraisal of collateral or sales contract price	Management appraisal adjustments and estimated costs to sell	4.0% - 20.0%

December 31, 2012	Valuation Technique	Unobservable Input	Range
Impaired loans	Appraisal of collateral	Management appraisal adjustments and estimated costs to sell	5.0% - 10.0%
Foreclosed assets	Appraisal of collateral or sales contract price	Management appraisal adjustments and estimated costs to sell	6.0% - 20.0%

Impaired Loans

At the time a loan is considered impaired, it is valued at the lower of cost or fair value. Impaired loans carried at fair value generally receive a specific valuation allowance for loan losses. For collateral dependent loans, fair value is commonly based on recent real estate appraisals. These real estate appraisals may include up to three approaches to value: the sales comparison approach, the income approach (for income-producing property) and the cost 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, if applicable. Although the fair value of the property normally will be based on an appraisal, the valuation should be consistent with the price that a market participant will pay to purchase the property at the measurement date. Circumstances may exist that indicate that the appraised value is not an accurate measurement of the property's current fair value. Examples of such circumstances include changed economic conditions since the last appraisal, stale appraisals or

Note 15 - Fair Value of Financial Instruments (Continued)

imprecision and subjectivity in the appraisal process. Appraisal adjustments may be made by management to reflect these conditions resulting in a discount of the appraised value. In addition, a discount is typically applied to account for estimated costs to sell. Non-real estate collateral may be valued using an appraisal, net book value per the borrower's financial statements, or aging reports, adjusted or discounted based on management's historical knowledge, changes in the market conditions from the time of the valuations, and management's expertise and knowledge of the client's business. The methods used to determine the fair values of impaired loans typically result in a level 3 fair value classification. Impaired loans are evaluated on a quarterly basis for additional impairment and adjusted accordingly.

Foreclosed Assets

Assets acquired through foreclosure or transfers in lieu of 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. Similar to the impaired loan disclosures above, fair value is commonly based on recent real estate appraisals adjusted as deemed necessary by independent appraisers and management and estimated costs to sell resulting in a level 3 fair value classification. Foreclosed assets are evaluated on a quarterly basis to determine whether an additional reduction in the fair value less estimated costs to sell should be recorded. Fair values for assets under contract for sale are based on the contract price less estimated selling costs.

Impairment charges on loans related to the above nonrecurring fair value measurements, included in the provision for loan losses, amounted to $1.8 million for the year ended December 31, 2013. For the year ended December 31, 2012, there was $839,000 included in the provision for loan losses for impaired loans.

Foreclosed asset losses related to the above nonrecurring fair value measurements, included in the other real estate owned expense, were $292,000 and $214,000 for the years ended December 31, 2013 and 2012, respectively.

The following information should not be interpreted as an estimate of the fair value of the entire Company since a fair value calculation is only provided for a limited portion of the Company's assets and liabilities. Due to a wide range of valuation techniques and the degree of subjectivity used in making the estimates, comparisons between the Company's disclosures and those of other companies may not be meaningful. The following methods and assumptions were used to estimate the fair values of the Company's financial instruments at December 31, 2013 and 2012:

Cash and Cash Equivalents, Federal Funds and Certificates of Deposit

The carrying amounts reported in the consolidated balance sheet for these instruments approximate the fair value.

Securities

Fair values of available for sale and held to maturity securities are based on quoted market prices of comparable instruments. When necessary, the Company utilizes matrix pricing from a third party pricing vendor to determine fair value pricing.

Matrix pricing is a mathematical technique used widely in the industry to value debt securities without relying exclusively on quoted market prices for the specific securities but rather by relying on the securities' relationship to other benchmark quoted prices. Securities valued using matrix pricing result in a level 2 classification.

Loans Held for Sale

Fair values for loans held for sale are based on existing commitments from investors or prevailing market prices resulting in a level 2 classification.

Loans Receivable

The fair values of loans are estimated using discounted cash flow analyses at interest rates currently offered in the market for loans with similar terms to borrowers of similar credit quality resulting in a level 3 classification. The estimate of maturities is based on the contractual cash flows adjusted for prepayment estimates based on current economic and lending conditions.

Note 15 - Fair Value of Financial Instruments (Continued)

Restricted Investments in Bank Stocks

The carrying amount of Federal Home Loan Bank and Atlantic Central Bankers Bank stock approximates fair value.

