



Hometown Bancorp, Inc.

2015 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, it is with great pleasure that I present to you our 2015 Annual Report.

During 2015, Hometown Bancorp, Inc. returned to profitability. Management and the Board have continued to focus on decreasing the Bank's risk exposure and expense reductions. As a result of this effort non-performing assets have decreased by \$1.8 million, non-interest expense has been reduced by \$652,000 and we also recorded a gain on the sale of other real estate owned of \$124,000 during 2015. As a result of improvements in our loan portfolio the Company was able to recognize a recovery of \$306,000 in the provision for loan losses. We continue to work to resolve the remaining non-performing assets in order to improve the Bank's financial condition.

We have increased our non-interest income during 2015, as our mortgage banking income, net increased by \$476,000 as a result of increased mortgage sales volume. We originated \$34.6 million residential mortgage loans in 2015 compared to \$16.3 million in 2014. We continue to sell a large portion of the loans originated, as we do not want to take on the interest rate risk associated with keeping fixed rate loans with low yielding rates on the balance sheet.

We continue to work with the OCC to meet the conditions in the Formal Agreement. The Board and Management remain committed on addressing the Articles in the Formal Agreement.

Our focus continues to be on delivering exceptional customer service. We offer all of the products, services and convenient delivery systems that are available at larger banks, but with the personal touch that you have enjoyed for years. Please take a moment to view our Website and i-Banking features. We have recently opened a Loan Office in Kingston, NY that serves the Ulster County Residential Mortgage Market providing expertise and superb customer service.

In closing, it has been a year of improvement and change. In May 2015, we welcomed Ian Green as a new Director, who provides experience in the capital and investment markets. I want to thank you our stockholders, depositors, customers and community for the confidence you have placed in us. I want to thank the staff for their volunteerism. Many of our Officers, Directors and Staff are involved and support our community initiatives.



Marjorie S. Rovereto
President and Chief Executive Officer

Selected Financial and Other Data

The information at December 31, 2015 and 2014 and for the years ended December 31, 2015 and 2014 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 13.

(Dollars in thousands)	At or for the Year Ended December 31,	
	2015	2014
Financial Condition Data:		
Total assets.....	\$119,593	\$124,979
Cash and cash equivalents.....	2,957	4,817
Investment securities.....	2,593	3,714
Loans held for sale.....	645	375
Loans receivable, net.....	105,537	107,116
Deposits.....	103,345	114,929
Borrowings.....	5,800	-
Total stockholders' equity.....	8,609	8,395
Operating Data:		
Interest income.....	\$ 4,875	\$ 5,159
Interest expense.....	280	343
Net interest income.....	4,595	4,816
Provision for loan losses.....	(306)	1,605
Net interest income after provision for loan losses.....	4,901	3,211
Non-interest income.....	2,027	1,290
Non-interest expenses.....	6,734	7,386
Income (loss) before income taxes.....	194	(2,885)
Income tax (benefit) expense.....	(7)	21
Net income (loss).....	\$ 201	\$ (2,906)

	At or for the Year Ended	
	December 31,	
	2015	2014
Performance Ratios:		
Return on average assets	0.17%	(2.20)%
Return on average equity.....	2.39	(30.12)
Interest rate spread (1).....	4.06	4.01
Net interest margin (2)	4.11	4.05
Non-interest income to average assets	1.67	0.98
Non-interest expense to average assets	5.54	5.58
Efficiency ratio (3)	101.69	120.96
Average interest-earning assets to average interest-bearing liabilities	120.14	115.49
Equity to total assets.....	7.20	6.72
Average equity to average assets.....	6.91	7.29
Capital Ratios (4):		
Tier 1 leverage capital	6.12	5.60
Tier 1 risk-based capital	7.86	7.57
Common equity tier1 risk-based	7.86	n/a
Total risk-based capital	9.12	8.84
Asset Quality Ratios:		
Allowance for loan losses as a percent of total loans	2.06	2.41
Allowance for loan losses as a percent of nonperforming loans	47.42	46.19
Net charge-offs to average outstanding loans during the year.....	0.11	1.50
Nonaccrual loans as a percent of total loans.....	4.35	5.23
Nonaccrual loans as a percent of total assets.....	3.91	4.58
Nonperforming assets as a percent of total assets	3.92	5.18
Per Share Related Data:		
Basic net income (loss) per common share	\$ 0.09	\$ (1.28)
Book value per share (5)	3.70	3.61
Tangible book value per share (6).....	3.51	3.39
Other Data:		
Number of Offices.....	4	4

- (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, 2015 and 2014.
- (6) Tangible book value per share is based on total stockholders' equity minus core deposit intangible of \$440,000 and \$517,000 at December 31, 2015 and 2014 respectively, divided by 2,326,939 outstanding common shares at December 31, 2015 and 2014.

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, 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 in the local residential and commercial markets.

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

(Dollars in thousands)	Year Ended December 31,					
	2015			2014		
	Average Balance	Interest and Dividends	Yield/ Cost	Average Balance	Interest and Dividends	Yield/ Cost
Assets:						
Interest-earning assets:						
Loans receivable	\$106,267	\$4,805	4.52%	\$111,166	\$5,070	4.56%
Investment securities, taxable	3,229	48	1.49	3,815	63	1.65
Other interest-earning assets	2,435	22	0.90	3,926	26	0.66
Total interest-earning assets	<u>111,931</u>	<u>4,875</u>	<u>4.36</u>	<u>118,907</u>	<u>5,159</u>	<u>4.34</u>
Non-interest-earning assets	9,560			13,365		
Total assets	<u>\$121,491</u>			<u>\$132,272</u>		
Liabilities and stockholders' equity:						
Interest-bearing liabilities:						
Interest-bearing demand deposits	\$ 11,073	12	0.11	\$ 12,466	13	0.10
Money market accounts	17,253	38	0.22	19,526	43	0.22
Savings accounts	21,873	31	0.14	21,526	30	0.14
Certificates of deposit	39,991	186	0.47	49,439	257	0.52
Borrowings	2,980	13	0.44	1	-	0.00
Total interest-bearing liabilities	<u>93,170</u>	<u>280</u>	<u>0.30</u>	<u>102,958</u>	<u>343</u>	<u>0.33</u>
Non-interest-bearing demand deposits	17,714			17,186		
Other non-interest-bearing liabilities	2,211			2,481		
Total liabilities	<u>113,095</u>			<u>122,625</u>		
Stockholders' equity	8,396			9,647		
Total liabilities and stockholders' equity	<u>\$121,491</u>			<u>\$132,272</u>		
Net interest income		<u>\$4,595</u>			<u>\$4,816</u>	
Interest rate spread			4.06			4.01
Net interest margin			4.11			4.05
Average interest-earning assets to average interest-bearing liabilities	<u>120.14%</u>			<u>115.49%</u>		

Comparison of Financial Condition at December 31, 2015 and 2014

Total Assets. Total assets declined \$5.4 million, or 4.3%, to \$119.6 million at December 31, 2015 from \$125.0 million at December 31, 2014. The decrease was due primarily to the decreases of \$1.9 million in cash and cash equivalents, \$1.6 million in loans receivable, net, \$1.1 million in securities available for sale and \$744,000 in other real estate owned. These decreases were offset by an increase of \$270,000 in loans held for sale.

Cash and cash equivalents. At December 31, 2015 cash and cash equivalents decreased \$1.9 million to \$3.0 million compared to \$4.8 million at December 31, 2014. The primary reason for the decrease in cash and cash equivalents during 2015 was the result of deposit account run off from allowing higher interest rate time deposits to mature.

Securities. The investment securities portfolio was \$2.6 million, or 2.2% of total assets, at December 31, 2015 compared to \$3.7 million, or 3.0% of total assets at December 31, 2014. The decrease in the portfolio was the result of maturities and pay downs in the residential mortgage-backed securities portfolio. Our investment securities portfolio consisted primarily of U.S. government agency, municipal and residential mortgage-backed securities at December 31, 2015.

