

Section 1: 10-K (FORM 10-K)

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-K

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

For the fiscal year ended December 31, 2018

OR

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

For the transition period from _____ to _____

Commission File Number: 001-37831

FSB BANCORP, INC.

(Exact name of registrant as specified in its charter)

Maryland
(State or other jurisdiction of
incorporation or organization)

81-2509654
(I.R.S. Employer
Identification No.)

45 South Main Street, Fairport, New York
(Address of principal executive offices)

14450
(Zip Code)

(585) 381-4040

(Registrant's telephone number, including area code)

Securities registered pursuant to Section 12(b) of the Act:

(Title of each class)

Common Stock, \$0.01 par value

(Name of each exchange on which registered)

The Nasdaq Stock Market, LLC

Securities registered pursuant to Section 12(g) of the Act: None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes No

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

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit such files). Yes No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

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

Large accelerated filer
Non-accelerated filer

Accelerated filer

Smaller reporting company
Emerging growth company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

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

The aggregate market value of the voting and non-voting common equity held by non-affiliates of the registrant, computed by reference to the closing price of the common stock on June 30, 2018, was \$31.4 million.

As of March 26, 2019, there were 1,940,661 outstanding shares of the registrant's common stock.

DOCUMENTS INCORPORATED BY REFERENCE

2018 Annual Report to Stockholders (Part II)
Proxy Statement for the 2019 Annual Meeting of Stockholders (Part III).

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PART I

ITEM 1. BUSINESS

Forward Looking Statements

This Annual Report on Form 10-K contains forward-looking statements, which can be identified by the use of words such as “estimate,” “project,” “believe,” “intend,” “anticipate,” “plan,” “seek,” “expect,” “will,” “would,” “should,” “could” or “may,” and words of similar meaning. These forward-looking statements include, but are not limited to:

- statements of our goals, intentions and expectations;
- statements regarding our business plans, prospects, growth and operating strategies;
- statements regarding the quality of our loan and investment portfolios; and
- estimates of our risks and future costs and benefits.

These forward-looking statements are based on current beliefs and expectations of FSB Bancorp, Inc.’s management and are inherently subject to significant business, economic and competitive uncertainties and contingencies, many of which are beyond our control. In addition, these forward-looking statements are subject to assumptions with respect to future business strategies and decisions that are subject to change.

The following factors, among others, could cause actual results to differ materially from the anticipated results or other expectations expressed in the forward-looking statements:

- general economic conditions, either nationally or in our market areas, that are worse than expected;
- changes in the level and direction of loan delinquencies and write-offs and changes in estimates of the adequacy of the allowance for loan losses;
- our ability to access cost-effective funding;
- fluctuations in real estate values and both residential and commercial real estate market conditions;
- demand for loans and deposits in our market area;
- our ability to implement and change our business strategies;
- competition among depository and other financial institutions;
- inflation and changes in the interest rate environment that reduce our margins and yields, our mortgage banking revenues, the fair value of financial instruments or our level of loan originations, or increase the level of defaults, losses and prepayments on loans we have made and make;
- adverse changes in the securities or secondary mortgage markets;
- changes in laws or government regulations or policies affecting financial institutions, including changes in regulatory fees and capital requirements, including as a result of Basel III;
- the impact of the Dodd-Frank Act and the implementing regulations;

- changes in the quality or composition of our loan or investment portfolios;
- technological changes that may be more difficult or expensive than expected;
- the inability of third party providers to perform as expected;
- our ability to manage market risk, credit risk and operational risk in the current economic environment;
- our ability to enter new markets successfully and capitalize on growth opportunities;
- our ability to successfully integrate into our operations any assets, liabilities, customers, systems and management personnel we may acquire and our ability to realize related revenue synergies and cost savings within expected time frames and any goodwill charges related thereto;
- changes in consumer spending, borrowing and savings habits;
- changes in accounting policies and practices, as may be adopted by the bank regulatory agencies, the Financial Accounting Standards Board, the Securities and Exchange Commission or the Public Company Accounting Oversight Board;
- our ability to retain key employees;
- our compensation expense associated with equity allocated or awarded to our employees; and
- changes in the financial condition, results of operations or future prospects of issuers of securities that we own.

Because of these and other uncertainties, our actual future results may be materially different from the results indicated by these forward-looking statements. Except as required by applicable law or regulation, we do not undertake, and we specifically disclaim any obligation, to release publicly the results of any revisions that may be made to any forward-looking statements to reflect events or circumstances after the date of the statements or to reflect the occurrence of anticipated or unanticipated events.

FSB Bancorp, Inc.

FSB Bancorp, Inc. (“FSB Bancorp” or the “Company”) is a Maryland corporation. The Company owns all of the outstanding shares of common stock of Fairport Savings Bank (the “Bank”), its banking subsidiary. At December 31, 2018, the Company had consolidated assets of \$328.3 million, total deposits of \$222.6 million, and stockholders’ equity of \$31.5 million. FSB Bancorp’s common stock is traded on the Nasdaq Capital Market under the symbol “FSBC.” The Company is subject to the supervision and regulation of the Board of Governors of the Federal Reserve System (the “Federal Reserve Board”).

On July 13, 2016, FSB Bancorp completed its second step conversion from the mutual-holding company structure to the stock-holding company structure, including a related public offering of common stock, and is now fully publicly owned. The Company sold 1,034,649 shares of common stock at \$10.00 per share and raised gross proceeds of approximately \$10.3 million in its stock offering. Additionally, in connection with the conversion, the Bank revoked its election for its holding company to be regulated as a savings and loan holding company pursuant to Section 10(1) of the Home Owners Loan Act. Consequently, the Company is regulated as a bank holding company under the Bank Holding Company Act of 1956.

Concurrent with the completion of the conversion and reorganization, shares of common stock of the Company’s predecessor, FSB Community Bankshares, Inc. (“FSB Community”) owned by public stockholders were exchanged for shares of FSB Bancorp’s common stock, so that the former public stockholders of FSB Community owned approximately the same percentage of FSB Bancorp’s common stock as they owned of FSB Community’s common stock immediately prior to the conversion. Stockholders of FSB Community received 1.0884 shares of FSB Bancorp common stock for each share of FSB Community’s stock they owned immediately prior to completion of the transaction. All financial information presented in this Annual Report on Form 10-K for periods before July 13, 2016 relates to the Company’s predecessor, FSB Community.

The Company's principal office is located at 45 South Main Street, Fairport, New York, 14450. Our website address is www.fairportsavingsbank.com. Our Annual Report on Form 10-K is available on our website under the "About Us" and "Investor Relations" tabs. Information on this website is not and should not be considered part of this Annual Report on Form 10-K.

Fairport Savings Bank

Fairport Savings Bank is a New York-chartered savings bank established in 1888 and headquartered in Fairport, New York. The Bank conducts business from its main office in Fairport and through four branch offices located in Penfield, Irondequoit, Webster and Perinton, New York, all of which are located in the greater Rochester metropolitan area. Fairport Savings Bank also operates loan origination offices in Pittsford and Greece, New York, in the Rochester metropolitan area, as well as in Buffalo and Watertown, New York. Fairport Savings Bank is subject to regulation and supervision by the New York State Department of Financial Services and the Federal Deposit Insurance Corporation.

The Bank's principal business consists of originating one- to four-family residential real estate mortgage loans and home equity lines of credit, and to a lesser but increasing extent, commercial real estate, multi-family and construction loans. We also offer commercial and industrial loans and other consumer loans. In 2017, we hired a Chief Lending Officer to manage and oversee the growth of our loan portfolio and supervise credit administration to continue to maintain our high asset quality. Our principal source of funds are the retail deposit products we offer to the general public in the areas surrounding our branch offices. We also utilize borrowings as a source of funds. Our revenues are derived primarily from interest on loans and, to a lesser extent, interest on investment and municipal securities and mortgage-backed securities. We also generate revenues from other income, including realized gains on sales of loans associated with loan production generated from our loan origination offices, deposit fees and service charges, realized gains on sales of securities, earnings on bank owned life insurance and loan fees. Additionally, we derive a portion of our other income through Fairport Wealth Management, our subsidiary that offers non-deposit investments such as annuities, insurance products and mutual funds as well as asset management.

Market Area

Our market area primarily consists of Monroe County, New York, and to a lesser extent, the surrounding counties in Western New York. Monroe County is a suburban market dominated by the city of Rochester, the third largest city in the State of New York. In 2017, Monroe County had a population of 748,000. The Monroe County economy is largely dependent on several large manufacturing companies, as well as sizeable higher education and health care facilities centered in Rochester. The University of Rochester and Strong Memorial Hospital were two of the largest employers in the Rochester area in 2018. Rochester is also home to a number of international businesses, including Bausch & Lomb and Paychex. Additionally, Xerox, while no longer headquartered in Rochester, has its principal offices and manufacturing facilities in Monroe County. As of December 2018, the unemployment rate for Monroe County was 3.8%, as compared to a 3.9% rate for the State of New York and the national average of 3.9%.

Competition

We face intense competition in our market area both in making loans and attracting deposits. Our market area has a high concentration of financial institutions, including large money center and regional banks, community banks and credit unions. We face additional competition for deposits from money market funds, brokerage firms, mutual funds and insurance companies. Most of our competitors are significantly larger institutions with greater financial and managerial resources and higher lending limits. Additionally, some of our competitors offer products and services that we currently do not offer, such as trust services and private banking. Our primary strategy for increasing and retaining our customer base is to offer competitive deposit and loan rates and product features, delivered with superior customer service.

The majority of our depositors live or work in Monroe County, New York. At June 30, 2018, the latest date for which information is available through the Federal Deposit Insurance Corporation, we held approximately 1.57% of the bank deposits in Monroe County.

Lending Activities

Our principal lending activity is the origination of one- to four-family residential real estate mortgages, home equity lines of credit and to a lesser extent, originations of commercial real estate, multi-family, construction, commercial and industrial, and other consumer loans (consisting of passbook, overdraft protection and unsecured loans). More recently, we have sought to increase our commercial real estate and commercial and industrial lending. At December 31, 2018, one- to four-family residential real estate mortgage loans totaled \$221.6 million, or 78.2% of our loan portfolio, home equity lines of credit totaled \$16.8 million, or 5.9% of our loan portfolio, commercial real estate and multi-family loans totaled \$32.7 million, or 11.5%, of our loan portfolio, construction loans totaled \$4.9 million, or 1.7%, of our loan portfolio, commercial and industrial loans totaled \$7.3 million, or 2.6%, of our loan portfolio, and all other loans totaled \$50,000, or 0.1% of our loan portfolio.

Our strategic plan continues to focus on residential real estate lending in addition to a greater emphasis being placed on increasing our commercial lending. We generally retain in our portfolio adjustable-rate or shorter-term fixed-rate residential real estate mortgage loans. Loans that we sell into the secondary market consist of long-term (a term 15 years or longer), conforming fixed-rate residential real estate mortgage loans and correspondent FHA, VA, and USDA mortgage loans. These loans are sold without recourse. We retain the servicing rights on all conforming fixed-rate residential mortgage loans that we sell to Freddie Mac. However, we also sell conforming fixed-rate residential mortgage loans servicing released to other secondary market investors. Correspondent FHA, VA, and USDA mortgage loans are sold in the secondary market on a servicing-released basis. During the year ended December 31, 2018, we sold \$59.9 million in long-term, fixed-rate one- to four family real estate loans in the secondary market. At December 31, 2018, we were servicing \$123.8 million of loans sold to others. For the year ended December 31, 2018, we realized a gain of \$1.4 million on the sale of loans, and we received servicing fees of \$325,000. We may experience declines in the residential mortgage loan portfolio during 2019 if interest rates increase.

As a community bank, we are increasing our focus on commercial lending efforts to the small to medium sized business market targeting borrowers with desired loan balances of between \$250,000 and \$1.0 million. Our loan products include commercial real estate, multi-family, commercial construction and commercial and industrial loans. We are an approved Small Business Administration (“SBA”) lender. As part of the commercial loan strategy, we will seek to use our commercial relationships to grow our commercial transactional deposit accounts.

Loan Portfolio Composition. The following table sets forth the composition of our loan portfolio, by type of loan at the dates indicated, excluding loans held for sale.

	At December 31,									
	2018		2017		2016		2015		2014	
	Amount	Percent	Amount	Percent	Amount	Percent	Amount	Percent	Amount	Percent
	(Dollars in thousands)									
Real estate loans:										
One- to four-family residential										
(1)	\$ 221,602	78.21%	\$ 206,894	78.38%	\$ 188,573	83.04%	\$ 177,037	87.47%	\$ 169,323	89.50%
Home equity lines of credit	16,766	5.92	17,127	6.49	16,797	7.40	14,523	7.18	13,378	7.07
Multi-family residential	10,241	3.61	10,650	4.03	5,103	2.25	5,146	2.54	3,819	2.02
Construction (2)	4,898	1.73	10,750	4.07	6,134	2.70	1,251	0.62	1,106	0.58
Commercial	22,492	7.94	14,803	5.61	8,440	3.72	3,522	1.74	1,427	0.75
Commercial and industrial loans	7,290	2.57	3,679	1.39	1,947	0.86	853	0.42	100	0.05
Other loans	50	0.02	70	0.03	75	0.03	61	0.03	65	0.03
Total loans receivable	283,339	100.00%	263,973	100.00%	227,069	100.00%	202,393	100.00%	189,218	100.00%
Deferred loan origination (fees) costs	(37)		(1)		113		248		265	
Allowance for loan losses	(1,561)		(1,261)		(990)		(811)		(653)	
Total loans receivable, net	<u>\$ 281,741</u>		<u>\$ 262,711</u>		<u>\$ 226,192</u>		<u>\$ 201,830</u>		<u>\$ 188,830</u>	

(1) Includes \$2.7 million, \$1.6 million, \$1.5 million, \$1.8 million, and \$2.0 million of closed-end home equity loans at December 31, 2018, 2017, 2016, 2015, and 2014.

(2) Represents amounts disbursed at December 31, 2018, 2017, 2016, 2015, and 2014. The undrawn amounts of the construction loans totaled \$4.4 million, \$5.9 million, \$5.0 million, \$1.3 million, and \$1.1 million at December 31, 2018, 2017, 2016, 2015, and 2014, respectively.

Loan Portfolio Maturities. The following table summarizes the scheduled repayments of our loan portfolio at December 31, 2018. Demand loans, loans having no stated repayment schedule or maturity, and overdraft loans are reported as being due in the year ending December 31, 2019. Maturities are based on the final contractual payment date and do not reflect the impact of prepayments and scheduled principal amortization.

	One- to Four-Family Residential Real Estate Loans	Home Equity Lines of Credit	Multi- Family Residential Real Estate Loans	Construction Loans	Commercial Real Estate Loans	Commercial & Industrial Loans	Other Loans	Total
	(Dollars in thousands)							
Due During the Years								
Ending December 31,								
2019	\$ 161	\$ 1,023	\$ -	\$ 1,258	\$ -	\$ 1,959	\$ 1	\$ 4,402
2020	191	-	-	-	275	211	3	680
2021	472	46	-	-	-	272	15	805
2022 to 2023	2,622	126	-	-	-	3,584	7	6,339
2024 to 2028	24,243	165	7,712	-	16,815	1,264	-	50,199
2029 to 2033	23,765	719	1,682	282	709	-	4	27,161
2034 and beyond	170,148	14,687	847	3,358	4,693	-	20	193,753
Total	\$ 221,602	\$ 16,766	\$ 10,241	\$ 4,898	\$ 22,492	\$ 7,290	\$ 50	\$283,339

The following table sets forth the scheduled repayments of fixed- and adjustable-rate loans at December 31, 2018 that are contractually due after December 31, 2019.

	Due After December 31, 2019		
	Fixed	Adjustable	Total
	(Dollars in thousands)		
Real estate loans:			
One- to four-family residential	\$ 218,250	\$ 3,191	\$ 221,441
Home equity lines of credit	-	15,743	15,743
Multi-family residential	2,529	7,712	10,241
Construction	3,204	436	3,640
Commercial	2,373	20,119	22,492
Commercial and industrial loans	2,726	2,605	5,331
Other loans	49	-	49
Total	\$ 229,131	\$ 49,806	\$ 278,937

One- to Four-Family Residential Real Estate Mortgage Loans. Our primary lending activity is the origination of one- to four-family residential real estate mortgage loans. At December 31, 2018, \$221.6 million, or 78.2% of our total loan portfolio, consisted of one- to four-family residential real estate mortgage loans. We offer conforming and non-conforming, fixed-rate and adjustable-rate residential real estate mortgage loans with maturities of up to 30 years and maximum loan amounts generally of up to \$1.5 million. Our adjustable-rate mortgage loans provide an initial fixed interest rate for three, five, seven, or ten years and then adjust annually thereafter and amortize over a period of up to 30 years. We originate fixed-rate mortgage loans with terms of less than 15 years, but at interest rates applicable to our 15-year loans.

One- to four-family residential real estate mortgage loans are generally underwritten according to Freddie Mac guidelines, and we refer to loans that conform to such guidelines as “conforming loans.” We generally originate both fixed-rate and adjustable-rate mortgage loans in amounts up to the maximum conforming loan limits as established by the Office of Federal Housing Enterprise Oversight, which at December 31, 2018 was \$453,100 for single-family homes in our market area. We also originate loans above the lending limit for conforming loans, commonly referred to as “jumbo loans.” At December 31, 2018, we had \$33.1 million in jumbo loans. We generally underwrite jumbo loans, which are not uncommon in our market area, in a manner similar to conforming loans. For first mortgage loans with loan-to-value ratios in excess of 80% we require private mortgage insurance. We do not have any loans in our loan portfolio that are considered sub-prime or Alt-A.

We currently offer several adjustable-rate mortgage loans secured by residential properties with interest rates that are fixed for an initial period ranging from one year to ten years. After the initial fixed period, the interest rate on adjustable-rate mortgage loans is generally reset every year based upon a contractual spread or margin above the average yield on U.S. Treasury securities, adjusted to a constant maturity of one year, as published weekly by the Federal Reserve Board, subject to periodic and lifetime limitations on interest rate changes. All of our traditional adjustable-rate mortgage loans with initial fixed-rate periods of one, three, five, seven, and ten years have initial and periodic caps of two percentage points on interest rate changes, with a cap of six percentage points for the life of the loan. Many of the borrowers who select these loans have shorter-term credit needs than those who select long-term, fixed-rate mortgage loans. We do not offer “Option ARM” loans, where borrowers can pay less than the interest owed on their loan, resulting in an increased principal balance during the life of the loan. At December 31, 2018, we had \$25.3 million in adjustable-rate one- to four-family residential real estate mortgage loans. Adjustable-rate mortgage loans generally present different credit risks than fixed-rate mortgage loans primarily because the underlying debt service payments of the borrowers increase as interest rates increase, thereby increasing the potential for default.

We require title insurance on all of our one- to four-family residential real estate mortgage loans, and we also require that borrowers maintain fire and extended coverage casualty insurance (and, if appropriate, flood insurance) in an amount at least equal to the lesser of the loan balance or the replacement cost of the improvements. For fixed-rate mortgage loans with terms of 15 years or less, we will accept an attorney’s letter in lieu of title insurance. A majority of our residential real estate mortgage loans have a mortgage escrow account from which disbursements are made for real estate taxes and flood insurance. We do not conduct environmental testing on residential real estate mortgage loans unless specific concerns for hazards are identified by the appraiser used in connection with the origination of the loan. If we identify an environmental problem on land that will secure a loan, the environmental hazard must be remediated before the closing of the loan.

Home Equity Lines of Credit. We offer home equity lines of credit, which are primarily secured by a second mortgage on single family residences. At December 31, 2018, home equity lines of credit totaled \$16.8 million, or 5.9% of total loans receivable. At that date we had an additional \$17.3 million of undisbursed home equity lines of credit. We offer an “interest only” period, where the borrower pays interest for an initial period (ten years), after which the loan converts to a fully amortizing loan with a term of 15 years.

The underwriting standards for home equity lines of credit include a determination of the applicant’s credit history, an assessment of the applicant’s ability to meet existing obligations and payments on the proposed loan and the value of the collateral securing the loan. The combined loan-to-value ratio (first and second mortgage liens) for home equity lines of credit is generally limited to 85%, or 90% if Fairport Savings Bank holds the first mortgage. We originate our home equity lines of credit without application fees or borrower-paid closing costs. Our home equity lines of credit are offered with adjustable-rates of interest indexed to the Prime Rate, as reported in *The Wall Street Journal*.

Multi-Family Residential and Commercial Real Estate Loans. Loans secured by multi-family real estate totaled \$10.2 million, or 3.6%, of the total loan portfolio at December 31, 2018. Multi-family residential loans generally are secured by rental properties. All multi-family residential loans are secured by properties located within our lending area. At December 31, 2018, we had 28 multi-family loans with an average principal balance of \$366,000, and the largest multi-family real estate loan had a principal balance of \$1.5 million. At December 31, 2018, all of our loans secured by multi-family real estate were performing in accordance with their terms. Multi-family real estate loans are offered with fixed or adjustable interest rates. Adjustable-rate multi-family real estate loans are tied to the average yield on U.S. Treasury securities, subject to periodic and lifetime limitations on interest rate changes.

At December 31, 2018, \$22.5 million, or 7.9% of our total loan portfolio, consisted of commercial real estate loans. Commercial real estate loans are secured by office, mixed use, retail, and other commercial properties. We generally originate adjustable-rate commercial real estate loans with maximum terms of up to 10 years. Adjustable-rate commercial real estate loans are tied to the five-year Federal Home Loan Bank advance rate plus a margin, subject to periodic and lifetime limitations on interest rate changes. The maximum loan-to-value ratio of commercial real estate loans is 80%. At December 31, 2018, we had 40 commercial real estate loans with an average principal balance of \$562,000. At December 31, 2018, our largest loan secured by commercial real estate consisted of a \$3.7 million loan secured by non-owner occupied office buildings. At December 31, 2018, all of our loans secured by commercial real estate were performing in accordance with their terms.

We consider a number of factors in originating multi-family real estate and commercial real estate loans. We evaluate the qualifications and financial condition of the borrower (including credit history), profitability and expertise, as well as the value and condition of the mortgaged property securing the loan. When evaluating the qualifications of the borrower, we consider the financial resources of the borrower, the borrower’s experience in owning or managing similar property and the borrower’s payment history with us and other financial institutions. In evaluating the property securing the loan, the factors we consider include the net operating income of the mortgaged property before debt service and depreciation, the debt service coverage ratio (the ratio of net operating income to debt service) to ensure that it is at least 120% of the monthly debt service and the ratio of the loan amount to the appraised value of the mortgaged property. Multi-family real estate loans and commercial real estate loans are originated in amounts up to 80% of the appraised value of the mortgaged property securing the loan. All multi-family and commercial real estate loans are appraised by outside independent appraisers approved by the Board of Directors. Personal guarantees are generally obtained from commercial real estate borrowers.

Loans secured by multi-family real estate generally involve a greater degree of credit risk than one- to four-family residential mortgage loans and carry larger loan balances. This increased credit risk is a result of several factors, including the concentration of principal in a limited number of loans and borrowers, the effects of general economic conditions on income producing properties, and the increased difficulty of evaluating and monitoring these types of loans. Furthermore, the repayment of loans secured by multi-family real estate typically depends upon the successful operation of the real estate property securing the loans. If the cash flow from the project is reduced, the borrower's ability to repay the loan may be impaired.

Loans secured by commercial real estate generally are larger than one- to four-family residential loans and involve greater credit risk. Commercial real estate loans often involve large loan balances to single borrowers or groups of related borrowers. Repayment of these loans depends to a large degree on the results of operations and management of the properties securing the loans or the businesses conducted on such property, 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 these loans makes them more difficult for management to monitor and evaluate.

Construction Loans. We originate construction loans for the purchase of developed lots and for the construction of single-family residences. Construction loans are offered to individuals for the construction of their personal residences by a qualified builder which will convert to a residential mortgage loan following construction (construction/permanent loans). At December 31, 2018, construction loans totaled \$4.9 million, or 1.7% of total loans receivable. At December 31, 2018, the additional unadvanced portion of these construction loans totaled \$4.4 million. We also originate commercial construction loans on a limited basis. Before making a commitment to fund a construction loan, we require an appraisal of the property by an independent licensed appraiser. We generally also review and inspect each property before disbursement of funds during the term of the construction loan.

Construction financing generally involves greater credit risk than long-term financing on improved, owner-occupied real estate. Risk of loss on a construction loan depends largely upon the accuracy of the initial estimate of the value of the property at completion of construction compared to the estimated cost (including interest) of construction and other assumptions. If the estimate of construction cost proves to be inaccurate, we may be required to advance additional funds beyond the amount originally committed in order to protect the value of the property. Moreover, if the estimated value of the completed project proves to be inaccurate, the borrower may hold a property with a value that is insufficient to assure full repayment of the loan.

Commercial and Industrial Loans. At December 31, 2018, we had \$7.3 million in commercial and industrial loans, which amounted to 2.6% of total loans. We make commercial and industrial loans primarily in our market area to a variety of sole proprietorships, partnerships, and corporations. Commercial lending products include term loans, revolving and demand lines of credit. Commercial term loans and revolving lines of credit are generally used for longer-term working capital purposes such as purchasing equipment, vehicles, or furniture. Demand lines of credit are generally used for shorter-term working capital purposes. Commercial and industrial loans are made with either adjustable, variable, or fixed rates of interest. Variable rates are based on the prime rate, as published in *The Wall Street Journal*, plus a margin. Fixed-rate commercial and industrial loans are set at a margin above the comparable Federal Home Loan Bank advance rate.

When making commercial and industrial loans, we consider the financial statements of the borrower, our lending history with the borrower, the debt service capabilities of the borrower, the projected cash flows of the business, and the value of the collateral. Commercial and industrial loans are generally secured by a variety of collateral, primarily accounts receivable, inventory and equipment, and in addition are supported by unlimited personal guarantees. Depending on the collateral used to secure the loans, commercial and industrial loans are made in amounts of up to 80% of the value of the collateral securing the loan. We generally do not make unsecured commercial and industrial loans.

Commercial and industrial loans generally have greater credit risk than residential real estate loans. Unlike residential real estate loans, which generally are made on the basis of the borrower's ability to make repayment from his or her employment or other income, and which are secured by real property whose value tends to be more easily ascertainable, commercial and industrial loans generally are made on the basis of the borrower's ability to repay the loan from the cash flow of the borrower's business. As a result, the availability of funds for the repayment of commercial and industrial loans may depend substantially on the success of the business itself. Further, any collateral securing the loans may depreciate over time, may be difficult to appraise and may fluctuate in value. We seek to minimize these risks through our underwriting standards. At December 31, 2018, our largest commercial and industrial loan was a \$1.0 million loan secured by equipment. This loan was performing according to its original terms at December 31, 2018.

Other Loans. We offer a variety of loans secured by property other than real estate. These loans include passbook, overdraft protection and unsecured loans. At December 31, 2018, these other loans totaled \$50,000, or 0.1% of the total loan portfolio.

Loan Originations, Sales, and Servicing. Lending activities are conducted by our loan personnel operating at our main and branch office locations and through our mortgage division's five origination offices. We also obtain referrals from existing or past customers and from local builders, real estate brokers and attorneys. All loans that we originate are underwritten pursuant to our policies and procedures, which incorporate Freddie Mac underwriting guidelines to the extent applicable. We originate both adjustable-rate and fixed-rate loans. Our ability to originate fixed or adjustable-rate loans is dependent upon the relative customer demand for such loans, which is affected by current market interest rates as well as anticipated future market interest rates. Our loan origination and sales activity may be adversely affected by a rising interest rate environment, which typically results in decreased loan demand.

Loans that we sell are sold without recourse. For the year ended December 31, 2018, we realized a gain of \$1.4 million on the sale of loans, and we received servicing fees of \$325,000. As of December 31, 2018, the principal balance of loans serviced for others totaled \$123.8 million. Historically, we have retained the servicing rights on all residential real estate mortgage loans that we have sold. However, we have begun to sell some loans servicing released. Loan servicing includes collecting and remitting loan payments, accounting for principal and interest, contacting delinquent borrowers, supervising foreclosures and property dispositions in the event of unremedied defaults, making certain insurance and tax payments on behalf of the borrowers and generally administering the loans. We retain a portion of the interest paid by the borrower on the loans we service as consideration for our servicing activities. The value of our servicing rights was \$812,000 at December 31, 2018. We have not engaged in whole loan purchases. We have purchased two loan participations secured by office buildings for \$4.7 million as of December 31, 2018.

The following table shows our loan originations, sales and repayment activities for the years indicated.

	For the Year Ended December 31,				
	2018	2017	2016	2015	2014
	(In thousands)				
Total loans at beginning of year	\$ 263,973	\$ 227,069	\$ 202,393	\$ 189,218	\$ 177,210
Loan originations:					
Real estate loans:					
One- to four-family residential	80,956	91,167	116,331	82,368	68,977
Home equity lines of credit	6,574	6,778	5,562	5,064	5,031
Multi-family residential	400	5,769	318	1,602	888
Construction	12,924	20,582	14,202	5,151	4,986
Commercial	6,992	7,560	10,065	3,924	—
Commercial and industrial loans	4,659	1,631	2,612	866	100
Other loans	172	210	101	18	26
Total loans originated	<u>112,677</u>	<u>133,697</u>	<u>149,191</u>	<u>98,993</u>	<u>80,008</u>
Sales and loan principal repayments:					
Principal repayments	33,441	26,690	50,547	30,508	19,750
Loan sales	59,870	70,103	73,968	55,310	48,250
Net loan activity	19,366	36,904	24,676	13,175	12,008
Total loans at end of year	<u>\$ 283,339</u>	<u>\$ 263,973</u>	<u>\$ 227,069</u>	<u>\$ 202,393</u>	<u>\$ 189,218</u>

Loan Approval Policy and Authority. Fairport Savings Bank's lending activities follow written, non-discriminatory underwriting standards and loan origination policies approved by Fairport Savings Bank's Board of Directors. The loan approval process is intended to assess the borrower's ability to repay the loan and the value of the property that will secure the loan. To assess the borrower's ability to repay, we review the borrower's employment and credit history and information on the historical and projected income and expenses of the borrower.

Residential mortgage loans up to \$453,100, home equity lines of credit up to \$250,000, lines of credit, personal loans, and unsecured property improvement loans up to \$10,000 may be approved by any Loan Underwriter. Residential mortgage loans between \$453,101 and \$750,000 may be approved by any two Loan Underwriters. Residential mortgage loans between \$750,001 and \$1.0 million may be approved by any two Senior Loan Committee members. Residential mortgage loans exceeding \$1.0 million must be approved by any two Senior Loan Committee members and the Board of Directors. Commercial loans (including commercial real estate, multi-family and commercial and industrial loans) up to \$1.0 million may be approved by any two members of the Senior Loan Committee with Board approval required for commercial loans exceeding \$1.0 million.

We generally require independent third-party appraisals of real property securing loans. Appraisals are performed by independent licensed appraisers. All appraisers are approved by the Board of Directors annually.

Loans to One Borrower. A New York savings bank generally may not make a loan or extend credit to a single or related group of borrowers in excess of 15% of unimpaired capital and surplus. An additional amount may be loaned equal to 10% of unimpaired capital and surplus if the loan is secured by readily marketable collateral, which generally does not include real estate. Our loans to one borrower limit under this regulation is \$4.6 million (excluding the additional amount). At December 31, 2018, we had no loans exceeding this amount. Our policy provides that residential loans to one borrower (or related borrowers) should generally not exceed \$1.5 million. At December 31, 2018, we had no loans exceeding this amount.

Non-Performing Assets and Delinquent Loans

System-generated late notices are mailed to borrowers after the late payment “grace period,” which is 15 days in the case of all loans secured by real estate and 10 days in the case of other loans. A second notice will be mailed to borrowers if the loan remains past due after 30 days. In addition, consistent and vigilant attempts are made by our Loan Servicing Department to contact the borrower. After the 45th day, if we have not successfully contacted the borrower, a letter indicating the serious nature of their loan default is sent. If the loan reaches more than 60 days past due and there is still no repayment plan, a 90 day demand letter is issued by the Bank. This letter provides information on homeownership counseling services the borrower may contact for further assistance in developing a repayment plan. During this period, the Bank continues proactive efforts to contact the borrower. After the end of the 90 day period and without a repayment in place, notification is provided to the borrower that the loan has been referred to our attorney to initiate foreclosure action. A report of all loans 30 days or more past due is provided to the Board of Directors on a monthly basis.

Loans are generally placed on non-accrual status when payment of principal or interest is more than 90 days delinquent, unless the loans are well-secured and in the process of collection. Loans are also placed on non-accrual status if collection of principal or interest in full is in doubt or if the loan has been restructured. When loans are placed on a non-accrual status, unpaid accrued interest is fully reversed, and further income is recognized only to the extent received. The loan may be returned to accrual status if unpaid principal and interest are repaid so that the loan is less than 90 days delinquent and a satisfactory payment history has been established. Loans not secured by real estate will be charged-off if they become 120 days past due. At December 31, 2018, the Bank had one non-accrual residential mortgage loan for \$55,000 and one non-accrual commercial and industrial loan for \$45,000.

Non-Performing Assets. The table below sets forth the amounts and categories of our non-performing assets at the dates indicated. We had no troubled debt restructurings at any of the dates presented below.

	At December 31,				
	2018	2017	2016	2015	2014
	(Dollars in thousands)				
Non-accrual loans:					
Real estate loans:					
One- to four-family residential	\$ 55	\$ 153	\$ —	\$ 63	\$ 56
Home equity lines of credit	—	—	—	18	18
Multi-family residential	—	—	—	—	—
Construction	—	—	—	—	—
Commercial	—	—	—	—	—
Commercial and industrial loans	45	—	—	—	—
Other loans	—	—	—	1	—
Total	100	153	—	82	74
Accruing loans 90 days or more past due:					
Real estate loans:					
One- to four-family residential	—	—	—	—	—
Home equity lines of credit	—	—	—	—	—
Multi-family residential	—	—	—	—	—
Construction	—	—	—	—	—
Commercial	—	—	—	—	—
Commercial and industrial loans	—	—	—	—	—
Other loans	—	—	—	—	—
Total loans 90 days or more past due	—	—	—	—	—
Total non-performing loans	100	153	—	82	74
Real estate owned	—	—	—	—	—
Other non-performing assets	—	—	—	—	—
Total non-performing assets	\$ 100	\$ 153	\$ —	\$ 82	\$ 74
Ratios:					
Total non-performing loans to total loans	0.04%	0.06%	—%	0.04%	0.04%
Total non-performing loans to total assets	0.03%	0.05%	—%	0.03%	0.03%
Total non-performing assets to total assets	0.03%	0.05%	—%	0.03%	0.03%

Delinquent Loans. The following table sets forth our loan delinquencies by type, by number and amount at the dates indicated.

