PATHFINDER BANCORP INC
Form 10-K
March 30, 2006

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

FORM 10-K

[X]ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 For the Fiscal Year Ended December 31, 2005

OR

[ ]TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d.) OF THE SECURITIES EXCHANGE ACT OF 1934 For the transaction period from _____ to _____

COMMISSION FILE NUMBER: 23601

PATHFINDER BANCORP, INC.
(Exact Name of Registrant as Specified in its Charter)

FEDERAL	16-1540137
State or Other Jurisdiction of Incorporation or Organization)	(I.R.S. Employer Identification Number)

214 West First Street, Oswego, NY 13126
(Address of Principal Executive Office) (Zip Code)

(315) 343-0057
(Registrant's Telephone Number including area code)

Securities Registered Pursuant to Section 12(b) of the Act:
None

Securities Registered Pursuant to Section 12(g) of the Act:
Common Stock, par value $.01 per share
(Title of Class)

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

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 [X].

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 twelve months (or for such shorter period that the Registrant was required to file such reports) and (2) has been subject to such requirements for the past 90 days. Yes [X] 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 amendments to this Form 10-K. [ ]

Indicate by check mark whether the Registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act. (Check one):

Large Accelerated Filer [ ] Accelerated Filer [ ] Non-Accelerated Filer [X]

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

As of March 15, 2006 there were 2,950,419 shares issued and 2,463,132 shares outstanding of the Registrant's Common Stock.

The aggregate market value of the voting and non-voting common equity held by non-affiliates of the Registrant, computed by reference to the last sale price on March 15, 2006, as reported by the Nasdaq National Market was approximately $10,602,711.

DOCUMENTS INCORPORATED BY REFERENCE:

(1) Proxy Statement for the 2005 Annual Meeting of Stockholders (Part III).

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FOR THE YEAR ENDED
DECEMBER 31, 2005
PATHFINDER BANCORP, INC.

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PART I

ITEM 1: BUSINESS

GENERAL

PATHFINDER BANCORP, INC.

Pathfinder Bancorp, Inc. (the "Company") is a Federally chartered mid-tier holding company headquartered in Oswego, New York. The primary business of the Company is its investment in Pathfinder Bank (the "Bank") and Pathfinder Statutory Trust I. The Company is majority owned by Pathfinder Bancorp, M.H.C., a federally-chartered mutual holding company (the "Mutual Holding Company"). At December 31, 2005, the Mutual Holding Company held 1,583,239 shares of Common Stock and the public held 879,893 shares of Common Stock (the "Minority Shareholders"). At December 31, 2005, Pathfinder Bancorp, Inc. had total assets of $296.9 million, total deposits of $236.4 million and shareholders' equity of $20.9 million.

The Company's executive office is located at 214 West First Street, Oswego, New York and the telephone number at that address is (315) 343-0057.

PATHFINDER BANK

The Bank is a New York-chartered savings bank headquartered in Oswego, New York. The Bank operates from its main office as well as six full-service offices located in its market area consisting of Oswego County and the contiguous counties. The Bank's deposits are insured by the Federal Deposit Insurance Corporation ("FDIC"). The Bank was chartered as a New York savings bank in 1859 as Oswego City Savings Bank. The Bank is a consumer-oriented institution dedicated to providing mortgage loans and other traditional financial services to its customers. The Bank is committed to meeting the financial needs of its customers in Oswego County, New York, the county in which it operates.

The Bank is primarily engaged in the business of attracting deposits from the general public in the Bank's market area, and investing such deposits, together with other sources of funds, in loans secured by one- to four-family residential real estate and commercial real estate. At December 31, 2005, $150.9 million, or 80% of the Bank's total loan portfolio consisted of loans secured by real estate, of which $119.1 million, or 64%, were loans secured by one- to four-family residences and $31.8 million, or 17%, were secured by commercial real estate. Additionally, $16.3 million, or 11%, of total real estate loans, were secured by second liens on residential properties that are classified as consumer loans. The Bank also originates commercial and consumer loans that totaled $18.3 and $3.4 million, respectively, or 12%, of the Bank's total loan portfolio. The Bank invests a portion of its assets in securities issued by the United States Government agencies and sponsored enterprises, state and municipal obligations, corporate debt securities, mutual funds, and equity securities. The Bank also invests in mortgage-backed securities primarily issued or guaranteed by United States Government sponsored enterprises. The Bank's principal sources of funds are deposits, principal and interest payments on loans and borrowings from correspondent financial institutions. The principal source of income is interest on loans and investment securities. The Bank's principal expenses are interest paid on deposits, and employee compensation and benefits.