Loans. At December 31, 2015, total loans, net, excluding loans held for sale, were \$105.5 million, or 88.2% of total assets at December 31, 2015 compared to \$107.1 million, or 85.7% of total assets at December 31, 2014. During the year ended December 31, 2015, the loan portfolio declined primarily as a result of decreases of \$2.7 million in construction mortgage loans, \$2.0 million in commercial business loans and \$837,000 in home equity loans. The decreases were a result of pay downs exceeding new volume during the year. The decrease was partially offset by increases of \$2.6 million in commercial real estate mortgages and \$1.0 million in residential mortgages. Loans held for sale increased by \$270,000 to \$645,000 at December 31, 2015.

Premises and Equipment. At December 31, 2015, premises and equipment was \$4.4 million, or 3.6% of total assets compared to \$4.6 million, or 3.7% of total assets at December 31, 2014.

Other real estate owned. At December 31, 2015, other real estate owned was \$6,000, or 0.01% of total assets compared to \$750,000, or 0.6% of total assets at December 31, 2014. Other real estate owned at December 31, 2015 consisted of one property for residential development. During the year ended December 31, 2015, we sold \$868,000 net, which resulted in an aggregate gain on sale of other real estate owned of \$124,000 as compared to a \$122,000 loss on sale of other real estate owned during 2014.

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, 2015, deposits decreased \$11.6 million, or 10.1% to \$103.3 million at December 31, 2015 from \$114.9 million at December 31, 2014. Deposits decreased in the following categories: certificates of deposit decreased by \$10.0 million, money market and interest-bearing demand accounts decreased by \$1.5 million and non-interest-bearing demand accounts decreased by \$398,000. These decreases were partially offset by an increase in savings accounts of \$299,000. 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 \$5.8 million of borrowings and \$0 at December 31, 2015 and 2014, respectively.

Stockholders' Equity. Total stockholders' equity increased \$214,000 from \$8.4 million at December 31, 2014 to \$8.6 million at December 31, 2015. Stockholders' equity increased primarily due to net income of \$201,000 for the year ended December 31, 2015.

Results of Operations for the Years Ended December 31, 2015 and 2014

Overview. For the year ended December 31, 2015, we reported net income of \$201,000, compared to a net loss of \$2.9 million for the year ended December 31, 2014. The primary reasons for the increase in net income for year ended December 31, 2015 were a decrease of \$1.9 million in the provision for loan losses, a decrease in non-interest expenses of \$652,000 and an increase of \$737,000 in non-interest income, offset in part by a decrease of \$221,000 in net interest income. Our provision for loan losses decreased as a result of lower charge-offs of loans in 2015. Non-interest expenses decreased as a result of lower costs on delinquent loans and other real estate owned properties, due to continued workouts and sales of problem loans and assets. Non-interest income increased as a result of increased mortgage banking income, net and a gain on the sale of other real estate owned. Net interest income declined as result of decreases in average interest-earning asset balances offset by an increase in average interest-earning asset yields and a decrease in the average balance of interest-bearing liabilities during 2015.

Net Interest Income. Net interest income decreased by \$221,000 or 4.6%, to \$4.6 million for the year ended December 31, 2015 compared to \$4.8 million for the prior year. The primary reason for the decrease in net interest income during the year ended December 31, 2015 was due to the decrease in the average balance of interest-earning assets of \$7.0 million. This decrease was partially offset by a decrease

in the average balance of interest-bearing liabilities of \$9.8 million, a decrease in the average cost of interest-bearing liabilities of three basis points to 0.30% and an increase in the average yield of interest-earning assets of two basis points to 4.36% for the year ended December 31, 2015 when compared to the year ended December 31, 2014. The interest rate spread increased by five basis points to 4.06% for the year ended December 31, 2015 from 4.01% for the year ended December 31, 2014. The net interest margin increased by six basis points to 4.11% for the year ended December 31, 2015 as compared to 4.05% for the year ended December 31, 2014.

Interest income on loans decreased \$265,000, or 5.2% to \$4.8 million during the year ended December 31, 2015 due to a decrease in the average balance of the loan portfolio of \$4.9 million, to \$106.3 million for the year ended December 31, 2015. In addition, the average yield on the loan portfolio decreased by four basis points to 4.52% for the year ended December 31, 2015. The decline in the average balance of loans was primarily the result of decreases in the average balances of construction and commercial business loans, as a result of less new loan production. The decrease in the average yield on loans was primarily the result of loan refinancing and new loan production at continued low market interest rates and the interest income not recognized on nonaccrual loans.

Interest income on investment securities decreased \$15,000, or 23.8% to \$48,000 for the year ended December 31, 2015 from \$63,000 for the year ended December 31, 2014. The decrease in interest income on investment securities was due to a decrease in the average yield of investment securities of 15 basis points to 1.49% for 2015 as compared for 1.65% in 2014 and a decrease in the average balance of investment securities to \$3.2 million for the year ended December 31, 2015 from \$3.8 million for the year ended December 31, 2014.

Interest income on other interest-earning assets decreased \$4,000, or 15.4%, to \$22,000 for the year ended December 31, 2015 from \$26,000 for the year ended December 31, 2014. The decrease in interest income on other interest-earning assets was due to a decrease in the average balance of such assets to \$2.4 million for the year ended December 31, 2015 from \$3.9 million for the year ended December 31, 2014, offset by an increase in the average yield of 24 basis points to 0.90% for 2015 as compared to 0.66% for 2014.

Interest expense on deposits decreased 22.2%, to \$267,000 for the year ended December 31, 2015 compared to \$343,000 for the year ended December 31, 2014. The primary reason for the decrease was a decrease of \$12.8 million, or 12.4% in the average balance of interest-bearing deposits during the year ended December 31, 2015 to \$90.2 million, compared with \$103.0 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 \$9.4 million and decreases in the average balances of money market and interest checking accounts of \$2.3 million and \$1.4 million, respectively, during 2015. The decrease in the average balance of certificates of deposit was the result of management allowing higher interest rate accounts to mature.

Provision for Loan Losses. The provision for loan losses decreased \$1.9 million to a credit of (\$306,000) for the year ended December 31, 2015 compared to \$1.6 million for the year ended December 31, 2014. The decrease in the provision for loan losses during the year ended December 31, 2015 was partially the result of a decrease in net charge-offs to approximately \$120,000 compared to \$1.7 million during 2014 (\$1.1 million of the 2014 year charge-offs was the result of selling non-accrual loans totaling \$3.0 million to help improve the asset quality of the Bank during the June 2014 quarter). As a result of the reduced risk in the nonaccrual and classified loans in our portfolio and a full review of the allowance methodology, which included a decrease in our historical loss factors, we were able to recognize a credit in the provision for loan losses. The allowance for loan losses totaled \$2.2 million at December 31, 2015, or 2.06% of total loans, as compared to \$2.6 million, or 2.41% of total loans as of December 31, 2014.

Nonperforming loans totaled \$4.7 million, or 4.4%, of total loans at December 31, 2015 compared to \$5.7 million, or 5.2%, of total loans at December 31, 2014. The decrease was primarily the result of our workout efforts during the year ended December 31, 2015. The \$4.7 million in non-accruing loans at December 31, 2015 were comprised of \$1.5 million in one-to four-family residential loans, \$1.9 million in

land loans, \$408,000 in construction loans, \$573,000 in commercial business loans, \$266,000 in home equity loans and \$36,000 in commercial real estate loans.

Non-interest Income. Non-interest income increased \$737,000, or 57.1% to \$2.0 million for the year ended December 31, 2015 compared to \$1.3 million for the year ended December 31, 2014. The primary reason for the increase in non-interest income for the year ended December 31, 2015 was due to mortgage banking income, net increasing by \$476,000 as a result of an increased volume of loans sold during the year ended December 31, 2015. In addition, gain on the sale of other real estate owned increased by \$246,000 in 2015 as a result of a gain on sale of \$124,000 during the year ended December 31, 2015 compared to a loss of \$122,000 during the year ended December 31, 2014. All other non-interest income categories net increased by a total of \$15,000 during 2015 as compared to 2014.