	Loans Delinquent For				Total	
	60-89 Days		90 Days and Over		Number	Amount
	Number	Amount	Number	Amount		
At December 31, 2018						
Real estate loans:						
One- to four-family residential	2	\$ 349	1	\$ 55	3	\$ 404
Home equity lines of credit	—	—	—	—	—	—
Multi-family residential	—	—	—	—	—	—
Construction	—	—	—	—	—	—
Commercial	—	—	—	—	—	—
Commercial and industrial loans	—	—	1	45	1	45
Other loans	—	—	—	—	—	—
Total	<u>2</u>	<u>\$ 349</u>	<u>2</u>	<u>\$ 100</u>	<u>4</u>	<u>\$ 449</u>
At December 31, 2017						
Real estate loans:						
One- to four-family residential	—	\$ —	2	\$ 153	2	\$ 153
Home equity lines of credit	—	—	—	—	—	—
Multi-family residential	—	—	—	—	—	—
Construction	—	—	—	—	—	—
Commercial	—	—	—	—	—	—
Commercial and industrial loans	—	—	—	—	—	—
Other loans	—	—	—	—	—	—
Total	<u>—</u>	<u>\$ —</u>	<u>2</u>	<u>\$ 153</u>	<u>2</u>	<u>\$ 153</u>
At December 31, 2016						
Real estate loans:						
One- to four-family residential	1	\$ 89	—	\$ —	1	\$ 89
Home equity lines of credit	—	—	—	—	—	—
Multi-family residential	—	—	—	—	—	—
Construction	—	—	—	—	—	—
Commercial	—	—	—	—	—	—
Commercial and industrial loans	1	47	—	—	1	47
Other loans	—	—	—	—	—	—
Total	<u>2</u>	<u>\$ 136</u>	<u>—</u>	<u>\$ —</u>	<u>2</u>	<u>\$ 136</u>
At December 31, 2015						
Real estate loans:						
One- to four-family residential	—	\$ —	1	\$ 63	1	\$ 63
Home equity lines of credit	—	—	1	18	1	18
Multi-family residential	—	—	—	—	—	—
Construction	—	—	—	—	—	—
Commercial	—	—	—	—	—	—
Commercial and industrial loans	—	—	—	—	—	—
Other loans	—	—	1	1	1	1
Total	<u>—</u>	<u>\$ —</u>	<u>3</u>	<u>\$ 82</u>	<u>3</u>	<u>\$ 82</u>
At December 31, 2014						
Real estate loans:						
One- to four-family residential	1	\$ 93	1	\$ 56	2	\$ 149
Home equity lines of credit	—	—	1	18	1	18
Multi-family residential	—	—	—	—	—	—
Construction	—	—	—	—	—	—
Commercial	—	—	—	—	—	—
Commercial and industrial loans	—	—	—	—	—	—
Other loans	—	—	—	—	—	—
Total	<u>1</u>	<u>\$ 93</u>	<u>2</u>	<u>\$ 74</u>	<u>3</u>	<u>\$ 167</u>

Foreclosed Real Estate. Real estate acquired by us as a result of foreclosure or by deed in lieu of foreclosure is classified as foreclosed real estate until sold. When property is acquired it is recorded at the estimated fair market value less cost to sell at the date of foreclosure, establishing a new cost basis. Estimated fair value generally represents the sale price a buyer would be willing to pay on the basis of current market

conditions, including normal terms from other financial institutions, less the estimated costs to sell the property. Holding costs and declines in estimated fair market value result in charges to expense after acquisition. At December 31, 2018, we had no foreclosed real estate.

Classification of Assets. Our policies, consistent with regulatory guidelines, provide for the classification of loans and other assets that are considered to be of lesser quality as substandard, doubtful, or loss assets. An asset is considered substandard if it is inadequately protected by the current net worth and paying capacity of the obligor or of the collateral pledged, if any. Substandard assets include those assets characterized by the distinct possibility that we will sustain some loss if the deficiencies are not corrected. Assets classified as doubtful have all of the weaknesses inherent in those classified substandard with the added characteristic that the weaknesses present make collection or liquidation in full, on the basis of currently existing facts, conditions and values, highly questionable and improbable. Assets (or portions of assets) classified as loss are those considered uncollectible and of such little value that their continuance as assets is not warranted. Assets that do not expose us to risk sufficient to warrant classification in one of the aforementioned categories, but which possess potential weaknesses that deserve our close attention, are required to be designated as special mention.

When we classify assets as either special mention, substandard, doubtful, or loss we allocate a portion of the related general loss allowances to such assets as we deem prudent. The allowance for loan losses is the amount estimated by management as necessary to absorb credit losses incurred in the loan portfolio that are both probable and reasonably estimable at the consolidated balance sheet date. Our determination as to the classification of our assets and the amount of our loss allowances are subject to review by our regulators, the New York State Department of Financial Services and the Federal Deposit Insurance Corporation, which can require that we establish additional loss allowances. We regularly review our asset portfolio to determine whether any assets require classification in accordance with applicable regulations. On the basis of our review of our assets, at December 31, 2018, classified assets consisted of three special mention loans totaling \$1.4 million, 22 substandard loans totaling \$3.4 million and no assets classified as doubtful or loss.

Allowance for Loan Losses

We provide for loan losses based on the allowance method. Accordingly, all loan losses are charged to the related allowance and all recoveries are credited to it. Additions to the allowance for loan losses are provided by charges to income based on various factors which, in our judgment, deserve current recognition in estimating probable losses. We regularly review the loan portfolio and make provisions for loan losses in order to maintain the allowance for loan losses in accordance with accounting principles generally accepted in the United States of America (“GAAP”).

The allowance for loan losses is evaluated on a regular basis by management and is based upon management’s periodic review of the collectability of the loans in light of historical experience, the nature and volume of the loan portfolio, adverse situations that may affect the borrower’s ability to repay, estimated value of any underlying collateral and prevailing economic conditions. This evaluation is inherently subjective as it requires estimates that are susceptible to significant revision as more information becomes available.

The allowance consists of specific, general, and unallocated components. The specific component relates to loans that are classified as doubtful, substandard or special mention. For such loans that are also classified as impaired, an allowance is generally established when the collateral value of the impaired loan is lower than the carrying value of that loan. The general component covers non-classified loans and is based on historical loss experience adjusted for qualitative factors. An unallocated component is maintained to cover uncertainties that could affect management’s estimate of probable losses. The unallocated component of the allowance reflects the margin of imprecision inherent in the underlying assumptions used in the methodologies for estimating specific and general losses in the portfolio.

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

Large groups of smaller balance homogeneous loans are collectively evaluated for impairment. Accordingly, we do not separately identify individual consumer and residential loans for impairment disclosures.

We periodically evaluate the carrying value of loans and the allowance is adjusted accordingly. While we use the best information available to make evaluations, future adjustments to the allowance may be necessary if conditions differ substantially from the information used in making the evaluations. In addition, as an integral part of their examination process, the New York State Department of Financial Services and the Federal Deposit Insurance Corporation periodically review the allowance for loan losses. These regulators may require us to recognize additions to the allowance based on their analysis of information available to them at the time of their examination.

The following table sets forth activity in our allowance for loan losses for the years indicated.

	At or For the Years Ended December 31,				
	2018	2017	2016	2015	2014
	(Dollars in thousands)				
Balance at beginning of year	\$ 1,261	\$ 990	\$ 811	\$ 653	\$ 526
Charge-offs:					
Real estate loans:					
One- to four-family residential	—	—	—	—	—
Home equity lines of credit	—	—	—	—	—
Multi-family residential	—	—	—	—	—
Construction	—	—	—	—	—
Commercial	—	—	—	—	—
Commercial and industrial loans	—	—	—	—	—
Other loans	—	—	(1)	—	—
Total charge-offs	—	—	(1)	—	—
Recoveries:					
Real estate loans:					
One- to four-family residential	—	—	—	—	—
Home equity lines of credit	—	—	—	—	—
Multi-family residential	—	—	—	—	—
Construction	—	—	—	—	—
Commercial	—	—	—	—	—
Commercial and industrial loans	—	—	—	—	—
Other loans	—	—	—	—	—
Total recoveries	—	—	—	—	—
Net charge-offs	—	—	(1)	—	—
Provision for loan losses	300	271	180	158	127
Balance at end of year	<u>\$ 1,561</u>	<u>\$ 1,261</u>	<u>\$ 990</u>	<u>\$ 811</u>	<u>\$ 653</u>
Ratios:					
Net charge-offs to average loans outstanding	—	—	—	—	—
Allowance for loan losses to non-performing loans at end of year	1,564.55%	825.59%	N/A	994.92%	883.71%
Allowance for loan losses to total loans at end of year	0.55%	0.48%	0.44%	0.40%	0.34%

Allocation of Allowance for Loan Losses. The following table sets forth the allowance for loan losses allocated by loan category, the total loan balances by category, and the percent of loans in each category to total loans at the dates indicated. The allowance for loan losses allocated to each category is not necessarily indicative of future losses in any particular category and does not restrict the use of the allowance to absorb losses in other categories.

	At December 31,								
	2018			2017			2016		
	Amount	Percent of Allowance to Total Allowance	Percent of Loans in Category to Total Loans	Amount	Percent of Allowance to Total Allowance	Percent of Loans in Category to Total Loans	Amount	Percent of Allowance to Total Allowance	Percent of Loans in Category to Total Loans
(Dollars in thousands)									
Real estate loans:									
One- to four-family residential	\$ 866	55.48%	78.21%	\$ 816	64.71%	78.38%	\$ 584	58.99%	83.04%
Home equity lines of credit	103	6.60	5.92	107	8.49	6.49	112	11.31	7.40
Multi-family residential	77	4.93	3.61	80	6.34	4.03	38	3.84	2.25
Construction	24	1.54	1.73	54	4.28	4.07	31	3.13	2.70
Commercial	284	18.19	7.94	148	11.74	5.61	84	8.49	3.72
Commercial and industrial loans	97	6.21	2.57	47	3.73	1.39	28	2.83	0.86
Other loans	1	0.07	0.02	1	0.08	0.03	1	0.10	0.03
Total allocated allowance	1,452	93.02	100.00	1,253	99.37	100.00	878	88.69	100.00
Unallocated allowance	109	6.98	—	8	0.63	—	112	11.31	—
Total allowance for loan losses	\$ 1,561	100.00%	100.00%	\$ 1,261	100.00%	100.00%	\$ 990	100.00%	100.00%

	At December 31,					
	2015			2014		
	Amount	Percent of Allowance to Total Allowance	Percent of Loans in Category to Total Loans	Amount	Percent of Allowance to Total Allowance	Percent of Loans in Category to Total Loans
(Dollars in thousands)						
Real estate loans:						
One- to four-family residential	\$ 524	64.61%	87.47%	\$ 448	68.62%	89.50%
Home equity lines of credit	101	12.45	7.18	87	13.32	7.07
Multi-family residential	39	4.81	2.54	29	4.44	2.02
Construction	6	0.74	0.62	6	0.92	0.58
Commercial	35	4.32	1.74	14	2.14	0.75
Commercial and industrial loans	11	1.36	0.42	1	0.15	0.05
Other loans	1	0.12	0.03	1	0.15	0.03
Total allocated allowance	717	88.41	100.00	586	89.74	100.00
Unallocated allowance	94	11.59	—	67	10.26	—
Total allowance for loan losses	\$ 811	100.00%	100.00%	\$ 653	100.00%	100.00%

Investments

Our Board of Directors is responsible for approving and overseeing our investment policy. The investment policy is reviewed at least annually by management and any changes to the policy are recommended to the Board of Directors and are subject to its approval. This policy dictates that investment decisions be made based on the safety of the investment, liquidity requirements, potential returns, the ability to provide collateral for pledging requirements, and consistency with our interest rate risk management strategy. Our asset/liability management committee, which consists of our chief executive officer, chief financial officer and other members of management, oversees our investing activities and strategies. All transactions are formally reviewed by the Board of Directors at least quarterly. Any investment which, subsequent to its purchase, fails to meet the guidelines of the policy is reported to the asset/liability management committee, which decides whether to hold or sell the investment.

Our current investment policy permits us to invest in debt securities issued by the U.S. Government, agencies of the U.S. Government or U.S. Government-sponsored enterprises. The policy also permits investments in mortgage-backed securities, including pass-through securities issued and guaranteed by Fannie Mae, Freddie Mac and Ginnie Mae. We also may hold investments in New York State municipal obligations. The investment policy also permits investments in asset-backed securities, pooled trust securities, bankers' acceptances, money market funds, term federal funds, repurchase agreements and reverse repurchase agreements.

Our current investment policy prohibits hedging through the use of such instruments as financial futures, interest rate options and swaps.

Debt and equity securities investment accounting guidance requires that, at the time of purchase, we designate a security as held to maturity, available for sale, or trading, depending on our ability and intent. Securities available for sale are reported at fair value, while securities held to maturity are reported at amortized cost. We do not have a trading portfolio.

U.S. Government and Agency Obligations. U.S. Government and agency securities are utilized as shorter-term investment vehicles. Investment in U.S. Government and agency securities provide lower yields than loans, however, they provide greater liquidity on a short-term basis.

Mortgage-Backed Securities. We purchase both fixed-rate and adjustable-rate mortgage-backed securities insured or guaranteed by Fannie Mae, Freddie Mac or Ginnie Mae. We invest in mortgage-backed securities to achieve interest income and monthly cash flow with minimal administrative expense, and to lower our credit risk as a result of the guarantees provided by Freddie Mac, Federal Farm Credit, Fannie Mae or Ginnie Mae.

Mortgage-backed securities are created by the pooling of mortgages and the issuance of a security with an interest rate that is less than the interest rate on the underlying mortgages. Mortgage-backed securities typically represent a participation interest in a pool of single-family or multi-family mortgages, although we invest only in mortgage-backed securities backed by one- to four-family mortgages. The issuers of such securities (generally Ginnie Mae, a U.S. Government agency, and U.S. government sponsored enterprises, such as Fannie Mae, Federal Farm Credit, and Freddie Mac) pool and resell the participation interests in the form of securities to investors such as Fairport Savings Bank, and guarantee the payment of principal and interest to investors. Mortgage-backed securities generally yield less than the loans that underlie such securities because of the cost of payment guarantees and credit enhancements. However, mortgage-backed securities are more liquid than individual mortgage loans since there is an active trading market for such securities. In addition, mortgage-backed securities may be used to collateralize our specific liabilities and obligations. Investments in mortgage-backed securities involve a risk that actual payments will be greater or less than the prepayment rate estimated at the time of purchase, which may require adjustments to the amortization of any premium or acceleration of any discount relating to such interests, thereby affecting the net yield on our securities. We periodically review current prepayment speeds to determine whether prepayment estimates require modification that could cause amortization or accretion adjustments. Our mortgage-backed securities portfolio contains no sub-prime mortgage loans and has no exposure to sub-prime investment activity.

State and Municipal Securities. We purchase state and municipal securities consisting of general obligation bonds backed by the full faith and credit of local municipalities located only in Monroe County, New York, and Ontario County, New York, such as townships and school districts.

The following table sets forth the amortized cost and fair value of our securities portfolio (excluding Federal Home Loan Bank of New York and Atlantic Community Bankers Bank common stock) at the dates indicated.

	At December 31,					
	2018		2017		2016	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value	Amortized Cost	Fair Value
	(In thousands)					
Securities available for sale:						
U.S. Government and agency obligations	\$ 12,610	\$ 12,455	\$ 10,612	\$ 10,470	\$ 8,106	\$ 7,999
Mortgage-backed securities	5,953	5,876	7,909	7,843	9,769	9,748
Total securities available for sale	<u>\$ 18,563</u>	<u>\$ 18,331</u>	<u>\$ 18,521</u>	<u>\$ 18,313</u>	<u>\$ 17,875</u>	<u>\$ 17,747</u>
Securities held to maturity:						
State and municipal securities	5,594	5,567	5,938	5,942	6,675	6,626
Mortgage-backed securities	458	463	637	646	745	758
Total securities held to maturity	<u>\$ 6,052</u>	<u>\$ 6,030</u>	<u>\$ 6,575</u>	<u>\$ 6,588</u>	<u>\$ 7,420</u>	<u>\$ 7,384</u>

Portfolio Maturities and Yields. The composition and maturities of the investment securities portfolio and the mortgage-backed securities portfolio at December 31, 2018 are summarized in the following table. Maturities are based on the final contractual payment dates, and do not reflect the impact of prepayments or early redemptions that may occur. The state and municipal securities have not been adjusted to a tax-equivalent basis.

	One Year or Less		More than One Year through Five Years		More than Five Years through Ten Years		More than Ten Years		Total Securities		
	Amortized Cost	Weighted Average Yield	Amortized Cost	Weighted Average Yield	Amortized Cost	Weighted Average Yield	Amortized Cost	Weighted Average Yield	Amortized Cost	Fair Value	Weighted Average Yield
	(Dollars in thousands)										
Securities available for sale:											
U.S. Government and agency obligations	\$ —	—%	\$ 11,110	2.01%	\$ 500	3.65%	\$ 1,000	2.50%	\$ 12,610	\$12,455	2.11%
Mortgage-backed securities	—	—%	—	—%	—	—%	5,953	2.19%	5,953	5,876	2.19%
Total securities available for sale	<u>\$ —</u>	<u>—%</u>	<u>\$ 11,110</u>	<u>2.01%</u>	<u>\$ 500</u>	<u>3.65%</u>	<u>\$ 6,953</u>	<u>2.24%</u>	<u>\$ 18,563</u>	<u>\$18,331</u>	<u>2.14%</u>
Securities held to maturity:											
State and municipal securities	\$ 817	1.87%	\$ 3,118	1.56%	\$ 1,659	2.50%	\$ —	—%	\$ 5,594	\$ 5,567	1.88%
Mortgage-backed securities	—	—%	—	—%	—	—%	458	4.15%	458	463	4.15%
Total securities held to maturity	<u>\$ 817</u>	<u>1.87%</u>	<u>\$ 3,118</u>	<u>1.56%</u>	<u>\$ 1,659</u>	<u>2.50%</u>	<u>\$ 458</u>	<u>4.15%</u>	<u>\$ 6,052</u>	<u>\$ 6,030</u>	<u>2.05%</u>

Sources of Funds

General. Deposits traditionally have been our primary source of funds for our lending and investment activities. We also borrow, primarily from the Federal Home Loan Bank of New York, to supplement cash flow needs, to lengthen the maturities of liabilities for interest rate risk management purposes and to manage our cost of funds. Our additional sources of funds are scheduled loan payments, loan prepayments, maturing investments, mortgage-backed securities amortizations and prepayments, proceeds of loan sales, and retained earnings.

Deposits. We generate deposits primarily from the areas in which our branch offices are located. We rely on our competitive pricing, convenient locations and customer service to attract and retain deposits. We offer a variety of deposit accounts with a range of interest rates and terms. Our deposit accounts consist of savings accounts, NOW accounts, money market accounts, certificates of deposit and individual retirement

accounts and non-interest-bearing demand deposits. We currently do not accept brokered deposits.

Interest rates paid, maturity terms, service fees and withdrawal penalties are established on a periodic basis. Deposit rates and terms are based primarily on current operating strategies and market interest rates, liquidity requirements, interest rates paid by competitors and our deposit growth goals.

At December 31, 2018, our deposits totaled \$222.6 million. At December 31, 2018, NOW accounts totaled \$28.4 million, savings accounts totaled \$27.5 million, money market accounts totaled \$31.9 million and non-interest-bearing checking accounts totaled \$10.9 million. At December 31, 2018, certificates of deposit, including individual retirement accounts (all of which were certificate of deposit accounts), totaled \$123.9 million, of which \$73.9 million had remaining maturities of one year or less. Based on historical experience and our current pricing strategy, we believe we will retain a large portion of these accounts upon maturity.

The following table sets forth the distribution of our average total deposit accounts, by account type, for the years indicated.

Deposit type:	For the Years Ended December 31,								
	2018			2017			2016		
	Average Balance	Percent	Weighted Average Rate	Average Balance	Percent	Weighted Average Rate	Average Balance	Percent	Weighted Average Rate
	(Dollars in thousands)								
NOW	\$ 30,018	13.74%	0.31%	\$ 29,659	15.04%	0.30%	\$ 28,437	15.27%	0.26%
Savings	27,533	12.61	0.53	26,488	13.43	0.39	27,410	14.71	0.37
Money market	34,593	15.84	1.00	34,330	17.41	0.83	24,643	13.23	0.41
Individual retirement accounts	6,792	3.11	1.25	7,081	3.59	1.05	7,442	4.00	0.86
Certificates of deposit	110,033	50.37	1.75	91,103	46.20	1.38	87,806	47.14	1.25
Non-interest-bearing demand deposits	9,467	4.33	—	8,526	4.33	—	10,534	5.65	—
Total deposits	\$218,436	100.00%	1.19%	\$197,187	100.00%	0.92%	\$186,272	100.00%	0.77%

As of December 31, 2018, the aggregate amount of our outstanding certificates of deposit in amounts greater than or equal to \$100,000 was approximately \$67.9 million. The following table sets forth the maturity of those certificates as of December 31, 2018.

At December 31, 2018 (In thousands)	
Three months or less	\$ 7,676
Over three months through six months	8,421
Over six months through one year	24,051
Over one year to three years	27,516
Over three years	236
Total	\$ 67,900

Borrowings. Our long-term borrowings consist primarily of advances from the Federal Home Loan Bank of New York. At December 31, 2018, we had the ability to borrow approximately \$165.9 million under our credit facilities with the Federal Home Loan Bank of New York, of which \$71.8 million was advanced. Borrowings from the Federal Home Loan Bank of New York are secured by our investment in the common stock of the Federal Home Loan Bank of New York as well as by a blanket pledge of our mortgage portfolio not otherwise pledged.

The following table sets forth information concerning balances and interest rates on our Federal Home Loan Bank advances at and for the years shown:

	<u>At or For the Years Ended December 31,</u>		
	<u>2018</u>	<u>2017</u>	<u>2016</u>
	(Dollars in thousands)		
Balance at end of year	\$ 71,826	\$ 64,447	\$ 56,813
Average balance during year	\$ 66,294	\$ 60,457	\$ 46,990
Maximum outstanding at any month end	\$ 73,796	\$ 69,524	\$ 56,813
Weighted average interest rate at end of year	2.34%	1.73%	1.49%
Weighted average interest rate during year	2.09%	1.60%	1.53%

We also have a repurchase agreement with Raymond James Financial providing an additional \$10.0 million in liquidity collateralized by our U.S. Government obligations. There were no advances outstanding under the repurchase agreement at December 31, 2018. In addition, we also have an unsecured line of credit through Atlantic Community Bankers Bank providing an additional \$5.0 million in liquidity. There were no draws or outstanding balances from the line of credit at December 31, 2018.

Other Services. Over the past several years we have focused on developing our electronic service offerings to stay relevant with the younger generation of banking consumers. Two of the major services that have demonstrated a high level of growth are mobile banking and online bill pay. While online bill pay has become a standard service that most banks offer, our online bill paying service has additional functionality that allows customers to send person-to-person payments using just an email address or phone number. From the mobile banking application, a customer can pay their bills as well as send person-to-person payments. In early 2016, we implemented online account opening. We intend to continue to expand our internet and mobile banking services as we grow.

Subsidiary Activities

Fairport Wealth Management, the Bank's wholly owned subsidiary, provides investment advisory services to our customers including brokerage, insurance, and asset management in partnership with Monarch Wealth Management. For the year ended December 31, 2018, we derived \$131,000 of fee income from Fairport Wealth Management.

Personnel

As of December 31, 2018, we had 72 full-time employees and five part-time employees. Our employees are not represented by any collective bargaining group. Management believes that our relationship with our employees is good.

REGULATION AND SUPERVISION

General

Fairport Savings Bank is a stock savings bank organized under the laws of the State of New York. The lending, investment, and other business operations of Fairport Savings Bank are governed by New York law and regulations, as well as applicable federal law and regulations, and Fairport Savings Bank is prohibited from engaging in any operations not authorized by such laws and regulations. Fairport Savings Bank is subject to extensive regulation, supervision and examination by the New York State Department of Financial Services and the Federal Deposit Insurance Corporation. This regulation and supervision establishes a comprehensive framework of activities in which an institution may engage and is intended primarily for the protection of the Federal Deposit Insurance Corporation's deposit insurance fund and depositors, and not for the protection of security holders. Fairport Savings Bank also is a member of and owns stock in the Federal Home Loan Bank of New York, which is one of the 11 regional banks in the Federal Home Loan Bank System.

Under this system of regulation, the regulatory authorities have extensive discretion in connection with their supervisory, enforcement, rulemaking and examination activities and policies, including rules or policies that: establish minimum capital levels; restrict the timing and amount of dividend payments; govern the classification of assets; determine the adequacy of loan loss reserves for regulatory purposes; and establish the timing and amounts of assessments and fees. Moreover, as part of their examination authority, the banking regulators assign numerical ratings to banks and savings institutions relating to capital, asset quality, management, liquidity, earnings and other factors. These ratings are inherently subjective and the receipt of a less than satisfactory rating in one or more categories may result in enforcement action by the banking regulators against a financial institution. A less than satisfactory rating may also prevent a financial institution, such as Fairport Savings Bank or its holding company, from obtaining necessary regulatory approvals to access the capital markets, pay dividends, acquire other financial institutions or establish new branches.

In addition, we must comply with significant anti-money laundering and anti-terrorism laws and regulations, Community Reinvestment Act laws and regulations, and fair lending laws and regulations. Government agencies have the authority to impose monetary penalties and other sanctions on institutions that fail to comply with these laws and regulations, which could significantly affect our business activities, including our ability to acquire other financial institutions or expand our branch network.

As a bank holding company, FSB Bancorp is required to comply with the rules and regulations of the Federal Reserve Board. The Company is required to file certain reports with the Federal Reserve Board and is subject to examination by and the enforcement authority of the Federal Reserve Board. FSB Bancorp is also subject to the rules and regulations of the Securities and Exchange Commission under the federal securities laws.

Any change in applicable laws or regulations, whether by the New York State Department of Financial Services, the Federal Deposit Insurance Corporation, the Federal Reserve Board or Congress, could have a material adverse impact on the operations and financial performance of FSB Bancorp and Fairport Savings Bank.

Set forth below is a brief description of material regulatory requirements that are or will be applicable to Fairport Savings Bank and FSB Bancorp. The description is limited to certain material aspects of the statutes and regulations addressed, and is not intended to be a complete description of such statutes and regulations and their effects on Fairport Savings Bank and FSB Bancorp.

Dodd-Frank Act

The Dodd-Frank Wall Street Reform and Consumer Protection Act (“Dodd-Frank Act”) was enacted in 2010. The Dodd-Frank Act has significantly changed the bank regulatory structure and is affecting the lending, investment, trading and operating activities of depository institutions and their holding companies.

The Dodd-Frank Act created a new Consumer Financial Protection Bureau with expansive powers to supervise and enforce consumer protection laws. The Consumer Financial Protection Bureau has broad rule-making authority for a wide range of consumer protection laws that apply to all banks and savings institutions, including the authority to prohibit “unfair, deceptive or abusive” acts and practices. The Consumer Financial Protection Bureau has examination and enforcement authority over all banks and savings institutions with more than \$10 billion in assets. Banks and savings institutions with \$10 billion or less in assets, such as Fairport Savings Bank, will continue to be examined for compliance with these laws by their applicable federal bank regulators. The legislation gave state attorneys general the ability to enforce applicable federal consumer protection laws and weakened federal preemption of state laws as to federal saving banks in certain respects.

The Dodd-Frank Act also broadened the base for Federal Deposit Insurance Corporation assessments for deposit insurance, permanently increased the maximum amount of deposit insurance to \$250,000 per depositor. The Dodd-Frank Act also provided for originators of certain securitized loans to retain a percentage of the risk for transferred credits, directed the Federal Reserve Board to regulate pricing of certain debit card interchange fees, repealed restrictions on paying interest on checking accounts and contained a number of reforms related to mortgage origination. The Dodd-Frank Act increased stockholder influence over Boards of Directors by requiring companies to give stockholders a non-binding vote on executive compensation and so-called “golden parachute” payments.

The Dodd-Frank Act also required the Consumer Financial Protection Bureau to issue regulations requiring lenders to make a reasonable, good faith determination as to the ability of a prospective borrower to repay a residential mortgage loan. The “Ability to Repay” final rule, effective January 1, 2014, established a “qualified mortgage” safe harbor from liability for loans which have terms and features which are deemed to make the loan less risky.

The Economic Growth, Regulatory Relief and Consumer Protection Act of 2018

On May 24, 2018, The Economic Growth, Regulatory Relief and Consumer Protection Act of 2018 (the “EGRRCPA”) was enacted, which repeals or modifies certain provisions of the Dodd-Frank Act and eases regulations on all but the largest banks. The EGRRCPA’s provisions include, among other things: (i) exempting banks with less than \$10 billion in assets from the ability-to-repay requirements for certain qualified residential mortgage loans held in portfolio; (ii) not requiring appraisals for certain transactions valued at less than \$400,000 in rural areas; (iii) exempting banks that originate fewer than 500 open-end and 500 closed-end mortgages from HMDA’s expanded data disclosures; (iv) clarifying that, subject to various conditions, reciprocal deposits of another depository institution obtained using a deposit broker through a deposit placement network for purposes of obtaining maximum deposit insurance would not be considered brokered deposits subject to the FDIC’s brokered-deposit regulations; (v) raising eligibility for the 18-month exam cycle from \$1 billion to banks with \$3 billion in assets; and (vi) simplifying capital calculations by requiring regulators to establish for institutions under \$10 billion in assets a community bank leverage ratio (tangible equity to average consolidated assets) at a percentage not less than 8% and not greater than 10% that such institutions may elect to replace the general applicable risk-based capital requirements for determining well-capitalized status. In addition, the law required the Federal Reserve Board to raise the asset threshold under its Small Bank Holding Company Policy Statement from \$1 billion to \$3 billion for bank or savings and loan holding companies that are exempt from consolidated capital requirements, provided that such companies meet certain other conditions such as not engaging in significant nonbanking activities.

New York Bank Regulation

Fairport Savings Bank derives its lending, investment, branching and other authority primarily from the applicable provisions of New York State Banking Law and the regulations of the New York State Department of Financial Services, as limited by federal laws and regulations. Under these laws and regulations, savings banks, including Fairport Savings Bank, may invest in real estate mortgages, consumer and commercial loans, certain types of debt securities, including certain corporate debt securities and obligations of federal, state and local governments and agencies, certain types of corporate equity securities and certain other assets. Under the statutory authority for investing in equity securities, a savings bank may invest up to 7.5% of its assets in corporate stock. Investment in the stock of a single corporation is limited to the lesser of 2% of the outstanding stock of such corporation or 1% of the savings bank’s assets, except as set forth below. Such equity securities must meet certain earnings ratios and other tests of financial performance. A savings bank’s lending powers are not subject to percentage of assets limitations, although there are limits applicable to single borrowers. A savings bank may also, pursuant to the “leeway” power, make investments not otherwise permitted under the New York State Banking Law. This power permits investments in otherwise impermissible investments of up to 1% of assets in any single investment, subject to certain restrictions and to an aggregate limit for all such investments of up to 5% of assets. Additionally, in lieu of investing in such securities in accordance with and reliance upon the specific investment authority set forth in the New York State Banking Law, savings banks are authorized to elect to invest under a “prudent person” standard in a wider range of investment securities as compared to the types of investments permissible under such specific investment authority. However, in the event a savings bank elects to utilize the “prudent person” standard, it will be unable to avail itself of the other provisions of the New York State Banking Law and regulations, which set forth specific investment authority. Fairport Savings Bank has not elected to conduct its investment activities under the “prudent person” standard. A savings bank may also exercise trust powers upon approval of the New York State Department of Financial Services. Fairport Savings Bank does not presently have trust powers.

New York State chartered savings banks may also invest in subsidiaries under their service corporation investment authority. A savings bank may use this power to invest in corporations that engage in various activities authorized for savings banks, plus any additional activities that may be authorized by the New York State Department of Financial Services. Investment by a savings bank in the stock, capital notes and debentures of its service corporations is limited to 3% of the bank’s assets, and such investments, together with the bank’s loans to its service corporations, may not exceed 10% of the savings bank’s assets.

Under the New York State Banking Law, the Superintendent may issue an order to a New York State chartered banking institution to appear and explain an apparent violation of law, to discontinue unauthorized or unsafe practices and to keep prescribed books and accounts. Upon a finding by the New York State Department of Financial Services that any director, trustee or officer of any banking organization has violated any law, or has continued unauthorized or unsafe practices in conducting the business of the banking organization after having been notified by the Superintendent to discontinue such practices, such director, trustee or officer may be removed from office after notice and an opportunity to be heard. Fairport Savings Bank does not know of any past or current practice, condition or violation that may lead to any proceeding by the Superintendent or the New York State Department of Financial Services against Fairport Savings Bank or any of its directors or officers.

New York State Community Reinvestment Regulation

Fairport Savings Bank is also subject to provisions of the New York State Banking Law, which imposes continuing and affirmative obligations upon banking institutions organized in New York State to serve the credit needs of its local community (“NYCRA”) which are substantially similar to those imposed by the Community Reinvestment Act. Pursuant to the NYCRA, a bank must file an annual NYCRA report and copies of all federal CRA reports with the New York State Department of Financial Services. The NYCRA requires the New York State Department of Financial Services to make a biennial written assessment of a bank’s compliance with the NYCRA, utilizing a four-tiered rating system and make such assessment available to the public. The NYCRA also requires the Superintendent to consider a bank’s NYCRA rating when reviewing a bank’s application to engage in certain transactions, including mergers, asset purchases and the establishment of branch offices or automated teller machines, and provides that such assessment may serve as a basis for the denial of any such application. Fairport Savings Bank underwent an examination in 2014 and in 2017 received the report for which a satisfactory NYCRA rating was issued from the New York State Department of Financial Services.