The Bank's executive office is located at 214 West First Street, Oswego, New York, and its telephone number at that address is (315) 343-0057.

Pathfinder Bank formed a limited purpose commercial bank subsidiary, Pathfinder Commercial Bank, in October of 2002. Pathfinder Commercial Bank was established to serve the depository needs of public entities in its market area.

In April 1999, the Bank established Pathfinder REIT, Inc. as the Bank's wholly-owned real estate investment trust subsidiary. At December 31, 2005, Pathfinder REIT, Inc. held $23.7 million in mortgages and mortgage related assets. Recent legislation proposed by the New York State legislature would eliminate the tax treatment accorded REITs. Enactment of this legislation would increase the state tax rate for the Company. All disclosures in the Form 10-K relating to the Bank's loans and investments include loans and investments that are held by Pathfinder REIT, Inc.

The Bank also has 100% ownership in Whispering Oaks Development Corp., which was originally formed to develop the Whispering Oaks real estate subdivision in Baldwinsville, New York. The Bank gained titled to the Whispering Oaks real estate subdivision through foreclosure. The Whispering Oaks real estate subdivision has been fully developed. The subsidiary is retained, however, in case the need to operate or develop other foreclosed real estate emerges.

MARKET AREA AND COMPETITION

The economy in the Bank's market area is manufacturing-oriented and is also significantly dependent upon the State University of New York College at Oswego. The major manufacturing employers in the Bank's market area are Entergy Nuclear Northeast, Novelis, Constellation, NRG and Huhtamaki. The Bank is the second largest financial institution headquartered in Oswego County. However, the Bank encounters competition from a variety of sources. The Bank's business and operating results are significantly affected by the general economic conditions prevalent in its market areas.

The Bank encounters strong competition both in attracting deposits and in originating real estate and other loans. Its most direct competition for deposits has historically come from commercial and savings banks, savings associations and credit unions in its market area. Competition for loans comes from such financial institutions as well as mortgage banking companies. The Bank expects continued strong competition in the foreseeable future, including increased competition from "super-regional" banks entering the market by purchasing large commercial banks and savings banks. Many such institutions have greater financial and marketing resources available to them than does the Bank. The Bank competes for savings deposits by offering depositors a high level of personal service and a wide range of competitively priced financial services. The Bank competes for real estate loans primarily through the interest rates and loan fees it charges and advertising, as well as by originating and holding in its portfolio mortgage loans which do not necessarily conform to secondary market underwriting standards.

REGULATION AND SUPERVISION

GENERAL

The Bank is a New York-chartered stock savings bank and its deposit accounts are insured up to applicable limits by the FDIC through the Bank Insurance Fund ("BIF"). The Bank is subject to extensive regulation by the New York State Banking Department (the "Department"), as its chartering agency, and by the

FDIC, as its deposit insurer and primary federal regulator. The Bank is required to file reports with, and is periodically examined by, the FDIC and the Superintendent of the Department concerning its activities and financial condition and must obtain regulatory approvals prior to entering into certain transactions, including, but not limited to, mergers with or acquisitions of other banking institutions. The Bank is a member of the Federal Home Loan Bank of New York ("FHLBNY") and is subject to certain regulations by the Federal Home Loan Bank System. On July 19, 2001 the Company and the Mutual Holding Company completed their conversion to federal charters. Consequently, they are subject to regulations of the Office of Thrift Supervision ("OTS") as savings and loan holding companies. Any change in such regulations, whether by the Department, the FDIC, or the OTS could have a material adverse impact on the Bank, the Company or the Mutual Holding Company.

Regulatory requirements applicable to the Bank, the Company and the Mutual Holding Company are referred to below or elsewhere herein.

NEW YORK BANK REGULATION

The exercise by an FDIC-insured savings bank of the lending and investment powers under the New York State Banking Law is limited by FDIC regulations and other federal law and regulations. In particular, the applicable provisions of New York State Banking Law and regulations governing the investment authority and activities of an FDIC insured state-chartered savings bank have been substantially limited by the Federal Deposit Insurance Corporation Improvement Act of 1991 ("FDICIA") and the FDIC regulations issued pursuant thereto.