Non-interest Expenses. Non-interest expenses decreased \$652,000, or 8.8% to \$6.7 million for the year ended December 31, 2015 compared to \$7.4 million for 2014. Non-interest expense decreased primarily due to a decrease in salaries and employee benefits expense of \$263,000. The decrease in salaries and employee benefits expense was the result of a decrease in full time equivalent employees between the comparable years of 2015 and 2014. There were decreases in most expense categories as we continue to reduce expenses. Expenses decreased in delinquent loan expense by \$184,000, in professional fees expense by \$214,000 (as a result of less nonperforming loans) and in data processing expense by \$78,000. These decreases were offset in part by an increase in other operating expenses of \$134,000, primarily as a result of litigation settlements of approximately \$93,000.

Income Taxes. Income tax benefit was \$7,000 for the year ended December 31, 2015 as compared to income tax expense of \$21,000 for the year ended December 31, 2014.

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, 2015, cash and cash equivalents totaled \$3.0 million. In addition, at December 31, 2015, we had borrowing capacity up

to \$12.5 million from the Federal Home Loan Bank of New York. On December 31, 2015, we had \$5.8 million of borrowings outstanding from the Federal Home Loan Bank.

A significant use of our liquidity is the funding of loan originations. At December 31, 2015, we had \$10.7 million in loan commitments outstanding, which primarily consisted of \$1.1 million in commitments to fund one- to four-family residential real estate loans, \$987,000 in unused home equity lines of credit, \$7.3 million in unused commercial lines of credit and \$1.0 million in letters of credit. 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, 2015 totaled \$31.5 million, or 86.8% 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, 2015, we were considered "adequately capitalized" under OCC regulations.

Effective January 1, 2015, the OCC and the other federal bank regulatory agencies implemented the new capital rules that revised their risk-based capital requirements and the method for calculating risk-weighted assets making them consistent with agreements that were reached by the Basel Committee on Banking Supervision and certain provisions of the Dodd-Frank Act. The rule limits capital distributions and certain discretionary bonus payments if the banking organization does not hold a "capital conservation buffer" consisting of 2.5% of common equity Tier 1 capital to risk-weighted assets in addition to the amount necessary to meet its minimum risk-based capital requirements. The capital conservation buffer requirement will be phased in beginning January 1, 2016 at 0.625% of risk-weighted assets increasing each year until fully implemented at 2.5% on January 1, 2019.

In May 2015, the Federal Reserve Board amended its "Small Bank Holding Company" Policy Statement to extend the applicability to bank and savings and loan holding companies of up to \$1 billion in assets. This exempts Hometown Bancorp, Inc. and Hometown Bancorp MHC from the consolidated holding company capital requirements.

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 OCC. 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.

On February 22, 2016, the Bank entered into an Amended Formal Written Agreement with the OCC. All requirements of the March 7, 2013 Agreement remain in effect without modification except that by June 30, 2016, the Bank has agreed to achieve higher capital minimums. The capital minimums are: common equity tier 1 capital ratio at least equal to 9%, total capital ratio at least equal to 13%, tier 1 capital ratio at least equal to 11% and tier 1 leverage capital ratio at least equal to 9%.

The Bank's compliance committee monitors and coordinates compliance with the Agreement. The committee consists of four 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 many requirements of the Agreement. The requirements of the Agreement will remain in effect until the OCC suspends or terminates the Agreement.

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 will all be unaffected. Customer deposits remain protected and insured by the FDIC up to \$250,000 per depositor.

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. 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 Holding Companies will no longer be subject to the conditions of the FRB Phil.

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, lines of credit and letters of credit.

For the year ended December 31, 2015, 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.



Index to Consolidated Financial Statements

	<u>Page</u>
Report of Independent Registered Public Accounting Firm	
Consolidated Financial Statements	
Consolidated Balance Sheets	15
Consolidated Statements of Operations	16
Consolidated Statements of Comprehensive Income (Loss)	17
Consolidated Statements of Stockholders' Equity	18
Consolidated Statements of Cash Flows	19
Notes to Consolidated Financial Statements	20

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

March 30, 2016

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

We have audited the accompanying consolidated balance sheets of Hometown Bancorp, Inc. and subsidiary (the "Company") as of December 31, 2015 and 2014, and the related consolidated statements of operations, comprehensive income (loss), stockholders' equity and cash flows for each of the years in the two-year period ended December 31, 2015. The Company's management is responsible for these consolidated financial statements. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

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

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

432 North Franklin Street, Suite 60
Syracuse, New York 13204
p (315) 476-4004
f (315) 475-1513

www.bonadio.com

Bonadio & Co., LLP

Hometown Bancorp, Inc.

Consolidated Balance Sheets

	December 31,	
	2015	2014
	(Dollars in Thousands, Except Share Data)	
Assets		
Cash and due from banks	\$ 2,083	\$ 2,211
Interest earning demand deposits with banks	874	2,606
Cash and Cash Equivalents	<u>2,957</u>	<u>4,817</u>
Certificates of deposit	25	278
Securities available for sale	2,562	3,677
Securities held to maturity (fair value 2015 \$31; 2014 \$38)	31	37
Loans held for sale	645	375
Loans receivable, net of allowance for loan losses (2015 \$2,220; 2014 \$2,646)	105,537	107,116
Premises and equipment, net	4,357	4,565
Restricted investments in bank stocks, at cost	627	390
Other real estate owned	6	750
Accrued interest receivable and other assets	2,846	2,974
Total Assets	<u><u>\$119,593</u></u>	<u><u>\$124,979</u></u>
Liabilities and Stockholders' Equity		
Liabilities		
Deposits:		
Non-interest bearing	\$ 17,045	\$ 17,443
Interest bearing	86,300	97,486
Total Deposits	<u>103,345</u>	<u>114,929</u>
Federal Home Loan Bank advances	5,800	-
Advances from borrowers for taxes and insurance	928	829
Accrued interest payable	1	2
Other liabilities	910	824
Total Liabilities	<u>110,984</u>	<u>116,584</u>
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; 2,326,939 outstanding	24	24
Paid-in capital	9,918	9,958
Accumulated deficit	(544)	(745)
Unearned ESOP shares, at cost	(513)	(560)
Treasury stock, at cost, 53,561 shares at December 31, 2015 and 2014	(311)	(311)
Accumulated other comprehensive income	35	29
Total Stockholders' Equity	<u>8,609</u>	<u>8,395</u>
Total Liabilities and Stockholders' Equity	<u><u>\$119,593</u></u>	<u><u>\$124,979</u></u>

See notes to consolidated financial statements.

Hometown Bancorp, Inc.

Consolidated Statements of Operations

	Years Ended December 31,	
	2015	2014
	(In Thousands Except Per Share Data)	
Interest Income		
Loans receivable, including fees	\$4,805	\$5,070
Securities, taxable	48	63
Other	22	26
Total Interest Income	4,875	5,159
Interest Expense		
Deposits	267	343
Federal Home Loan Bank advances	13	-
Total Interest Expense	280	343
Net Interest Income	4,595	4,816
Provision for Loan Losses	(306)	1,605
Net Interest Income after Provision for Loan Losses	4,901	3,211
Non-interest Income		
Banking fees and service charges	815	798
Mortgage banking income, net	935	459
Investment brokerage fees	55	56
Realized gain (loss) on sale of other real estate owned	124	(122)
Other	98	99
Total Non-interest Income	2,027	1,290
Non-interest Expenses		
Salaries and employee benefits	3,294	3,557
Occupancy and equipment	750	782
Professional fees	396	610
Advertising and marketing	143	157
Data processing	657	735
Telephone and postage	132	133
FDIC premiums	267	286
Other real estate owned expense	78	59
Delinquent loan expense	186	370
Other	831	697
Total Non-interest Expenses	6,734	7,386
Income (Loss) before Income Taxes	194	(2,885)
Income Tax (Benefit) Expense	(7)	21
Net income (loss)	\$ 201	\$ (2,906)
Net income (loss) per common share - basic	\$ 0.09	\$ (1.28)
Weighted average number of common shares outstanding – basic	2,273	2,268

See notes to consolidated financial statements.

Hometown Bancorp, Inc.