Federal Bank Regulation

Capital Requirements. Federal regulations require state banks to meet several minimum capital standards: a common equity Tier 1 capital to risk-based assets ratio of 4.5%; a Tier 1 capital to risk-based assets ratio of 6.0%; a total capital to risk-based assets ratio of 8%; and a 4% Tier 1 capital to total assets leverage ratio. These capital requirements were effective January 1, 2015 and are the result of regulations implementing recommendations of the Basel Committee on Banking Supervision and certain requirements of the Dodd-Frank Act.

As noted, the risk-based capital standards for state banks require the maintenance of common equity Tier 1 capital, Tier 1 capital and total capital to risk-weighted assets ratios of at least 4.5%, 6% and 8%, respectively. In determining the amount of risk-weighted assets, all assets, including certain off-balance sheet assets (e.g., recourse obligations, direct credit substitutes, residual interests) are multiplied by a risk weight factor (from 0.0% to 200.0%) assigned by the regulations based on the risks believed inherent in the type of asset. Higher levels of capital are required for asset categories believed to present greater risk. Common equity Tier 1 capital is generally defined as common stockholders’ equity and retained earnings. Tier 1 capital is generally defined as common equity Tier 1 and additional Tier 1 capital. Additional Tier 1 capital includes certain noncumulative perpetual preferred stock and related surplus and minority interests in equity accounts of consolidated subsidiaries. Total capital includes Tier 1 capital (common equity Tier 1 capital plus additional Tier 1 capital) and Tier 2 capital. Tier 2 capital is comprised of capital instruments and related surplus, meeting specified requirements, and may include cumulative preferred stock and long-term perpetual preferred stock, mandatory convertible securities, intermediate preferred stock and subordinated debt. Also included in Tier 2 capital is the allowance for loan and lease losses limited to a maximum of 1.25% of risk-weighted assets and, for institutions that have exercised an opt-out election regarding the treatment of Accumulated Other Comprehensive Income, up to 45% of net unrealized gains on available-for-sale equity securities with readily determinable fair market values. Calculation of all types of regulatory capital is subject to deductions and adjustments specified in the regulations. In assessing an institution’s capital adequacy, the Federal Reserve takes into consideration not only these numeric factors, but qualitative factors as well, and has the authority to establish higher capital requirements for individual institutions where necessary.

In addition to establishing the minimum regulatory capital requirements, the regulations limit capital distributions and certain discretionary bonus payments to management if the institution does not hold a “capital conservation buffer” consisting of 2.5% of common equity Tier 1 capital to risk-weighted assets above the amount necessary to meet its minimum risk-based capital requirements. The capital conservation buffer requirement was phased in beginning January 1, 2016 at 0.625% of risk-weighted assets and increased each year until fully implemented at 2.5% on January 1, 2019.

Notwithstanding the foregoing, pursuant to the EGRRCPA, the FDIC proposed a rule that establishes a community bank leverage ratio (tangible equity to average consolidated assets) at 9% for institutions under \$10 billion in assets that such institutions may elect to utilize in lieu of the general applicable risk-based capital requirements under Basel III. Such institutions that meet the community bank leverage ratio and certain other qualifying criteria will automatically be deemed to be well-capitalized. Until the FDIC’s proposed rule is finalized, the Basel III risk-based and leverage ratios remain in effect.

The Federal Deposit Insurance Corporation Improvement Act required each federal banking agency to revise its risk-based capital standards for insured institutions to ensure that those standards take adequate account of interest-rate risk, concentration of credit risk, and the risk of nontraditional activities, as well as to reflect the actual performance and expected risk of loss on multi-family residential loans. The Federal Deposit Insurance Corporation, along with the other federal banking agencies, adopted a regulation providing that the agencies will take into account the exposure of a bank's capital and economic value to changes in interest rate risk in assessing a bank's capital adequacy. The Federal Deposit Insurance Corporation also has authority to establish individual minimum capital requirements in appropriate cases upon determination that an institution's capital level is, or is likely to become, inadequate in light of the particular circumstances.

Standards for Safety and Soundness. As required by statute, the federal banking agencies adopted final regulations and Interagency Guidelines Establishing Standards for Safety and Soundness to implement safety and soundness standards. The guidelines set forth the safety and soundness standards that the federal banking agencies use to identify and address problems at insured depository institutions before capital becomes impaired. The guidelines address internal controls and information systems, internal audit system, credit underwriting, loan documentation, interest rate exposure, asset growth, asset quality, earnings and compensation, fees and benefits. The agencies have also established standards for safeguarding customer information. If the appropriate federal banking agency determines that an institution fails to meet any standard prescribed by the guidelines, the agency may require the institution to submit to the agency an acceptable plan to achieve compliance with the standard.

Investment Activities. All Federal Deposit Insurance Corporation insured banks, including savings banks, are generally limited in their equity investment activities to equity investments of the type and in the amount authorized for national banks, notwithstanding state law, subject to certain exceptions. In addition, a state bank may engage in state-authorized activities or investments not permissible for national banks (other than non-subsidiary equity investments) if it meets all applicable capital requirements and it is determined by the Federal Deposit Insurance Corporation that such activities or investments do not pose a significant risk to the Deposit Insurance Fund.

Interstate Banking and Branching. Federal law permits well capitalized and well managed holding companies to acquire banks in any state, subject to Federal Reserve Board approval, certain concentration limits and other specified conditions. Interstate mergers of banks are also authorized, subject to regulatory approval and other specified conditions. In addition, among other things, recent amendments made by the Dodd-Frank Act permit banks to establish de novo branches on an interstate basis provided that branching is authorized by the law of the host state for the banks chartered by that state.

Prompt Corrective Regulatory Action. Federal law requires, among other things, that federal bank regulatory authorities take "prompt corrective action" with respect to banks that do not meet minimum capital requirements. For these purposes, the law establishes five capital categories: well capitalized, adequately capitalized, undercapitalized, significantly undercapitalized and critically undercapitalized.

The Federal Deposit Insurance Corporation has adopted regulations to implement the prompt corrective action legislation. The regulations were amended to incorporate the previously mentioned increased regulatory capital standards that were effective January 1, 2015. An institution is deemed to be "well capitalized" if it has a total risk-based capital ratio of 10.0% or greater, a Tier 1 risk-based capital ratio of 8.0% or greater, a leverage ratio of 5.0% or greater and a common equity Tier 1 ratio of 6.5% or greater. An institution is "adequately capitalized" if it has a total risk-based capital ratio of 8.0% or greater, a Tier 1 risk-based capital ratio of 6.0% or greater, a leverage ratio of 4.0% or greater and a common equity Tier 1 ratio of 4.5% or greater. An institution is "undercapitalized" if it has a total risk-based capital ratio of less than 8.0%, a Tier 1 risk-based capital ratio of less than 6.0%, a leverage ratio of less than 4.0% or a common equity Tier 1 ratio of less than 4.5%. An institution is deemed to be "significantly undercapitalized" if it has a total risk-based capital ratio of less than 6.0%, a Tier 1 risk-based capital ratio of less than 4.0%, a leverage ratio of less than 3.0%, or a common equity Tier 1 ratio of less than 3.0%. An institution is considered to be "critically undercapitalized" if it has a ratio of tangible equity (as defined in the regulations) to total assets that is equal to or less than 2.0%.

As noted above, the EGRRCPA has eliminated the Basel III requirements for banks with less than \$10.0 billion in assets who elect to follow the community bank leverage ratio once the FDIC's rule is finalized. The FDIC's proposed rule provides that the Bank will be well-capitalized with a community bank leverage ratio of 9% or greater, adequately capitalized with a community bank leverage ratio of 7.5% or greater, undercapitalized if the Bank's community bank leverage ratio is less than 7.5% and greater than 6% and significantly undercapitalized if the Bank's community bank leverage ratio is less than 6%. The definition of critically undercapitalized is unchanged from the current regulations.

At each successive lower capital category, an insured depository institution is subject to more restrictions and prohibitions, including restrictions on growth, restrictions on interest rates paid on deposits, restrictions or prohibitions on payment of dividends, and restrictions on the acceptance of brokered deposits. Furthermore, if an insured depository institution is classified in one of the undercapitalized categories, it is required to submit a capital restoration plan to the appropriate federal banking agency, and the holding company must guarantee the performance of that plan. Based upon its capital levels, a bank that is classified as well-capitalized, adequately capitalized, or undercapitalized may be treated as though it were in the next lower capital category if the appropriate federal banking agency, after notice and opportunity for hearing, determines that an unsafe or unsound condition, or an unsafe or unsound practice, warrants such treatment. An undercapitalized bank's compliance with a capital restoration plan is required to be guaranteed by any company that controls the undercapitalized institution in an amount equal to the lesser of 5.0% of the institution's total assets when deemed undercapitalized or the amount necessary to achieve the status of adequately capitalized. If an "undercapitalized" bank fails to submit an acceptable plan, it is treated as if it is "significantly undercapitalized." "Significantly undercapitalized" banks must comply with one or more of a number of additional restrictions, including but not limited to an order by the Federal Deposit Insurance Corporation to sell sufficient voting stock to become adequately capitalized, requirements to reduce total assets, cease receipt of deposits from correspondent banks or dismiss directors or officers, and restrictions on interest rates paid on deposits, compensation of executive officers and capital distributions by the parent holding company. "Critically undercapitalized" institutions are subject to additional measures including, subject to a narrow exception, the appointment of a receiver or conservator within 270 days after it obtains such status.

Transactions with Affiliates and Regulation W of the Federal Reserve Regulations. Transactions between banks and their affiliates are governed by federal law. An affiliate of a bank is any company or entity that controls, is controlled by or is under common control with the bank. In a holding company context, the parent bank holding company and any companies which are controlled by such parent holding company are affiliates of the bank (although subsidiaries of the bank itself, except financial subsidiaries, are generally not considered affiliates). Generally, Section 23A of the Federal Reserve Act and the Federal Reserve Board's Regulation W limit the extent to which a bank or its subsidiaries may engage in "covered transactions" with any one affiliate to an amount equal to 10.0% of such institution's capital stock and surplus, and with all such transactions with all affiliates to an amount equal to 20.0% of such institution's capital stock and surplus. Section 23B applies to "covered transactions" as well as to certain other transactions and requires that all such transactions be on terms substantially the same, or at least as favorable, to the institution or subsidiary as those provided to a non-affiliate. The term "covered transaction" includes the making of loans to, purchase of assets from, and issuance of a guarantee to an affiliate, and other similar transactions. Section 23B transactions also include the provision of services and the sale of assets by a bank to an affiliate. In addition, loans or other extensions of credit by the financial institution to the affiliate are required to be collateralized in accordance with the requirements set forth in Section 23A of the Federal Reserve Act.

Sections 22(h) and (g) of the Federal Reserve Act place restrictions on loans to a bank's insiders, i.e., executive officers, directors and principal stockholders. Under Section 22(h) of the Federal Reserve Act, loans to a director, an executive officer and to a greater than 10.0% stockholder of a financial institution, and certain affiliated interests of these persons, together with all other outstanding loans to such person and affiliated interests, may not exceed specified limits. Section 22(h) of the Federal Reserve Act also requires that loans to directors, executive officers and principal stockholders be made on terms substantially the same as offered in comparable transactions to other persons and also requires prior Board approval for certain loans. In addition, the aggregate amount of extensions of credit by a financial institution to insiders cannot exceed the institution's unimpaired capital and surplus. Section 22(g) of the Federal Reserve Act places additional restrictions on loans to executive officers.

Enforcement. The Federal Deposit Insurance Corporation has extensive enforcement authority over insured state savings banks, including Fairport Savings Bank. The enforcement authority includes, among other things, the ability to assess civil money penalties, issue cease and desist orders and remove directors and officers. In general, these enforcement actions may be initiated in response to violations of laws and regulations, breaches of fiduciary duty and unsafe or unsound practices.

Federal Insurance of Deposit Accounts. Fairport Savings Bank is a member of the Deposit Insurance Fund, which is administered by the Federal Deposit Insurance Corporation. Deposit accounts in Fairport Savings Bank are insured up to a maximum of \$250,000 for each separately insured depositor.

The Dodd-Frank Act increased the minimum target Deposit Insurance Fund ratio from 1.15% of estimated insured deposits to 1.35% of estimated insured deposits. The Federal Deposit Insurance Corporation was required to seek to achieve the 1.35% ratio by September 30, 2020. The FDIC indicated that the 1.35% ratio was exceeded in November 2018. Insured institutions of less than \$10 billion of assets will receive credits for the portion of their assessments that contributed to the reserve ratio between 1.15% and 1.35%. The Dodd-Frank Act eliminated the 1.5% maximum fund ratio, instead leaving it to the discretion of the Federal Deposit Insurance Corporation, which has exercised that discretion by establishing a long range fund ratio of 2%.

The Federal Deposit Insurance Corporation imposes an assessment for deposit insurance on all depository institutions. Assessments for most institutions are based on financial measures and supervisory ratings derived from statistical modeling estimating the probability of failure within three years. In conjunction with the Deposit Insurance Fund reserve ratio achieving 1.5%, the assessment range (inclusive of possible adjustments) was reduced for most banks and savings associations to 1.5 basis points to 30 basis points.

The Federal Deposit Insurance Corporation has authority to increase insurance assessments. A significant increase in insurance premiums would likely have an adverse effect on the operating expenses and results of operations of Fairport Savings Bank. Future insurance assessment rates cannot be predicted.

Insurance of deposits may be terminated by the Federal Deposit Insurance Corporation upon a finding that the institution has engaged in unsafe or unsound practices, is in an unsafe or unsound condition to continue operations, or has violated any applicable law, regulation, rule order or regulatory condition imposed in writing. We do not know of any practice, condition or violation that might lead to termination of deposit insurance.

In addition to the Federal Deposit Insurance Corporation assessments, the Financing Corporation (“FICO”) is authorized to impose and collect, with the approval of the Federal Deposit Insurance Corporation, assessments for anticipated payments, issuance costs and custodial fees on bonds issued by the FICO in the 1980s to recapitalize the former Federal Savings and Loan Insurance Corporation. The bonds issued by the FICO will mature in September 2019. For the quarter ended December 31, 2018, the annualized FICO assessment was equal to 0.32 of a basis point of total assets less tangible capital.

Privacy Regulations. Federal regulations generally require that Fairport Savings Bank disclose its privacy policy, including identifying with whom it shares a customer’s “non-public personal information,” to customers at the time of establishing the customer relationship and annually thereafter. In addition, Fairport Savings Bank is required to provide its customers with the ability to “opt-out” of having their personal information shared with unaffiliated third parties and not to disclose account numbers or access codes to non-affiliated third parties for marketing purposes. Fairport Savings Bank currently has a privacy protection policy in place and believes that such policy is in compliance with the regulations.

Community Reinvestment Act. Under the Community Reinvestment Act, or CRA, as implemented by federal regulations, a state member bank has a continuing and affirmative obligation, consistent with its safe and sound operation, to help meet the credit needs of its entire community, including low and moderate income neighborhoods. The CRA does not establish specific lending requirements or programs for financial institutions nor does it limit an institution’s discretion to develop the types of products and services that it believes are best suited to its particular community, consistent with the CRA. The CRA does require the Federal Deposit Insurance Corporation, in connection with its examination of a state savings bank, to assess the institution’s record of meeting the credit needs of its community and to take such record into account in its evaluation of certain applications by such institution, including applications to acquire branches and other financial institutions. The CRA requires a written evaluation of an institution’s CRA performance utilizing a four-tiered descriptive rating system. Fairport Savings Bank’s latest federal CRA rating was “Satisfactory.”

USA Patriot Act. Fairport Savings Bank is subject to the USA PATRIOT Act, which gives federal agencies additional powers to address terrorist threats through enhanced domestic security measures, expanded surveillance powers, increased information sharing, and broadened anti-money laundering requirements. The USA PATRIOT Act contains provisions intended to encourage information sharing among bank regulatory agencies and law enforcement bodies. Further, certain provisions impose affirmative obligations on a broad range of financial institutions, including banks, thrifts, brokers, dealers, credit unions, money transfer agents, and parties registered under the Commodity Exchange Act.

Other Regulations

Interest and other charges collected or contracted for by Fairport Savings Bank are subject to state usury laws and federal laws concerning interest rates. Loan operations are also subject to state and federal laws applicable to credit transactions, such as the:

- Home Mortgage Disclosure Act of 1975, requiring financial institutions to provide information to enable the public and public officials to determine whether a financial institution is fulfilling its obligation to help meet the housing needs of the community it serves;
- Equal Credit Opportunity Act, prohibiting discrimination on the basis of race, creed or other prohibited factors in extending credit;
- Fair Credit Reporting Act of 1978, governing the use and provision of information to credit reporting agencies; and
- Rules and regulations of the various federal and state agencies charged with the responsibility of implementing such federal and state laws.

The deposit operations of Fairport Savings Bank also are subject to, among others, the:

- Right to Financial Privacy Act, which imposes a duty to maintain confidentiality of consumer financial records and prescribes procedures for complying with administrative subpoenas of financial records;
- Check Clearing for the 21st Century Act (also known as “Check 21”), which gives “substitute checks,” such as digital check images and copies made from that image, the same legal standing as the original paper check; and
- Electronic Funds Transfer Act and Regulation E promulgated thereunder, which govern automatic deposits to and withdrawals from deposit accounts and customers’ rights and liabilities arising from the use of automated teller machines and other electronic banking services.

Federal Reserve System

The Federal Reserve Board regulations require depository institutions to maintain non-interest-earning reserves against their transaction accounts (primarily NOW and regular checking accounts). The Federal Reserve Board regulations generally require that reserves be maintained against aggregate transaction accounts as follows: for that portion of transaction accounts aggregating \$124.2 million or less (which may be adjusted by the Federal Reserve Board) the reserve requirement is 3.0%, and for amounts greater than \$124.2 million the reserve requirement is 10.0% (which may be adjusted annually by the Federal Reserve Board to between 8.0% and 14.0%). The first \$16.3 million of otherwise reservable balances (which may be adjusted by the Federal Reserve Board) are exempted from the reserve requirements. Fairport Savings Bank is in compliance with these requirements.

Federal Home Loan Bank System

Fairport Savings Bank is a member of the Federal Home Loan Bank System, which consists of 11 regional Federal Home Loan Banks. The Federal Home Loan Bank provides a central credit facility primarily for member institutions. Members of the Federal Home Loan Bank are required to acquire and hold shares of capital stock in the Federal Home Loan Bank. Fairport Savings Bank was in compliance with this requirement at December 31, 2018. Based on redemption provisions of the Federal Home Loan Bank of New York, the stock has no quoted market value and is carried at cost. Fairport Savings Bank reviews for impairment, based on the ultimate recoverability, the cost basis of the Federal Home Loan Bank of New York stock. As of December 31, 2018, no impairment has been recognized.

Holding Company Regulation

In connection with its second step conversion in 2016, Fairport Savings Bank revoked its Section 10(l) election, changing the status of its holding company from that of a savings and loan holding company to that of a bank holding company. By so doing, the previously applicable requirement that the Bank comply with the “Qualified Thrift Lender Test,” which limited commercial lending, was eliminated. Consequently, FSB Bancorp is subject to examination, regulation, and periodic reporting under the Bank Holding Company Act of 1956, as administered by the Federal Reserve Board. FSB Bancorp is required to obtain the prior approval of the Federal Reserve Board to acquire all, or substantially all, of the assets of any bank or bank holding company. Prior Federal Reserve Board approval would be required for FSB Bancorp to acquire direct or indirect ownership or control of any voting securities of any bank or bank holding company if it would, directly or indirectly, own or control more than 5% of any class of voting shares of the bank or bank holding company.

A bank holding company is generally prohibited from engaging in, or acquiring, direct or indirect control of more than 5% of the voting securities of any company engaged in non-banking activities. One of the principal exceptions to this prohibition is for activities found by the Federal Reserve Board to be so closely related to banking or managing or controlling banks as to be a proper incident thereto. Some of the principal activities that the Federal Reserve Board has determined by regulation to be closely related to banking are: (i) making or servicing loans; (ii) performing certain data processing services; (iii) providing securities brokerage services; (iv) acting as fiduciary, investment or financial advisor; (v) leasing personal or real property under certain conditions; (vi) making investments in corporations or projects designed primarily to promote community welfare; and (vii) acquiring a savings association.

The Gramm-Leach-Bliley Act of 1999 authorizes a bank holding company that meets specified conditions, including that its depository institution subsidiaries that are “well capitalized” and “well managed,” to opt to become a “financial holding company.” A “financial holding company” may engage in a broader array of financial activities than permitted a typical bank holding company. Such activities can include insurance underwriting and investment banking. FSB Bancorp has elected “financial holding company” status, which became effective following completion of the conversion and reorganization.

FSB Bancorp is not subject to the Federal Reserve Board’s consolidated capital adequacy guidelines for bank holding companies. Legislation was enacted in December 2014 requiring the Federal Reserve Board to generally extend its “Small Bank Holding Company” exemption from consolidated holding company capital requirements to bank and savings and loan holding companies of up to \$1 billion in assets. As noted above, the EGRRCPA further increased the exemption from consolidated holding company capital requirements to bank and savings and loan holding companies to \$3 billion in assets. Consequently, bank holding companies with less than \$3 billion in consolidated assets remain exempt from consolidated regulatory capital requirements, unless the Federal Reserve determines otherwise in particular cases.

A bank holding company is generally required to give the Federal Reserve Board prior written notice of any purchase or redemption of then outstanding equity securities if the gross consideration for the purchase or redemption, when combined with the net consideration paid for all such purchases or redemptions during the preceding 12 months, is equal to 10% or more of the company’s consolidated net worth. The Federal Reserve Board may disapprove such a purchase or redemption if it determines that the proposal would constitute an unsafe and unsound practice, or would violate any law, regulation, Federal Reserve Board order or directive, or any condition imposed by, or written agreement with, the Federal Reserve Board. The Federal Reserve Board has adopted an exception to that approval requirement for well-capitalized bank holding companies that meet certain other conditions. The Federal Reserve Board has issued guidance which requires consultation with the Federal Reserve Board prior to a redemption or repurchase in certain circumstances.

The Federal Reserve Board has issued a policy statement regarding the payment of dividends by bank holding companies. In general, the Federal Reserve Board’s policies provide that dividends should be paid only out of current earnings and only if the prospective rate of earnings retention by the bank holding company appears consistent with the organization’s capital needs, asset quality and overall financial condition. The Federal Reserve Board’s policies also require that a bank holding company serve as a source of financial strength to its subsidiary banks by using available resources to provide capital funds during periods of financial stress or adversity and by maintaining the financial flexibility and capital-raising capacity to obtain additional resources for assisting its subsidiary banks where necessary. The Dodd-Frank Act codified the source of strength policy. Under the prompt corrective action laws, the ability of a bank holding company to pay dividends may be restricted if a subsidiary bank becomes undercapitalized. These regulatory policies could affect the ability of FSB Bancorp to pay dividends or otherwise engage in capital distributions.

FSB Bancorp and Fairport Savings Bank is affected by the monetary and fiscal policies of various agencies of the United States Government, including the Federal Reserve System. In view of changing conditions in the national economy and in the money markets, it is impossible for management to accurately predict future changes in monetary policy or the effect of such changes on the business or financial condition of FSB Bancorp or Fairport Savings Bank.

FSB Bancorp's status as a registered bank holding company under the Bank Holding Company Act does not exempt it from certain federal and state laws and regulations applicable to corporations generally, including, without limitation, certain provisions of the federal securities laws.

Federal Securities Laws

FSB Bancorp common stock is registered with the Securities and Exchange Commission. FSB Bancorp is subject to the information, proxy solicitation, insider trading restrictions and other requirements under the Securities Exchange Act of 1934.

The registration under the Securities Act of 1933 of shares of common stock issued in FSB Bancorp's public offering does not cover the resale of those shares. Shares of common stock purchased by persons who are not affiliates of FSB Bancorp may be resold without registration. Shares purchased by an affiliate of FSB Bancorp will be subject to the resale restrictions of Rule 144 under the Securities Act of 1933. If FSB Bancorp meets the current public information requirements of Rule 144 under the Securities Act of 1933, each affiliate of FSB Bancorp that complies with the other conditions of Rule 144, including those that require the affiliate's sale to be aggregated with those of other persons, would be able to sell in the public market, without registration, a number of shares not to exceed, in any three-month period, the greater of 1% of the outstanding shares of FSB Bancorp, or the average weekly volume of trading in the shares during the preceding four calendar weeks. In the future, FSB Bancorp may permit affiliates to have their shares registered for sale under the Securities Act of 1933.

Emerging Growth Company Status

On April 5, 2012, the JOBS Act was signed into law. The JOBS Act made numerous changes to the federal securities laws to facilitate access to capital markets. Under the JOBS Act, a company with total annual gross revenues of less than \$1.07 billion during its most recently completed fiscal year qualifies as an "emerging growth company." We qualify as an "emerging growth company" and believe that we will continue to qualify as an "emerging growth company" for five years from the completion of the stock offering.

Subject to certain conditions set forth in the JOBS Act, as an "emerging growth company," we expect to rely on such exemptions so that we may not be required to, among other things, (i) provide an auditor's attestation report on our system of internal controls over financial reporting, (ii) provide all of the compensation disclosure that may be required of non-emerging growth public companies under the Dodd-Frank Act, (iii) hold non-binding stockholder votes regarding annual executive compensation or executive compensation payable in connection with a merger or similar corporate transaction, (iv) comply with any requirement that may be adopted by the Public Company Accounting Oversight Board regarding mandatory audit firm rotation or a supplement to the auditor's report providing additional information about the audit and the financial statements (auditor discussion and analysis), and (v) disclose certain executive compensation related items such as the correlation between executive compensation and performance and comparisons of the chief executive officer's compensation to median employee compensation. These exemptions will apply for a period of five years following the completion of our initial public offering or until we are no longer an "emerging growth company," whichever is earlier. However, we will not be subject to the auditor attestation requirement or additional executive compensation disclosure, regardless of the exemptions, so long as we remain a "smaller reporting company" under Securities and Exchange Commission regulations (generally less than \$250 million of voting and non-voting equity held by non-affiliates).

We could remain an "emerging growth company" for up to five years, or until the earliest of (a) the last day of the first fiscal year in which our annual gross revenues exceed \$1.07 billion, (b) the date that we become a "large accelerated filer" as defined in Rule 12b-2 under the Securities Exchange Act of 1934, as amended, which would occur if the market value of our common stock that is held by non-affiliates exceeds \$700 million as of the last business day of our most recently completed second fiscal quarter, or (c) the date on which we have issued more than \$1.0 billion in non-convertible debt during the preceding three-year period.

Sarbanes-Oxley Act of 2002

The Sarbanes-Oxley Act of 2002 is intended to improve corporate responsibility, to provide for enhanced penalties for accounting and auditing improprieties at publicly traded companies and to protect investors by improving the accuracy and reliability of corporate disclosures pursuant to the securities laws. We have policies, procedures and systems designed to comply with these regulations, and we review and document such policies, procedures and systems to ensure continued compliance with these regulations.

Change in Control Regulations

Under the Change in Bank Control Act, no person may acquire control of a bank holding company such as FSB Bancorp unless the Federal Reserve Board has been given 60 days' prior written notice and has not issued a notice disapproving the proposed acquisition, taking into consideration certain factors, including the financial and managerial resources of the acquirer and the competitive effects of the acquisition. Control, as defined under federal law, means ownership, control of or holding irrevocable proxies representing more than 25% of any class of voting stock, control in any manner of the election of a majority of the institution's directors, or a determination by the regulator that the acquiror has the power, directly or indirectly, to exercise a controlling influence over the management or policies of the institution. Acquisition of more than 10% of any class of a bank holding company's voting stock constitutes a rebuttable determination of control under the regulations under certain circumstances including where, as is the case with FSB Bancorp, the issuer has registered securities under Section 12 of the Securities Exchange Act of 1934.

In addition, federal regulations provide that no company may acquire control of a bank holding company without the prior approval of the Federal Reserve Board. Any company that acquires such control becomes a "bank holding company" subject to registration, examination and regulation by the Federal Reserve Board.

TAXATION

FSB Bancorp and Fairport Savings Bank are subject to federal and state income taxation in the same general manner as other corporations, with some exceptions discussed below. The following discussion of federal and state taxation is intended only to summarize certain pertinent tax matters and is not a comprehensive description of the tax rules applicable to FSB Bancorp or Fairport Savings Bank.

Federal Taxation

Tax Cuts and Jobs Act. On December 22, 2017, the Tax Cuts and Jobs Act (the "Tax Act") was enacted which reduced the corporate federal income tax rate from 35% to 21% and caused a reevaluation of net deferred tax assets. Generally accepted accounting principles requires that the impact of the provisions of the Tax Act be accounted for in the period of enactment. As changes in tax laws or rates are enacted, deferred tax assets and liabilities are adjusted through the provision for income taxes.

Method of Accounting. For federal income tax purposes, FSB Bancorp and Fairport Savings Bank currently report their income and expenses on the accrual method of accounting and use a tax year ending December 31 for filing their federal income tax returns.

Bad Debt Reserves. Prior to the Small Business Protection Act of 1996 (the "1996 Act"), Fairport Savings Bank was permitted to establish a reserve for bad debts and to make annual additions to the reserve. These additions could, within specified formula limits, be deducted in arriving at our taxable income. As a result of the 1996 Act, Fairport Savings Bank was required to use the specific charge off method in computing its bad debt deduction beginning with its 1996 federal tax return. Savings institutions were required to recapture any excess reserves over those established as of December 31, 1987 (base year reserve). At December 31, 2018, Fairport Savings Bank had no reserves subject to recapture in excess of its base year reserves.

Taxable Distributions and Recapture. Prior to the 1996 Act, bad debt reserves created prior to January 1, 1988 were subject to recapture into taxable income if Fairport Savings Bank failed to meet certain thrift asset and definitional tests. Federal legislation has eliminated these thrift-related recapture rules. At December 31, 2018, our total federal pre-1988 base year reserve was approximately \$1.5 million. However, under current law, pre-1988 base year reserves remain subject to recapture if Fairport Savings Bank makes certain non-dividend distributions, repurchases any of its stock, pays dividends in excess of tax earnings and profits, or ceases to maintain a savings bank charter.

Alternative Minimum Tax. The Internal Revenue Code imposes an alternative minimum tax ("AMT") at a rate of 20% on a base of regular taxable income plus certain tax preferences, which we refer to as "alternative minimum taxable income." The AMT is payable to the extent such alternative minimum taxable income is in excess of an exemption amount and the AMT exceeds the regular income tax. Net operating losses can offset no more than 90% of alternative minimum taxable income. Certain AMT payments may be used as credits against regular tax liabilities in future years. Under the Tax Act, AMT is no longer imposed beginning in 2018.

Net Operating Loss Carryovers. For net operating losses incurred prior to January 1, 2018, a company may carry back those net operating losses to the preceding two taxable years and forward to the succeeding 20 taxable years. As part of the Act, net operating losses incurred after December 31, 2017 can be carried forward indefinitely and used to offset up to 80% of taxable income. At December 31, 2018, FSB Bancorp had no net operating loss carry forwards for federal income tax purposes.

Corporate Dividends-Received Deduction. FSB Bancorp may exclude from its income 100% of dividends received from Fairport Savings Bank as a member of the same affiliated group of corporations. The corporate dividends-received deduction is 80% in the case of dividends received from a corporation in which a corporate recipient owns at least 20% of its stock, and corporations that own less than 20% of the stock of a corporation distributing a dividend may deduct only 70% of dividends received or accrued on their behalf.

State Taxation

New York State Taxation. Effective January 1, 2015, banking corporations became subject to taxation under the New York State General Business Corporation Franchise Tax provisions. The New York State tax rate on “entire net income” was reduced from 7.1% to 6.5% effective January 1, 2016, and various modifications were available to community banks (defined as banks with less than \$8 billion in total assets) regarding deductions associated with interest income.

Maryland State Taxation. As a Maryland business corporation, FSB Bancorp is required to file an annual report with and pay franchise taxes to the state of Maryland.

ITEM 1A. RISK FACTORS

As a “smaller reporting company,” FSB Bancorp is not required to provide the information required by this item.

ITEM 1B. UNRESOLVED STAFF COMMENTS

None.

ITEM 2. PROPERTIES

As of December 31, 2018, the net book value of our office properties was \$5.0 million. The following table sets forth information regarding our offices.

<u>Location</u>	<u>Leased or Owner</u>	<u>Year Acquired or Leased</u>	<u>Net Book Value of Real Property</u>
Main Office:	Owner	1932	\$ 1,492,000
Fairport			
Other Properties:			
Penfield	Leased ¹	2002	\$ 1,223,000
Irondequoit	Leased ¹	2007	\$ 1,084,000
Webster	Leased ¹	2009	\$ 236,000
Perinton	Leased ¹	2011	\$ 898,000
Pittsford	Leased	2010	\$ 60,000 ²
Greece	Leased	2014	\$ 10,000 ²
Watertown	Leased	2010	—
Cheektowaga	Leased	2015	—
Lewiston	Leased	2017	—

¹Ground lease only

²Leasehold improvements

ITEM 3. LEGAL PROCEEDINGS

Periodically, the Company is involved in claims and lawsuits, such as claims to enforce liens, condemnation proceedings on properties in which we hold security interests, claims involving the making and servicing of real property loans and other issues incident to our business. At December 31, 2018, the Company was not a party to any pending legal proceedings that we believe would have a material adverse effect on our financial condition, results of operations or cash flows.

ITEM 4. MINE SAFETY DISCLOSURES

Not applicable.

PART II

ITEM 5. MARKET FOR REGISTRANT’S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES

The approximate number of holders of record of FSB Bancorp’s common stock as of February 11, 2019 was 175. Shares of FSB Bancorp common stock trade on the Nasdaq Capital Market under the symbol “FSBC.” Certain shares of FSB Bancorp are held in “nominee” or “street name” and, accordingly, the number of beneficial owners of such shares is not known or included in the foregoing number.

The table below sets forth the high and low sales prices of FSB Bancorp’s common stock for the periods listed.

	<u>High</u>	<u>Low</u>
<u>Year Ended December 31, 2018</u>		
Quarter ended December 31, 2018	\$ 17.75	\$ 15.96
Quarter ended September 30, 2018	\$ 18.50	\$ 17.45
Quarter ended June 30, 2018	\$ 17.96	\$ 16.85
Quarter ended March 31, 2018	\$ 18.00	\$ 16.56
<u>Year Ended December 31, 2017</u>		
Quarter ended December 31, 2017	\$ 17.75	\$ 15.30
Quarter ended September 30, 2017	\$ 16.72	\$ 14.60
Quarter ended June 30, 2017	\$ 15.10	\$ 14.21
Quarter ended March 31, 2017	\$ 14.84	\$ 13.97

FSB Bancorp has not declared dividends on its common stock. Dividend payments by FSB Bancorp are dependent in part on dividends it receives from Fairport Savings Bank because FSB Bancorp has no source of income other than dividends from Fairport Savings Bank, earnings from the investment of proceeds from the sale of shares of common stock retained by FSB Bancorp and interest payments with respect to FSB Bancorp’s loan to the Employee Stock Ownership Plan. For more information on restrictions on dividend payments, please see “Item 1. Business—Regulation and Supervision—Holding Company Regulation.”