The Bank derives its lending, investment and other authority primarily from the applicable provisions of New York State Banking Law and the regulations of the Department, as limited by FDIC regulations. Under these laws and regulations, savings banks, including the 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. 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, which may be authorized by the Banking Board. Under FDICIA and the FDIC's implementing regulations, the Bank's investment and service corporation activities are limited to activities permissible for a national bank unless the FDIC otherwise permits it.

The FDIC and the Superintendent have broad enforcement authority over the Bank. Under this authority, the FDIC and the Superintendent have the ability to issue formal or informal orders to correct violations of law or unsafe or unsound banking practices.

INSURANCE OF ACCOUNTS AND REGULATION BY THE FDIC

The Bank is a member of the BIF, which is administered by the FDIC. Deposits are insured up to applicable limits by the FDIC and such insurance is backed by the full faith and credit of the U.S. Government.

On February 15, 2006, federal legislation to reform federal deposit insurance was signed into law. This law requires, among other things, the merger of the Savings Association Insurance Fund and the Bank Insurance Fund into a unified insurance deposit fund, an increase in the amount of federal deposit insurance

coverage from $100,000 to $130,000 (with a cost of living adjustment to become effective in five years), and the reserve ratio to be modified to provide for a range between 1.15% and 1.50% of estimated insured deposits. The law requires the FDIC to issue implementing regulations and the changes required by the law will not become effective until final regulations have been issued, which must be no later than 270 days from February 15, 2006.

REGULATORY CAPITAL REQUIREMENTS

The FDIC has adopted risk-based capital guidelines to which the Bank is subject. The guidelines establish a systematic analytical framework that makes regulatory capital requirements more sensitive to differences in risk profiles among banking organizations. The Bank is required to maintain certain levels of regulatory capital in relation to regulatory risk-weighted assets. The ratio of such regulatory capital to regulatory risk-weighted assets is referred to as the Bank's "risk-based capital ratio." Risk-based capital ratios are determined by allocating assets and specified off-balance sheet items to four risk-weighted categories ranging from 0% to 100%, with higher levels of capital being required for the categories perceived as representing greater risk.

These guidelines divide a savings bank's capital into two tiers. The first tier ("Tier I") includes common equity, retained earnings, certain non-cumulative perpetual preferred stock (excluding auction rate issues) and minority interests in equity accounts of consolidated subsidiaries, less goodwill and other intangible assets (except mortgage servicing rights and purchased credit card relationships subject to certain limitations). Supplementary ("Tier II") capital

includes, among other items, cumulative perpetual and long-term limited-life preferred stock, mandatory convertible securities, certain hybrid capital instruments, term subordinated debt and the allowance for loan and lease losses, subject to certain limitations, less required deductions. Savings banks are required to maintain a total risk-based capital ratio of at least 8%, of which at least 4% must be Tier I capital.

In addition, the FDIC has established regulations prescribing a minimum Tier I leverage ratio (Tier I capital to adjusted total assets as specified in the regulations). These regulations provide for a minimum Tier I leverage ratio of 3% for banks that meet certain specified criteria, including that they have the highest examination rating and are not experiencing or anticipating significant growth. All other banks are required to maintain a Tier I leverage ratio of 3% plus an additional cushion of at least 100 to 200 basis points. The FDIC and the other federal banking regulators have proposed amendments to their minimum capital regulations to provide that the minimum leverage capital ratio for a depository institution that has been assigned the highest composite rating of 1 under the Uniform Financial Institutions Rating System will be 3% and that the minimum leverage capital ratio for any other depository institution will be 4% unless a higher leverage capital ratio is warranted by the particular circumstances or risk profile of the depository institution. The FDIC may, however, set higher leverage and risk-based capital requirements on individual institutions when particular circumstances warrant. Savings banks experiencing or anticipating significant growth are expected to maintain capital ratios, including tangible capital positions, well above the minimum levels.

LIMITATIONS ON DIVIDENDS AND OTHER CAPITAL DISTRIBUTIONS

The FDIC has the authority to use its enforcement powers to prohibit a savings bank from paying dividends if, in its opinion, the payment of dividends would constitute an unsafe or unsound practice. Federal law also prohibits the

payment of dividends by a bank that will result in the bank failing to meet its applicable capital requirements on a pro forma basis. New York law also restricts the Bank from declaring a dividend which would reduce its capital below (i) the amount required to be maintained by state law and regulation, or (ii) the amount of the Bank's liquidation account established in connection with the reorganization undertook in 1997.