Consolidated Statements of Comprehensive Income (Loss)

	Years Ended December 31,	
	<u>2015</u>	<u>2014</u>
	<small>(In Thousands)</small>	
Net Income (Loss)	<u>\$ 201</u>	<u>\$ (2,906)</u>
Other comprehensive income (loss), before tax:		
Unrealized (losses) gains on available-for-sale securities:		
Unrealized holding (losses) gains arising during the year	(11)	58
Directors' retirement plan:		
Pension gains	<u>17</u>	<u>2</u>
Other comprehensive income, before tax	6	60
Income tax expense (benefit), net	=	=
Other comprehensive income, net of tax	<u>6</u>	<u>60</u>
Comprehensive income (loss)	<u>\$ 207</u>	<u>\$ (2,846)</u>

See notes to consolidated financial statements.

Hometown Bancorp, Inc.

Consolidated Statements of Stockholders' Equity

Years Ended December 31, 2015 and 2014

(In Thousands Except Share Data)

	Common Stock	Paid-In Capital	Retained Earnings (Accumulated Deficit)	Unearned ESOP Shares	Treasury Stock	Accumulated Other Comprehensive Income (Loss)	Total
Balance - December 31, 2013	\$ 24	\$ 9,997	\$ 2,161	\$ (607)	\$ (311)	\$ (31)	\$ 11,233
Net loss	-	-	(2,906)	-	-	-	(2,906)
Other comprehensive income	-	-	-	-	-	60	60
ESOP shares committed to be released (4,666 shares)	-	(39)	-	47	-	-	8
Balance - December 31, 2014	24	9,958	(745)	(560)	(311)	29	8,395
Net income	-	-	201	-	-	-	201
Other comprehensive income	-	-	-	-	-	6	6
ESOP shares committed to be released (4,666 shares)	-	(40)	-	47	-	-	7
Balance - December 31, 2015	<u>\$ 24</u>	<u>\$ 9,918</u>	<u>\$ (544)</u>	<u>\$ (513)</u>	<u>\$ (311)</u>	<u>\$ 35</u>	<u>\$ 8,609</u>

See notes to consolidated financial statements.

Hometown Bancorp, Inc.

Consolidated Statements of Cash Flows

	Years Ended December 31,	
	2015	2014
	(In Thousands)	
Cash Flows from Operating Activities		
Net income (loss)	\$ 201	\$ (2,906)
Adjustments to reconcile net income (loss) to net cash flow from operating activities:		
Depreciation and amortization	220	236
Provision for loan losses	(306)	1,605
Amortization of deposit premium	78	78
Amortization of mortgage servicing rights	117	151
Net amortization of securities premiums and discounts	12	19
Net gain on sale of loans	(469)	(187)
Loans originated for sale	(24,932)	(8,915)
Proceeds from sale of loans	25,131	8,877
(Gain) loss on sale of other real estate owned	(124)	122
ESOP expense	7	8
Valuation write-down of other real estate owned	-	10
(Increase) decrease in accrued interest receivable and other assets	(67)	(53)
Increase (decrease) in accrued interest payable and other liabilities	102	(466)
Net Cash Flow From Operating Activities	<u>(30)</u>	<u>(1,421)</u>
Cash Flows from Investing Activities		
Maturity of certificates of deposit	253	-
Activity in available for sale securities:		
Purchases	-	(1,000)
Maturities, calls and principal repayments	1,092	73
Activity in held to maturity securities:		
Maturities, calls and principal repayments	6	1,010
Net decrease in loans receivable	1,885	5,542
Proceeds from sale of other real estate owned	868	1,102
Net (increase) decrease in restricted investment in bank stocks	(237)	86
Purchases of bank premises and equipment	(12)	(57)
Net Cash Flow From Investing Activities	<u>3,855</u>	<u>6,756</u>
Cash Flows from Financing Activities		
Net decrease in deposits	(11,584)	(7,804)
Increase in borrowings	5,800	-
Net increase in advances from borrowers for taxes and insurance	99	146
Net Cash Flow From Financing Activities	<u>(5,685)</u>	<u>(7,658)</u>
Net Change in Cash and Cash Equivalents	<u>(1,860)</u>	<u>(2,323)</u>
Cash and Cash Equivalents - Beginning	<u>4,817</u>	<u>7,140</u>
Cash and Cash Equivalents - Ending	<u>\$ 2,957</u>	<u>\$ 4,817</u>
Supplementary Cash Flows Information		
Interest paid	<u>\$ 281</u>	<u>\$ 344</u>
Income taxes paid (refund)	<u>\$ (7)</u>	<u>\$ 21</u>
Supplemental Schedule of Noncash Investing Activities		
Loans transferred to other real estate owned	<u>\$ -</u>	<u>\$ 1,255</u>

See notes to consolidated financial statements.

Hometown Bancorp, Inc.

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 outstanding 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, 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.

Concentrations of Credit Risk

Most of the Company’s activities are with customers located within Orange and Ulster Counties, New York and to a lesser extent the adjacent county of 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, 2015 or 2014.

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 \$567,000 and \$330,000 at December 31, 2015 and 2014, 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) at December 31, 2015 and 2014. 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

Notes to Consolidated Financial Statements

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.

Hometown Bancorp, Inc.

Notes to Consolidated Financial Statements

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, 2015 and 2014 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 physical possession. Physical possession of residential real estate property collateralizing a residential real estate mortgage occurs when legal title is obtained upon completion of foreclosure or when the borrower conveys all interest in the property to satisfy the loan through completion of a deed in lieu of foreclosure or through similar legal agreement. Write-downs from cost to fair value less estimated selling costs 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 \$440,000 and \$517,000 at December 31, 2015 and 2014, respectively. The gross carrying amount and accumulated amortization of the CDI amounted to \$776,000 and \$336,000, respectively, at December 31, 2015 and

Hometown Bancorp, Inc.

Notes to Consolidated Financial Statements

Note 1 - Significant Accounting Policies (Continued)

\$776,000 and \$259,000, respectively, at December 31, 2014. The estimated amortization expense is \$77,000 for each of the next five years ending December 31, 2020 and \$55,000 thereafter.

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, 2015 and 2014, 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 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).

There were no income taxes allocated to components of other comprehensive income (loss) at December 31, 2015 and 2014.

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

	Unrealized Gains (Losses) on Available-for- Sale Securities	Directors Retirement Plan	Accumulated Other Comprehensive Income (Loss)
Balance, December 31, 2013	\$ (29)	\$ (2)	\$ (31)
Other comprehensive income for 2014	58	2	60
Balance, December 31, 2014	29	-	29
Other comprehensive income (loss) for 2015	(11)	17	6
Balance, December 31, 2015	<u>\$ 18</u>	<u>\$ 17</u>	<u>\$ 35</u>

Hometown Bancorp, Inc.

Notes to Consolidated Financial Statements

Note 2 - Securities

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

	<u>Amortized Cost</u>	<u>Gross Unrealized Gains</u>	<u>Gross Unrealized Losses</u>	<u>Fair Value</u>
	(In Thousands)			
Available For Sale:				
December 31, 2015:				
U. S. Government agency securities	\$ 1,750	\$ -	\$ 8	\$ 1,742
Municipal securities	530	27	-	557
Residential mortgage-backed securities	264	-	1	263
Total	<u>\$ 2,544</u>	<u>\$ 27</u>	<u>\$ 9</u>	<u>\$ 2,562</u>
December 31, 2014:				
U. S. Government agency securities	\$ 2,750	\$ 6	\$ 9	\$ 2,747
Municipal securities	539	30	-	569
Residential mortgage-backed securities	359	2	-	361
Total	<u>\$ 3,648</u>	<u>\$ 38</u>	<u>\$ 9</u>	<u>\$ 3,677</u>
	<u>Amortized Cost</u>	<u>Gross Unrealized Gains</u>	<u>Gross Unrealized Losses</u>	<u>Fair Value</u>
	(In Thousands)			
Held to Maturity:				
December 31, 2015:				
Residential mortgage-backed securities	\$ 31	\$ -	\$ -	\$ 31
Total	<u>\$ 31</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 31</u>
December 31, 2014:				
Residential mortgage-backed securities	\$ 37	\$ 1	\$ -	\$ 38
Total	<u>\$ 37</u>	<u>\$ 1</u>	<u>\$ -</u>	<u>\$ 38</u>

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

There were no sales of investments in 2015 and 2014. At December 31, 2015 and 2014, 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, 2015 and 2014:

Hometown Bancorp, Inc.