The following table provides certain information with regard to shares repurchased by the Company during the quarter ended December 31, 2018.

<u>Period</u>	<u>(a) Total Number of Shares Purchased</u>	<u>(b) Average Price Paid per Share</u>	<u>(c) Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs(1)</u>	<u>(d) Maximum Number of Shares that May Yet Be Purchased Under the Plans or Programs(1)</u>
October 1 — October 31, 2018	-	\$ -	-	27,549
November 1 — November 30, 2018	882	\$ 16.48	882	26,667
December 1 — December 31, 2018	1,710	\$ 16.32	1,710	24,957
Total	<u>2,592</u>	\$ 16.38	<u>2,592</u>	

(1) The Company’s Board of Directors authorized its first stock repurchase program on July 27, 2017 to acquire up to 97,084 shares, or 5.0% of the Company’s then outstanding common stock. Repurchases will be made from time to time depending on market conditions and other factors, and will be conducted through open market or private transactions, through block trades, and pursuant to any trading plan that may be adopted in accordance with Rule 10b5-1 of the Securities and Exchange Commission. There is no guarantee as to the exact number of shares to be repurchased by the Company.

ITEM 6. SELECTED FINANCIAL DATA

This item is not applicable to smaller reporting companies.

ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The information contained in the section captioned "Management's Discussion and Analysis of Financial Condition and Results of Operations" is incorporated by reference to our Annual Report to Stockholders.

ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

As a "smaller reporting company," FSB Bancorp is not required to provide the information required by this item.

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

The consolidated financial statements included in our Annual Report to Stockholders are incorporated herein by reference.

ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

None.

ITEM 9A. CONTROLS AND PROCEDURES

Disclosure controls and procedures are the controls and other procedures that are designed to ensure that information required to be disclosed in the reports that the Company files or submits under the Exchange Act is recorded, processed, summarized, and reported within the time periods specified in the SEC's rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed in the reports that the Company files or submits under the Securities and Exchange Act of 1934, as amended (the "Exchange Act") is accumulated and communicated to management, including the Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure. In designing and evaluating the disclosure controls and procedures, management recognizes that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives. In addition, the design of disclosure controls and procedures must necessarily reflect the fact that there are resource constraints and that management is required to apply its judgement in evaluating the benefits of possible controls and procedures relative to their costs.

Under the supervision and with the participation of the Company's management, including our Chief Executive Officer and Chief Financial Officer, the Company has evaluated the effectiveness of the design and operation of its disclosure controls and procedures (as defined in Rule 13a-15(e) and 15d-15(e) under the Exchange Act) as of December 31, 2018. Based upon that evaluation, the Chief Executive Officer and Chief Financial Officer concluded that, as of December 31, 2018, the Company's disclosure controls and procedures are effective to ensure that information required to be disclosed in the reports that the Company files or submits under the Exchange Act is recorded, processed, summarized and reported, within the time periods specified in the Securities and Exchange Commission's rules and forms.

Management's Report on Internal Control over Financial Reporting

Management of the Company is responsible for establishing and maintaining adequate internal control over financial reporting. Internal control over financial reporting is defined in Rule 13a-15(f) under the Exchange Act as a process designed by, or under the supervision of, the Company's principal executive and principal financial officers and effected by the Company's Board of Directors, management and other personnel, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. The Company's internal control over financial reporting includes those policies and procedures that:

- (i) pertain to the maintenance of records that in reasonable detail accurately and fairly reflects the transactions and disposition of the assets of the Company;
- (ii) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the Company are being made only in accordance with authorization of management and directors of the Company; and
- (iii) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of the Company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

Management assessed the effectiveness of the Company's internal control over financial reporting as of December 31, 2018. In making this assessment, management used the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) in Internal Control-Integrated Framework (2013).

Based on our assessment and those criteria, management believes that the Company maintained effective internal control over financial reporting as of December 31, 2018.

This annual report does not include an attestation report of the Company's registered public accounting firm regarding internal control over financial reporting. Management's report was not subject to attestation by the Company's registered public accounting firm pursuant to rules of the Securities and Exchange Commission that permit the Company to provide only management's report in this annual report.

There has been no change in the Company's internal control over financial reporting during the fourth quarter of the fiscal year ended December 31, 2018 that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting.

ITEM 9B. OTHER INFORMATION

None.

PART III

ITEM 10. DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE

Information concerning our directors and certain officers is incorporated herein by reference to the section entitled "Proposal I—Election of Directors" in the Proxy Statement for the 2019 Annual Meeting of Stockholders.

ITEM 11. EXECUTIVE COMPENSATION

Information with respect to management compensation required under this item is incorporated herein by reference to the section entitled "Proposal I—Election of Directors" in the Proxy Statement for the 2019 Annual Meeting of Stockholders.

ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS

Set forth below is information as of December 31, 2018 regarding equity compensation plans categorized by those plans that have been approved by the Company's stockholders. There are no plans that have not been approved by the Company's stockholders.

Plan	Number of Securities to be Issued Upon Exercise of Outstanding Options and Rights	Weighted Average Exercise Price	Number of Securities Remaining Available for Issuance Under Plan
Equity compensation plans approved by stockholders	172,080	\$ 16.82	28,657
Equity compensation plans not approved by stockholders	—	—	—
Total	172,080	\$ 16.82	28,657

Information with respect to management compensation required under this item is incorporated herein by reference to the section entitled "Proposal I—Election of Directors" in the Proxy Statement for the 2019 Annual Meeting of Stockholders.

ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS AND DIRECTOR INDEPENDENCE

Information with respect to management compensation required under this item is incorporated herein by reference to the section entitled "Proposal I—Election of Directors" in the Proxy Statement for the 2019 Annual Meeting of Stockholders.

ITEM 14. PRINCIPAL ACCOUNTANT FEES AND SERVICES

Information with respect to management compensation required under this item is incorporated herein by reference to the section entitled "Proposal II—Ratification of Appointment of Independent Registered Public Accounting Firm" in the Proxy Statement for the 2019 Annual Meeting of Stockholders.

PART IV

ITEM 15. EXHIBITS AND FINANCIAL STATEMENT SCHEDULES

(a)(1) Financial Statements

The documents filed as a part of this Annual Report on Form 10-K are:

- (A) Report of Independent Registered Public Accounting Firm
- (B) Consolidated Balance Sheets – as of December 31, 2018 and 2017
- (C) Consolidated Statements of Income – years ended December 31, 2018 and 2017
- (D) Consolidated Statements of Comprehensive Income – years ended December 31, 2018 and 2017
- (E) Consolidated Statements of Stockholders' Equity – years ended December 31, 2018 and 2017
- (F) Consolidated Statements of Cash Flows – years ended December 31, 2018 and 2017
- (G) Notes to Consolidated Financial Statements

(a)(2) Financial Statement Schedules

All financial statement schedules have been omitted as the required information is inapplicable or has been included in the Notes to Consolidated Financial Statements.

(a)(3) Exhibits

- 3.1 [Articles of Incorporation of FSB Bancorp, Inc. \(incorporated by reference to Exhibit 3.1 to the Registration Statement on Form S-1 of FSB Bancorp, Inc. \(File No. 333-210129\), filed with the Securities and Exchange Commission on March 11, 2016\).](#)
- 3.2 [Bylaws of FSB Bancorp, Inc. \(incorporated by reference to Exhibit 3.2 to Pre-Effective Amendment No. 1 to the Registration Statement on Form S-1 of FSB Bancorp, Inc. \(File No. 333-210129\), filed with the Securities and Exchange Commission on April 28, 2016\).](#)
- 4 [Form of Common Stock Certificate of FSB Bancorp, Inc. \(incorporated by reference to Exhibit 4 to the Registration Statement on Form S-1 of FSB Bancorp, Inc. \(File No. 333-210129\), filed with the Securities and Exchange Commission on March 11, 2016\).](#)
- 10.1 [Employment Agreement by and between Fairport Savings Bank and Kevin D. Maroney dated October 26, 2017 \(incorporated by reference to Exhibit 10.1 to the Current Report on Form 8-K of FSB Bancorp, Inc. \(File No. 001-37831\) filed with the Securities and Exchange Commission on October 31, 2017\).](#)
- 10.2 [Supplemental Executive Retirement Plan for Dana C. Gavenda \(incorporated by reference to Exhibit 10.3 to the Registration Statement on Form S-1 of FSB Bancorp, Inc. \(File No. 333-210129\), filed with the Securities and Exchange Commission on March 11, 2016\).](#)
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- 10.5 [FSB Bancorp, Inc. Annual Incentive Plan \(incorporated by reference to Exhibit 10.6 to the Registration Statement on Form S-1 of FSB Bancorp, Inc. \(File No. 333-210129\), filed with the Securities and Exchange Commission on March 11, 2016\).](#)
- 10.6 [FSB Bancorp, Inc. 2017 Equity Incentive Plan \(incorporated by reference to Appendix A of the definitive Proxy Statement \(File No. 001-37831\) filed with the Securities and Exchange Commission on July 19, 2017\).](#)
- 10.7 [Amendment to Fairport Savings Bank Supplemental Executive Retirement Plan, dated September 27, 2017 \(incorporated by reference to Exhibit 10.1 to the Current Report on Form 8-K of FSB Bancorp, Inc. \(File No. 001-37831\), filed with the Securities and Exchange Commission on October 3, 2017\).](#)
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- 10.9 [Form of Restricted Stock Award Agreements \(incorporated by reference to Exhibit 10.2 to the Registration Statement on Form S-8 \(File No. 333-220742\), filed with the Securities and Exchange Commission on September 29, 2017\).](#)
- 10.10 [Form of Incentive Stock Option Award Agreement \(incorporated by reference to Exhibit 10.3 to the Registration Statement on Form S-8 \(File No. 333-220742\), filed with the Securities and Exchange Commission on September 29, 2017\).](#)
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- 10.13 [Change in Control Agreement by and between Fairport Savings Bank and Michael R. Giancursio.](#)
- 13 [2018 Annual Report to Stockholders](#)
- 23 [Consent of Bonadio & Co., LLP](#)
- 31.1 [Certification required pursuant to Section 302 of the Sarbanes-Oxley Act of 2002](#)
- 31.2 [Certification required pursuant to Section 302 of the Sarbanes-Oxley Act of 2002](#)
- 32.1 [Certification of Chief Executive Officer and Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002](#)
- 101 The following materials from the Company's Annual Report on Form 10-K for the year ended December 31, 2018, formatted in XBRL (Extensible Business Reporting Language): (i) Consolidated Balance Sheets; (ii) Consolidated Statements of Income; (iii) Consolidated Statements of Comprehensive Income; (iv) Consolidated Statements of Stockholders' Equity; (v) Consolidated Statements of Cash Flows; and (v) Notes to Consolidated Financial Statements

ITEM 16. FORM 10-K SUMMARY

The Company has elected not to provide summary information.

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

SB BANCORP, INC.

Date: March 27, 2019

By: /s/ Kevin D. Maroney
Kevin D. Maroney
President and Chief Executive Officer
(Duly Authorized Representative)

<u>/s/ Kevin D. Maroney</u> Kevin D. Maroney	President, Chief Executive Officer and Director (Principal Executive Officer)	<u>March 27, 2019</u>
<u>/s/ Angela M. Krezmer</u> Angela M. Krezmer	Chief Financial Officer (Chief Accounting and Financial Officer)	<u>March 27, 2019</u>
<u>/s/ Dana C. Gavenda</u> Dana C. Gavenda	Chairman of the Board	<u>March 27, 2019</u>
<u>/s/ Dawn DePerrior</u> Dawn DePerrior	Director	<u>March 27, 2019</u>
<u>/s/ Stephen Meyer</u> Stephen Meyer	Director	<u>March 27, 2019</u>
<u>/s/ Lowell C. Patric</u> Lowell C. Patric	Director	<u>March 27, 2019</u>
<u>/s/ Alicia H. Pender</u> Alicia H. Pender	Director	<u>March 27, 2019</u>
<u>/s/ James E. Smith</u> James E. Smith	Director	<u>March 27, 2019</u>
<u>/s/ Charis W. Warshof</u> Charis W. Warshof	Director	<u>March 27, 2019</u>
<u>/s/ Thomas Weldgen</u> Thomas Weldgen	Director	<u>March 27, 2019</u>

EXHIBIT INDEX

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Section 2: EX-10.13 (EXHIBIT 10.13)

Exhibit 10.13

CHANGE IN CONTROL AGREEMENT

This Change in Control Agreement (this "Agreement") is made effective as of October 30, 2017 (the "Effective Date"), by and between Fairport Savings Bank (the "Bank") and Michael Giancursio ("Executive"). Any reference to the "Company" shall mean FSB Bancorp, Inc., the stock holding company of the Bank, or any successor thereto.

WHEREAS, the Bank wishes to assure itself of the continued services of Executive as Chief Lending Officer of the Bank for the period

provided in this Agreement; and

WHEREAS, in order to induce Executive to continue employment with the Bank and to provide further incentive to achieve the financial and performance objectives of the Bank, the parties desire to specify the benefits which shall be due to Executive in the event of a Change in Control (as defined below).

NOW THEREFORE, in consideration of the mutual agreements herein contained, and upon the other terms and conditions hereinafter provided, the parties hereby agree as follows:

1. **Term of Agreement.** The term of this Agreement shall commence as of the Effective Date and shall continue thereafter for a period of two (2) years. Commencing on the first anniversary date of this Agreement (the “**Anniversary Date**”) and continuing on each Anniversary Date thereafter, the term of this Agreement shall renew for an additional year such that the remaining term of this Agreement is always two (2) years unless written notice of non-renewal (“**Non-Renewal Notice**”) is provided to Executive at least 30 days prior to any such Anniversary Date, in which event this Agreement shall terminate at the end of 12 months following such Anniversary Date. Prior to each notice period for non-renewal, the disinterested members of the Board of Directors of the Bank (the “**Board**”) will conduct a comprehensive performance evaluation and review of Executive for purposes of determining whether to take action regarding non-renewal of the Agreement, and the results thereof shall be included in the minutes of the Board’s meeting. Reference herein to the term of this Agreement shall refer to both such initial term and such extended terms.

2. **Definitions.** The following words and terms shall have the meanings set forth below for purposes of this Agreement.

(a) **Change in Control.** For purposes of this Agreement, the term “Change in Control” shall mean the occurrence of any of the following events:

(i) **Merger:** The Bank or the Company merges into or consolidates with another entity whereby the Bank or the Company is not the surviving entity, or the Bank or the Company merges another bank or corporation into the Bank or the Company, and as a result, less than a majority of the combined voting power of the resulting corporation immediately after the merger or consolidation is held by persons who were stockholders of the Company or the Bank immediately before the merger or consolidation;

(ii) Acquisition of Significant Share Ownership: There is filed, or is required to be filed, a report on Schedule 13D or another form or schedule (other than Schedule 13G) required under Sections 13(d) or 14(d) of the Securities Exchange Act of 1934, as amended, if the schedule discloses that the filing person or persons acting in concert has or have become the beneficial owner of 25% or more of a class of the Company's or the Bank's voting securities; provided, however, this clause (ii) shall not apply to beneficial ownership of the Company's or the Bank's voting shares held in a fiduciary capacity by an entity of which the Company directly or indirectly beneficially owns 50% or more of its outstanding voting securities;

(iii) Change in Board Composition: During any period of two (2) consecutive years, individuals who constitute the Company's or the Bank's Board of Directors at the beginning of the two-year period cease for any reason to constitute at least a majority of the Company's or the Bank's Board of Directors; provided, however, that for purposes of this clause (iii), each director who is first elected by the board (or first nominated by the board for election by the stockholders) by a vote of at least two-thirds (2/3) of the directors who were directors at the beginning of the two-year period or who is appointed to the board as the result of a directive, supervisory agreement or order issued by the primary federal regulator of the Company or the Bank shall be deemed to have also been a director at the beginning of such period; or

(iv) Sale of Assets: The Company or the Bank sells to a third party all or substantially all of its assets.

(b) Good Reason. For purposes of this Agreement, "**Good Reason**" shall mean a termination by Executive, without Executive's express written consent, any of the following occurs:

(i) a material reduction in Executive's base compensation as in effect immediately prior to the date of Change in Control or as may be increased from time to time thereafter;

(ii) a material reduction in Executive's authority, duties or responsibilities in effect immediately prior to a Change in Control;

(iii) a material reduction in the authority, duties, or responsibilities of the officer (as in effect immediately prior to the date of the Change in Control) to whom Executive is required report;

(iv) a relocation of Executive's principal place of employment by more than 25 miles from the Bank's main office as of the Effective Date; or

(v) any material breach of this Agreement by the Bank.

Notwithstanding the foregoing, prior to any termination of employment for Good Reason, Executive must first provide written notice to the Board within 90 days following the initial existence of the condition, describing the existence of such condition, and the Bank shall thereafter have the right to remedy the condition within 30 days of the date the Board received the written notice from Executive, but the Bank may waive its right to cure. If the Bank remedies the condition within such 30-day cure period, then no Good Reason shall be deemed to exist with respect to such condition. If the Bank does not remedy the condition within such 30-day cure period, then Executive may deliver a notice of termination for Good Reason at any time within 60 days following the expiration of such cure period.

(c) Termination for Cause. Termination for Cause shall mean termination because of, in the good faith determination of the Board, Executive's:

- (i) material act of dishonesty or fraud in performing Executive's duties on behalf of the Bank;
- (ii) willful misconduct that in the judgment of the Board will likely cause economic damage to the Bank or injury to the business reputation of the Bank;
- (iii) incompetence (in determining incompetence, the acts or omissions shall be measured against standards generally prevailing in the savings institutions industry);
- (iv) breach of fiduciary duty involving personal profit;
- (v) intentional failure to perform stated duties under this Agreement after written notice thereof from the Board;
- (vi) willful violation of any law, rule or regulation (other than traffic violations or similar offenses which results only in a fine or other non-custodial penalty) that reflect adversely on the reputation of the Bank, any felony conviction, any violation of law involving moral turpitude, or any violation of a final cease-and-desist order; any violation of the policies and procedures of the Bank as outlined in the Bank's employee handbook, which would result in termination of the Bank employees, as from time to time amended and incorporated herein by reference, or
- (vii) material breach by Executive of any provision of this Agreement.

3. Benefits upon Termination in Connection with a Change in Control. In the event of Executive's involuntary termination of employment by the Bank for reasons other than Termination for Cause, or a voluntary termination of employment by Executive for Good Reason occurring on or after a Change in Control, the Bank shall pay Executive, or in the event of Executive's subsequent death, Executive's beneficiary or estate, as the case may be, as severance pay, a cash lump sum payment equal to two (2) times the sum of Executive's: (i) highest annual rate of base salary, payable by the Bank, as of the date of the Change in Control; and (ii) highest annual cash bonus paid to, or earned by, Executive during the calendar year of the Change in Control or either of the two (2) calendar years immediately preceding the Change in Control. Such payment shall be payable within 10 business days following Executive's date of termination, and will be subject to applicable withholding taxes.

In addition, the Bank will continue to provide to Executive with life insurance coverage and non-taxable medical and dental insurance coverage substantially comparable (and on substantially the same terms and conditions) to the coverage maintained by the Bank for Executive immediately prior to Executive's date of termination under the same cost-sharing arrangements that apply for active employees of the Bank as of Executive's date of termination. Such continued coverage shall cease upon the earlier of: (i) the date which is 18 months from Executive's date of termination; or (ii) the date on which Executive becomes a full-time employee of another employer, provided Executive is entitled to the benefits that are substantially similar to the health and welfare benefits provided by the Bank (or its successor). If the Bank cannot provide one or more of the benefits set forth in this paragraph because Executive is no longer an employee, applicable rules and regulations prohibit such benefits or the payment of such benefits in the manner contemplated, or it would subject the Bank to penalties, then the Bank shall pay Executive a cash lump sum payment reasonably estimated to be equal to the value of such benefits or the value of the remaining benefits at the time of such determination. Such cash payment shall be made in a lump sum within 10 business days after the later of Executive's date of termination or the effective date of the rules or regulations prohibiting such benefits or subjecting the Bank to penalties.

4. **280G Cutback.** Notwithstanding anything in this Agreement to the contrary, in no event shall the aggregate payments or benefits to be made or afforded to Executive under this Agreement, either as a stand-alone benefit or when aggregated with other payments to, or for the benefit of, Executive (collectively referred to as the "**Change in Control Benefits**") that are contingent on a change in control (as defined under Code Section 280G), constitute an "excess parachute payment" under Code Section 280G or any successor thereto, and in order to avoid such a result, Executive's benefits payable under this Agreement shall be reduced by the minimum amount necessary so that the Change in Control Benefits that are payable to Executive are not subject to penalties under Code Sections 280G and 4999.

5. **Source of Payments.** All payments provided in this Agreement shall be timely paid by check or direct deposit from the general funds of the Bank (or any successor to the Bank).

6. **Entire Agreement.** This Agreement embodies the entire agreement between the Bank and Executive with respect to the matters agreed to herein. All prior agreements between the Bank and Executive with respect to the matters agreed to herein are hereby superseded and shall have no force or effect, except that this Agreement shall not affect or operate to reduce any benefit or compensation inuring to Executive of a kind elsewhere provided. No provision of this Agreement shall be interpreted to mean that Executive is subject to receiving fewer benefits than those available to Executive without reference to this Agreement.

7. **No Attachment.** Except as required by law, no right to receive payments under this Agreement shall be subject to anticipation, commutation, alienation, sale, assignment, encumbrance, charge, pledge, or hypothecation, or to execution, attachment, levy, or similar process or assignment by operation of law, and any attempt, voluntary or involuntary, to affect any such action shall be null, void, and of no effect.

8. **Binding on Successors.** The Bank shall require any successor or assignee, whether direct or indirect, by purchase, merger, consolidation or otherwise, to all or substantially all the business or assets of the Bank, expressly and unconditionally to assume and agree to perform the Bank's obligations under this Agreement, in the same manner and to the same extent that the Bank would be required to perform if no such succession or assignment had taken place.

9. Modification and Waiver.

(a) This Agreement may not be modified or amended except by an instrument in writing signed by the parties hereto.

(b) No term or condition of this Agreement shall be deemed to have been waived, nor shall there be any estoppel against the enforcement of any provision of this Agreement, except by written instrument of the party charged with such waiver or estoppel. No such written waiver shall be deemed a continuing waiver unless specifically stated therein, and each such waiver shall operate only as to the specific term or condition waived and shall not constitute a waiver of such term or condition for the future or as to any act other than that specifically waived.

10. Required Provisions.

(a) The Board may terminate Executive's employment at any time, but any termination by the Bank's Board other than termination for Cause shall not prejudice Executive's right to compensation or other benefits under this Agreement. Executive shall have no right to receive compensation or other benefits for any period after Executive's termination for Cause.

(b) Notwithstanding anything herein contained to the contrary, any payments to Executive by the Company, whether pursuant to this Agreement or otherwise, are subject to and conditioned upon their compliance with Section 18(k) of the Federal Deposit Insurance Act, 12 U.S.C. Section 1828(k), and the regulations promulgated thereunder in 12 C.F.R. Part 359.

(c) Notwithstanding anything else in this Agreement to the contrary, Executive's employment shall not be deemed to have been terminated unless and until Executive has a Separation from Service within the meaning of Code Section 409A. For purposes of this Agreement, a "**Separation from Service**" shall have occurred if the Bank and Executive reasonably anticipate that either no further services will be performed by Executive after the date of termination (whether as an employee or as an independent contractor) or the level of further services performed is less than 50 percent of the average level of bona fide services in the 36 months immediately preceding the termination. For all purposes hereunder, the definition of Separation from Service shall be interpreted consistent with Treasury Regulation Section 1.409A-1(h)(ii).

(d) Notwithstanding the foregoing, in the event Executive is a Specified Employee (as defined herein), then, solely, to the extent required to avoid penalties under Code Section 409A, Executive's payments shall be delayed until the first day of the seventh month following Executive's Separation from Service. A "**Specified Employee**" shall be interpreted to comply with Code Section 409A and shall mean a key employee within the meaning of Code Section 416(i) (without regard to paragraph 5 thereof), but an individual shall be a "Specified Employee" only if the Bank or Company is or becomes a publicly traded company.

(e) **Protected Rights.** Executive understands that nothing contained in this Agreement limits Executive's ability to file a charge or complaint with the Securities and Exchange Commission or any other federal, state or local governmental agency or commission ("**Government Agencies**") about a possible securities law violation without approval of the Company or the Bank. Executive further understands that this Agreement does not limit Executive's ability to communicate with any Government Agency or otherwise participate in any investigation or proceeding that may be conducted by any Government Agency, including providing documents or other information, without notice to the Company or the Bank related to the possible securities law violation. This Agreement does not limit the Executive's right to receive any resulting monetary award for information provided to any Government Agency.

11. Governing Law. This Agreement shall be governed by the laws of the State of New York but only to the extent not superseded by federal law.

12. Arbitration. Any dispute or controversy arising under or in connection with this Agreement shall be settled exclusively by binding arbitration, as an alternative to civil litigation and without any trial by jury to resolve such claims, conducted by a single arbitrator mutually acceptable to the Bank and Executive, sitting in a location selected by the Bank within 50 miles from the main office of the Bank, in accordance with the rules of the American Arbitration Association's National Rules for the Resolution of Employment Disputes then in effect. Judgment may be entered on the arbitrator's award in any court having jurisdiction. The cost of the arbitrator shall be paid by the Bank; all other costs of arbitration shall be borne by the respective parties.

13. Notice. For the purposes of this Agreement, notices and all other communications provided for in this Agreement shall be in writing and shall be deemed to have been duly given when delivered or mailed by certified or registered mail, return receipt requested, postage prepaid, addressed to the respective addresses set forth below:

To the Bank	Fairport Savings Bank 45 South Main Street Fairport, NY 14450 To the Attention of: Chairman of the Board
To Executive:	Most recent address on file with the Bank

[Signature Page to Follow]

IN WITNESS WHEREOF, this Agreement is entered into as of the date first above written.

FAIRPORT SAVINGS BANK

By: /s/ Kevin Maroney

Name: Kevin Maroney

Title: President

EXECUTIVE

/s/ Michael Giancursio

Michael Giancursio

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Section 3: EX-13 (EXHIBIT 13)

Exhibit 13

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

This discussion and analysis reflects our consolidated financial statements and other relevant statistical data, and is intended to enhance your understanding of our financial condition and results of operations. The information in this section has been derived from the audited consolidated financial statements that appear beginning on page 22 of this Annual Report. You should read the information in this section in conjunction with the business and financial information regarding FSB Bancorp and the consolidated financial statements provided in this Annual Report.

Overview

Our business has traditionally focused on originating one- to four-family residential real estate mortgage loans, home equity lines of credit, and offering retail deposit accounts. In recent years, we have expanded our mortgage origination footprint and opened new mortgage offices in Cheektowaga and Lewiston, New York. Our primary market area now consists of Monroe County and the surrounding western New York counties of Erie, Livingston, Ontario, Orleans, Jefferson, Niagara, and Wayne. Management has made the decision to deploy available funds from deposit and borrowing growth into higher-yielding assets, primarily commercial loan products and both fixed and adjustable rate one- to four-family mortgage loans in 2018. Increases in the loan portfolio average balances as well as higher average yields on the overall loan and investment portfolios resulted in higher interest income in 2018. More recently, we shifted attention to expand our commercial loan department in an effort to improve our interest rate risk exposure with shorter duration commercial loan products, as well as higher yielding assets. In 2017, we hired a Chief Lending Officer to manage and oversee the growth of our loan portfolio and supervise credit administration to continue to maintain our high asset quality.

At December 31, 2018, the Company had \$328.3 million in consolidated assets, an increase of \$13.9 million, or 4.4%, from \$314.4 million at December 31, 2017. During 2018, we continued to focus on loan production, particularly with respect to residential mortgage loans as well as commercial real estate and commercial and industrial loans. The credit quality of our loan portfolio remains strong. At December 31, 2018, we had one non-accrual residential mortgage loan for \$55,000 and one non-accrual commercial and industrial loan for \$45,000 as compared to two non-accrual residential mortgage loans for \$153,000 at December 31, 2017.

Our results of operations depend primarily on our net interest income and, to a lesser extent, other income. Net interest income is the difference between the interest income we earn on our interest-earning assets, consisting primarily of loans, investment securities and other interest-earning assets (primarily cash and cash equivalents), and the interest we pay on our interest-bearing liabilities, consisting primarily of savings accounts, NOW accounts, money market accounts, time deposits and borrowings. Other income consists primarily of realized gains on sales of loans and securities, mortgage fee income, fees and service charges from deposit products, fee income from our financial services subsidiary, earnings on bank owned life insurance and miscellaneous other income. Our results of operations also are affected by our provision for loan losses and other expense. Other expense consists primarily of salaries and employee benefits, occupancy, equipment, electronic banking, data processing costs, mortgage fees and taxes, advertising, directors' fees, FDIC deposit insurance premium expense, audit and tax services, and other miscellaneous expenses. Our results of operations also may be affected significantly by general and local economic and competitive conditions, changes in market interest rates, government policies and actions of regulatory authorities. For the year ended December 31, 2018, we had net income of \$135,000 compared to net income of \$211,000 for the year ended December 31, 2017. The year over year decrease in earnings of \$76,000 was attributable to a decrease in other income along with increases in other expense and provision for loan losses, partially offset by an increase in net interest income and a decrease in income tax expense.

Critical Accounting Policies

Critical accounting policies are defined as those that involve significant judgments and uncertainties, and could potentially result in materially different results under different assumptions and conditions. We believe that the most critical accounting policies upon which our financial condition and results of operations depend, involve the most complex subjective decisions or assessments including our policies with respect to our allowance for loan losses, deferred tax assets, and the estimation of fair values for accounting and disclosure purposes.

Allowance for Loan Losses. The allowance for loan losses is the amount estimated by management as necessary to absorb credit losses incurred in the loan portfolio that are both probable and reasonably estimable at the consolidated balance sheet date. The amount of the allowance is based on significant estimates, and the ultimate losses may vary from such estimates as more information becomes available or conditions change. The methodology for determining the allowance for loan losses is considered a critical accounting policy by management due to the high degree of judgment involved, the subjectivity of the assumptions used and the potential for changes in the economic environment that could result in changes to the amount of the recorded allowance for loan losses.

As a substantial percentage of our loan portfolio is collateralized by real estate, appraisals of the underlying value of property securing loans are critical in determining the amount of the allowance required for specific loans. Assumptions are instrumental in determining the value of properties. Overly optimistic assumptions or negative changes to assumptions could significantly affect the valuation of a property securing a loan and the related allowance determined. Management carefully reviews the assumptions supporting such appraisals to determine that the resulting values reasonably reflect amounts realizable on the related loans.

Management performs a quarterly evaluation of the adequacy of the allowance for loan losses. We consider a variety of factors in establishing this estimate including, but not limited to, current economic conditions, delinquency statistics, geographic concentrations, the adequacy of the underlying collateral, the financial strength of the borrower, results of internal loan reviews and other relevant factors. This evaluation is inherently subjective as it requires material estimates by management that may be susceptible to significant change based on changes in economic and real estate market conditions.

The evaluation has specific, general, and unallocated components. The specific component relates to loans that are deemed to be impaired and classified as special mention, substandard, doubtful, or loss. For such loans that are also classified as impaired, an allowance is generally established when the collateral value of the impaired loan is lower than the carrying value of that loan. The general component covers non-classified loans and is based on historical loss experience adjusted for qualitative factors. An unallocated component is maintained to cover uncertainties that could affect management's estimate of probable losses. The unallocated component of the allowance reflects the margin of imprecision inherent in the underlying assumptions used in the methodologies for estimating specific and general losses in the portfolio.

Actual loan losses may be significantly more than the allowance we have established which could have a material negative effect on our financial results.

Deferred Tax Assets. The deferred tax assets and liabilities represent the future tax return consequences of the temporary differences, which will either be taxable or deductible when the assets and liabilities are recovered or settled. 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 reflected at income tax rates applicable to the period in which the deferred tax assets and liabilities are expected to be realized or settled. As changes in tax laws or rates are enacted, deferred tax assets and liabilities are adjusted through the provision for income taxes. The Tax Cuts and Jobs Act (the "Tax Act") was signed into law in December 2017 which reduced the corporate federal statutory tax rate from 35% to 21%. U.S. GAAP requires the impact of the Tax Act to be accounted for in the period of enactment. As such, the Company was required to write down the value of its net deferred tax assets as of December 31, 2017 to reflect the reduction in the corporate tax rate for future periods.

Estimation of Fair Values. Fair values for securities available-for-sale are obtained from an independent third-party pricing service. Where available, fair values are based on quoted prices on a nationally recognized securities exchange. If quoted prices are not available, fair values are measured using quoted market prices for similar benchmark securities. Management generally makes no adjustments to the fair value quotes provided by the pricing source. The fair values of foreclosed real estate and the underlying collateral value of impaired loans are typically determined based on evaluations by third parties, less estimated costs to sell. When necessary, appraisals are updated to reflect changes in market conditions.