PROMPT CORRECTIVE ACTION

The federal banking agencies have promulgated regulations to implement the system of prompt corrective action required by federal law. Under the regulations, a bank shall be deemed to be (i) "well capitalized" if it has total risk-based capital of 10.0% or more, has a Tier I risk-based capital ratio of 6.0% or more, has a Tier I leverage capital ratio of 5.0% or more and is not subject to any written capital order or directive; (ii) "adequately capitalized" if it has a total risk-based capital ratio of 8.0% or more, a Tier I risk-based capital ratio of 4.0% or more and a Tier I leverage capital ratio of 4.0% or more (3.0% under certain circumstances) and does not meet the definition of "well capitalized"; (iii) "undercapitalized" if it has a total risk-based capital ratio that is lessthan 8.0%, a Tier I risk-based capital ratio that is less than 4.0% or a Tier I leverage capital ratio that is less than 4.0% (3.0% under certain circumstances); (iv) "significantly undercapitalized" if it has a total risk-based capital ratio that is less than 6.0%, a Tier I risk-based capital ratio that is less than 3.0% or a Tier I leverage capital ratio that is less than 3.0%; and (v) "critically undercapitalized" if it has a ratio of tangible equity to total assets that is equal to or less than 2.0%. Federal law and regulations also specify circumstances under which a federal banking agency may reclassify a well capitalized institution as adequately capitalized and may require an adequately capitalized institution to comply with supervisory actions as if it were in the next lower category (except that the FDIC may not reclassify a significantly undercapitalized institution as critically undercapitalized).

Based on the foregoing, the Bank currently meets the criteria to be classified as a "well capitalized" savings institution.

TRANSACTIONS WITH AFFILIATES AND INSIDERS

Under current federal law, transactions between depository institutions and their affiliates are governed by Sections 23A and 23B of the Federal Reserve Act and its implementing regulations. An affiliate of a savings bank is any company

or entity that controls, is controlled by, or is under common control with the savings bank, other than a subsidiary of the savings bank. In a holding company context, at a minimum, the parent holding company of a savings bank and any companies which are controlled by such parent holding company are affiliates of the savings bank. Generally, Section 23A limits the extent to which the savings bank or its subsidiaries may engage in "covered transactions" with any one affiliate to an amount equal to 10% of such savings bank's capital stock and surplus and contains an aggregate limit on all such transactions with all affiliates to an amount equal to 20% of such capital stock and surplus. The term "covered transaction" includes the making of loans or other extensions of credit to an affiliate; the purchase of assets from an affiliate, the purchase of, or an investment in, the securities of an affiliate; the acceptance of securities of an affiliate as collateral for a loan or extension of credit to any person; or issuance of a guarantee, acceptance, or letter of credit on behalf of an affiliate. Section 23A also establishes specific collateral requirements for loans or extensions of credit to, or guarantees, acceptances on letters of

credit issued on behalf of an affiliate. Section 23B requires that covered transactions and a broad list of other specified transactions be on terms substantially the same, or no less favorable, to the savings bank or its subsidiary as similar transactions with nonaffiliates.

Further, Section 22(h) of the Federal Reserve Act and its implementing regulations restrict a savings bank with respect to loans to directors, executive officers, and principal stockholders. Under Section 22(h), loans to directors, executive officers and stockholders who control, directly or indirectly, 10% or more of voting securities of a savings bank and certain related interests of any of the foregoing, may not exceed, together with all other outstanding loans to such persons and affiliated entities, the savings bank's total capital and surplus. Section 22(h) also prohibits loans above amounts prescribed by the appropriate federal banking agency to directors, executive officers, and stockholders who control 10% or more of voting securities of a stock savings bank, and their respective related interests, unless such loan is approved in advance by a majority of the board of directors of the savings bank. Any "interested" director may not participate in the voting. The loan amount (which includes all other outstanding loans to such person) as to which such prior board of director approval is required, is the greater of $25,000 or 5% of capital and surplus or any loans over $500,000. Further, pursuant to Section 22(h), loans to directors, executive officers and principal stockholders must generally be made on terms substantially the same as offered in comparable transactions to other persons. Section 22(g) of the Federal Reserve Act places additional limitations on loans to executive officers.