Notes to Consolidated Financial Statements

Note 2 – Securities (Continued)

	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, 2015:						
U. S. Government agency securities	\$ 748	\$ 2	\$ 994	\$ 6	\$ 1,742	\$ 8
Residential mortgage-backed securities	263	1	-	-	263	1
Total	\$ 1,011	\$ 3	\$ 994	\$ 6	\$ 2,005	\$ 9
December 31, 2014:						
U. S. Government agency securities	\$ -	\$ -	\$ 1,741	\$ 9	\$ 1,741	\$ 9
Total	\$ -	\$ -	\$ 1,741	\$ 9	\$ 1,741	\$ 9

At December 31, 2015, there was one security in a continuous loss position for less than 12 months and one security in a continuous loss position for more than 12 months. These 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, 2015.

The amortized cost and fair value of securities as of December 31, 2015, 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.

	Available for Sale		Held to Maturity	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
	(In Thousands)			
Due in one year or less	\$ -	\$ -	\$ -	\$ -
Due after one year through five years	1,985	1,990	-	-
Due after five years through ten years	295	309	-	-
Due after ten years	-	-	-	-
Residential Mortgage-backed securities	264	263	31	31
	\$ 2,544	\$ 2,562	\$ 31	\$ 31

Hometown Bancorp, Inc.

Notes to Consolidated Financial Statements

Note 3 - Loans Receivable and Allowance for Loan Losses

The composition of loans receivable at December 31, 2015 and 2014 is as follows:

	2015	2014
	(In Thousands)	
Real estate mortgages:		
Residential	\$ 61,236	\$ 60,139
Construction	708	3,415
Multi-family	2,456	2,591
Commercial	24,146	21,541
Land	7,162	7,128
Total Real Estate Mortgages	95,708	94,814
Other loans:		
Commercial	4,595	6,561
Home equity loans and credit lines	7,015	7,852
Consumer	289	403
Total Loans	107,607	109,630
Deferred loan origination costs, net	150	132
Allowance for loan losses	(2,220)	(2,646)
Net Loans	\$ 105,537	\$ 107,116

The Bank grants loans to customers primarily within Orange County and Ulster County, New York, and to a lesser extent, portions of the adjacent county of 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 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, 2015 and 2014 (In Thousands):

Hometown Bancorp, Inc.

Notes to Consolidated Financial Statements

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

For the Year Ended December 31, 2015

Allowance for loan losses:	Residential mortgage	Construction	Multi-family	Commercial real estate	Land	Commercial	Home equity	Consumer	Unallocated	Total
Beginning Balance	\$ 997	\$ 43	\$ 50	\$ 663	\$ 438	\$ 209	\$ 128	\$ 6	\$ 112	\$ 2,646
Charge-offs	(176)	(4)	-	-	-	(63)	-	(8)	-	(251)
Recoveries	92	-	-	-	-	36	-	3	-	131
Provisions	(234)	(26)	(21)	(90)	73	(107)	(39)	1	137	(306)
Ending balance	\$ 697	\$ 13	\$ 29	\$ 573	\$ 511	\$ 75	\$ 89	\$ 2	\$ 249	\$ 2,220
Ending balance: related to loans individually evaluated for impairment	\$ 99	\$ -	\$ -	\$ 250	\$ 207	\$ 3	\$ 27	\$ -	\$ -	\$ 586
Ending balance: related to loans collectively evaluated for impairment	\$ 580	\$ 13	\$ 29	\$ 323	\$ 304	\$ 72	\$ 62	\$ 2	\$ 249	\$ 1,634
Loans receivable:										
Ending balance	\$ 61,236	\$ 708	\$ 2,456	\$ 24,146	\$ 7,162	\$ 4,595	\$ 7,015	\$ 289		\$ 107,607
Ending balance: individually evaluated for impairment	\$ 4,487	\$ 408	\$ -	\$ 4,211	\$ 1,923	\$ 592	\$ 392	\$ -		\$ 12,013
Ending balance: collectively evaluated for impairment	\$ 56,749	\$ 300	\$ 2,456	\$ 19,935	\$ 5,239	\$ 4,003	\$ 6,623	\$ 289		\$ 95,594

Hometown Bancorp, Inc.

Notes to Consolidated Financial Statements

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

For the Year Ended December 31, 2014

Allowance for loan losses:	Residential mortgage	Construction	Multi-family	Commercial real estate	Land	Commercial	Home equity	Consumer	Unallocated	Total
Beginning Balance	\$ 1,088	\$ 112	\$ 19	\$ 575	\$ 389	\$ 353	\$ 191	\$ 6	\$ 8	\$ 2,741
Charge-offs	(848)	(134)	-	(413)	(614)	(1)	(3)	(12)	-	(2,025)
Recoveries	280	-	-	38	-	5	-	2	-	325
Provisions	477	65	31	463	663	(148)	(60)	10	104	1,605
Ending balance	\$ 997	\$ 43	\$ 50	\$ 663	\$ 438	\$ 209	\$ 128	\$ 6	\$ 112	\$ 2,646
Ending balance: related to loans individually evaluated for impairment	\$ 288	\$ -	\$ -	\$ 366	\$ -	\$ 87	\$ 6	\$ -	\$ -	\$ 747
Ending balance: related to loans collectively evaluated for impairment	\$ 709	\$ 43	\$ 50	\$ 297	\$ 438	\$ 122	\$ 122	\$ 6	\$ 112	\$ 1,899
Loans receivable:										
Ending balance	\$ 60,139	\$ 3,415	\$ 2,591	\$ 21,541	\$ 7,128	\$ 6,561	\$ 7,852	\$ 403		\$ 109,630
Ending balance: individually evaluated for impairment	\$ 5,328	\$ 412	\$ -	\$ 4,347	\$ 1,318	\$ 862	\$ 399	\$ -		\$ 12,666
Ending balance: collectively evaluated for impairment	\$ 54,811	\$ 3,003	\$ 2,591	\$ 17,194	\$ 5,810	\$ 5,699	\$ 7,453	\$ 403		\$ 96,964

Hometown Bancorp, Inc.

Notes to Consolidated Financial Statements

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, 2015. 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, 2015, nonaccrual loans totaling \$1.3 million were in the process of foreclosure.

The following table represents nonaccrual loans by classes of the loan portfolio as of December 31, 2015 and 2014.

(Dollars in thousands)	December 31,	
	2015	2014
Nonaccrual loans:		
Residential mortgage	\$ 1,476	\$ 2,737
Construction	408	412
Commercial real estate	36	62
Land	1,923	1,284
Commercial	573	936
Home equity loans and credit lines	266	298
Total nonaccrual loans	<u>4,682</u>	<u>5,729</u>
Total nonaccrual loans to total loans	4.35%	5.23%
Total nonaccrual loans to total assets	3.91%	4.58%

Interest not recognized on nonaccrual loans was \$356,000 and \$299,000 for the years ended December 31, 2015 and 2014, respectively. There were no loans past due 90 days or more and still accruing interest at December 31, 2015 and 2014.

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, 2015 (In Thousands):

Hometown Bancorp, Inc.

Notes to Consolidated Financial Statements

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	\$ 252	\$ 131	\$ 571	\$ 954	\$ 60,282	\$ 61,236
Construction	-	-	408	408	300	708
Multi-family	-	-	-	-	2,456	2,456
Commercial real estate	1,082	-	36	1,118	23,028	24,146
Land	88	-	1,923	2,011	5,151	7,162
Commercial	14	-	295	309	4,286	4,595
Home equity	9	-	97	106	6,909	7,015
Consumer	-	2	-	2	287	289
Total	\$ 1,445	\$ 133	\$ 3,330	\$ 4,908	\$ 102,699	\$ 107,607

The following table presents the classes of the loan portfolio summarized by the past due status as of December 31, 2014 (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	\$ 503	\$ 401	\$ 1,566	\$ 2,470	\$ 57,669	\$ 60,139
Construction	-	-	412	412	3,003	3,415
Multi-family	-	-	-	-	2,591	2,591
Commercial real estate	1,235	-	61	1,296	20,245	21,541
Land	-	-	428	428	6,700	7,128
Commercial	-	-	616	616	5,945	6,561
Home equity	40	-	240	280	7,572	7,852
Consumer	-	-	-	-	403	403
Total	\$ 1,778	\$ 401	\$ 3,323	\$ 5,502	\$ 104,128	\$ 109,630

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.