Business Strategy

Fairport Savings Bank, a wholly owned banking subsidiary of FSB Bancorp, Inc. has been serving the Fairport and surrounding communities since 1888. One of the most significant initiatives implemented over the past decade has been the Bank's conversion from a mutual institution to a stock company. The conversion process enabled the Bank to raise additional capital to successfully support its growth and expansion strategies. We are committed to meeting the financial needs of the communities we serve, primarily the greater Rochester and Buffalo, New York metropolitan areas, and are dedicated to providing personalized superior service to our customers. The business of banking has changed rapidly, requiring extensive investment in technology as well as significantly increased compliance expenses to address the substantial regulatory changes enacted in recent years. In addition, we are committed to maintaining a cybersecurity program to match the relevant risks and keep pace with technological advances in order to protect sensitive customer information as well as our information technology systems. We recognize that to continue to meet the needs of our customers and to provide a competitive return to our stockholders, we will need to continue to grow, by both expanding our residential lending business and diversifying our lending efforts. Instead of concentrating solely on residential mortgage lending, the Bank now offers a full complement of financial services, including commercial and industrial, commercial real estate, and small business administration ("SBA") loans and deposit services to small businesses in our primary service areas. Our principal strategies to achieve these goals are as follows:

- ***Continuing to Emphasize Residential Real Estate Lending.*** Historically we have emphasized the origination of one- to four-family residential loans within Monroe County and the surrounding counties of Livingston, Ontario, Orleans and Wayne, New York. More recently the Bank has expanded its lending efforts to include the counties of Erie and Niagara, New York. As of December 31, 2018, 78.2% of our loan portfolio consisted of one- to four-family residential loans. We intend to continue to emphasize originations of loans secured by one- to four-family residential real estate, holding in portfolio loans that are either adjustable-rate or have fixed-rates with terms of less than 15 years and selling longer-term fixed-rate one- to four-family residential real estate loans in the secondary market to increase other income.
- ***Expanding Our Commercial Banking Market Share.*** We offer a variety of lending and deposit products for commercial banking customers in our markets. We have invested heavily in developing our commercial loan department over the last four years by recruiting and hiring talented commercial loan officers, including the hire of a new Chief Lending Officer in 2017, and enhancing our commercial product offerings. We grew our commercial loan portfolio, which includes commercial real estate, multi-family, and commercial and industrial loans, \$10.9 million, or 37.4% to \$40.0 million at December 31, 2018 from \$29.1 million at December 31, 2017. We seek to develop broad customer deposit and loan relationships based on our service and competitive pricing while maintaining a conservative approach to lending and sound asset quality. We intend to focus our efforts on the needs of small and medium sized businesses in our market, focusing on commercial real estate, multi-family, and construction loans while gradually growing our portfolio of commercial and industrial loans as well as SBA guaranteed loans.
- ***Maintaining High Asset Quality.*** We believe that strong asset quality is critical to the long-term financial success of a small community bank. We attribute our high asset quality to maintaining conservative underwriting standards, the diligence of our loan collection personnel, and the stability of our local economy. At December 31, 2018, we had one non-accrual residential mortgage loan for \$55,000 and one non-accrual commercial and industrial loan for \$45,000 and our ratio of allowance for loan losses to total loans was 0.55%. Over the last five years, we have charged off only \$1,000. We believe that our allowance for loan losses is adequate to absorb the probable losses inherent in our loan portfolio.

- ***Managing Our Interest Rate Risk.*** To improve our interest rate risk, in recent years we have reduced the fixed-rate loan originations added to our loan portfolio by selling more fixed-rate residential mortgages with terms of 15 years or greater in the secondary market. We also invest a portion of funds received from loan payments and repayments in shorter term and intermediate term, liquid investment securities and securities classified as available-for-sale including U.S. Government agency debt obligations and mortgage-backed securities. We emphasize marketing our lower cost passbook, savings and checking accounts, money market accounts and increasing the duration whenever possible of our certificates of deposit and Federal Home Loan Bank borrowings.
- ***Offering A Wide Selection Of Non-Deposit Investment Products and Services.*** Fairport Wealth Management, a wholly owned subsidiary of Fairport Savings Bank, offers a broad range of investment, insurance, and financial products. In October 2018, Fairport Savings Bank entered into a partnership with Monarch Wealth Management to offer a wide array of wealth management services including brokerage, insurance, and asset management to our customers. This collaboration offers expanded representation of investment advisors that evaluate the needs of clients to determine the suitable investment and insurance solutions to meet their short and long-term wealth management goals. In 2018, Fairport Wealth Management had fee income of \$131,000 and we intend to continue to emphasize these investment, insurance, and financial products to our customers. In May 2017, Fairport Savings Bank partnered with Insuritas, the nation's premier provider of turn-key insurance agencies for financial institutions. This partnership with Insuritas allows the Company to provide a comprehensive suite of insurance products for our customers and the community we serve.
- ***Continuing to Grow Customer Relationships and Core Deposits.***

As we continue to grow our core deposits we remain committed to developing and maintaining full-service long-term customer relationships by offering competitive products while providing exceptional customer service. In 2018, total deposits grew \$5.9 million, or 2.7%, to \$222.6 million at December 31, 2018 from \$216.7 million at December 31, 2017. At December 31, 2018, certificates of deposit, including individual retirement accounts increased \$10.6 million, or 9.4% to \$123.9 million compared to \$113.3 million at December 31, 2017 with preferential rates given to relationship customers.

Selected Consolidated Financial and Other Data

	At December 31, At December 31,	
	2018	2017
	(In thousands)	
Selected Financial Condition Data:		
Total assets	\$ 328,269	\$ 314,382
Cash and cash equivalents	6,291	10,397
Securities available-for-sale	18,331	18,313
Securities held-to-maturity	6,052	6,575
Loans held for sale	2,133	2,770
Loans, net	281,741	262,711
Premises and equipment, net	2,731	3,064
Deposits	222,615	216,691
Borrowings	71,826	64,447
Stockholders' equity	31,513	31,056
	For the Year Ended	
	December 31,	
	2018	2017
	(In thousands)	
Selected Operating Data:		
Interest and dividend income	\$ 12,540	\$ 10,732
Interest expense	3,979	2,778
Net interest income	8,561	7,954
Provision for loan losses	300	271
Net interest income after provision for loan losses	8,261	7,683
Other income	2,717	3,576
Other expense	10,811	10,641
Income before income taxes	167	618
Provision for income taxes	32	407
Net income	\$ 135	\$ 211

At or For the Year Ended December 31,	
2018	2017

Selected Financial Ratios and Other Data:

Performance Ratios:

Return on average assets	0.04%	0.07%
Return on average equity	0.43%	0.66%
Interest rate spread ⁽¹⁾	2.63%	2.71%
Net interest margin ⁽²⁾	2.79%	2.85%
Efficiency ratio ⁽³⁾	98.48%	94.51%
Other income to average total assets	0.85%	1.23%
Other expense to average total assets	3.40%	3.65%
Average interest-earning assets to average interest-bearing liabilities	112%	113%

Asset Quality Ratios:

Non-performing assets as a percent of total assets	0.03%	0.05%
Non-performing loans as a percent of total loans	0.03%	0.06%
Allowance for loan losses as a percent of non-performing loans	1564.55%	825.59%
Allowance for loan losses as a percent of total loans	0.55%	0.48%

Capital Ratios:

Total risk-based capital (to risk-weighted assets)	15.70%	16.11%
Tier 1 leverage (core) capital (to adjusted tangible assets)	9.07%	9.47%
Common Equity Tier 1 capital (to risk-weighted assets)	14.91%	15.44%
Tier 1 risk-based capital (to risk-weighted assets)	14.91%	15.44%
Average equity to average total assets	9.87%	10.92%

Other Data:

Number of full service offices	5	5
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- (1) Represents the difference between the weighted-average yield on interest-earning assets and the weighted-average cost of interest-bearing liabilities for the year.
- (2) The net interest margin represents net interest income as a percent of average interest-earning assets for the year.
- (3) The efficiency ratio represents other expense divided by the sum of net interest income after provision for loan loss and other income.

Comparison of Financial Condition at December 31, 2018 and 2017

Total Assets. Total assets increased \$13.9 million, or 4.4%, to \$328.3 million at December 31, 2018 from \$314.4 million at December 31, 2017, primarily reflecting increases in net loans receivable and investment in restricted stock, partially offset by decreases in cash and cash equivalents, loans held for sale, securities held-to-maturity, and premises and equipment.

Net loans receivable increased \$19.0 million, or 7.2%, to \$281.7 million at December 31, 2018 from \$262.7 million at December 31, 2017. The Bank continues to focus on loan production as we continue to primarily grow our residential mortgage and commercial loan portfolios at a measured pace while still maintaining our strong credit quality and strict underwriting standards. Residential mortgage loans increased \$14.7 million, or 7.1%, to \$221.6 million at December 31, 2018 from \$206.9 million at December 31, 2017. Commercial real estate loans increased \$7.7 million, or 51.9%, to \$22.5 million at December 31, 2018 from \$14.8 million at December 31, 2017. Commercial and industrial loans increased \$3.6 million, or 98.2%, to \$7.3 million at December 31, 2018 from \$3.7 million at December 31, 2017. The Bank originated \$91.4 million of residential mortgage loans and sold \$59.9 million in conventional mortgage loans and correspondent FHA, VA, and USDA mortgages in the secondary market to reduce interest-rate risk in 2018. The mortgage loans serviced for others decreased by \$8.7 million, or 6.5%, to \$123.8 million at December 31, 2018 compared to \$132.4 million at December 31, 2017 as a result of selling more loans servicing released which yields higher premiums producing higher gain on sale of loans income for the Bank.

Investment in restricted stock increased by \$367,000, or 11.2%, to \$3.6 million at December 31, 2018 from \$3.3 million at December 31, 2017 due to increased borrowings from the Federal Home Loan Bank of New York.

Cash and cash equivalents decreased by \$4.1 million, or 39.5%, to \$6.3 million at December 31, 2018 from \$10.4 million at December 31, 2017 to fund loan growth.

Mortgage loans held for sale decreased by \$637,000, or 23.0%, to \$2.1 million at December 31, 2018 compared to \$2.8 million at December 31, 2017 due to a lower volume of loans closed and committed for sale at December 31, 2018 compared to December 31, 2017.

Securities held-to-maturity decreased \$523,000, or 8.0%, to \$6.1 million at December 31, 2018 from \$6.6 million at December 31, 2017 due to maturities and calls of \$835,000, \$178,000 of principal repayments on mortgage-backed securities, and \$27,000 in net amortization of premiums and accretion of discounts, partially offset by purchases of \$517,000 in state and municipal securities.

Premises and equipment decreased by \$333,000, or 10.9%, to \$2.7 million at December 31, 2018 from \$3.1 million at December 31, 2017, primarily due to disposals and depreciation of fixed assets.

Deposits and Borrowings. Total deposits increased \$5.9 million, or 2.7%, to \$222.6 million at December 31, 2018 from \$216.7 million at December 31, 2017. The increase in our deposits reflected a \$10.6 million increase in certificates of deposit, including individual retirement accounts, primarily due to promotional specials offered in 2018, a \$2.6 million increase in non-interest bearing checking accounts, and a \$2.0 million increase in savings accounts, partially offset by a \$5.9 million decrease in money market accounts and a \$3.4 million decrease in interest bearing checking accounts. Total borrowings from the Federal Home Loan Bank of New York increased \$7.4 million, or 11.4%, to \$71.8 million at December 31, 2018 from \$64.4 million at December 31, 2017. Long-term borrowings increased \$6.6 million, or 12.9%, to \$58.1 million at December 31, 2018 from \$51.4 million at December 31, 2017 due to \$25.5 million in new advances partially offset by \$18.9 million in principal repayments on our amortizing advances and maturities in 2018. Short-term borrowings increased by \$750,000, or 5.8%, to \$13.8 million at December 31, 2018 compared to \$13.0 million at December 31, 2017. The increases in both deposits and FHLB borrowings were used to fund the additional growth in the loan portfolio in 2018.

Stockholders' Equity. Total stockholders' equity increased \$457,000, or 1.5%, to \$31.5 million at December 31, 2018 from \$31.1 million at December 31, 2017 due to a \$305,000 increase in additional paid in capital primarily related to the issuance of restricted shares of FSB Bancorp, Inc. stock by the Company to its directors and senior management as part of the 2017 Equity Incentive Plan (the "Plan"). In addition, stockholders' equity increased as a result of an increase in retained earnings due to \$135,000 in net income, and a \$35,000 increase resulting from the release of ESOP shares, partially offset by a \$18,000 increase in accumulated other comprehensive loss. FSB Bancorp Inc. announced on July 27, 2017 that the Board of Directors had adopted its first stock repurchase program. Under the repurchase program, the Company may repurchase up to 97,084 shares of its common stock, or approximately 5% of its then outstanding shares. In 2018, the Company repurchased 2,592 shares at an average price of \$16.38 per share. As of December 31, 2018, the Company had repurchased 72,127 shares at an average price of \$15.31 per share. On September 27, 2017, the Board of Directors of the Company approved restricted stock and stock option grants to senior management and directors of the Company, pursuant to the terms of the Plan. In 2018, an aggregate of 20,000 stock options and 8,400 shares of restricted stock were granted. In 2017, an aggregate of 152,080 stock options and 62,700 shares of restricted stock were granted. The main purpose of the stock repurchases was to fund these stock-based compensation plans. Generally, the grants to senior management and directors vest over a five year period.

Comparison of Operating Results for the Years Ended December 31, 2018 and 2017

General. Net income decreased \$76,000, or 36.0%, to \$135,000 for the year ended December 31, 2018 from \$211,000 for the year ended December 31, 2017. The year over year decrease in earnings of \$76,000 was attributable to an \$859,000 decrease in other income along with a \$170,000 increase in other expense and a \$29,000 increase in provision for loan losses, partially offset by a \$607,000 increase in net interest income and a \$375,000 decrease in income tax expense.

Interest and Dividend Income. Total interest and dividend income increased \$1.8 million, or 16.9%, to \$12.5 million for the year ended December 31, 2018 from \$10.7 million for the year ended December 31, 2017. The interest and dividend income increase resulted from a \$26.9 million increase year over year in average interest-earning assets, primarily loans, in addition to a 24 basis point increase in the average yield on interest-earning assets from 3.84% for 2017 to 4.08% for 2018.

Interest income on loans, including fees, increased \$1.7 million, or 16.4%, to \$11.8 million for 2018 from \$10.2 million for 2017, reflecting an increase in the average balance of loans to \$277.0 million for 2018 from \$247.7 million for 2017, in addition to a 17 basis point increase in average yield on loans. The increase in the average balance of loans was due to our focus on increasing our portfolio of one- to four-family residential, commercial real estate, and commercial and industrial loans. The average yield on loans increased to 4.27% for 2018 from 4.10% for 2017, reflecting increases in market interest rates on most loan products, primarily commercial, adjustable rate residential mortgage, and consumer loans as a result of upward repricing for adjustable rate loans in addition to higher interest rates on new fixed-rate residential mortgage loans in a rising interest rate environment.

Interest income on taxable investment securities increased \$111,000 to \$415,000 in 2018, from \$304,000 in 2017. The average balance of taxable investment securities increased \$1.6 million, or 13.1%, to \$14.2 million in 2018 from \$12.6 million in 2017 in addition to an increase in the average yield of 50 basis points to 2.92% in 2018 from 2.42% in 2017. The average yield on investment securities increased due to new purchases of modestly higher-yielding investment securities replacing calls of lower-yielding investment securities. Interest income on mortgage-backed securities increased \$25,000 to \$141,000 in 2018, from \$116,000 in 2017, reflecting an increase in the average yield on mortgage-backed securities of 65 basis points to 1.90% in 2018 from 1.25% in 2017, partially offset by a decrease in the average balance of mortgage-backed securities of \$1.8 million, or 19.6%, to \$7.4 million in 2018 from \$9.3 million in 2017. The increase in average yield on mortgage-backed securities was primarily attributable to upward repricing on the pools of mortgage-backed securities held in portfolio. Interest income on federal funds sold increased \$7,000, or 15.6%, to \$52,000 in 2018, from \$45,000 in 2017 as the average yield on federal funds sold increased by 62 basis points to 1.51% for 2018 from 0.89% for 2017 due to five rate increases from the Federal Reserve beginning in December 2017 which increased the fed funds rate from 1.25% to 2.50%. The average balance of federal funds sold decreased \$1.7 million, or 32.7%, to \$3.4 million in 2018 from \$5.1 million in 2017. Interest income on tax-exempt securities decreased \$5,000 to \$105,000 in 2018 from \$110,000 in 2017. The average balance of tax-exempt securities decreased by \$524,000, or 8.2%, to \$5.9 million in 2018 from \$6.4 million in 2017, in addition to a decrease in the average yield of tax-exempt securities of 36 basis points to 2.26% in 2018, from 2.62% in 2017 on a tax equivalent basis as a result of the enactment of the Tax Act that took effect on January 1, 2018 which reduced the corporate federal income tax rate from 35% to 21%.

Total Interest Expense. Total interest expense increased \$1.2 million, or 43.2%, to \$4.0 million for the year ended December 31, 2018 from \$2.8 million for the year ended December 31, 2017. The increase in total interest expense resulted from a 33 basis point increase in the average cost of interest-bearing liabilities from 1.12% for 2017 to 1.45% for 2018, as a result of higher interest rates paid on deposits, primarily promotional certificates of deposit, savings, and money market accounts along with an increase in interest rates on Federal Home Loan Bank borrowings. In addition, the average balance of interest-bearing liabilities increased \$26.1 million, or 10.5%, to \$275.3 million for 2018 from \$249.1 million for 2017.

Interest expense on deposits increased \$780,000, or 43.1%, to \$2.6 million for 2018 from \$1.8 million for 2017 due primarily to increases in the average cost and balances of our deposits. The weighted average rate of deposits increased to 1.24% for 2018 from 0.96% for 2017 as a result of promotional certificates of deposit, savings, and money market rates to grow branch deposits. In addition, the average balance of our deposits increased \$20.3 million, or 10.8%, to \$209.0 million for 2018 from \$188.7 million for 2017 primarily due to increases in promotional certificates of deposit, savings, and money market accounts. The average balance on transaction accounts, traditionally our lower costing deposit accounts, consisting of checking, savings, and money market accounts, increased by \$2.6 million to \$101.6 million for 2018 from \$99.0 million for 2017, with an increase in the average cost of transaction accounts of nine basis points to 0.57% in 2018 from 0.48% in 2017. Additionally, the average balance of certificates of deposit (including individual retirement accounts) traditionally our higher cost deposits, increased by \$18.6 million to \$116.8 million in 2018 from \$98.2 million in 2017 with an increase in the average cost of certificates of deposit accounts of 36 basis points to 1.72% in 2018 from 1.36% in 2017.

Interest expense on Federal Home Loan Bank borrowings increased \$421,000, or 43.5%, to \$1.4 million for the year ended December 31, 2018 from \$967,000 for the year ended December 31, 2017. The increase in interest expense on Federal Home Loan Bank borrowings was caused by an increase in our average balance of Federal Home Loan Bank borrowings to \$66.3 million for 2018 compared to \$60.5 million for 2017 along with an increase in the average cost of these funds of 49 basis points from 1.60% in 2017 to 2.09% in 2018 due to the rising interest rate environment.

Net Interest Income. Net interest income increased \$607,000, or 7.6%, to \$8.6 million for the year ended December 31, 2018 from \$8.0 million for the year ended December 31, 2017. The increase in net interest income despite a decrease in net interest margin was primarily due to substantially higher average balances in loans year over year and a modest increase in the average balance of taxable investment securities in addition to higher average yields on loans, federal funds sold, mortgage-backed securities, and taxable investment securities when comparing 2018 to 2017. Net interest-earning assets increased to \$32.7 million for 2018 from \$31.9 million for 2017. The growth of the Bank continues to focus on loan production, particularly with respect to residential mortgage, commercial real estate, and commercial and industrial loans. Our net interest margin for the year ended December 31, 2018 decreased six basis points to 2.79% from 2.85% for the year ended December 31, 2017. The average cost of interest-bearing liabilities was negatively impacted by an increase in the average cost of interest-bearing deposit accounts due to promotional certificates of deposit, savings, and money market accounts as well as an increase in the average cost of Federal Home Loan Bank borrowings.

Provision for Loan Losses. We establish provisions for loan losses which are charged to operations in order to maintain the allowance for loan losses at a level we consider necessary to absorb credit losses inherent in the loan portfolio that are both probable and reasonably estimable at the consolidated balance sheet date. In determining the level of the allowance for loan losses, we consider past and current loss experience, evaluations of real estate collateral, current economic conditions, volume and type of lending, adverse situations that may affect a borrower's ability to repay a loan, and the levels of non-performing and other classified loans. The amount of the allowance is based on estimates and the ultimate losses may vary from such estimates as more information becomes available or conditions change. We assess the allowance for loan losses on a quarterly basis and make provisions for loan losses in order to maintain the allowance.

Based on our evaluation of the above factors, we recorded a \$300,000 provision for loan losses for the year ended December 31, 2018 compared to a \$271,000 provision for loan losses for the year ended December 31, 2017. The rationale for the increase in 2018 was primarily due to a \$1.3 million increase in loans rated special mention from \$116,000 at December 31, 2017 to \$1.4 million at December 31, 2018 in addition to adding reserves to support the growth in our residential mortgage, commercial real estate, and commercial and industrial loan portfolios. The allowance for loan losses was \$1.6 million or 0.55% of net loans outstanding, at December 31, 2018 compared to \$1.3 million, or 0.48% of net loans outstanding, at December 31, 2017. We had no net-charge-offs in 2018 or 2017.

Other Income. Other income decreased by \$859,000, or 24.0%, to \$2.7 million for 2018 from \$3.6 million for 2017. The decrease resulted primarily from decreases in realized gains on the sales of loans, mortgage fees, and fee income. A substantial portion of the year over year decrease was in realized gains on the sale of loans which decreased \$709,000, or 33.0%, to \$1.4 million in 2018 from \$2.1 million in 2017 due to lower volume of mortgage loans sold in 2018. Mortgage fee income decreased by \$102,000, or 12.1%, to \$743,000 in 2018 from \$845,000 in 2017 due to lower volume of residential mortgage loans originated in 2018 compared to 2017, partially offset by an increase in commercial loan fees. Fee income from Fairport Wealth Management decreased \$43,000, or 24.7%, to \$131,000 in 2018 compared to \$174,000 in 2017 due to a decrease in non-deposit investment product sales.

Other Expense. Other expense increased \$170,000, or 1.6%, to \$10.8 million in 2018 from \$10.6 million in 2017. The increase was primarily the result of increases in mortgage fees and taxes of \$158,000, data processing costs of \$78,000, other miscellaneous expense of \$55,000, and audit and tax services of \$31,000, partially offset by decreases in salaries and employee benefits of \$112,000 and directors' fees of \$56,000. Mortgage fees and taxes increased \$158,000, or 59.9%, to \$422,000 in 2018 from \$264,000 in 2017 due to revisions to estimates. Data processing costs increased \$78,000, or 22.4%, to \$426,000 in 2018 from \$348,000 in 2017 primarily due to the end of first year promotional pricing associated with the conversion of our core processing system from in-house hosting to data center hosting. Other miscellaneous expense increased \$58,000, or 7.5%, to \$828,000 in 2018 from \$770,000 in 2017 as a result of an increase in legal expenses associated with the Company's restatement of its 2017 audited consolidated financial statements and its first quarter 2018 unaudited consolidated financial statements. Audit and tax services increased \$31,000, or 17.0%, to \$213,000 in 2018 from \$182,000 in 2017 as a result of increased expenses related to the Company's restatement of its 2017 audited consolidated financial statements and its first quarter 2018 unaudited consolidated financial statements. Salaries and employee benefits decreased \$112,000, or 1.7%, to \$6.5 million in 2018 from \$6.6 million in 2017. The decrease in salaries and employee benefits was primarily attributable to a decrease in commission expense due to lower volume of mortgage loan originations in 2018 compared to 2017 in addition to a reversal of excess funds from the Company's annual discretionary 401(k) contribution paid to eligible employees. This decrease was partially offset by annual merit increases for existing staff and the expense related to the issuance of restricted stock awards and options to senior management and the Board of Directors in the fourth quarter of 2017 and the first and third quarters of 2018. Directors' fees decreased \$56,000, or 21.5%, to \$205,000 in 2018 from \$261,000 in 2017 due to the retirement of four directors as of December 31, 2017.

Provision for Income Taxes. Provision for income taxes was \$32,000 for 2018, a decrease of \$375,000 compared to a provision for income taxes of \$407,000 for 2017. The effective tax rate was 19.2% in 2018 compared to 65.9% in 2017. The decrease was primarily due to lower income before income taxes in addition to the Tax Act that was enacted on December 22, 2017, which reduced the corporate federal income tax rate from 35% to 21% and caused a reevaluation of net deferred tax assets. Generally accepted accounting principles required that the impact of the provisions of the Tax Act be accounted for in the period of enactment. As such, the additional expense in 2017 was largely attributable to the reduction in carrying value of net deferred tax assets, primarily unrealized losses on available-for-sale securities, reflecting lower future tax benefits resulting from the lower corporate tax rates.

Average balances and yields. The following table sets forth average balance sheets, average yields and costs and certain other information at and for the years indicated. All average balances are daily average balances. Non-accrual loans were included in the computation of average balances, but have been reflected in the table as loans carrying a zero yield. The yields set forth below include the effect of deferred fees, discounts and premiums that are accreted or amortized to interest income or interest expense.

	For the Years Ended December 31,					
	2018			2017		
	Average Balance	Interest Income/ Expense	Yield/ Cost	Average Balance	Interest Income/ Expense	Yield/ Cost
<i>(Dollars in thousands)</i>						
Interest-earning assets:						
Loans, including fees	\$ 277,004	\$ 11,827	4.27%	\$ 247,704	\$ 10,157	4.10%
Federal funds sold	3,413	52	1.51	5,068	45	0.89
Securities-taxable	14,206	415	2.92	12,563	304	2.42
Mortgage-backed securities	7,444	141	1.90	9,264	116	1.25
Securities-tax-exempt ⁽¹⁾	5,853	132	2.26	6,377	167	2.62
Total interest-earning assets	307,920	12,567	4.08	280,976	10,789	3.84
Noninterest-earning assets	10,376			10,849		
Total assets	\$ 318,296			\$ 291,825		
Interest-bearing liabilities:						
NOW accounts	\$ 30,018	92	0.31	\$ 29,659	89	0.30
Passbook savings	27,533	147	0.53	26,488	103	0.39
Money market savings	34,593	345	1.00	34,330	284	0.83
Individual retirement accounts	6,792	85	1.25	7,081	75	1.05
Certificates of deposit	110,033	1,922	1.75	91,103	1,260	1.38
Borrowings	66,294	1,388	2.09	60,457	967	1.60
Total interest-bearing liabilities	275,263	3,979	1.45%	249,118	2,778	1.12%
Noninterest-bearing liabilities:						
Demand deposits	9,467			8,526		
Other	2,298			2,325		
Total liabilities	287,028			259,969		
Stockholders' equity	31,268			31,856		
Total liabilities and stockholders' equity	\$ 318,296			\$ 291,825		
Net interest income		\$ 8,588			\$ 8,011	
Interest rate spread ⁽²⁾			2.63%			2.72%
Net interest-earning assets ⁽³⁾	\$ 32,657			\$ 31,858		
Net interest margin ⁽⁴⁾			2.79%			2.85%
Average interest-earning assets to average interest-bearing liabilities			112%			113%

(1) Tax-exempt interest income is presented on a tax equivalent basis using a 21% federal tax rate for the year ended December 31, 2018 and a 34% federal tax rate for the year ended December 31, 2017.

(2) Interest rate spread represents the difference between the yield on average interest-earning assets and the cost of average interest-bearing liabilities.

(3) Net interest-earning assets represent total interest-earning assets less total interest-bearing liabilities.

(4) Net interest margin represents net interest income divided by total interest-earning assets.

Rate/Volume Analysis

The following table presents the effects of changing rates and volumes on our net interest income for the years indicated. The rate column shows the effects attributable to changes in rate (changes in rate multiplied by prior volume). The volume column shows the effects attributable to changes in volume (changes in volume multiplied by prior rate). The net column represents the sum of the prior columns. For purposes of this table, changes attributable to both rate and volume, which cannot be segregated, have been allocated proportionately, based on the changes due to rate and the changes due to volume.

	For the Years Ended December 31, 2018 vs. 2017		
	Increase (Decrease)		
	Due to		
	Volume	Rate	Net
	(In thousands)		
Interest-earning assets:			
Loans, including fees	\$ 1,237	\$ 433	\$ 1,670
Federal funds sold	(6)	13	7
Securities-taxable	43	68	111
Mortgage-backed securities	(15)	40	25
Securities-tax-exempt ⁽¹⁾	(13)	(22)	(35)
Total interest-earning assets	1,246	532	1,778
Interest-bearing liabilities:			
NOW accounts	1	2	3
Passbook savings	4	40	44
Money market savings	2	59	61
Individual retirement accounts	(3)	13	10
Certificates of deposit	289	373	662
Borrowings	101	320	421
Total interest-bearing liabilities	394	807	1,201
Net change in net interest income	\$ 852	\$ (275)	\$ 577

(1) Tax-exempt interest income is presented on a tax equivalent basis using a 21% federal tax rate for the year ended December 31, 2018 and a 34% federal tax rate for the year ended December 31, 2017.

Management of Market Risk

General. The majority of our assets and liabilities are monetary in nature. Consequently, our most significant form of market risk is interest rate risk. Our assets, consisting primarily of mortgage loans, have longer maturities than our liabilities, consisting primarily of deposits. As a result, a principal part of our business strategy is to manage interest rate risk and limit the exposure of our net interest income to changes in market interest rates. Accordingly, we have an asset/liability management committee which is responsible for evaluating the interest rate risk inherent in our assets and liabilities, for determining the level of risk that is appropriate, given our business strategy, operating environment, capital, liquidity and performance objectives, and for managing this risk consistent with the guidelines approved by the Board of Directors.

We intend to continue to manage our interest rate risk in order to control the exposure of our earnings and capital to changes in interest rates. As part of our ongoing asset-liability management, we intend to use the following strategies to manage our interest rate risk.

- (i) invest in shorter to medium-term repricing and/or maturing securities whenever the market allows;
- (ii) emphasize the marketing of our money market, savings and checking accounts and increasing the duration of our certificates of deposit;
- (iii) sell a portion of our long-term, fixed-rate one- to four-family residential real estate mortgage loans;
- (iv) increase our commercial loan portfolio with shorter term, higher yielding loan products; and
- (v) maintain a strong capital position.

In 2018, we sold \$59.9 million of mortgage loan originations including \$41.5 million of conventional conforming fixed-rate residential mortgages and \$18.4 million of correspondent FHA, VA, and USDA mortgage loans to improve our interest rate risk position in the event of increases in market interest rates. We intend to continue to originate and, subject to market conditions, sell long term (terms of 15 years or greater) fixed-rate one- to four-family residential real estate loans.

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-earning assets and interest-bearing liabilities in an effort to minimize the adverse effects of changes in the interest rate environment. The majority of our assets are long-term fixed-rate mortgage loans that do not reprice as quickly as our deposits, therefore we would experience a significant decrease in our net interest income in the event of an inversion of the yield curve. We have \$73.9 million in certificates of deposit accounts (including individual retirement accounts) that are scheduled to mature during 2019. If we retain these deposits it most likely will be at a higher cost to us than their current contractual rates.

Additionally, shortening the average maturity of our interest-earning assets by increasing our investments in shorter term loans, as well as loans with variable rates of interest, helps to better match the maturities and interest rates of our assets and liabilities, thereby reducing the exposure of our net interest income to changes in market interest rates. By following these strategies, we believe that we are better-positioned to react to changes in market interest rates.

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 and Capital Resources

Liquidity is the ability to meet current and future financial obligations of a short-term nature. Our cash flows are derived from operating activities, investing activities, and financing activities as reported in our consolidated statements of cash flows included in our consolidated financial statements.

The Company strives to optimize the funding of the consolidated balance sheet, continually balancing the stability and cost factors of our various funding sources. To achieve this goal, the Company maintains a funding strategy that provides effective diversification in the sources and tenor of funding. The objective is a funding mix diversified across a full range of retail as well as secured and unsecured wholesales sources of funds. In general, funding concentrations (including specific retail products) will be avoided to prevent over-reliance on any one source, maintaining an appropriately diverse mix of existing and potential future funding sources. The Company may use this variety of funding sources to manage the funding cost or balance the interest rate risk position.

These sources will include, but not be limited to retail deposit growth, Fed Funds purchased, brokered deposits, wholesale funding, dealer repos, and other short-term alternatives. Management will ensure access to these sources is being actively managed, monitored, and tested. Alternatively, if necessary the Company may liquidate assets or take other measures consistent with our Contingency Funding Plan.

Our primary sources of funds consist of deposit inflows, loan repayments, advances from the Federal Home Loan Bank of New York, maturities and principal repayments of securities, and loan sales. 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. Our asset/liability management committee is responsible for establishing and monitoring our liquidity targets and strategies in order to ensure that sufficient liquidity exists for meeting the borrowing needs and deposit withdrawals of our customers as well as unanticipated contingencies. We seek to maintain a liquidity ratio of 20.0% or greater. For the year ended December 31, 2018, our liquidity ratio averaged 28.2%. We believe that we have enough sources of liquidity to satisfy our short and long-term liquidity needs as of December 31, 2018.

We regularly adjust our investments in liquid assets based upon our assessment of:

- (i) expected loan demand;
- (ii) expected deposit flows;
- (iii) yields available on interest-earning deposits and securities; and
- (iv) the objectives of our asset/liability management program.

Excess liquid assets are invested generally in interest-earning deposits, short and intermediate-term securities and federal funds sold. Our most liquid assets are cash and cash equivalents. The levels of these assets are dependent on our operating, financing, lending, and investing activities during any given period. At December 31, 2018, cash and cash equivalents totaled \$6.3 million.

At December 31, 2018, we had \$5.6 million in loan commitments outstanding and \$4.4 million in additional unadvanced portion of construction loans. In addition to commitments to originate loans, we had \$18.8 million in unused lines of credit to borrowers. Certificates of deposit (including individual retirement accounts) comprised solely of certificates of deposits, due within one year of December 31, 2018 totaled \$73.9 million, or 59.7% of our certificates of deposit (including individual retirement accounts) and 33.2% of total deposits. If these deposits do not remain with us, we will be required to seek other sources of funds, including loan sales, other deposit products, including certificates of deposit, and Federal Home Loan Bank advances. Depending on market conditions, we may be required to pay higher rates on such deposits or other borrowings than we currently pay on the certificates of deposit due on or before December 31, 2019. We believe, however, based on past experience that a significant portion of such deposits will remain with us. We have the ability to attract and retain deposits by adjusting the interest rates offered.

Liquidity management is both a daily and long-term function of business management. If we require funds beyond our ability to generate them internally, borrowing agreements exist with the Federal Home Loan Bank of New York, which provides an additional source of funds. Federal Home Loan Bank advances increased by \$7.4 million to \$71.8 million at December 31, 2018, compared to \$64.4 million at December 31, 2017. At December 31, 2018, we had the ability to borrow approximately \$165.9 million from the Federal Home Loan Bank of New York, of which \$71.8 million had been advanced.