Accrued Interest Receivable and Payable

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

Mortgage Servicing Rights

The Company accounts for mortgage servicing rights (MSRs) at amortized cost. The Company performs a valuation of fair value to determine if there is any impairment. Fair value for MSRs is determined using a static discounted cash flow valuation approach resulting in a level 2 classification. This approach consists of projecting servicing cash flows under static interest-rate scenarios and discounting these cash flows using risk-adjusted rates. The model assumptions used in the valuation of MSRs include mortgage prepayment speeds and discount rates. The fair value of MSRs is primarily affected by changes in prepayments that result from shifts in mortgage interest rates.

Deposits

Fair values for demand deposits, savings accounts and certain money market deposits are, by definition, equal to the amount payable on demand at the reporting date. Fair values of fixed-maturity certificates of deposit are estimated using a discounted cash flow calculation that applies interest rates currently being offered in the market on similar instruments with similar maturities resulting in a level 2 classification.

The estimated fair values of the Company's financial instruments at December 31, 2013 and 2012 were as follows:

		December 31,			
		2013		2012	
	Fair Value Hierarchy	Carrying Amount	Fair Value	Carrying Amount	Fair Value
		(In Thousands)			
Financial assets:					
Cash and cash equivalents	1	**$ 7,140**	**$ 7,140**	$ 11,682	$ 11,682
Federal funds	1	**-**	**-**	528	528
Certificates of deposit	1	**275**	**275**	275	275
Securities available for sale	2	**2,704**	**2,704**	2,934	2,934
Securities held to maturity	2	**1,054**	**1,063**	1,077	1,092
Loans held for sale	2	**150**	**150**	843	843
Loans receivable, net	3	**115,339**	**116,534**	123,828	126,891
Restricted investments in bank stocks	2	**476**	**476**	514	514
Accrued interest receivable	1	**401**	**401**	489	489
Mortgage servicing rights	2	**763**	**1,072**	744	791
Financial liabilities:					
Non-interest bearing demand accounts	1	**17,886**	**17,886**	18,519	18,519
NOW accounts	1	**13,703**	**13,703**	11,943	11,943
Money market accounts	1	**21,258**	**21,258**	24,202	24,202
Savings accounts	1	**22,199**	**22,199**	23,184	23,184
Certificates of deposit	2	**47,687**	**47,770**	55,805	55,863
Accrued interest payable	1	**3**	**3**	6	6

Note 16 – Subsequent Events

The Company has evaluated subsequent events through April 2, 2014, the date that the consolidated financial statements were available to be issued.

STOCKHOLDER INFORMATION

Corporate Office
Hometown Bancorp, Inc.
12 Main Street
Walden, NY 12586
(845) 778-2171

Annual Meeting of Stockholders
The annual meeting of Hometown Bancorp, Inc. will be held May 14, 2014 at 4:00pm at the Company's office, 12 Main Street, Walden, NY 12586.

Stock Transfer Agent & Registrar
Stockholders wishing to change name, address or ownership of stock, or to report lost certificates or to consolidate accounts should contact the Company's stock registrar and transfer agent directly at:

Registrar & Transfer Company
10 Commerce Drive
Cranford, NJ 07016-3572
(800) 368-5948

Regulatory Counsel
Luse Gorman Pomerenk & Schick, P.C.
5335 Wisconsin Avenue, N.W. Suite 780
Washington, DC 20015

Independent Accounting Firm
Bonadio & Co., LLP
115 Solar Street, Suite 100
Syracuse, NY 13204

Market Information for Common Stock
The common stock of Hometown Bancorp, Inc. trades on the Over-the-Counter market under the symbol "HTWC.PK." At December 31, 2013, there were approximately 267 stockholders of record, not including the number of persons or entities holding stock in nominee or street names through various brokers and banks.

DIRECTORS AND OFFICERS
Hometown Bancorp, Inc.

Board of Directors
Steven E. Howell: Chairman of the Board, CPA and partner with Vanacore, DeBenedictus, DiGovanni & Weddell, LLP, CPAs.

Joseph B. Horan: President and funeral Director of Gridley Horan, Inc.

Gerald N. Jacobowitz: Senior partner in the law firm of Jacobowitz and Gubits, LLP

Stephen E. Sabine: Retired Division Manager from New York State Electric & Gas Corp.

Kenneth R. Schliphack: Retired from B&C Fuel Oil Co. Inc.

Curtis J. Schoeberl, Sr.: Assessor for the Town of Shawangunk, NY

Officers
Marjorie S. Rovereto: President & Chief Executive Officer, Hometown Bancorp, Inc.

Michael Shaughnessy: Senior Vice President and Chief Lending Officer

Stephen W. Dederick: Senior Vice President and Chief Financial Officer

Amy Sherwood: Vice President and Operations Officer and Corporate Secretary

Hometown Bancorp, Inc.

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