Hometown Bancorp, Inc.

Notes to Consolidated Financial Statements

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 and substandard within the Bank's internal risk rating system as of December 31, (In Thousands):

<u>2015</u>	<u>Pass</u>	<u>Special Mention</u>	<u>Substandard</u>	<u>Total</u>
Residential mortgage	\$ 59,412	\$ -	\$ 1,824	\$ 61,236
Construction	300	-	408	708
Multi-family	2,456	-	-	2,456
Commercial real estate	19,758	1,909	2,479	24,146
Land	3,859	-	3,303	7,162
Commercial	3,620	267	708	4,595
Home equity	6,664	-	351	7,015
Consumer	289	-	-	289
Total	\$ 96,358	\$ 2,176	\$ 9,073	\$ 107,607

<u>2014</u>	<u>Pass</u>	<u>Special Mention</u>	<u>Substandard</u>	<u>Total</u>
Residential mortgage	\$ 55,417	\$ 671	\$ 4,051	\$ 60,139
Construction	3,003	-	412	3,415
Multi-family	2,031	560	-	2,591
Commercial real estate	17,015	1,903	2,623	21,541
Land	4,789	76	2,263	7,128
Commercial	5,190	353	1,018	6,561
Home equity	7,363	100	389	7,852
Consumer	403	-	-	403
Total	\$ 95,211	\$ 3,663	\$ 10,756	\$ 109,630

The Bank had no loans classified as Doubtful or Loss at December 31, 2015 and 2014.

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, 2015 and 2014 (In Thousands):

Hometown Bancorp, Inc.

Notes to Consolidated Financial Statements

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

Impaired Loans

	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Interest Income Recognized
December 31, 2015					
With no related allowance recorded:					
Residential mortgage	\$ 3,141	\$ 3,420	\$ -	\$ 3,212	\$ 63
Construction	408	521	-	412	-
Commercial real estate	2,851	2,855	-	2,919	139
Land	1,698	1,890	-	1,538	-
Commercial	531	571	-	521	-
Home equity	328	349	-	314	5
Total	\$ 8,957	\$ 9,606	\$ -	\$ 8,916	\$ 207
With an allowance recorded:					
Residential mortgage	1,346	1,349	99	1,106	37
Commercial real estate	1,360	1,360	250	1,379	47
Land	225	270	207	238	-
Commercial	61	61	3	66	2
Home equity	64	64	27	41	2
Total	\$ 3,056	\$ 3,104	\$ 586	\$ 2,830	\$ 88
Total:					
Residential mortgage	\$ 4,487	\$ 4,769	\$ 99	\$ 4,318	\$ 100
Construction	408	521	-	412	-
Commercial real estate	4,211	4,215	250	4,298	186
Land	1,923	2,160	207	1,776	-
Commercial	592	632	3	587	2
Home equity	392	413	27	355	7
Total	\$ 12,013	\$ 12,710	\$ 586	\$ 11,746	\$ 295
December 31, 2014					
With no related allowance recorded:					
Residential mortgage	\$ 2,742	\$ 3,066	\$ -	\$ 2,171	\$ 46
Construction	412	521	-	456	-
Commercial real estate	2,958	2,958	-	2,942	159
Land	1,318	1,567	-	712	3
Commercial	711	716	-	473	-
Home equity	291	309	-	290	5
Total	\$ 8,432	\$ 9,137	\$ -	\$ 7,044	\$ 213
With an allowance recorded:					
Residential mortgage	2,586	2,613	288	2,124	58
Commercial real estate	1,389	1,389	366	1,011	42
Commercial	151	159	87	144	-
Home equity	108	113	6	94	-
Total	\$ 4,234	\$ 4,274	\$ 747	\$ 3,373	\$ 100
Total:					
Residential mortgage	\$ 5,328	\$ 5,679	\$ 288	\$ 4,295	\$ 104
Construction	412	521	-	456	-
Commercial real estate	4,347	4,347	366	3,953	201
Land	1,318	1,567	-	712	3
Commercial	862	875	87	617	-
Home equity	399	422	6	384	5
Total	\$ 12,666	\$ 13,411	\$ 747	\$ 10,417	\$ 313

Hometown Bancorp, Inc.

Notes to Consolidated Financial Statements

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

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, 2015 and 2014, 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.

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

<u>For the year ended December 31, 2015</u>	<u>Number of Contracts</u>	<u>Pre-Modification Outstanding Recorded Investments</u>	<u>Post-Modification Outstanding Recorded Investments</u>
Residential mortgage	1	\$ 258	\$ 261
Home equity loans and credit lines	2	\$ 120	\$ 142
Commercial	5	\$ 247	\$ 295

<u>For the year ended December 31, 2014</u>	<u>Number of Contracts</u>	<u>Pre-Modification Outstanding Recorded Investments</u>	<u>Post-Modification Outstanding Recorded Investments</u>
Residential mortgage	1	\$ 191	\$ 200
Commercial real estate	1	\$ 522	\$ 522
Home equity loans and credit lines	1	\$ 38	\$ 38
Land	1	\$ 37	\$ 37

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 2015 and 2014.

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, 2015 and 2014, one- to four-family residential mortgage loans serviced for others amounted to approximately \$140.1 million and \$130.3 million, respectively. Advances from borrowers for taxes and insurance related to loans serviced for others amounted to approximately \$1.6 million and \$1.4 million at December 31, 2015 and 2014. 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, 2015 and 2014:

	<u>2015</u>	<u>2014</u>
	<u>(In Thousands)</u>	
Balance, beginning	\$ 696	\$ 763
Capitalized during the year	250	84
Amortization	(117)	(151)
Balance, ending	<u>\$ 829</u>	<u>\$ 696</u>

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

Hometown Bancorp, Inc.

Notes to Consolidated Financial Statements

Note 4 – Other Real Estate Owned

Other real estate owned activity was as follows:

	<u>2015</u>	<u>2014</u>
	(In Thousands)	
Beginning balance	\$ 750	\$ 729
Loans transferred to other real estate owned	-	1,255
Capitalized expenditures	-	-
Direct write-downs	-	(10)
Gain (loss) on sales	124	(122)
Proceeds from sales of other real estate owned	<u>(868)</u>	<u>(1,102)</u>
End of year	<u>\$ 6</u>	<u>\$ 750</u>

At December 31, 2015, the recorded investment of consumer mortgage loans secured by residential real estate properties for which formal foreclosure proceeds are in process is \$919,000.

Expenses related to other real estate owned include:

	<u>2015</u>	<u>2014</u>
	(In Thousands)	
Provision for unrealized losses	\$ -	\$ 10
Operating expenses, net of rental income	<u>78</u>	<u>49</u>
	<u>\$ 78</u>	<u>\$ 59</u>

Note 5 - Premises and Equipment

The components of premises and equipment at December 31, 2015 and 2014 are as follows:

	<u>2015</u>	<u>2014</u>
	(In Thousands)	
Land	\$ 1,801	\$ 1,801
Buildings and leasehold improvements	3,998	3,998
Furniture and equipment	1,013	1,001
Automobiles	<u>32</u>	<u>32</u>
	6,844	6,832
Accumulated depreciation	<u>2,487</u>	<u>2,267</u>
	<u>\$ 4,357</u>	<u>\$ 4,565</u>

Depreciation and amortization expense was \$220,000 and \$236,000 in 2015 and 2014, respectively.

Note 6 - Deposits

Deposits at December 31, 2015 and 2014 consist of the following major classifications:

	<u>2015</u>	<u>2014</u>
	(In Thousands)	
Non-interest bearing demand	\$ 17,045	\$ 17,443
NOW	11,700	11,038
Money market	16,536	18,684
Savings	21,770	21,471
Certificates of deposit	<u>36,294</u>	<u>46,293</u>
	<u>\$ 103,345</u>	<u>\$ 114,929</u>

Hometown Bancorp, Inc.