The Company also has a repurchase agreement with Raymond James providing an additional \$10.0 million in liquidity. Funds obtained under the repurchase agreement are secured by the Company's U.S. Government and agency obligations. There were no advances outstanding under the repurchase agreement at December 31, 2018 and 2017. In addition to the repurchase agreement with Raymond James, the Company also has an unsecured line of credit through Atlantic Community Bankers Bank which would provide an additional \$5.0 million in liquidity. There were no draws or outstanding balances from the line of credit at December 31, 2018 and 2017.

Fairport Savings Bank is subject to various regulatory capital requirements, 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, 2018, Fairport Savings Bank exceeded all regulatory capital requirements and was considered "well capitalized" under regulatory guidelines. See Note 13 of the notes to the consolidated financial statements.

Off-Balance Sheet Arrangements

In the ordinary course of business, Fairport Savings Bank is a party to credit-related financial instruments with off-balance sheet risk to meet the financing needs of our customers. These financial instruments include commitments to extend credit. We follow the same credit policies in making commitments as we do for on-balance sheet instruments.

Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. The commitments for unused lines of credit may expire without being drawn upon. Therefore, the total commitment amounts do not necessarily represent future cash requirements. The amount of collateral obtained, if it is deemed necessary by us, is based on our credit evaluation of the customer.

At December 31, 2018 and 2017, we had \$5.6 million and \$12.4 million, respectively, of commitments to grant loans, \$4.4 million and \$5.9 million, respectively, of unadvanced portion of construction loans, and \$18.8 million and \$17.5 million, respectively, of unfunded commitments under lines of credit.

For additional information, see Note 12 of the notes to our consolidated financial statements.

Impact of Inflation and Changing Prices

Our consolidated financial statements and related notes have been prepared in accordance with accounting principles generally accepted in the United States of America ("GAAP"). GAAP generally requires the measurement of financial position and operating results in terms of historical dollars without consideration for changes in the relative purchasing power of money over time due to inflation. The impact of inflation is reflected in the increased cost of our operations. Unlike industrial companies, our assets and liabilities are primarily monetary in nature. As a result, changes in market interest rates have a greater impact on performance than the effects of inflation.

Impact of Recent Accounting Pronouncements

For a discussion of the impact of recent accounting pronouncements, see Note 1 of the notes to the consolidated financial statements.

Market for Common Stock

FSB Bancorp, Inc.'s common stock is traded on the Nasdaq Capital Market under the trading symbol "FSBC."

The following table sets forth the high and low trading prices for our shares of common stock for the periods indicated. As of December 31, 2018, there were 1,940,661 shares of our common stock issued and outstanding. On such date our shares were held by approximately 175 holders of record. The Company has never paid cash dividends.

Year Ended December 31, 2018	High	Low
Fourth quarter	\$ 17.75	\$ 15.96
Third quarter	18.50	17.45
Second quarter	17.96	16.85
First quarter	18.00	16.56

Year Ended December 31, 2017	High	Low
Fourth quarter	\$ 17.75	\$ 15.30
Third quarter	16.72	14.60
Second quarter	15.10	14.21
First quarter	14.84	13.97

STOCKHOLDER INFORMATION

ANNUAL MEETING

The Annual Meeting of Stockholders will be held at 2:00 p.m., New York time on Wednesday, May 22, 2019 at the Perinton Community Center located at 1350 Turk Hill Road, Fairport, New York 14450.

TRANSFER AGENT

Computershare Investor Services
PO Box 30170
College Station, Texas 77842-3170
www.computershare.com/investor

If you have any questions concerning your stockholder account, please call our transfer agent, noted above, at (800) 368-5948. This is the number to call if you require a change of address or need records or information about lost certificates.

STOCK LISTING

The Company's Common Stock is traded on the Nasdaq Capital Market under the symbol "FSBC."

ANNUAL REPORT

A copy of the Company's Annual Report for the year ended December 31, 2018 will be furnished without charge to stockholders as of the record date, upon written request to the Secretary, FSB Bancorp, Inc., 45 South Main Street, Fairport, New York 14450.

SPECIAL COUNSEL

Luse Gorman, PC
5335 Wisconsin Avenue, N.W., Suite 780
Washington, D.C. 20015

INDEPENDENT AUDITOR

Bonadio & Co., LLP
432 N. Franklin St., Suite 60
Syracuse, New York 13204

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Stockholders of
FSB Bancorp Inc.:

Opinion on the Consolidated Financial Statements

We have audited the accompanying consolidated balance sheets of FSB Bancorp, Inc. (the Company) as of December 31, 2018 and 2017 and the related consolidated statements of income, comprehensive income, stockholders' equity, and cash flows for each of the years in the two-year period ended December 31, 2018, and the related notes (collectively referred to as the consolidated financial statements). In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of the Company as of December 31, 2018 and 2017, and the results of their operations and their cash flows for each of the years in the two-year period ended December 31, 2018, in conformity with accounting principles generally accepted in the United States of America.

Basis for Opinion

These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on the Company's consolidated financial statements based on our audits. We are a public accounting firm registered with the Public Company Accounting Oversight Board (United States) (PCAOB) and are required to be independent with respect to the Company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audits in accordance with the standards of the PCAOB. 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, whether due to error or fraud. The Company is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. As part of our audits, we are required to obtain an understanding of internal control over financial reporting, 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.

Our audits included performing procedures to assess the risks of material misstatement of the consolidated financial statements, whether due to error or fraud, and performing procedures that respond to those risks. Such procedures included examining, on a test basis, evidence regarding the amounts and disclosures in the consolidated financial statements. Our audits also included evaluating the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements. We believe that our audits provide a reasonable basis for our opinion.

We have served as the Company's auditor since 2011.

/s/ Bonadio & Co., LLP

Syracuse, New York

March 27, 2019

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*FSB Bancorp, Inc.***Consolidated Balance Sheets**
December 31, 2018 and 2017

	<u>2018</u>	<u>2017</u>
	(Dollars in Thousands, except share and per share data)	
Assets		
Cash and due from banks	\$ 1,581	\$ 1,672
Interest-earning demand deposits	4,710	8,725
Total Cash and Cash Equivalents	6,291	10,397
Securities available-for-sale, at fair value	18,331	18,313
Securities held-to-maturity, at amortized cost (fair value of 2018 \$6,030; 2017 \$6,588)	6,052	6,575
Investment in restricted stock, at cost	3,637	3,270
Loans held for sale	2,133	2,770
Loans, net of allowance for loan losses (2018 \$1,561; 2017 \$1,261)	281,741	262,711
Bank owned life insurance	3,819	3,758
Accrued interest receivable	876	824
Premises and equipment, net	2,731	3,064
Other assets	2,658	2,700
Total Assets	\$ 328,269	\$ 314,382
Liabilities and Stockholders' Equity		
Liabilities		
Deposits:		
Non-interest-bearing	\$ 10,947	\$ 8,385
Interest-bearing	211,668	208,306
Total Deposits	222,615	216,691
Short-term borrowings	13,750	13,000
Long-term borrowings	58,076	51,447
Official bank checks	863	929
Other liabilities	1,452	1,259
Total Liabilities	296,756	283,326
Commitments and contingent liabilities – see Note 12		
Stockholders' Equity		
Preferred stock, par value \$0.01; 25,000,000 shares authorized, no shares issued and outstanding	-	-
Common stock; par value \$0.01; 50,000,000 shares authorized; 1,940,661 and 1,934,853 shares outstanding in 2018 and 2017, respectively	19	19
Paid-in capital	15,746	15,441
Retained earnings	16,212	16,077
Accumulated other comprehensive loss	(183)	(165)
Unearned ESOP shares, at cost	(281)	(316)
Total Stockholders' Equity	31,513	31,056
Total Liabilities and Stockholders' Equity	\$ 328,269	\$ 314,382

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

*FSB Bancorp, Inc.*Consolidated Statements of Income
Years Ended December 31, 2018 and 2017

	2018	2017
	(Dollars in Thousands, Except Per Share Data)	
Interest and Dividend Income		
Loans, including fees	\$ 11,827	\$ 10,157
Securities - taxable	415	304
Securities - tax exempt	105	110
Mortgage-backed securities	141	116
Other	52	45
Total Interest and Dividend Income	12,540	10,732
Interest Expense		
Deposits	2,591	1,811
Short-term borrowings	215	102
Long-term borrowings	1,173	865
Total Interest Expense	3,979	2,778
Net Interest Income	8,561	7,954
Provision for loan losses	300	271
Net Interest Income after Provision for loan losses	8,261	7,683
Other Income		
Service fees	149	164
Fee income	131	174
Increase in cash surrender value of bank owned life insurance	61	62
Realized gain on sale of loans	1,437	2,146
Mortgage fee income	743	845
Other	196	185
Total Other Income	2,717	3,576
Other Expense		
Salaries and employee benefits	6,497	6,609
Occupancy	1,088	1,069
Data processing costs	426	348
Advertising	147	162
Equipment	542	563
Electronic banking	109	93
Directors' fees	205	261
Mortgage fees and taxes	422	264
FDIC premium expense	120	103
Audit and tax services	213	182
Professional services	214	217
Other	828	770
Total Other Expense	10,811	10,641
Income before Income Taxes	167	618
Provision for Income Taxes	32	407
Net Income	\$ 135	\$ 211
Basic and diluted earnings per common share	\$ 0.07	\$ 0.11

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

FSB Bancorp, Inc.

Consolidated Statements of Comprehensive Income
Years Ended December 31, 2018 and 2017

	<u>2018</u>	<u>2017</u>
	(In Thousands)	
Net Income	<u>\$ 135</u>	<u>\$ 211</u>
Other Comprehensive Loss		
Change in unrealized holding losses on securities available-for-sale	(24)	(53)
Reclassification of effect of tax rate change on other comprehensive income	-	(27)
Other Comprehensive Loss, Before Tax	<u>(24)</u>	<u>(80)</u>
Income Tax Benefit Related to Other Comprehensive Loss	<u>6</u>	<u>-</u>
Other Comprehensive Loss, Net of Tax	<u>(18)</u>	<u>(80)</u>
Comprehensive Income	<u>\$ 117</u>	<u>\$ 131</u>
Tax Effect Allocated to Each Component of Other Comprehensive Loss		
Change in unrealized holding losses on securities available-for-sale	<u>\$ 6</u>	<u>\$ -</u>
Income tax effect related to other comprehensive income	<u>\$ 6</u>	<u>\$ -</u>

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

**Consolidated Statements of Stockholders' Equity
Years Ended December 31, 2018 and 2017**

	<u>Common Stock</u>	<u>Paid-In Capital</u>	<u>Retained Earnings</u>	<u>Accumulated Other Comprehensive Loss</u>	<u>Unearned ESOP Shares</u>	<u>Total</u>
	(In Thousands)					
Balance - January 1, 2017	\$ 19	\$ 16,352	\$ 15,839	\$ (85)	\$ (350)	\$ 31,775
Net income	-	-	211	-	-	211
Other comprehensive loss, net	-	-	-	(53)	-	(53)
Reclassification of effect of tax rate change on other comprehensive income ⁽¹⁾	-	-	27	(27)	-	-
ESOP shares committed to be released	-	18	-	-	34	52
Stock based compensation	1	132	-	-	-	133
Effect of stock repurchase plan	(1)	(1,061)	-	-	-	(1,062)
Balance - December 31, 2017	19	15,441	16,077	(165)	(316)	31,056
Net income	-	-	135	-	-	135
Other comprehensive loss, net	-	-	-	(18)	-	(18)
ESOP shares committed to be released	-	37	-	-	35	72
Stock based compensation	-	310	-	-	-	310
Effect of stock repurchase plan	-	(42)	-	-	-	(42)
Balance - December 31, 2018	<u>\$ 19</u>	<u>\$ 15,746</u>	<u>\$ 16,212</u>	<u>\$ (183)</u>	<u>\$ (281)</u>	<u>\$ 31,513</u>

⁽¹⁾ Reclassification adjustment from accumulated other comprehensive loss to retained earnings for stranded tax effects resulting from the newly enacted Federal corporate income tax rate of 21% in accordance with the early adoption of ASU 2018-02.

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

FSB Bancorp, Inc.

**Consolidated Statements of Cash Flows
Years Ended December 31, 2018 and 2017**

	<u>2018</u>	<u>2017</u>
	(In Thousands)	
Cash Flows from Operating Activities		
Net income	\$ 135	\$ 211
Adjustments to reconcile net income to net cash flows from operating activities:		
Net amortization of premiums and accretion of discounts on investments	83	136
Gain on sale of loans	(1,437)	(2,146)
Proceeds from loans sold	62,069	72,249
Loans originated for sale	(59,995)	(70,814)
Amortization of net deferred loan origination costs	(37)	(1)
Depreciation and amortization	445	473
Provision for loan losses	300	271
Stock based compensation	310	133
Expense related to ESOP	72	52
Deferred income tax (benefit) expense	(135)	166
Earnings on investment in bank owned life insurance	(61)	(62)
Increase in accrued interest receivable	(52)	(172)
Decrease (increase) in other assets	42	(341)
Increase (decrease) in other liabilities	334	(632)
Net Cash Flows From Operating Activities	<u>2,073</u>	<u>(477)</u>
Cash Flows from Investing Activities		
Purchases of securities available-for-sale	(1,999)	(7,533)
Proceeds from maturities and calls of securities available-for-sale	-	3,500
Proceeds from principal paydowns on securities available-for-sale	1,901	3,284
Purchases of securities held-to-maturity	(517)	(547)
Proceeds from maturities and calls of securities held-to-maturity	835	1,250
Proceeds from principal paydowns on securities held-to-maturity	178	108
Net increase in loans	(19,293)	(36,789)
Purchase of restricted stock	(1,477)	(1,999)
Redemption of restricted stock	1,110	1,615
Purchase of premises and equipment	(112)	(362)
Net Cash Flows From Investing Activities	<u>(19,374)</u>	<u>(37,473)</u>
Cash Flows from Financing Activities		
Net increase in deposits	5,924	33,757
Proceeds from borrowings	67,300	81,001
Repayments on borrowings	(59,921)	(73,367)
Effect of stock repurchase plan	(42)	(1,062)
Net (decrease) increase in official bank checks	(66)	611
Net Cash Flows From Financing Activities	<u>13,195</u>	<u>40,940</u>
Change in Cash and Cash Equivalents	<u>(4,106)</u>	<u>2,990</u>
Cash and Cash Equivalents - Beginning	<u>10,397</u>	<u>7,407</u>
Cash and Cash Equivalents - Ending	<u>\$ 6,291</u>	<u>\$ 10,397</u>
Supplementary Cash Flows Information		
Interest paid	<u>\$ 3,905</u>	<u>\$ 2,755</u>
Taxes paid	<u>\$ 38</u>	<u>\$ 453</u>

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

**Notes to Consolidated Financial Statements
December 31, 2018 and 2017**

Note 1 - Nature of Operations and Summary of Significant Accounting Policies

Organization and Nature of Operations

On March 2, 2016, the Boards of Directors of the FSB Community Bankshares, Inc. (“FSB Community”), FSB Community Bankshares, MHC (the “MHC”), and Fairport Savings Bank (the “Bank”) unanimously adopted a Plan of Conversion of the MHC pursuant to which the MHC undertook a “second-step” conversion and now no longer exists. The Bank reorganized from a two-tier mutual holding company structure to a fully public stock holding company structure effective July 13, 2016, and, as a result, is now the wholly-owned subsidiary of FSB Bancorp, Inc. (the “Company”).

FSB Bancorp, Inc., the new stock holding company for the Bank, sold 1,034,649 shares of common stock at \$10.00 per share, for gross offering proceeds of \$10.3 million in its stock offering. Additionally, after accounting for conversion-related expenses of \$1.4 million, which offset gross proceeds, the Company received \$8.9 million in net proceeds.

Concurrent with the completion of the conversion and reorganization, shares of common stock of FSB Community owned by public stockholders were exchanged for shares of the Company’s common stock so that the former public stockholders of FSB Community owned approximately the same percentage of the Company’s common stock as they owned of FSB Community’s common stock immediately prior to the conversion. Stockholders of FSB Community received 1.0884 shares of the Company’s common stock for each share of FSB Community’s stock they owned immediately prior to completion of the transaction. Cash in lieu of fractional shares was paid based on the offering price of \$10.00 per share. As a result of the offering and the exchange of shares, the Company had 1,941,688 shares outstanding as of December 31, 2016.

In accordance with Board of Governors of the Federal Reserve System regulations, at the time of the reorganization, the Company substantially restricted retained earnings by establishing a liquidation account. The liquidation account will be maintained for the benefit of eligible account holders who continue to maintain their accounts at the Bank after conversion. The Bank has established a parallel liquidation account to support the Company’s liquidation account in the event the Company does not have sufficient assets to fund its obligations under its liquidation account. The liquidation accounts will be reduced annually to the extent that eligible account holders have reduced their qualifying deposits. Subsequent increases will not restore an eligible account holder’s interest in the liquidation accounts. In the event of a complete liquidation of the Bank or the Company, each account holder will be entitled to receive a distribution in an amount proportionate to the adjusted qualifying account balances then held. The Bank may not pay dividends if those dividends would reduce equity capital below the required liquidation account amount.

The Company provides a variety of financial services to individuals and corporate customers through its wholly-owned subsidiary, Fairport Savings Bank. The Bank’s operations are conducted in five branches located in Monroe County, New York. The Company and the Bank are subject to the regulations of certain regulatory authorities and undergo periodic examinations by those regulatory authorities.

The Company’s principal business consists of originating one-to-four-family residential real estate mortgages, home equity loans and lines of credit and to a lesser extent, originations of commercial real estate, multi-family, construction, commercial and industrial, and other consumer loans. The Company has five mortgage origination offices located in Pittsford, New York; Watertown, New York; Greece, New York; Lewiston, New York; and Buffalo, New York.

The Bank also provides non-deposit investment services to its customers through its wholly-owned subsidiary, Fairport Wealth Management. Previous to January 15, 2016, Fairport Wealth Management was known as Oakleaf Services Corporation. The results of operations of Fairport Wealth Management are not material to the consolidated financial statements.

Basis of Consolidation

The consolidated financial statements include the accounts of the Company, the Bank and Fairport Wealth Management. All significant intercompany accounts and transactions have been eliminated in consolidation.

Use of Estimates

The preparation of consolidated financial statements in conformity with accounting principles generally accepted in the United States of America (“GAAP”) 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 revenue and expense during the reporting period. Actual results could differ from those estimates. Material estimates that are particularly susceptible to significant changes in the near term relate to the determination of the allowance for loan losses, deferred tax assets, and the estimation of fair values for accounting and disclosure purposes.

The Company is subject to the regulations of various governmental agencies. The Company also undergoes periodic examinations by the regulatory agencies which may subject it to further changes with respect to asset valuations, amounts of required loss allowances, and operating restrictions resulting from the regulators’ judgments based on information available to them at the time of their examinations.

Significant Group Concentrations of Credit Risk

Most of the Company’s activities are with customers located within Monroe, Livingston, Ontario, Orleans, Wayne, Jefferson, Niagara, and Erie Counties, New York. Note 2 discusses the types of securities that the Company invests in. The concentration of credit by type of loan is set forth in Note 3. Although the Bank has a diversified loan portfolio, its debtors’ ability to honor their contracts is primarily dependent upon the real estate and general economic conditions in those areas.

Cash and Cash Equivalents

For purposes of the consolidated statement of cash flows, cash and cash equivalents include cash, balances due from banks and interest-earning demand deposits (with an original maturity of three months or less).

Securities

The Company classifies investment securities as either available-for-sale or held-to-maturity. The Company does not hold any securities considered to be trading. Available-for-sale securities are reported at fair value, with net unrealized gains and losses reflected as a separate component of stockholders’ equity, net of the applicable income tax effect. Held-to-maturity securities are those that the Company has the ability and intent to hold until maturity and are reported at amortized cost.

Gains or losses on investment security transactions are based on the amortized cost of the specific securities sold. Premiums and discounts on securities are amortized and accreted into income using the interest method over the period to maturity.

When the fair value of a held-to-maturity or available-for-sale security is less than its amortized cost basis, an assessment is made at the balance sheet date as to whether other-than-temporary impairment (“OTTI”) is present.

The Company considers numerous factors when determining whether potential OTTI exists and the period over which the debt security is expected to recover. The principal factors considered are (1) the length of time and the extent to which the fair value has been less than amortized cost basis, (2) the financial condition of the issuer (and guarantor, if any) and adverse conditions specifically related to the security industry or geographic area, (3) failure of the issuer of the security to make scheduled interest or principal payments, (4) any changes to the rating of a security by a rating agency, and (5) the presence of credit enhancements, if any, including the guarantee of the federal government or any of its agencies.

For debt securities, OTTI is considered to have occurred if (1) the Company intends to sell the security, (2) it is more likely than not the Company will be required to sell the security before recovery of its amortized cost basis, or (3) if the present value of expected cash flows is not sufficient to recover the entire amortized cost basis or carrying value.

For debt securities, credit-related OTTI is recognized in earnings while noncredit-related OTTI on securities not expected to be sold is recognized in other comprehensive income (loss). Credit-related OTTI is measured as the difference between the present value of an impaired security's expected cash flows and its amortized cost basis or carrying value. Noncredit-related OTTI is measured as the difference between the fair value of the security and its amortized cost, or carrying value, less any credit-related losses recognized. For securities classified as held-to-maturity, the amount of OTTI recognized in other comprehensive income (loss) is accreted to the credit-adjusted expected cash flow amounts of the securities over future periods.

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

Restricted Stock

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

The Company holds restricted stock from Federal Home Loan Bank and Atlantic Community Bankers Bank.

No impairment charges were recorded related to the restricted stock during 2018 or 2017.

Loans Held for Sale

Mortgage loans held for sale in the secondary market are carried at the lower of amortized cost or fair value. Separate determinations of fair value for residential and commercial loans are made on an aggregate basis. 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 consolidated financial statements. Realized gains and losses on sales are computed using the specific identification method.

Loan Servicing Rights

The Company retains the servicing on a portion of conventional fixed-rate mortgage loans sold and receives a fee based on the principal balance outstanding.

Loans serviced for others totaled \$123,755,000 and \$132,427,000 at December 31, 2018 and 2017, respectively.

The Company also sells correspondent FHA, VA, and USDA mortgage loans, servicing released.

Loan servicing rights are recorded at fair value when loans are sold with servicing rights retained. The fair value of the mortgage servicing rights ("MSRs") is determined using a method which utilizes servicing income, discount rates, and prepayment speeds relative to the Bank's portfolio for MSRs and are amortized over the life of the loan. MSRs amounted to \$812,000 and \$892,000 at December 31, 2018 and 2017, respectively, and are included in other assets on the consolidated balance sheets. In 2018, \$5,000 was capitalized and \$85,000 was amortized. In 2017, \$131,000 was capitalized with \$43,000 amortized.

Loans

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

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 collectibility 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 well secured. When a loan is placed on nonaccrual status, unpaid interest credited to income in the current year is reversed. Interest received on nonaccrual loans generally is either applied against principal or reported as interest income, according to management's judgment as to the collectibility of principal. Generally, loans are restored to accrual status when the obligation is brought current, has performed in accordance with the contractual terms for a reasonable period of time and the ultimate collectibility of the total contractual principal and interest is no longer in doubt.

Allowance for Loan Losses

The allowance for loan losses (the "Allowance") is established as losses are estimated to have occurred in the loan portfolio. The allowance for loan losses is recorded through a provision for loan losses charged to earnings. Loan losses are charged against the allowance when management believes the loan is uncollectable. Subsequent recoveries, if any, are credited to the allowance.

The allowance for loan losses is evaluated on a regular basis by management and is based upon management's periodic review of the collectibility of the loans in light of historical experience, the nature and volume of the loan portfolio, adverse situations that may affect the borrower's ability to repay, the estimated value of any underlying collateral and prevailing economic conditions. This evaluation is inherently subjective as it requires estimates that are susceptible to significant revision as more information becomes available.

The allowance consists of specific, general and unallocated components. The specific component relates to loans that are deemed impaired and classified as either special mention, substandard, doubtful, or loss. For such loans that are also classified as impaired, an allowance is generally established when the collateral value of the impaired loan is lower than the carrying value of that loan. The general component covers non-classified loans and is based on historical loss experience adjusted for the following qualitative factors: effects of changes in lending policies; national and/or local economic trends and conditions; trends in volume and terms of loans; experience, ability, and depth of management; levels and trends of delinquencies, non-accruals and classified loans; quality of institutions loan review system; collateral value for collateral dependent loans; concentrations of credit; and competition, legal and regulatory requirements on level of estimated credit losses. An unallocated component is maintained to cover uncertainties that could affect management's estimate of probable losses. The unallocated component of the allowance reflects the margin of imprecision inherent in the underlying assumptions used in the methodologies for estimating specific and general losses in the portfolio.

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

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

In addition, Federal regulatory agencies, as an integral part of their examination process, periodically review the Company's allowance for loan losses and may require the Company to recognize additions to the allowance based on their judgments about information available to them at the time of their examination, which may not be currently available to management. Based on management's comprehensive analysis of the loan portfolio, management believes the current level of the allowance for loan losses is adequate.

Bank Owned Life Insurance

The Company holds life insurance policies on a key executive. Bank owned life insurance is recorded at the amount that can be realized under the insurance contract at the balance sheet date, which is the cash surrender value adjusted for other charges or other amounts due that are probable at settlement.

Premises and Equipment

Premises and equipment are stated at cost. Depreciation and amortization are computed on the straight-line basis over the shorter of the estimated useful lives or lease terms (in the case of leasehold improvements) of the related assets. Estimated useful lives are generally 20 to 30 years for premises and 3 to 10 years for furniture and equipment.

Foreclosed Real Estate

Real estate properties acquired through, or in lieu of, loan foreclosure are initially recorded at fair value less estimated selling costs at the date of foreclosure. Any write-downs based on the asset's fair value at date of acquisition are charged to the allowance for loan losses. After foreclosure, property held for sale is carried at the lower of the new basis or fair value less any costs to sell. Costs of significant property improvements are capitalized, whereas costs relating to holding property are expensed. Valuations are periodically performed by management, and any subsequent write-downs are recorded as a charge to earnings, if necessary, to reduce the carrying value of the property to the lower of its cost or fair value less cost to sell. The Company had no foreclosed real estate at December 31, 2018 and 2017. At December 31, 2018 the Company had one residential mortgage loan for \$55,000 in the process of foreclosure and at December 31, 2017 the Company had one residential mortgage loan for \$37,000 in the process of foreclosure.

Income Taxes

Income taxes are provided for the tax effects of certain transactions reported in the consolidated financial statements. Income taxes consist of taxes currently due plus deferred taxes related primarily to temporary differences between the financial reporting and income tax basis of the allowance for loan losses, premises and equipment, certain state tax credits, and deferred loan origination costs. The deferred tax assets and liabilities represent the future tax return consequences of the temporary differences, which will either be taxable or deductible when the assets and liabilities are recovered or settled. 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 reflected at income tax rates applicable to the period in which the deferred tax assets and liabilities are expected to be realized or settled. On December 22, 2017, the Tax Cuts and Jobs Act (the "Tax Act") was enacted which reduced the corporate federal income tax rate from 34% to 21% and caused a reevaluation of net deferred tax assets. Generally accepted accounting principles requires that the impact of the provisions of the Tax Act be accounted for in the period of enactment. As changes in tax laws or rates are enacted, deferred tax assets and liabilities are adjusted through the provision for income taxes.

Advertising Costs

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

Off-Balance Sheet Financial Instruments

In the ordinary course of business, the Company has entered into off-balance sheet financial instruments consisting of commitments to extend credit. Such financial instruments are recorded in the consolidated balance sheets when they are funded.

Transfers of Financial Assets

Transfers of financial assets are accounted for as sales, when control over the assets has been surrendered. Control over transferred assets is deemed to be surrendered when (1) the assets have been isolated from the Company, (2) the transferee obtains the right (free of conditions that constrain it from taking advantage of that right) to pledge or exchange the transferred assets, and (3) the Company does not maintain effective control over the transferred assets through an agreement to repurchase them before their maturity.

Comprehensive Income (Loss)

Accounting principles generally require that recognized revenue, expenses, gains, and losses be included in earnings. Although certain changes in assets and liabilities, such as unrealized gains and losses on available-for-sale securities, are reported as a separate component of the stockholders' equity section of the consolidated balance sheets, such items, along with net income, are components of comprehensive income (loss).

Accumulated other comprehensive income (loss) represents the sum of these items, with the exception of net income, as of the consolidated balance sheet date and is represented in the table below.

	As of December 31,	
	2018	2017
	<u> </u>	<u> </u>
Accumulated Other Comprehensive Loss By Component:		
Unrealized losses on securities available-for-sale	\$ (232)	\$ (208)
Tax effect	<u>49</u>	<u>43</u>
Net unrealized losses on securities available-for-sale	<u>(183)</u>	<u>(165)</u>
Accumulated other comprehensive loss	<u>\$ (183)</u>	<u>\$ (165)</u>

Earnings Per Common Share

Basic earnings per common share is calculated by dividing net income available to common stockholders by the weighted-average number of common shares outstanding during the period. Diluted earnings per share is computed in a similar manner to that of basic earnings per share except that the weighted-average number of common shares outstanding is increased to reflect the assumed exercise and conversion of dilutive stock options and unvested restricted stock. Net income available to common stockholders is net income of the Company. 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.

The following table sets forth the calculation of basic and diluted earnings per share.

<i>(In thousands, except per share data)</i>	Year Ended December 31,	
	2018	2017
Basic and Diluted Earnings Per Common Share		
Net income available to common stockholders	\$ 135	\$ 211
Weighted average basic common shares outstanding	1,851	1,899
Weighted average diluted common shares outstanding	1,853	1,899
Earnings per common share – basic and diluted	\$ 0.07	\$ 0.11

Share Repurchases

The Company announced on July 27, 2017 that the Board of Directors had adopted its first stock repurchase program. Under the repurchase program, the Company may repurchase up to 97,084 shares of its common stock, or approximately 5% of its then outstanding shares. In 2018, the Company repurchased 2,592 shares at an average price of \$16.38 per share. In 2017, the Company repurchased 69,535 shares at an average price of \$15.27 per share. As of December 31, 2018, the Company had repurchased 72,127 shares at an average price of \$15.31 per share.

Stock-Based Compensation

On September 27, 2017, the Board of Directors of the Company approved restricted stock and stock option grants to senior management and the directors of the Company, pursuant to the terms of the 2017 Equity Incentive Plan (the “Plan”). The Plan was approved previously by the Company’s stockholders on August 29, 2017. An aggregate of 20,000 stock options and 8,400 shares of restricted stock were granted to senior management for the year ended December 31, 2018. An aggregate of 152,080 stock options and 62,700 shares of restricted stock were granted to senior management and directors for the year ended December 31, 2017. The grants to senior management and directors vest over a five year period in equal annual installments, with the first installment vesting on the first anniversary date of the grant and succeeding installments on each anniversary thereafter, through 2023.

Treasury Stock

Treasury stock was recorded using the cost method and accordingly was presented as a reduction of stockholders’ equity. All treasury stock shares associated with our common stock have been cancelled as a result of the stock conversion and reorganization that occurred in July 2016.

Reclassifications

Amounts in the prior year’s consolidated financial statements have been reclassified whenever necessary to conform to the current year’s presentation. Such reclassifications had no impact on stockholders’ equity or net income as previously reported.

New Accounting Pronouncements

In May 2014, the FASB issued Accounting Standards Update (“ASU”) No. 2014-09, Revenue from Contracts with Customers (Topic 606) and subsequent updates. This ASU clarifies the principles for recognizing revenue and develops a common standard for U.S. GAAP and International Financial Reporting Standards. The ASU establishes a core principle that requires an entity to identify the contract(s) with a customer, identify the performance obligations in the contract, determine the transaction price, allocate the transaction price to the performance obligations in the contract, and recognize revenue when (or as) the entity satisfies a performance obligation. The ASU provides for improved disclosure requirements that require entities to disclose sufficient financial statements to understand the nature, amount, timing, and uncertainty of revenue and cash flows arising from contracts with customers. The Company adopted the guidance effective January 1, 2018 using the modified retrospective method. The Company’s revenue is the sum of net interest income and non-interest income. The scope of the guidance excludes nearly all net interest income as well as many other revenues for financial assets and liabilities including loans, leases, securities, and derivatives. The Company completed its review and determined that the majority of non-interest income revenue streams are within the scope of the new standard. Non-interest income streams that are out of scope of the new standard include BOLI, sales of investment securities, mortgage banking activities, and certain items within service charges and other income. Management reviewed contracts related to service charges on deposits, investment advisory commissions and fee income, insurance commission and fee income, and certain items within other service charges and other income. The Company evaluated the impact of this ASU on the Company’s various revenue streams and, upon adoption on January 1, 2018 and going forward, does not anticipate a material impact to the consolidated financial statements. The Company has included applicable disclosures regarding revenue recognition within Note 10 of these consolidated financial statements.

In January 2016, the FASB issued ASU No. 2016-01, Financial Instruments-Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Liabilities. The amendments in this update address certain aspects of recognition, measurement, presentation, and disclosure of financial instruments. The amendments in this update require all equity investments to be measured at fair value with changes in the fair value recognized through net income (other than those accounted for under equity method of accounting or those that result in consolidation of the investee). The amendments in this update also require an entity to present separately in other comprehensive income the portion of the total change in the fair value of a liability resulting from a change in the instrument-specific credit risk when the entity has elected to measure the liability at fair value in accordance with the fair value option for financial instruments. In addition, the amendments in this update also simplify the impairment assessment of equity investments without readily determinable fair values by requiring assessment for impairment qualitatively at each reporting period. For public business entities, the amendments in this update are effective for fiscal years beginning after December 15, 2017, including interim periods with those fiscal years. The adoption had no impact on the consolidated financial statements and only impacted fair value measurement disclosures.

In February 2016, the FASB issued ASU 2016-02, Leases (Topic 842). This new guidance supersedes the lease requirements in Topic 840, Leases and is based on the principle that a lessee should recognize in the statement of financial position a liability to make lease payments (the lease liability) and a right-of-use asset representing its right to use the underlying asset for the lease term. The accounting applied by a lessor is largely unchanged from that applied under the previous guidance. In addition, the guidance requires an entity to separate the lease components from the nonlease components in a contract. The ASU requires disclosures about the amount, timing, and judgments related to a reporting entity's accounting for leases and related cash flows. The standard is required to be applied to all leases in existence as of the date of adoption using a modified retrospective transition approach. This guidance is effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. Early adoption is permitted for all companies in any interim or annual period. The Company occupies certain offices and uses certain equipment under non-cancelable operating lease agreements, which currently are not reflected in its consolidated statement of condition. The Company adopted this ASU on January 1, 2019 and going forward will recognize lease liabilities and right of use assets associated with these lease agreements and does not anticipate a material impact to the consolidated financial statements.

In June 2016, the FASB issued ASU No. 2016-13, Financial Instruments – Credit Losses (Topic 326). This new guidance significantly changes how entities will measure credit losses for most financial assets and certain other instruments that are not measured at fair value through net income. This ASU will replace the "incurred loss" model under existing guidance with an "expected loss" model for instruments measured at amortized cost, and require entities to record allowances for available-for-sale debt securities rather than reduce the carrying amount, as they do today under the other-than-temporary impairment model. This ASU also simplifies the accounting model for purchased credit-impaired debt securities and loans. This guidance requires adoption through a cumulative-effect adjustment to retained earnings as of the beginning of the first reporting period in which the guidance is adopted. This ASU is effective for fiscal years beginning after December 15, 2019, including interim periods within those fiscal years. Early adoption is permitted for all companies as of fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. The Company is currently evaluating the impact the guidance will have on the Company's consolidated financial statements, and expects an increase in the allowance for credit losses resulting from the change to expected losses for the estimated life of the financial asset, including an allowance for debt securities. The amount of the increase in the allowance for credit losses resulting from the new guidance will be impacted by the portfolio composition and asset quality at the adoption date, as well as economic conditions and forecasts at the time of adoption. The Company will run a second model concurrently in 2019 to evaluate the impact of the new guidance.

In August 2016, the FASB issued ASU No. 2016-15, Statement of Cash Flows (Topic 230). The amendments provide guidance on the following eight specific cash flow issues: 1) debt prepayment or debt extinguishment costs; 2) settlement of zero-coupon debt instruments or other debt instruments with coupon interest rates that are insignificant in relation to the effective interest rate of the borrowing; 3) contingent consideration payments made after a business combination; 4) proceeds from the settlement of insurance claims; 5) proceeds from the settlement of corporate-owned life insurance policies, including bank-owned life insurance policies; 6) distributions received from equity method investees; 7) beneficial interests in securitization transactions; and 8) separately identifiable cash flows and application of the predominance principle. This ASU is effective for fiscal years beginning after December 31, 2017, including interim periods within those fiscal years. Early adoption is permitted, including adoption in an interim period. The Company adopted the amendment in this update during the three months ended March 31, 2018 and noted no material impact to the consolidated financial statements.

In March 2017, the FASB issued an Update (ASU 2017-08) to its guidance on "Receivables – Nonrefundable Fees and Other Costs (Subtopic 310-20) related to premium amortization on purchased callable debt securities. The amendments in this Update shorten the amortization period for certain callable debt securities held at a premium. Specifically, the amendments require the premium to be amortized to the earliest call date. The amendments do not require an accounting change for securities held at a discount; the discount continues to be amortized to maturity. For public business entities, the amendments in this Update are effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2018. Early adoption is permitted, including adoption in an interim period. If an entity early adopts the amendments in an interim period, any adjustments should be reflected as of the beginning of the fiscal year that includes that interim period. An entity should apply the amendments in this Update on a modified retrospective basis through a cumulative-effect adjustment directly to retained earnings as of the beginning of the period of adoption. Additionally, in the period of adoption, an entity should provide disclosure about a change in accounting principle. The adoption of this guidance is not expected to have a material impact on our consolidated results of operations or financial position.

In May 2018, the FASB issued ASU No. 2018-06, *Codification Improvements to Topic 942, Financial Services - Depository and Lending*. This update superseded outdated guidance related to the Office of the Comptroller of the Currency's Banking Circular 202, Accounting for Net Deferred Tax Charges. The Company does not expect the new guidance to have a material impact on the consolidated financial statements.

In June 2018, the FASB issued ASU No. 2018-07, *Compensation - Stock Compensation (Topic 718): Improvements to Nonemployee Share-Based Payment Accounting*. This update expands the scope of Topic 718 to include share-based payment transactions for acquiring goods and services from nonemployees. As a result, nonemployee share-based payment awards will be measured at the grant-date fair value of the equity instruments that an entity is obligated to issue when the service has been rendered, subject to the probability of satisfying performance conditions when applicable. For public entities, this update is effective for fiscal years beginning after December 15, 2018. The Company does not expect the new guidance to have a material impact on the consolidated financial statements.

In July 2018, the FASB issued ASU No. 2018-09, *Codification Improvements* to address stakeholder suggestions for minor corrections and clarifications within the codification. The transition and effective date guidance is based on the facts and circumstances of each amendment. Some of the amendments in this update do not require transition guidance and will be effective upon issuance of this update. However, many of the amendments in this update do have transition guidance with effective dates for annual periods beginning after December 15, 2018, for public business entities. The Company does not expect the new guidance to have a material impact on the consolidated financial statements.

In July 2018, the FASB issued ASU No. 2018-10, *Codification Improvements to Topic 842, Leases* to address certain narrow aspects of the guidance issued in ASU No. 2016-02. This guidance did not change the Company's assessment of the impact of ASU No. 2016-02 on the consolidated financial statements as described above.

In July 2018, the FASB issued ASU No. 2018-11, *Leases (Topic 842): Targeted Improvements*, which amends FASB Accounting Standards Codification (ASC) Topic 842, *Leases*, to (1) add an optional transition method that would permit entities to apply the new requirements by recognizing a cumulative-effect adjustment to the opening balance of retained earnings in the year of adoption, and (2) provide a practical expedient for lessors regarding the separation of the lease and non-lease components of a contract. This guidance did not change the Company's assessment of the impact of ASU No. 2016-02 on the consolidated financial statements as described above.

In August 2018, the FASB has issued Accounting Standards Update (ASU) No. 2018-15, *Intangibles—Goodwill and Other—Internal Use Software (Subtopic 350-40): Customer's Accounting for Implementation Costs Incurred in a Cloud Computing Arrangement That Is a Service Contract*, a consensus of the FASB Emerging Issues Task Force, which amends the FASB ASC to provide guidance on accounting for costs of implementation activities performed in a cloud computing arrangement that is a service contract. In April 2015, the FASB issued ASU No. 2015-05, *Intangibles—Goodwill and Other—Internal-Use Software (Subtopic 350-40): Customer's Accounting for Fees Paid in a Cloud Computing Arrangement*, which provided guidance to customers concerning whether a cloud computing arrangement (e.g., software, platform, or infrastructure offered as a service) includes a software license. Pursuant to that guidance, (1) if a cloud computing arrangement includes a software license, the software license element of the arrangement should be accounted for in a manner consistent with the acquisition of other software licenses, or (2) if the arrangement does not include a software license, then the arrangement should be accounted for as a service contract, with the fees associated with the hosting element (service) of the arrangement expensed as they are incurred. Following the issuance of ASU No. 2015-05, constituents requested that the FASB provide additional guidance on the accounting for costs of implementation activities performed in a cloud computing arrangement that is a service contract. Accordingly, because U.S. GAAP do not contain explicit guidance on accounting for such costs, and to address the resulting diversity in practice, the FASB has issued ASU No. 2018-15 to align the requirements for capitalizing implementation costs incurred in a hosting arrangement that is a service contract with the requirements for capitalizing implementation costs incurred to develop or obtain internal-use software (and hosting arrangements that include an internal-use software license). Note that the guidance on accounting for the service element of a hosting arrangement that is a service contract is not affected by the amendments in ASU No. 2018-15. For Public Business Entities, the amended guidance is effective for fiscal years beginning after December 15, 2019 (i.e., calendar-year 2020), and for interim periods within those fiscal years.

In October 2018, the FASB issued Accounting Standards Update (ASU) No. 2018-16, *Derivatives and Hedging (Topic 815): Inclusion of the Secured Overnight Financing Rate (SOFR) Overnight Index Swap (OIS) Rate as a Benchmark Interest Rate for Hedge Accounting Purposes*, which adds the SOFR OIS as a benchmark rate that businesses can use to designate hedges of interest rate risk. This update adds to U.S. GAAP a new interest rate from the market for U.S. Treasury repurchase contracts to the list of accepted benchmark rates for hedge accounting. The SOFR is calculated by the Fed based on the interest rates banks charge one another in the overnight market for loans they make to one another, typically called repurchase agreements. In introducing the new rate, the Fed said that because it is based on transactions in the open market, it is more reflective of market conditions than LIBOR, which relies more on judgment. Adding the SOFR OIS as an acceptable hedge accounting benchmark for U.S. GAAP is considered a critical step in helping it gain more acceptance in the market. FASB ASC 815 provides guidance on the risks associated with financial assets or liabilities that are allowed to be hedged. Among those risks is the risk of changes in fair values or cash flows of existing or forecasted issuances or purchases of fixed-rate financial assets or liabilities attributable to a designated benchmark interest rate. U.S. GAAP considers a benchmark rate as a rate that is widely recognized, commonly referenced, and quoted in an active financial market. FASB ASC 815 lists three rates as benchmarks: the rate on direct Treasury obligations of the U.S. government, the Fed Funds Effective Swap Rate (Overnight Index Swap Rate), and the LIBOR swap rate. In 2017, the FASB added a fourth rate, the Securities Industry and Financial Markets Association (SIFMA) Municipal Swap Rate when it published ASU No. 2017-12, *Derivatives and Hedging (Topic 815): Targeted Improvements to Accounting for Hedging Activities*, which made several other changes to simplify hedge accounting and expand its use. The FASB wants businesses and organizations to adopt the amendments in ASU No. 2018-16 at the same time they adopt the changes in ASU No. 2017-12. For public companies that have adopted ASU No. 2017-12, the new amendments are effective for fiscal years beginning after December 15 and interim periods within those fiscal years. For other companies and organizations that already have adopted ASU No. 2017-12, the new amendments are effective for fiscal years beginning after December 15, 2019, and interim periods within those fiscal years. Early adoption is permitted in any interim period as long as the company or organization already has adopted the broader 2017 hedge accounting update.

Note 2 - Securities

The amortized cost and estimated fair value of securities with gross unrealized gains and losses at December 31, 2018 and 2017 are as follows:

	<u>Amortized Cost</u>	<u>Gross Unrealized Gains</u>	<u>Gross Unrealized Losses</u>	<u>Fair Value</u>
	(In Thousands)			
December 31, 2018:				
Available-for-Sale:				
U.S. Government and agency obligations	\$ 12,610	\$ 7	\$ (162)	\$ 12,455
Mortgage-backed securities - residential	5,953	24	(101)	5,876
	<u>\$ 18,563</u>	<u>\$ 31</u>	<u>\$ (263)</u>	<u>\$ 18,331</u>
Held-to-Maturity:				
Mortgage-backed securities - residential	\$ 458	\$ 6	\$ (1)	\$ 463
State and municipal securities	5,594	29	(56)	5,567
	<u>\$ 6,052</u>	<u>\$ 35</u>	<u>\$ (57)</u>	<u>\$ 6,030</u>
December 31, 2017:				
Available-for-Sale:				
U.S. Government and agency obligations	\$ 10,612	\$ -	\$ (142)	\$ 10,470
Mortgage-backed securities - residential	7,909	19	(85)	7,843
	<u>\$ 18,521</u>	<u>\$ 19</u>	<u>\$ (227)</u>	<u>\$ 18,313</u>
Held-to-Maturity:				
Mortgage-backed securities - residential	\$ 637	\$ 9	\$ -	\$ 646
State and municipal securities	5,938	41	(37)	5,942
	<u>\$ 6,575</u>	<u>\$ 50</u>	<u>\$ (37)</u>	<u>\$ 6,588</u>

Mortgage-backed securities consist of securities that are issued by Fannie Mae ("FNMA"), Freddie Mac ("FHLMC"), Ginnie Mae ("GNMA"), and are collateralized by residential mortgages. U.S. Government and agency obligations include notes and bonds with both fixed and variable rates. State and municipal securities consist of government obligations and revenue bonds.

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The amortized cost and estimated fair value by contractual maturity of debt securities at December 31, 2018 are shown below. Actual maturities may differ from contractual maturities because borrowers may have the right to call or prepay obligations.

	<u>Available-for-Sale</u>		<u>Held-to-Maturity</u>	
	<u>Amortized Cost</u>	<u>Estimated Fair Value</u>	<u>Amortized Cost</u>	<u>Estimated Fair Value</u>
		(In Thousands)		
Due in one year or less	\$ -	\$ -	\$ 817	\$ 817
Due after one year through five years	11,110	10,970	3,118	3,080
Due after five years through ten years	500	500	1,659	1,670
Due after ten years	1,000	985	-	-
Mortgage-backed securities - residential	5,953	5,876	458	463
	<u>\$ 18,563</u>	<u>\$ 18,331</u>	<u>\$ 6,052</u>	<u>\$ 6,030</u>

There were no realized gains on sales of securities in 2018 or 2017.

No securities were pledged to secure public deposits or for any other purpose required or permitted by law at December 31, 2018 and 2017.

Management has reviewed its loan and mortgage-backed securities portfolios and determined that, to the best of its knowledge, little or no exposure exists to sub-prime or other high-risk residential mortgages. The Company is not in the practice of investing in, or originating, these types of investments or loans.

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The following table shows gross unrealized losses and fair value, aggregated by investment category and length of time the individual securities have been in a continuous unrealized loss position, at December 31, 2018 and 2017:

	<u>Less than 12 Months</u>		<u>12 Months or More</u>		<u>Total</u>	
	<u>Fair Value</u>	<u>Gross Unrealized Losses</u>	<u>Fair Value</u>	<u>Gross Unrealized Losses</u>	<u>Fair Value</u>	<u>Gross Unrealized Losses</u>
2018:						
Available-for-Sale						
U.S. Government and agency obligations	\$ -	\$ -	\$ 9,445	\$ 162	\$ 9,445	\$ 162
Mortgage-backed securities - residential ⁽¹⁾	203	-	3,749	101	3,952	101
	<u>\$ 203</u>	<u>\$ -</u>	<u>\$ 13,194</u>	<u>\$ 263</u>	<u>\$ 13,397</u>	<u>\$ 263</u>
2018:						
Held-to-Maturity						
Mortgage-backed securities - residential	\$ -	\$ -	\$ 165	\$ 1	\$ 165	\$ 1
State and municipal Securities	1,039	4	3,021	52	4,060	56
	<u>\$ 1,039</u>	<u>\$ 4</u>	<u>\$ 3,186</u>	<u>\$ 53</u>	<u>\$ 4,225</u>	<u>\$ 57</u>
2017:						
Available-for-Sale						
U.S. Government and agency obligations	\$ 4,472	\$ 34	\$ 5,998	\$ 108	\$ 10,470	\$ 142
Mortgage-backed securities - residential	2,459	23	3,435	62	5,894	85
	<u>\$ 6,931</u>	<u>\$ 57</u>	<u>\$ 9,433</u>	<u>\$ 170</u>	<u>\$ 16,364</u>	<u>\$ 227</u>
2017:						
Held-to-Maturity						
Mortgage-backed securities - residential ⁽¹⁾	\$ -	\$ -	\$ 171	\$ -	\$ 171	\$ -
State and municipal Securities	1,574	16	1,331	21	2,905	37
	<u>\$ 1,574</u>	<u>\$ 16</u>	<u>\$ 1,502</u>	<u>\$ 21</u>	<u>\$ 3,076</u>	<u>\$ 37</u>

⁽¹⁾ Aggregate unrealized loss position of these securities is less than \$500.

Management evaluates securities for other-than-temporary impairment at least on a quarterly basis, and more frequently when economic or market concerns warrant such evaluation. In 2018 and 2017, the Company did not record an other-than-temporary impairment charge.

At December 31, 2018, one residential mortgage-backed security and three state and municipal securities were in a continuous unrealized loss position for less than twelve months. At December 31, 2018, five residential mortgage-backed securities, eight U.S. Government and agency obligations, and 15 state and municipal securities were in a continuous unrealized loss position for more than twelve months. The debt securities and residential mortgage-backed securities were issued by U.S. Government sponsored agencies.

All are paying in accordance with their terms with no deferrals of interest or defaults. Because the decline in fair value is attributable to changes in interest rates, not credit quality, and because management does not intend to sell and will not be required to sell these securities prior to recovery or maturity, no declines are deemed to be other-than-temporary. The state and municipal securities are general obligation (G.O.) bonds backed by the full faith and credit of local municipalities. There has never been a default of a New York G.O. in the history of the state. Historical performance does not guarantee future performance, but it does indicate that the risk of loss on default of a G.O. municipal bond for the Company is relatively low. All are paying in accordance with their terms and with no deferrals of interest or defaults.

Note 3 – Loans and The Allowance for Loan Losses

Net loans at December 31, 2018 and 2017 consist of the following:

	<u>2018</u>	<u>2017</u>
	(In Thousands)	
Real estate loans:		
Secured by one- to four-family residences	\$ 221,602	\$ 206,894
Secured by multi-family residences	10,241	10,650
Construction	4,898	10,750
Commercial real estate	22,492	14,803
Home equity lines of credit	16,766	17,127
Commercial & industrial	7,290	3,679
Other loans	50	70
Total Loans	283,339	263,973
Net deferred loan origination fees	(37)	(1)
Allowance for loan losses	(1,561)	(1,261)
Net Loans	\$ 281,741	\$ 262,711

To develop and document a systematic methodology for determining the allowance for loan losses, the Company has divided the loan portfolio into two portfolio segments, each with different risk characteristics but with similar methodologies for assessing risk. Each portfolio segment is broken down into loan classes where appropriate. Loan classes contain unique measurement attributes, risk characteristics, and methods for monitoring and assessing risk that are necessary to develop the allowance for loan losses. Unique characteristics such as borrower type, loan type, collateral type, and risk characteristics define each class.

The following table illustrates the portfolio segments and classes for the Company's loan portfolio:

<u>Portfolio Segment</u>	<u>Class</u>
Real Estate Loans	Secured by one- to four-family residences Secured by multi-family residences Construction Commercial real estate Home equity lines of credit
Other Loans	Commercial & industrial Other loans

The Company's primary lending activity is the origination of one- to four-family residential real estate mortgage loans. At December 31, 2018, \$221.6 million, or 78.2%, of the total loan portfolio consisted of one- to four-family residential real estate mortgage loans compared to \$206.9 million, or 78.3%, of the total loan portfolio at December 31, 2017.

The Company offers home equity lines of credit, which are primarily secured by a second mortgage on one- to four-family residences. At December 31, 2018, home equity lines of credit totaled \$16.8 million, or 5.9%, of total loans receivable compared to \$17.1 million, or 6.5%, of total loans receivable at December 31, 2017.

The underwriting standards for home equity lines of credit include a determination of the applicant's credit history, an assessment of the applicant's ability to meet existing obligations and payments on the proposed loan and the value of the collateral securing the loan. The combined loan-to-value ratio (first and second mortgage liens) for home equity lines of credit is generally limited to 90%. The Company originates home equity lines of credit without application fees or borrower-paid closing costs. Home equity lines of credit are offered with adjustable-rates of interest indexed to the prime rate, as reported in *The Wall Street Journal*.

Multi-family residential loans generally are secured by rental properties. Multi-family real estate loans are offered with fixed and adjustable interest rates. Loans secured by multi-family real estate totaled \$10.2 million, or 3.6%, of the total loan portfolio at December 31, 2018 compared to \$10.7 million, or 4.0%, of the total loan portfolio at December 31, 2017. Multi-family real estate loans are originated for terms of up to 20 years. Adjustable-rate multi-family real estate loans are tied to the average yield on U.S. Treasury securities, subject to periodic and lifetime limitations on interest rate changes.

Loans secured by multi-family real estate generally involve a greater degree of credit risk than one- to four-family residential mortgage loans and carry larger loan balances. This increased credit risk is a result of several factors, including the concentration of principal in a limited number of loans and borrowers, the effects of general economic conditions on income producing properties, and the increased difficulty of evaluating and monitoring these types of loans. Furthermore, the repayment of loans secured by multi-family real estate typically depends upon the successful operation of the real estate property securing the loans. If the cash flow from the project is reduced, the borrower's ability to repay the loan may be impaired.

The Company originates construction loans for the purchase of developed lots and for the construction of single-family residences. At December 31, 2018, construction loans totaled \$4.9 million, or 1.7%, of total loans receivable compared to \$10.8 million, or 4.1%, at December 31, 2017. At December 31, 2018, the additional unadvanced portion of these construction loans totaled \$4.4 million compared to \$5.9 million at December 31, 2017. Construction loans are offered to individuals for the construction of their personal residences by a qualified builder (construction/permanent loans).

Before making a commitment to fund a construction loan, the Company requires an appraisal of the property by an independent licensed appraiser. The Company generally also reviews and inspects each property before disbursement of funds during the term of the construction loan.

Construction financing generally involves greater credit risk than long-term financing on improved, owner-occupied real estate. Risk of loss on a construction loan depends largely upon the accuracy of the initial estimate of the value of the property at completion of construction compared to the estimated cost (including interest) of construction and other assumptions. If the estimate of construction cost proves to be inaccurate, the Company may be required to advance additional funds beyond the amount originally committed in order to protect the value of the property. Moreover, if the estimated value of the completed project proves to be inaccurate, the borrower may hold a property with a value that is insufficient to assure full repayment of the loan.

Commercial real estate loans are secured by office buildings, mixed-use properties, places of worship and other commercial properties. Loans secured by commercial real estate totaled \$22.5 million, or 7.9%, of the Company's total loan portfolio at December 31, 2018 compared to \$14.8 million, or 5.6%, of our total loan portfolio at December 31, 2017.

The Company generally originates adjustable-rate commercial real estate loans with maximum terms of up to 15 years. The maximum loan-to-value ratio of commercial real estate loans is 80%.

Loans secured by commercial real estate generally are larger than one- to four-family residential loans and involve greater credit risk. Commercial real estate loans often involve large loan balances to single borrowers or groups of related borrowers. Repayment of these loans depends to a large degree on the results of operations and management of the properties securing the loans or the businesses conducted on such property, 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 these loans makes them more difficult for management to monitor and evaluate.

The commercial and industrial product set includes loans to individuals or businesses on an installment basis secured by vehicles, equipment or other durable goods for which the loans were made, loans for and secured by machinery and/or equipment for which a legitimate resale market exists, lines of credit to businesses and individuals, and unsecured loans to businesses and individuals on a short-term basis. At December 31, 2018, these loans totaled \$7.3 million, or 2.6%, of the total loan portfolio compared to \$3.7 million, or 1.4%, at December 31, 2017.

These loans carry a higher risk than commercial real estate loans by the nature of the underlying collateral, which can be business assets such as equipment and accounts receivable. To reduce the risk, management also attempts to secure secondary collateral, such as real estate, and obtain personal guarantees of the borrowers. To further reduce risk and enhance liquidity, these loans generally carry variable rates of interest, repricing in five-year periods, and have a maturity of ten years or less.

The Company is an approved SBA lender. SBA acts as a loan guarantor and these loans are generally for commercial business purposes versus real estate. The Company follows the Small Business Administration lending guidelines regarding eligibility, underwriting etc. as stated in SBA's most current version of SOP 50 10 SBA's Lender and Development Company Loan Program.

The Company offers a variety of other loans secured by property other than real estate. At December 31, 2018, these other loans totaled \$50,000, or 0.1%, of the total loan portfolio compared to other loans totaling \$70,000, or 0.1%, of the total loan portfolio at December 31, 2017. These loans include automobile, passbook, overdraft protection and unsecured loans. Due to the relative immateriality of other loans, the Company's risk associated with these loans is not considered significant.

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The following table sets forth the allowance for loan losses allocated by loan class and the activity in the allowance for loan losses for the years ending December 31, 2018 and 2017. The allowance for loan losses allocated to each class is not necessarily indicative of future losses in any particular class and does not restrict the use of the allowance to absorb losses in other classes.

	Secured by 1-4 family residential	Secured by multi- family residential	Construction	Commercial	Home Equity Lines of Credit	Commercial & Industrial	Other/ Unallocated	Total
(In Thousands)								
At December 31, 2018								
Beginning Balance	\$ 816	\$ 80	\$ 54	\$ 148	\$ 107	\$ 47	\$ 9	\$1,261
Charge Offs	-	-	-	-	-	-	-	-
Recoveries	-	-	-	-	-	-	-	-
Provisions	50	(3)	(30)	136	(4)	50	101	300
Ending Balance (1)	\$ 866	\$ 77	\$ 24	\$ 284	\$ 103	\$ 97	\$ 110	\$1,561
At December 31, 2017								
Beginning Balance	\$ 584	\$ 38	\$ 31	\$ 84	\$ 112	\$ 28	\$ 113	\$ 990
Charge Offs	-	-	-	-	-	-	-	-
Recoveries	-	-	-	-	-	-	-	-
Provisions	232	42	23	64	(5)	19	(104)	271
Ending Balance (1)	\$ 816	\$ 80	\$ 54	\$ 148	\$ 107	\$ 47	\$ 9	\$1,261

(1) All Loans are collectively evaluated for impairment.

The Company's policies, consistent with regulatory guidelines, provide for the classification of loans that are considered to be of lesser quality as substandard, doubtful, or loss assets. An asset is considered substandard if it is inadequately protected by the current net worth and paying capacity of the obligor or of the collateral pledged, if any. Substandard assets include those assets characterized by the distinct possibility that the Company will sustain some loss if the deficiencies are not corrected. Assets classified as doubtful have all of the weaknesses inherent in those classified as substandard with the added characteristic that the weaknesses present make collection or liquidation in full, on the basis of currently existing facts, conditions and values, highly questionable and improbable. Assets (or portions of assets) classified as loss are those considered uncollectible and of such little value that their continuance as assets is not warranted. Assets that do not expose the Company to risk sufficient to warrant classification in one of the aforementioned categories, but which possess potential weaknesses that deserve close attention, are required to be designated as special mention.

When the Company classifies assets as pass a portion of the related general loss allowances is allocated to such assets as deemed prudent. The allowance for loan losses is the amount estimated by management as necessary to absorb credit losses incurred in the loan portfolio that are both probable and reasonably estimable at the consolidated balance sheet date. The Company's determination as to the classification of its assets and the amount of its loss allowances are subject to review by its principal state regulator, the New York State Department of Financial Services, which can require that the Company establish additional loss allowances. The Company regularly reviews its asset portfolio to determine whether any assets require classification in accordance with applicable regulations.

At December 31, 2018 and 2017, there were no loans considered to be impaired and no troubled debt restructurings.

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The following table presents the risk category of loans by class at December 31, 2018 and 2017:

	Pass	Special Mention	Substandard (In Thousands)	Doubtful	Total
2018					
One- to four-family residential	\$ 218,222	\$ 494	\$ 2,886	\$ -	\$ 221,602
Multi-family residential	10,241	-	-	-	10,241
Construction	4,898	-	-	-	4,898
Commercial real estate	21,313	931	248	-	22,492
Home equity lines of credit	16,565	-	201	-	16,766
Commercial & industrial	7,245	-	45	-	7,290
Other loans	50	-	-	-	50
Total	\$ 278,534	\$ 1,425	\$ 3,380	\$ -	\$ 283,339
2017					
One- to four-family residential	\$ 203,815	\$ 116	\$ 2,963	\$ -	\$ 206,894
Multi-family residential	10,650	-	-	-	10,650
Construction	10,750	-	-	-	10,750
Commercial real estate	14,803	-	-	-	14,803
Home equity lines of credit	16,897	-	230	-	17,127
Commercial & industrial	3,679	-	-	-	3,679
Other loans	70	-	-	-	70
Total	\$ 260,664	\$ 116	\$ 3,193	\$ -	\$ 263,973

At December 31, 2018, the Company had one non-accrual residential mortgage loan for \$55,000 and one non-accrual commercial and industrial loan for \$45,000 and at December 31, 2017, the Company had two non-accrual residential mortgage loans for \$153,000. There were no loans that were past due 90 days or more and still accruing interest at December 31, 2018 and 2017. Interest on non-accrual loans that would have been earned if loans were accruing interest was immaterial for 2018 and 2017. At December 31, 2018 the Company had one residential mortgage loan for \$55,000 in the process of foreclosure and at December 31, 2017 the Company had one residential mortgage loan for \$37,000 in the process of foreclosure.

Delinquent Loans. Loans are considered past due if the required principal and interest payments have not been received within thirty days of the payment due date. An age analysis of past due loans, segregated by portfolio segment and class of loans, as of December 31, 2018 and December 31, 2017, are detailed in the following table:

	<u>30-59 Days Past Due</u>	<u>60-89 Days Past Due</u>	<u>Greater than 90 Days</u>	<u>Total Past Due</u>	<u>Current</u>	<u>Total Loans Receivable</u>
(In thousands)						
2018						
Real estate loans:						
One- to four-family residential	\$ 227	\$ 349	\$ 55	\$ 631	\$ 220,971	\$ 221,602
Multi-family residential	-	-	-	-	10,241	10,241
Construction	-	-	-	-	4,898	4,898
Commercial	248	-	-	248	22,244	22,492
Home equity lines of credit	147	-	-	147	16,619	16,766
Commercial & industrial	-	-	45	45	7,245	7,290
Other loans	-	-	-	-	50	50
Total	\$ 622	\$ 349	\$ 100	\$ 1,071	\$ 282,268	\$ 283,339
2017						
Real estate loans:						
One- to four-family residential	\$ 699	\$ -	\$ 153	\$ 852	\$ 206,042	\$ 206,894
Multi-family residential	-	-	-	-	10,650	10,650
Construction	-	-	-	-	10,750	10,750
Commercial	-	-	-	-	14,803	14,803
Home equity lines of credit	-	-	-	-	17,127	17,127
Commercial & industrial	-	-	-	-	3,679	3,679
Other loans	-	-	-	-	70	70
Total	\$ 699	\$ -	\$ 153	\$ 852	\$ 263,121	\$ 263,973

Management has reviewed its loan portfolio and determined that, to the best of its knowledge, no exposure exists to sub-prime or other high-risk residential mortgages. The Company is not in the practice of originating these types of loans.

Note 4 - Premises and Equipment

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

	<u>2018</u>	<u>2017</u>
(In Thousands)		
Premises	\$ 5,003	\$ 4,946
Furniture and equipment	3,357	3,356
	8,360	8,302
Accumulated depreciation and amortization	(5,629)	(5,238)
	\$ 2,731	\$ 3,064

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At December 31, 2018, the Company was obligated under non-cancelable operating leases for existing branches in Penfield, Irondequoit, Webster, and Perinton, New York and for five mortgage-origination offices in Watertown, Pittsford, Greece, Lewiston, and Buffalo, New York. Rent expense under leases totaled \$457,000 during 2018 and \$448,000 during 2017. Future minimum rental payments under these leases for the next five years and thereafter are as follows (in thousands):

Years ending December 31,	
2019	\$ 451
2020	396
2021	375
2022	307
2023	241
Thereafter	1,385
Total	\$ 3,155

Note 5 - Deposits

The components of deposits at December 31, 2018 and 2017 consist of the following:

	<u>2018</u>	<u>2017</u>
	(In Thousands)	
Non-interest bearing	\$ 10,947	\$ 8,385
NOW accounts	28,376	31,807
Regular savings, tax escrow and demand clubs	27,478	25,413
Money market	31,880	37,772
Individual retirement accounts	6,477	7,069
Certificates of deposit	117,457	106,245
	<u>\$ 222,615</u>	<u>\$ 216,691</u>

As of December 31, 2018, individual retirement accounts and certificates of deposit have scheduled maturities as follows (in thousands):

2019	\$ 73,943
2020	38,741
2021	8,567
2022	1,702
2023	981
	<u>\$ 123,934</u>

The aggregate amount of time deposits, each with a minimum denomination of \$250,000 was \$18,032,000 and \$13,342,000 at December 31, 2018 and 2017, respectively. Listing service deposits totaled \$11,225,000 and \$10,000,000 at December 31, 2018 and 2017, respectively. Under the Dodd-Frank Act, deposit insurance per account owner is \$250,000.

Interest expense on deposits for the years ended December 31, 2018 and 2017 is as follows:

	<u>2018</u>	<u>2017</u>
	<u>(In Thousands)</u>	
NOW accounts	\$ 92	\$ 89
Regular savings and demand clubs	147	103
Money market	345	284
Individual retirement accounts	85	75
Certificates of deposit	<u>1,922</u>	<u>1,260</u>
	<u>\$ 2,591</u>	<u>\$ 1,811</u>

Note 6 - Borrowings

Borrowings consist of advances from the Federal Home Loan Bank of New York (FHLB).