Notes to Consolidated Financial Statements

Note 6 – Deposits (Continued)

A summary of certificates of deposit by maturity at December 31, 2015 is as follows (In Thousands):

Year ending December 31:	
2016	\$ 31,501
2017	3,593
2018	668
2019	425
2020	107
	<u>36,294</u>

The aggregate amount of certificates of deposit with a minimum denomination of \$250,000 was \$8.0 million and \$7.8 million at December 31, 2015 and 2014, respectively. At December 31, 2015 and 2014, \$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 7).

A summary of interest expense on deposits for the years ended December 31, 2015 and 2014 is as follows:

	<u>2015</u>	<u>2014</u>
	(In Thousands)	
NOW and money market demand	\$ 50	\$ 56
Savings	31	30
Certificates of deposit	186	257
	<u>\$ 267</u>	<u>\$ 343</u>

Note 7 – Federal Home Loan Bank and Other Borrowings

At December 31, 2015, the Bank had borrowings of \$5.8 million at 0.53% due January 1, 2016 and no borrowings at December 31, 2014. 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, 2015, the Bank had pledged residential mortgage loans totaling \$36.7 million. Based on \$5.8 million of outstanding borrowings and a secured \$7.5 million municipal letter of credit, the Bank had unused borrowing capacity with FHLB of approximately \$12.5 million at December 31, 2015.

Note 8 - 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 9 - 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, 2015 and 2014, 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.

Hometown Bancorp, Inc.

Notes to Consolidated Financial Statements

Note 10 - Lease Commitments and Total Rental Expense

The Bank leases two 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, 2015 (In Thousands):

Years ending December 31:	
2016	\$ 46
2017	28
2018	24
	<u>\$ 98</u>

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 both of the years ended December 31, 2015 and 2014 was approximately \$40,000.

Note 11 - Income Taxes

The income tax expense (benefit) consists of the following for the years ended December 31, 2015 and 2014:

	<u>2015</u>	<u>2014</u>
	(In Thousands)	
Federal:		
Current	\$ -	\$ 21
Deferred	-	-
	<u>-</u>	<u>21</u>
State		
Current	(7)	-
Deferred	-	-
	<u>-</u>	<u>-</u>
Income Tax Expense (Benefit)	<u>\$ (7)</u>	<u>\$ 21</u>

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, 2015 and 2014 is as follows:

	<u>2015</u>		<u>2014</u>	
	<u>Amount</u>	<u>% of Pretax Income</u>	<u>Amount</u>	<u>% of Pretax Income</u>
	(Dollars in Thousands)			
Federal income tax at statutory rate	\$ 66	34.0 %	\$ (981)	(34.0) %
State income taxes, net of federal tax benefit	(5)	(2.6)	-	-
Tax-exempt interest and other permanent differences	(29)	(14.9)	(20)	(0.7)
Valuation allowance for federal net deferred tax assets	(44)	(22.7)	1,072	37.1
Other	5	2.6	(50)	(1.7)
	<u>\$ (7)</u>	<u>(3.6) %</u>	<u>\$ 21</u>	<u>0.7 %</u>

Hometown Bancorp, Inc.

Notes to Consolidated Financial Statements

Note 11 - Income Taxes (Continued)

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

	December 31,	
	2015	2014
	(In Thousands)	
Deferred tax assets:		
Allowance for loan losses	\$ 795	\$ 1,010
Directors' retirement plan	135	137
Nonaccrual interest	136	116
Net operating losses	3,875	3,721
Other	1	-
	<u>4,942</u>	<u>4,984</u>
Deferred tax liabilities:		
Premises and equipment	123	165
Mortgage servicing rights	317	269
Other	-	4
	<u>440</u>	<u>438</u>
Valuation allowance	<u>(4,502)</u>	<u>(4,546)</u>
Net Deferred Tax Asset	<u>\$ -</u>	<u>\$ -</u>

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 operating losses in 2014 and 2013, management assessed the potential realization of the deferred tax assets and recorded a valuation allowance equal to the full amount of the net deferred tax assets at both December 31, 2015 and 2014.

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, 2015, 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, 2015.

The Company has net operating loss carry forwards for Federal income tax purposes of approximately \$9.7 million which begin to expire in 2033. In addition, the Company has net operating loss carry forwards for New York State income tax purposes of approximately \$12.1 million which will begin to expire in 2031.

Hometown Bancorp, Inc.

Notes to Consolidated Financial Statements

Note 12 - 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 2015 and 2014, the Board of Directors did not approve any matching or additional contributions.

Employee Stock Ownership Plan ("ESOP")

In June 2007, the Bank established an ESOP which acquired 93,315 shares of the Company's common stock 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 \$7,000 and \$8,000 of compensation expense related to this plan for the years ended December 31, 2015 and 2014. At December 31, 2015, there were 51,321 shares not yet released having an aggregate market value of approximately \$77,000. 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, 2015 and 2014 measurement date, activity in the plan and the amounts recognized in the accompanying consolidated financial statements follows:

	Year Ended December 31, 2015	Year Ended December 31, 2014
	(In Thousands)	
Change in projected benefit obligation:		
Projected benefit obligation at beginning of year	\$ 354	\$ 339
Service cost	2	1
Interest cost	14	16
Gains	(17)	(2)
Projected benefit obligation at end of year	<u>\$ 353</u>	<u>\$ 354</u>

The discount rate used to determine the projected benefit obligation at December 31, 2015 and 2014 was 4.25% and 4.00%, respectively. The projected benefit obligation is recorded in the other liabilities in the consolidated balance sheets.

Hometown Bancorp, Inc.

Notes to Consolidated Financial Statements

Note 12 - Employee Benefit Plans (Continued)

Directors' Retirement Plan (Continued)

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

	<u>2015</u>	<u>2014</u>
Service cost	\$ 2	\$ 1
Interest cost	14	16
Net periodic pension expense	<u>\$ 16</u>	<u>\$ 17</u>

Discount rates of 4.00% and 4.75% were used to determine net periodic pension expense for the years ended December 31, 2015 and 2014, respectively.

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

<u>Years ending December 31,</u>	
2016	\$ 22
2017	43
2018	43
2019	43
2020	42
2021 - 2025	212

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 13 - 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 \$509,000 and \$888,000 at December 31, 2015 and 2014, respectively. During 2015, there were no new loans requested and approximately \$78,000 of repayments were made. Included at December 31, 2014, were loans totaling \$105,000 from a director that retired January 1, 2015 and \$196,000 from an officer that left employment during 2015.

Deposits from related parties held by the Bank at December 31, 2015 and 2014 amounted to approximately \$316,000 and \$379,000, respectively.

Note 14 - 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.

Hometown Bancorp, Inc.

Notes to Consolidated Financial Statements

Note 14 - Off-Balance Sheet Risk (Continued)

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, 2015 and 2014 is as follows:

	<u>2015</u>	<u>2014</u>
	(In Thousands)	
Commitments to grant loans	\$ 1,089	\$ 2,304
Unfunded commitments under lines of credit	8,598	7,428
Letters of credit	<u>1,044</u>	<u>1,026</u>
	<u>\$ 10,731</u>	<u>\$ 10,758</u>

Fixed rate commitments to grant loans amounted to approximately \$648,000 at December 31, 2015, and had interest rates that ranged from 3.50% 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, 2015 and 2014 for guarantees under standby letters of credit issued is not material.

Note 15 - 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 \$463,000 and \$493,000 at December 31, 2015 and 2014, respectively.

Banks, savings banks, bank holding companies and savings and loan holding companies are subject to regulatory capital requirements administered by federal banking agencies. Capital adequacy guidelines and, additionally for banks, prompt corrective action regulations, involve quantitative measures of assets, liabilities, and certain off-balance-sheet items calculated under regulatory accounting practices. Capital amounts and classification are also subject to qualitative judgments by the regulators. Failure to meet capital requirements can initiate regulatory action. The final rules implementing Basel Committee on Banking Supervision's capital guidelines for U.S. banks (Basel III rules) became effective for the Bank on January 1, 2015 with full compliance with all of the requirements being phased in over a multi-year schedule, and fully phased in by January 1, 2019. The net unrealized gain or loss on available for sale securities is not included in computing regulatory capital. Capital amounts and ratios for December 31, 2014 are calculated using Basel I rules.

Prompt corrective action regulations provide five classification: well capitalized, adequately capitalized, undercapitalized, significantly undercapitalized and critically undercapitalized, although these terms are not used to represent overall financial condition. If adequately capitalized, regulatory approval is required to accept brokered deposits. If undercapitalized, capital

Hometown Bancorp, Inc.

Notes to Consolidated Financial Statements

Note 15 - Regulatory Matters (Continued)

distributions are limited, as is asset growth and expansion, and capital restoration plans are required. At year-end 2015 and 2014, the most recent regulatory notifications categorized the Bank as adequately capitalized under the regulatory framework for prompt corrective action.

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, 2015:						
Tier 1 leverage	\$ 7,271	6.12 %	\$ ≥4,754	≥4.0 %	\$ ≥5,942	≥ 5.0 %
Common equity Tier 1 risk-based	7,271	7.86	\$ ≥4,164	≥4.5	\$ ≥6,015	≥ 6.5
Tier 1 risk-based	7,271	7.86	≥5,552	≥6.0	≥7,403	≥ 8.0
Total risk-based	8,441	9.12	≥7,403	≥8.0	≥9,253	≥10.0
As of December 31, 2014:						
Tier 1 leverage	\$ 6,969	5.60 %	\$ ≥4,977	≥4.0 %	\$ ≥6,222	≥ 5.0 %
Tier 1 risk-based	6,969	7.57	≥3,680	≥4.0	≥5,520	≥ 6.0
Total risk-based	8,138	8.84	≥7,361	≥8.0	≥9,201	≥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.

On February 22, 2016, the Bank entered into an Amended Formal Written Agreement with the OCC. All requirements of the March 7, 2013 Agreement remain in effect without modification except that by June 30, 2016, the Bank has agreed to achieve higher capital minimums. The capital minimums are: common equity tier 1 capital ratio at least equal to 9%, total capital ratio at least equal to 13%, tier 1 capital ratio at least equal to 11% and tier 1 leverage capital ratio at least equal to 9%.

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 (the “Holding Companies”) 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 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 Holding Companies 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

Hometown Bancorp, Inc.

Notes to Consolidated Financial Statements

Note 15 - Regulatory Matters (Continued)

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.

As outlined above, the Bank's regulators have required 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 the increased capital requirements or other aspects of 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 16 - 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, 2015 and 2014 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, 2015 are as follows:

Description	Carrying Amount	(Level 1)	(Level 2)	(Level 3)
		Quoted Prices in Active Markets for Identical Assets	Significant Other Observable Inputs	Significant Unobservable Inputs
(In Thousands)				
U. S. Government agency securities	\$ 1,742	\$ -	\$ 1,742	\$ -
Municipal securities	\$ 557	\$ -	\$ 557	\$ -
Residential mortgage-backed securities	\$ 263	\$ -	\$ 263	\$ -
Forward sales contract	\$ 22	\$ -	\$ 22	\$ -

Hometown Bancorp, Inc.

Notes to Consolidated Financial Statements

Note 16 - Fair Value of Financial Instruments (Continued)

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, 2014 are as follows:

Description	Carrying Amount	(Level 1)	(Level 2)	(Level 3)
		Quoted Prices in Active Markets for Identical Assets	Significant Other Observable Inputs	Significant Unobservable Inputs
(In Thousands)				
U. S. Government agency securities	\$ 2,747	\$ -	\$ 2,747	\$ -
Municipal securities	\$ 569	\$ -	\$ 569	\$ -
Residential mortgage-backed securities	\$ 361	\$ -	\$ 361	\$ -
Forward sales contract	\$ 4	\$ -	\$ 4	\$ -

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, 2015 are as follows:

Description	Carrying Amount	(Level 1)	(Level 2)	(Level 3)
		Quoted Prices in Active Markets for Identical Assets	Significant Other Observable Inputs	Significant Unobservable Inputs
(In Thousands)				
Impaired loans	\$ 1,270	\$ -	\$ -	\$ 1,270

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, 2014 are as follows:

Description	Carrying Amount	(Level 1)	(Level 2)	(Level 3)
		Quoted Prices in Active Markets for Identical Assets	Significant Other Observable Inputs	Significant Unobservable Inputs
(In Thousands)				
Impaired loans	\$ 1,089	\$ -	\$ -	\$ 1,089

Hometown Bancorp, Inc.

Notes to Consolidated Financial Statements

Note 16 - Fair Value of Financial Instruments (Continued)

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, 2015 and 2014 are as follows:

<u>December 31, 2015</u>	<u>Valuation Technique</u>	<u>Unobservable Input</u>	<u>Range</u>
Impaired loans	Appraisal of collateral	Management appraisal adjustments and estimated costs to sell	10.0% - 20.0%

<u>December 31, 2014</u>	<u>Valuation Technique</u>	<u>Unobservable Input</u>	<u>Range</u>
Impaired loans	Appraisal of collateral	Management appraisal adjustments and estimated costs to sell	10.0% - 30.0%

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 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.

Impairment charges on loans related to the above nonrecurring fair value measurements, included in the provision for loan losses, amounted to \$205,000 for the year ended December 31, 2015. For the year ended December 31, 2014, there was \$268,000 included in the provision for loan losses for impaired loans.

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

Cash and Cash Equivalents and Certificates of Deposit

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

Notes to Consolidated Financial Statements

Note 16 - Fair Value of Financial Instruments (Continued)

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.

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.

Hometown Bancorp, Inc.

Notes to Consolidated Financial Statements

Note 16 - Fair Value of Financial Instruments (Continued)

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

Fair Value Hierarchy	December 31,				
	2015		2014		
	Carrying Amount	Fair Value	Carrying Amount	Fair Value	
(In Thousands)					
Financial assets:					
Cash and cash equivalents	1	\$ 2,957	\$ 2,957	\$ 4,817	\$ 4,817
Certificates of deposit	1	25	25	278	278
Securities available for sale	2	2,562	2,562	3,677	3,677
Securities held to maturity	2	31	31	37	38
Loans held for sale	2	645	645	375	375
Loans receivable, net	3	105,537	106,318	107,116	108,275
Restricted investments in bank stocks	2	627	627	390	390
Accrued interest receivable	1	351	351	372	372
Mortgage servicing rights	2	829	1,023	696	925
Financial liabilities:					
Non-interest bearing demand accounts	1	17,045	17,045	17,443	17,443
NOW accounts	1	11,700	11,700	11,038	11,038
Money market accounts	1	16,536	16,536	18,684	18,684
Savings accounts	1	21,770	21,770	21,471	21,471
Certificates of deposit	2	36,294	36,343	46,293	46,381
Accrued interest payable	1	1	1	2	2

Note 17 – Subsequent Events

The Company has evaluated subsequent events through March 30, 2016, the date that the consolidated financial statements were available to be issued.

Hometown Bancorp, Inc.

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 18, 2016 at 4:00 pm 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:

Computershare, Inc.
P.O. Box 30170
College Station, TX 77842
(800) 368-5948

Regulatory Counsel

Luse Gorman, P.C.
5335 Wisconsin Avenue, N.W. Suite 780
Washington, DC 20015

Independent Accounting Firm

Bonadio & Co., LLP
432 N. Franklin Street, Suite 60
Syracuse, NY 13204

Market Information for Common Stock

The common stock of Hometown Bancorp, Inc. is quoted on the OTC Pink under the symbol "HTWC." At December 31, 2015, there were approximately 245 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, DiGiovanni & Weddell, LLP, CPAs.

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

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

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

Ian J. Green: President of Pendragon Capital Management Inc., CEO of BrokerageSelect and CPA.

Officers

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

Michael Shaughnessy: Senior Vice President and Chief Credit Officer

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

Amy Sherwood: Vice President and Compliance Officer and Corporate Secretary



Hometown Bancorp, Inc.

12 Main Street
Walden, New York 12586
(845) 778-2171