The following table sets forth the contractual maturities of borrowings with the FHLB as of December 31:

Advance Date	Maturity Date	Current Rate	2018	2017
(In Thousands)				
09/05/12	09/05/19	1.13%	246	539
12/19/12	12/19/19	1.20%	321	613
01/04/13	01/04/19	1.52%	1,000	1,000
01/15/13	01/16/18	1.18%	-	1,000
01/22/13	01/22/18	1.20%	-	1,000
01/22/13	01/22/19	1.44%	1,000	1,000
02/20/13	02/20/20	1.28%	185	331
02/20/13	02/21/23	1.77%	447	547
07/02/13	07/02/18	1.35%	-	274
07/22/13	07/23/18	1.27%	-	275
09/19/13	09/19/18	1.37%	-	171
01/21/14	01/22/18	1.72%	-	1,000
01/21/14	01/22/19	1.45%	34	240
03/20/14	03/20/19	1.50%	103	411
07/21/14	07/21/21	1.94%	397	541
07/21/14	07/22/19	2.08%	500	500
07/21/14	07/23/18	1.79%	-	1,000
08/06/14	08/06/18	1.80%	-	1,000
08/21/14	08/21/19	2.12%	1,000	1,000
10/02/14	10/04/21	2.00%	867	1,153
10/15/14	10/15/21	1.69%	431	574
11/28/14	11/29/21	1.90%	890	1,175
12/31/14	12/31/19	1.63%	224	427
12/31/14	01/02/18	1.52%	-	1,000
01/14/15	01/14/20	1.73%	1,500	1,500
01/21/15	01/21/20	1.79%	500	500
01/21/15	01/21/21	1.97%	500	500
04/13/15	04/13/20	1.74%	1,000	1,000
05/20/15	05/20/20	1.52%	308	509
05/20/15	05/20/22	1.91%	517	658
06/25/15	06/25/20	1.65%	326	527
10/29/15	10/29/20	1.51%	784	1,185
10/29/15	10/29/20	1.90%	1,000	1,000
01/27/16	01/27/21	1.92%	1,000	1,000
01/27/16	01/27/23	1.87%	611	751
02/12/16	02/13/23	1.66%	621	761
02/12/16	02/13/23	2.04%	500	500
08/24/16	08/24/18	1.22%	-	1,000
10/28/16	10/28/20	1.57%	1,000	1,000
11/04/16	11/04/21	1.72%	2,000	2,000
11/17/16	11/17/21	2.13%	1,000	1,000
11/17/16	11/17/21	1.78%	611	807

Advance Date	Maturity Date	Current Rate	2018	2017
(In Thousands)				
11/17/16	11/17/23	2.07%	729	866
11/28/16	11/29/19	1.78%	1,500	1,500
12/21/16	12/23/19	1.91%	1,000	1,000
01/04/17	01/04/19	1.62%	1,500	1,500
01/19/17	01/21/20	1.91%	1,000	1,000
03/24/17	03/24/22	2.00%	1,017	1,309
03/24/17	03/25/24	2.28%	1,164	1,367
07/24/17	07/24/20	1.88%	1,000	1,000
07/24/17	07/26/21	2.03%	1,000	1,000
07/24/17	07/25/22	1.94%	743	936
08/31/17	08/31/18	1.55%	-	1,000
08/31/17	08/31/21	1.96%	1,000	1,000
09/11/17	09/11/20	1.80%	1,000	1,000
09/11/17	09/12/22	2.07%	1,500	1,500
09/27/17	09/27/18	1.66%	-	1,500
09/27/17	09/27/22	2.28%	1,000	1,000
10/04/17	04/04/18	1.50%	-	1,500
11/27/17	05/29/18	1.76%	-	3,500
12/04/17	03/05/18	1.59%	-	1,500
12/08/17	04/09/18	1.64%	-	1,000
12/11/17	01/11/18	1.55%	-	1,500
12/11/17	03/12/18	1.61%	-	1,500
12/29/17	01/02/18	1.53%	-	2,500
01/18/18	01/18/19	2.17%	1,500	-
01/24/18	01/24/20	2.42%	1,500	-
02/09/18	02/09/22	2.78%	2,500	-
03/21/18	03/21/23	3.13%	1,500	-
04/04/18	04/04/23	3.00%	2,000	-
05/22/18	05/23/22	3.22%	1,500	-
05/29/18	05/31/22	2.97%	2,000	-
05/29/18	05/30/23	3.01%	1,500	-
06/28/18	06/28/23	3.13%	1,000	-
06/28/18	06/28/24	3.25%	2,000	-
07/23/18	07/23/24	3.34%	1,000	-
08/20/18	08/20/20	2.93%	2,000	-
08/31/18	02/28/19	2.56%	1,500	-
09/25/18	03/25/19	2.66%	2,000	-
09/27/18	09/27/21	3.24%	1,500	-
10/18/18	04/18/19	2.76%	1,500	-
10/30/18	04/30/19	2.78%	1,500	-
11/23/18	05/23/19	2.82%	1,500	-
12/03/18	01/03/19	2.61%	3,750	-
12/20/18	06/20/19	2.81%	2,000	-
			\$ 71,826	\$ 64,447

Borrowings are secured by residential mortgages with a carrying amount of \$201,922,000 at December 31, 2018 and the Company's investment in FHLB stock. As of December 31, 2018, \$94,106,000 was available for borrowings. At December 31, 2017, the carrying amount of borrowings secured by residential mortgages was \$190,382,000 and \$101,788,000 was available for new borrowings.

The following table sets forth the contractual maturities of all FHLB borrowings at December 31, 2018 (dollars in thousands):

	Contractual Maturity	Weighted Average Rate
2019	\$ 23,679	2.31%
2020	13,103	2.00
2021	11,196	2.08
2022	10,776	2.56
2023	8,908	2.68
Thereafter	4,164	3.00
	<u>\$ 71,826</u>	<u>2.34%</u>

The Company also has a repurchase agreement with Raymond James providing an additional \$10.0 million in liquidity collateralized by the Company's U.S. Government and agency obligations. There were no advances outstanding under the repurchase agreement at December 31, 2018 and 2017. Securities are not pledged until the borrowing is initiated. In addition to the repurchase agreement with Raymond James, the Company also has an unsecured line of credit through Atlantic Community Bankers Bank which would provide an additional \$5.0 million in liquidity. There were no draws or outstanding balances from the line of credit at December 31, 2018 and 2017.

Note 7 - Income Taxes

The provision for (benefit from) income taxes for 2018 and 2017 consists of the following:

	2018	2017
	(In Thousands)	
Current		
Federal	\$ 163	\$ 238
State	4	4
Deferred	(135)	165
	<u>\$ 32</u>	<u>\$ 407</u>

During 2017, the Tax Act was signed into law. The most significant impact of the Act was the reduction in the corporate federal income tax rate from a maximum rate of 35% to 21% beginning in 2018. As a result, the Company revalued its deferred tax assets and liabilities at its new effective tax rate and recorded a net adjustment of \$228,000 in 2017 to income tax expense to reduce the carrying value of the net deferred tax assets. The Company's effective tax rate was 19% and 66% in 2018 and 2017, respectively. The effective tax rate primarily reflects the impact of non-tax interest and dividends from tax exempt securities, as well as a reduction in tax rates, as part of the Act.

Items that give rise to differences between income tax expense included in the consolidated statements of income and taxes computed by applying the statutory federal tax at a rate of 21% in 2018 or 34% in 2017 included the following (dollars in thousands):

	2018		2017	
	Amount	% of Pre-tax Income	Amount	% of Pre-tax Income
Federal Tax at a Statutory rate	\$ 35	21%	\$ 211	34%
State taxes, net of Federal provision	14	9	(108)	(17)
Change in tax rate	-	-	228	37
Change in valuation allowance	(11)	(7)	106	17
Nontaxable interest and dividend income	(19)	(11)	(42)	(7)
Other items	13	7	12	2
Income tax provision	<u>\$ 32</u>	<u>19%</u>	<u>\$ 407</u>	<u>66%</u>

Deferred income tax assets and liabilities resulting from temporary differences are summarized as follows and are included in other assets at December 31, 2018 and at December 31, 2017 in the accompanying consolidated balance sheets:

	2018	2017
	(In Thousands)	
Deferred tax assets:		
Deferred loan origination fees	\$ 94	\$ 92
Allowance for loan losses - Federal	408	330
State tax credits	825	1,075
Supplemental Executive Retirement Plan	216	208
Unrealized loss on securities available for sale	49	44
Net operating loss	477	270
Stock compensation	32	14
Other	43	1
	<u>2,144</u>	<u>2,034</u>
Valuation allowance	(1,413)	(1,424)
Total deferred tax assets, net of valuation allowance	<u>731</u>	<u>610</u>
Deferred tax liabilities:		
Depreciation	(9)	(9)
Mortgage servicing rights	(213)	(233)
Total deferred tax liabilities	<u>(222)</u>	<u>(242)</u>
Net deferred tax asset	<u>\$ 509</u>	<u>\$ 368</u>

The Company has recorded a valuation allowance for mortgage recording tax credits incurred before 2015 as well as state tax deductions since anticipated levels of future state taxable income makes it more likely than not that all of these tax benefits will not be used. Beginning in 2015, the New York State Special Additional Mortgage Recording Tax Credit became a refundable credit, with the exception of residential mortgage loans originated in Erie County. To the extent that the credit exceeds the Company's New York State tax liability, any remaining credit will be refunded to the Company.

As a thrift institution, the Bank is subject to special provisions in the income tax laws regarding its allowable income tax bad debt deduction and related tax basis bad debt reserves. Deferred income tax liabilities are to be recognized with respect to any base-year reserves which are to become taxable (or "recaptured") in the foreseeable future.

Under current income tax laws, the base-year reserves would be subject to recapture if the Company pays a cash dividend in excess of earnings and profits or liquidates. The Bank does not expect to take any actions in the foreseeable future that would require the recapture of any Federal reserves. As a result, a deferred tax liability has not been recognized with respect to the Federal base-year reserve of \$1,518,000 at December 31, 2018 and 2017, because the Bank does not expect that this amount will become taxable in the foreseeable future. The unrecognized deferred tax liability with respect to the Federal base-year reserve was \$319,000 at December 31, 2018 and 2017. It is more likely than not that this liability will never be incurred because, as noted above, the Bank does not expect to take any action in the future that would result in this liability being incurred.

The Company's Federal and New York State tax returns, constituting the returns of the major taxing jurisdictions, are subject to examination by the taxing authorities for 2015, 2016, and 2017 as prescribed by applicable statute. No waivers have been executed that would extend the period subject to examination beyond the period prescribed by statute.

Note 8 – Accumulated Other Comprehensive Loss

Changes in the components of accumulated other comprehensive loss (“AOCI”), net of tax, for the periods indicated are summarized in the table below, in thousands.

<i>(In thousands)</i>	For the year ended December 31, 2018	
	Unrealized Losses on Available- for-Sale Securities	Total
Beginning balance	\$ (165)	\$ (165)
Other comprehensive loss	(18)	(18)
Ending balance	<u>\$ (183)</u>	<u>\$ (183)</u>

<i>(In thousands)</i>	For the year ended December 31, 2017	
	Unrealized Losses on Available- for-Sale Securities	Total
Beginning balance	\$ (85)	\$ (85)
Other comprehensive loss	(80)	(80)
Ending balance	<u>\$ (165)</u>	<u>\$ (165)</u>

Note 9 - Employee Benefit Plans

The Bank has a 401(k) plan for all eligible employees. Employees are eligible for participation in the 401(k) Plan after one year of service and attaining age 19. The 401(k) Plan allows employees to contribute 1% to 100% of their annual salary subject to statutory limitations. Matching contributions made by the Bank are 100% of the first 6% of compensation that an employee contributes to the 401(k) Plan. In addition, the Bank may make a discretionary contribution as a percentage of each eligible employee’s annual base compensation including the value of ESOP shares allocated. Matching contributions to the 401(k) Plan amounted to \$218,000 and \$225,000 for the years ended December 31, 2018 and 2017, respectively. Discretionary contributions to the 401(k) Plan were \$28,000 and \$85,000 for the years ended December 31, 2018 and 2017, respectively.

The Bank sponsors an Employee Stock Ownership Plan (ESOP) for eligible employees who have attained age 21 and completed one year of employment. The cost of shares not committed to be released is presented in the accompanying consolidated balance sheets as a reduction of stockholders’ equity. Allocations to individual accounts are based on participant compensation. As shares are committed to be released to participants, the Company reports compensation expense equal to the current market price of the shares and the shares become outstanding for earnings per share computations. 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. Any dividends on allocated shares reduce retained earnings. Any dividends on unallocated ESOP shares reduce debt and accrued interest. In connection with establishing the ESOP in 2007, the ESOP borrowed \$700,000 from FSB Community to purchase 69,972 common shares of FSB Community’s stock. The loan is being repaid in twenty equal annual installments through 2026. The loan bears interest at the Prime Rate.

Shares are released to participants on a straight-line basis as the loan is repaid and totaled 3,808 shares for each of the years ended December 31, 2018 and December 31, 2017. Total expense for the ESOP was \$72,000 and \$52,000 for the years ended December 31, 2018 and 2017, respectively. At December 31, 2018, the Company had 30,463 unearned ESOP shares having an aggregate market value of \$517,871.

FSB Bancorp, Inc.

The Bank has a supplemental executive retirement plan (SERP) for two participants, one current executive and one retired executive. All benefits provided under the SERP are unfunded and, as these executives retire, the Company will make payments to participants. The Company has recorded \$826,000 and \$797,000 at December 31, 2018 and 2017 respectively, for the SERP in other liabilities. In 2018 and 2017, the expense under the SERP totaled \$59,000 and \$38,000, respectively.

On September 27, 2017, the Board of Directors of the Company approved the grant of restricted stock awards to its Directors and executive officers under the 2017 Equity Incentive Plan that was approved at the special meeting of stockholders on August 29, 2017 when 77,668 shares were authorized for award. On January 5, 2018 and July 2, 2018, a total of 8,400 restricted stock awards were granted to five executive officers of the Company with the fair value of the stock at \$17.52 and \$17.75, respectively. On October 2, 2017 and October 30, 2017, a total of 21,380 restricted stock awards were granted to the 11 external directors of the Company and a total of 41,320 restricted stock awards were granted to three executive officers, with the fair value of the stock at \$16.72 and \$16.69, respectively. The awards will vest ratably over five years (20% per year for each year of the participant's service with the Company) with the exception of four Directors whose shares vested immediately upon their retirement from the Board of Directors on December 31, 2017.

A summary of the Company's stock award activity for the years ended December 31, 2018 and 2017 is as follows:

	2018		2017	
	Stock Awards	Weighted Average Price Per Share	Stock Awards	Weighted Average Price Per Share
Outstanding at beginning of year	62,700	\$ 16.72	-	\$ -
Grants	8,400	17.57	62,700	16.72
Outstanding at year end	<u>71,100</u>	\$ 16.82	<u>62,700</u>	\$ 16.72
Vested shares at year end	15,644	\$ 16.72	3,880	\$ 16.72
Unvested shares at year end	55,456	\$ 16.85	58,820	\$ 16.72
Total outstanding shares at year end	<u>71,100</u>		<u>62,700</u>	

The Bank also has a stock-based compensation plan which allows the Company to issue up to 194,168 stock options. On January 5, 2018 and July 2, 2018, the Board of Directors granted a combined total of 20,000 options to buy stock under the plan at exercise prices of \$17.52 and \$17.75, the fair value of the stock as of January 5th and July 2nd, respectively. On October 2, 2017 and October 30, 2017, the Board of Directors granted a combined total of 152,080 options to buy stock under the plan at exercise prices of \$16.72 and \$16.69, the fair value of the stock as of October 2nd and October 30th, respectively. These options have a 10-year term and are vested over a five-year period.

A summary of the Company's stock option activity and related information for its option plans for the years ended December 31, 2018 and 2017 is as follows:

	2018			2017		
	Options	Exercise Price Range	Weighted Average Exercise Price Per Share	Options	Exercise Price Range	Weighted Average Exercise Price Per Share
Outstanding at beginning of year	152,080	\$16.69-\$16.72	\$ 16.72	-	-	\$ -
Grants	20,000	\$17.52-\$17.75	17.58	152,080	\$16.69-\$16.72	16.72
Exercised	-	-	-	-	-	-
Outstanding at year end	<u>172,080</u>	\$16.69-\$17.75	\$ 16.82	<u>152,080</u>	\$16.69-\$16.72	\$ 16.72
Exercisable at year end	<u>30,416</u>	\$16.69-\$16.72	\$ 16.72	-	-	\$ -

We use the Black-Scholes option-pricing model to estimate fair value of stock-based awards. The following weighted average assumptions were used to value options granted during the years ended December 31, 2018 and 2017:

	<u>2018</u>	<u>2017</u>
Risk-free interest rate	2.41%	1.94%
Volatility factor	10.47%	9.35%
Dividends	0.00%	0.00%
Weighted average expected life (years)	5.00	5.00
Forfeiture rate	0.00%	0.00%

We calculate expected volatility for stock options by taking an average of historical volatility over the past five years and a computation of implied volatility. The computation of expected term was determined based on the contractual terms of the stock-based awards and vesting schedules. The interest rate for periods within the contractual life of the award is based on the U.S. Treasury yield in effect at the time of grant. Forfeiture rates are calculated by dividing unvested shares forfeited by beginning shares outstanding.

The grants to senior management and directors vest over a five year period in equal annual installments, with the first installment vesting on the first anniversary date of the grant and succeeding installments on each anniversary thereafter, through 2023.

The compensation expense of the awards is based on the fair value of the instruments on the date of grant. The Company recorded compensation expense in the amount of \$310,000 and \$132,000 for the years ended December 31, 2018 and 2017, respectively and is expected to record approximately \$304,000 in 2019 through 2021, \$238,000 in 2022, and \$5,000 in 2023.

The grant date fair value of all options granted during 2018 and 2017 under the methods and assumptions described above was \$55,000 and \$362,000, respectively.

The Company's unrecognized compensation cost, net of estimated forfeitures, related to the non-vested share-based compensation arrangements granted under the plan is expected to be recognized over a weighted average period of approximately 3.80 years.

The aggregate intrinsic value of options outstanding and exercisable at December 31, 2018 and 2017 were approximately \$8,000 and \$0, respectively.

A summary of changes in the Company's unvested shares for the year is as follows:

Unvested Shares	Shares	Weighted Average Grant Date Fair Value
Unvested at January 1, 2018	152,080	\$ 2.24
Granted	20,000	2.73
Vested	30,416	2.24
Unvested at December 31, 2018	<u>141,664</u>	\$ 2.31

Note 10: Other Income

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

<i>(In thousands)</i>	For the year ended December 31, 2018	For the year ended December 31, 2017
Service fees		
Deposit related fees	66	75
Insufficient funds fee	83	89
Total service fees	<u>149</u>	<u>164</u>
Fee income		
Securities commission income	43	63
Insurance commission income	88	111
Total insurance and securities commission income	<u>131</u>	<u>174</u>
Card income		
Debit card interchange fee income	146	135
ATM fees	31	30
Total card income	<u>177</u>	<u>165</u>
Mortgage fee income and realized gain on sales of loans*		
Residential mortgage loan origination fees	324	480
Commercial loan fees	88	51
Loan servicing income	331	314
Realized gain on sales of residential mortgage loans	1,390	2,146
Realized gain on sale of SBA loan	47	-
Total mortgage fee income and realized gain on sales of loans	<u>2,180</u>	<u>2,991</u>
Bank owned life insurance	61	62
Other miscellaneous income	19	20
Total non-interest income	<u>\$ 2,717</u>	<u>\$ 3,576</u>

*Outside scope of ASC 606

The Company recognizes revenue as it is earned and noted no impact to its revenue recognition policies as a result of the adoption of ASU 2014-09 on January 1, 2018. The following is a discussion of key revenues within the scope of the new revenue guidance:

- *Service fees* – Revenue from fees on deposit accounts is earned through the presentation of an individual item for processing for insufficient funds fees or customer initiated activities or passage of time for deposit related fees.
- *Fee income* – Fee income is earned through commissions on insurance and securities sales and earned at a point in time.
- *Card income* – Card income consists of interchange fees from consumer debit card networks and other card related services. Interchange rates are set by the card networks. Interchange fees are based on purchase volumes and other factors and are recognized as transactions occur.
- *Mortgage fee income and realized gain on sales of loans* – Revenue from mortgage fee income and realized gain on sales of loans is earned through the origination of residential and commercial mortgage loans and the sales of one-to-four family residential mortgage loans and government guaranteed portions of SBA loans and is recognized as transactions occur.

Note 11 - Related Party Transactions

Certain employees, executive officers and directors are engaged in transactions with the Bank in the ordinary course of business. It is the Bank's policy that all related party transactions are conducted at "arms length" and all loans and commitments included in such transactions are made in the ordinary course of business, 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 and do not involve more than the normal risk of collectibility or present other unfavorable terms.

As of December 31, 2018 and 2017, loans outstanding with related parties were \$485,000 and \$560,000, respectively. During 2018, there were new loans of \$450,000, sales of \$235,000 and repayments totaled \$290,000.

Note 12 - Commitments

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. These instruments involve, to varying degrees, elements of credit and interest rate risk in excess of the amounts recognized in the consolidated balance sheets. The Bank uses the same credit policies in making commitments and conditional obligations as it does for on-balance-sheet instruments. 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 summarized as follows at December 31, 2018 and 2017:

	<u>2018</u>	<u>2017</u>
	(In Thousands)	
Commitments to extend credit:		
Commitments to grant loans	\$ 5,578	\$ 12,397
Unadvanced portion of construction loans	4,439	5,945
Unfunded commitments under lines of credit	<u>18,774</u>	<u>17,523</u>
	<u>\$ 28,791</u>	<u>\$ 35,865</u>

Commitments to grant loans at fixed-rates at December 31, 2018 totaled \$3,098,000 and had interest rates that ranged from 4.50% to 6.00% as compared to commitments to grant loans at fixed-rates at December 31, 2017 which totaled \$10,836,000 and had interest rates that ranged from 3.25% to 5.25%.

Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. Since many of the commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. We had three commercial letters of credit for \$64,000 at December 31, 2018 and two commercial letters of credit for \$414,000 at December 31, 2017.

The Bank evaluates each customer's credit worthiness on a case-by-case basis. The amount and type of collateral obtained, if deemed necessary by the Bank upon extension of credit, varies and is based on management's credit evaluation of the counterparty.

In the ordinary course of business, the Bank sells residential mortgage loans to third parties and in certain limited situations, such as in the event of an early payment default, the Bank retains credit risk exposure on those residential mortgage loans and may be required to repurchase them or to indemnify guarantors for certain losses. The Bank may also be required to repurchase residential mortgage loans when representations and warranties made by the Bank in connection with those sales are breached. When a residential mortgage loan sold to an investor fails to perform according to its contractual terms, the investor will typically review the loan file to search for errors that may have been made in the process of originating the loan. If errors were discovered and it is determined that such errors constitute a breach of a representation or warranty made to the investor in connection with the Bank's sale of the residential mortgage loan, the Bank will be required to either repurchase the loan or indemnify the investor for losses sustained. The bank has not been required to repurchase any residential mortgage loans or indemnify any investors for any such errors.

Note 13 - Regulatory Matters

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

Quantitative measures established by regulation to ensure capital adequacy require the Bank to maintain minimum amounts and ratios (set forth in the table below) of total, Tier 1 capital (as defined), and Common Equity Tier 1 capital (as defined in the regulations) to risk-weighted assets (as defined), and of Tier 1 to adjusted total assets (as defined). Management believes that, as of December 31, 2018 and 2017, the Bank met all capital adequacy requirements to which it was subject. As of December 31, 2018, the most recent notification categorized the Bank as well capitalized under the regulatory framework for prompt corrective action. To be categorized as well capitalized the Bank must maintain minimum total risk-based, Tier 1 risk-based, Common Equity Tier 1 risk-based, and Tier 1 leverage ratios as set forth in the following table. There are no conditions or events since that notification that management believes have changed the Bank's status as well capitalized.

The Bank's actual capital amounts and ratios are presented in the table below.

<i>(Dollars in thousands)</i>	<u>Actual</u>		<u>Minimum For Capital Adequacy Purposes</u>		<u>Minimum To Be "Well-Capitalized" Under Prompt Corrective Provisions</u>		<u>Well-Capitalized With Buffer, Fully Phased in for 2019</u>	
	<u>Amount</u>	<u>Ratio</u>	<u>Amount</u>	<u>Ratio</u>	<u>Amount</u>	<u>Ratio</u>	<u>Amount</u>	<u>Ratio</u>
As of December 31, 2018								
Total Core Capital (to Risk-Weighted Assets)	\$ 30,896	15.70%	≥\$15,745	≥8.0%	≥\$19,681	≥10.0%	≥\$20,665	≥10.5%
Tier 1 Capital (to Risk-Weighted Assets)	29,335	14.91	≥11,808	≥6.0	≥15,745	≥8.0	≥16,729	≥8.5
Tier 1 Common Equity (to Risk-Weighted Assets)	29,335	14.91	≥8,856	≥4.5	≥12,793	≥6.5	≥13,777	≥7.0
Tier 1 Capital (to Assets)	29,335	9.07	≥12,938	≥4.0	≥16,173	≥5.0	≥16,173	≥5.0
As of December 31, 2017:								
Total Core Capital (to Risk-Weighted Assets)	\$ 30,067	16.11%	≥\$14,927	≥8.0%	≥\$18,658	≥10.0%	≥\$19,591	≥10.5%
Tier 1 Capital (to Risk-Weighted Assets)	28,806	15.44	≥11,195	≥6.0	≥14,927	≥8.0	≥15,860	≥8.5
Tier 1 Common Equity (to Risk-Weighted Assets)	28,806	15.44	≥8,396	≥4.5	≥12,128	≥6.5	≥13,061	≥7.0
Tier 1 Capital (to Assets)	28,806	9.47	≥12,173	≥4.0	≥15,216	≥5.0	≥15,216	≥5.0

The FRB has issued a policy guidance regarding the payment of dividends by bank holding companies. In general, the FRB's policies provide that dividends should be paid only out of current earnings and only if the prospective rate of earnings retention by the holding company appears consistent with the organization's capital needs, asset quality and overall financial condition. FRB guidance provides for prior regulatory review of capital distributions in certain circumstances such as where the company's net income for the past four quarters, net of dividends previously paid over that period, is insufficient to fully fund the dividend or the company's overall rate of earnings retention is inconsistent with the company's capital needs and overall financial condition. The ability of a holding company to pay dividends may be restricted if a subsidiary bank becomes undercapitalized. These regulatory policies could affect the ability of FSB Bancorp to pay dividends or otherwise engage in capital distributions.

Note 14 - Fair Value Measurement and Fair Values of Financial Instruments

Management uses its best judgment in estimating the fair value of the Company's assets and liabilities; however, there are inherent weaknesses in any estimation technique. Therefore, for substantially all assets and liabilities, 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 their respective year-ends and have not been re-evaluated or updated for purposes of these consolidated financial statements subsequent to those respective dates. As such, the estimated fair values of assets and liabilities subsequent to the respective reporting dates may be different than the amounts reported at each year-end.

Accounting guidance establishes a fair value hierarchy 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 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 are as follows at December 31:

	(In Thousands)			
	Total	Level 1	Level 2	Level 3
2018				
U.S. Government and agency obligations	\$ 12,455	\$ -	\$ 12,455	\$ -
Mortgage-backed securities - residential	5,876	-	5,876	-
Total Available-for-Sale Securities	<u>\$ 18,331</u>	<u>\$ -</u>	<u>\$ 18,331</u>	<u>\$ -</u>
2017				
	Total	Level 1	Level 2	Level 3
U.S. Government and agency obligations	\$ 10,470	\$ -	\$ 10,470	\$ -
Mortgage-backed securities - residential	7,843	-	7,843	-
Total Available-for-Sale Securities	<u>\$ 18,313</u>	<u>\$ -</u>	<u>\$ 18,313</u>	<u>\$ -</u>

There were no securities transferred out of level 2 securities available-for-sale during the twelve months ended December 31, 2018 or 2017. No assets or liabilities have been measured on a non-recurring basis at December 31, 2018 or 2017.

Required disclosures include fair value information about financial instruments, whether or not recognized in the consolidated balance sheets, for which it is practicable to estimate that value. In cases where quoted market prices are not available, fair values are based on estimates using present value or other valuation techniques. Those techniques are significantly affected by the assumptions used, including the discount rate and estimates of future cash flows. In that regard, the fair value estimates cannot be substantiated by comparison to independent markets and, in many cases, could not be realized in immediate settlement of the instrument. Certain financial instruments and all non-financial instruments are excluded from the disclosure requirements. Accordingly, the aggregate fair value amounts presented do not represent the underlying value of the Company.

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 certain of the Company's assets and liabilities at December 31, 2018 and 2017.

Cash, Due from Banks, and Interest-Earning Demand Deposits

The carrying amounts of these assets approximate their fair values.

Investment Securities

The fair value of securities available-for-sale (carried at fair value) and held-to-maturity (carried at amortized cost) are determined by matrix pricing, which 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 relying on the securities' relationship to other benchmark quoted prices and is considered to be a Level 2 measurement.

Investment in Restricted Stock

The carrying value of restricted stock, which consists of Federal Home Loan Bank and Atlantic Community Bankers Bank, approximates its fair value based on the redemption provisions of the restricted stock, resulting in a Level 2 classification.

Loans and Loans Held for Sale

The fair values of loans held in portfolio are estimated using discounted cash flow analyses. The discount rate considers a market participant's cost of funds, liquidity premiums, capital charges, servicing charges, and expectations of future rate movements (for variable rate loans), resulting in a Level 3 classification. Projected future cash flows are calculated based upon contractual maturity or call dates, projected repayments and prepayments of principal, and adjusted for potential defaulted loans.

Mortgage loans held for sale in the secondary market are carried at the lower of cost or fair value, resulting in a Level 2 classification. Separate determinations of fair value for residential and commercial loans are made on an aggregate basis. 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 consolidated financial statements.

Accrued Interest Receivable and Payable

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

Deposits

The fair values disclosed for demand deposits (e.g., NOW accounts, non-interest checking, regular savings and certain types of money market accounts) are, by definition, equal to the amount payable on demand at the reporting date (i.e., their carrying amounts), resulting in a Level 1 classification. The carrying amounts for variable-rate certificates of deposit approximate their fair values at the reporting date, resulting in a Level 1 classification. Fair values for fixed-rate certificates of deposit are estimated using a discounted cash flow calculation that applies market interest rates currently being offered on certificates to a schedule of aggregated expected monthly maturities on time deposits, resulting in a Level 2 classification.

Borrowings

The fair values of FHLB long-term borrowings are estimated using discounted cash flow analyses, based on the quoted rates for new FHLB advances with similar credit risk characteristics, terms and remaining maturity, resulting in a Level 2 classification.

FSB Bancorp, Inc.

The carrying amounts and estimated fair values of the Company's financial instruments at December 31, 2018 and 2017 are as follows:

	Fair Value Hierarchy	2018		2017	
		Carrying Amount	Fair Value (In Thousands)	Carrying Amount	Fair Value
Financial assets:					
Cash and due from banks	1	\$ 1,581	\$ 1,581	\$ 1,672	\$ 1,672
Interest bearing demand deposits	1	4,710	4,710	8,725	8,725
Securities available for sale	2	18,331	18,331	18,313	18,313
Securities held to maturity	2	6,052	6,030	6,575	6,588
Investment in restricted stock	2	3,637	3,637	3,270	3,270
Loans held for sale	2	2,133	2,133	2,770	2,770
Loans, net	3	281,741	280,173	262,711	261,588
Accrued interest receivable	1	876	876	824	824
Financial liabilities:					
Deposits	1/2	222,615	222,863	216,691	216,878
Borrowings	2	71,826	71,086	64,447	64,502
Accrued interest payable	1	168	168	94	94

Note 15 - FSB Bancorp, Inc. (Parent Company Only) Financial Information**Balance Sheets**

	December 31	
	2018	2017
	(In Thousands)	
Assets		
Cash and cash equivalents	\$ 1,570	\$ 1,717
Investment in banking subsidiary	29,661	29,008
ESOP loan receivable	331	365
Total Assets	\$ 31,562	\$ 31,090
Liabilities and Stockholders' Equity		
Total Liabilities	\$ 49	\$ 34
Stockholders' Equity	31,513	31,056
Total Liabilities and Stockholders' Equity	\$ 31,562	\$ 31,090

Statements of Income

	Year Ended December 31	
	2018	2017
	(In Thousands)	
Interest Income	\$ 36	\$ 29
Other Expense	(500)	(301)
Equity in undistributed earnings of banking subsidiary	599	483
Net Income	\$ 135	\$ 211

Statements of Cash Flows

	Year Ended December 31	
	2018	2017
	(In Thousands)	
Cash flows from operating activities		
Net income	\$ 135	\$ 211
Adjustments to reconcile net income to net cash flows from operating activities		
Equity in undistributed earnings of banking subsidiary	(599)	(483)
Stock based compensation	310	133
Net increase in other liabilities	15	4
Net cash flows from operating activities	(139)	(135)
Cash flows from investing activities		
Payments received on ESOP loan	34	33
Net cash flows from investing activities	34	33
Cash flows from financing activities		
Purchase of common stock	(42)	(1,062)
Net cash flows from financing activities	(42)	(1,062)
Net (decrease) increase in cash and cash equivalents	(147)	(1,164)
Cash and cash equivalents - beginning	1,717	2,881
Cash and cash equivalents - ending	\$ 1,570	\$ 1,717

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Section 4: EX-23 (EXHIBIT 23)

Exhibit 23

CONSENT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

We hereby consent to the incorporation by reference in this Annual Report on Form 10-K of FSB Bancorp, Inc. for the year ended December 31, 2018 of our report dated March 27, 2019 included in its Registration Statements on Form S-8 (No. 333-220742) and (No. 333-214302) relating to the consolidated financial statements for the two years ended December 31, 2018.

/s/ Bonadio & Co., LLP

Bonadio & Co., LLP
Syracuse, New York
March 27, 2019

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Section 5: EX-31.1 (EXHIBIT 31.1)

Exhibit 31.1

CERTIFICATION

I, Kevin D. Maroney, certify that:

1. I have reviewed this annual report on Form 10-K of FSB Bancorp, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the consolidated financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13-a-15(f) and 15d-15(f)) for the registrant have:
 - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this annual report is being prepared;
 - b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of consolidated financial statements for external purposes in accordance with generally accepted accounting principles; and
 - c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation;
 - d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of registrant's Board of Directors (or persons performing the equivalent functions):
 - a) All significant deficiencies and material weakness in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: March 27, 2019

/s/ Kevin D. Maroney

Kevin D. Maroney

President and Chief Executive Officer

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Section 6: EX-31.2 (EXHIBIT 31.2)

Exhibit 31.2

CERTIFICATION

I, Angela M. Krezmer, certify that:

1. I have reviewed this annual report on Form 10-K of FSB Bancorp, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the consolidated financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant have:
 - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this annual report is being prepared;
 - b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of consolidated financial statements for external purposes in accordance with generally accepted accounting principles; and
 - c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation;
 - d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of registrant's Board of Directors (or persons performing the equivalent functions):
 - a) All significant deficiencies and material weakness in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: March 27, 2019

/s/ Angela M. Krezmer

Angela M. Krezmer

Chief Financial Officer

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Section 7: EX-32.1 (EXHIBIT 32.1)

Exhibit 32

**CERTIFICATION PURSUANT TO
18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

Kevin D. Maroney, President and Chief Executive Officer, and Angela M. Krezmer, Chief Financial Officer of FSB Bancorp, Inc. (the "Company") each certify in their capacity as an officer of the Company that they have reviewed this Annual Report on Form 10-K of the Company for the fiscal year ended December 31, 2018 and that to the best of their knowledge:

- (1) the report fully complies with the requirements of Section 13(a) of the Securities Exchange Act of 1934; and
- (2) the information contained in the report fairly presents, in all material respects, the financial condition and results of operations of the Company.

The purpose of this statement is solely to comply with Title 18, Chapter 63, Section 1350 of the United States Code, as amended by Section 906 of

the Sarbanes-Oxley Act of 2002.

Date: March 27, 2019

/s/ Kevin D. Maroney

Kevin D. Maroney
President and Chief Executive Officer

Date: March 27, 2019

/s/ Angela M. Krezmer

Angela M. Krezmer
Chief Financial Officer

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