FEDERAL HOLDING COMPANY REGULATION

GENERAL. The Company and the Mutual Holding Company are nondiversified mutual savings and loan holding companies within the meaning of the Home Owners' Loan Act. The Company and the Mutual Holding Company are registered with the OTS and are subject to OTS regulations, examinations, supervision and reporting requirements. As such, the OTS has enforcement authority over the Company and the Mutual Holding Company, and their non-savings institution subsidiaries. Among other things, this authority permits the OTS to restrict or prohibit activities that are determined to be a serious risk to the subsidiary savings institution.

PERMITTED ACTIVITIES. Under OTS regulation and policy, a mutual holding company and a federally chartered mid-tier holding company, such as the Company, may engage in the following activities: (i) investing in the stock of a savings association; (ii) acquiring a mutual association through the merger of such association into a savings association subsidiary of such holding company or an interim savings association subsidiary of such holding company; (iii) merging with or acquiring another holding company, one of whose subsidiaries is a savings association; (iv) investing in a corporation, the capital stock of which is available for purchase by a savings association under federal law or under the law of any state where the subsidiary savings association or associations share their home offices; (v) furnishing or performing management services for a savings association subsidiary of such company; (vi) holding, managing or liquidating assets owned or acquired from a savings subsidiary of such company; (vii) holding or managing properties used or occupied by a savings association subsidiary of such company; (viii) acting as trustee under deeds of trust; (ix) any other activity (A) that the Federal Reserve Board, by regulation, has determined to be permissible for bank holding companies under Section 4(c) of the Bank Holding Company Act of 1956, unless the Director of the OTS, by regulation, prohibits or limits any such activity for savings and loan holding companies; or (B) in which multiple savings and loan holding companies were authorized (by regulation) to directly engage on March 5, 1987; (x) any activity permissible for financial holding companies under Section 4(k) of the Bank

Holding Company Act, including securities and insurance underwriting; and (xi) purchasing, holding, or disposing of stock acquired in connection with a qualified stock issuance if the purchase of such stock by such savings and loan holding company is approved by the Director. If a mutual holding company acquires or merges with another holding company, the holding company acquired or the holding company resulting from such merger or acquisition may only invest in assets and engage in activities listed in (i) through (xi) above, and has a period of two years to cease any nonconforming activities and divest of any nonconforming investments.

The Home Owners' Loan Act prohibits a savings and loan holding company, directly or indirectly, or through one or more subsidiaries, from acquiring another savings association or holding company thereof, without prior written approval of the OTS. It also prohibits the acquisition or retention of, with certain exceptions, more than 5% of a nonsubsidiary savings association, a nonsubsidiary holding company, or a nonsubsidiary company engaged in activities other than those permitted by the Home Owners' Loan Act; or acquiring or retaining control of an institution that is not federally insured. In evaluating applications by holding companies to acquire savings associations, the OTS must consider the financial and managerial resources, future prospects of the company and association involved, the effect of the acquisition on the risk to the insurance fund, the convenience and needs of the community and competitive factors.

The Office of Thrift Supervision is prohibited from approving any acquisition that would result in a multiple savings and loan holding company controlling savings associations in more than one state, subject to two exceptions: (i) the approval of interstate supervisory acquisitions by savings and loan holding companies, and (ii) the acquisition of a savings institution in another state if the laws of the state of the target savings institution specifically permit such acquisitions. The states vary in the extent to which they permit interstate savings and loan holding company acquisitions.

WAIVERS OF DIVIDENDS BY MUTUAL HOLDING COMPANY. Office of Thrift Supervision regulations require the Mutual Holding Company to notify the OTS of any proposed waiver of its receipt of dividends from the Company

CONVERSION OF THE MUTUAL HOLDING COMPANY TO STOCK FORM. OTS regulations permit the Mutual Holding Company to convert from the mutual form of organization to the capital stock form of organization (a "Conversion Transaction"). There can be no assurance when, if ever, a Conversion Transaction will occur, and the Board of Directors has no current intention or plan to undertake a Conversion Transaction. In a Conversion Transaction a new holding company would be formed as the successor to the Company (the "New Holding Company"), the Mutual Holding Company's corporate existence would end, and certain depositors of the Bank would receive the right to subscribe for additional shares of the New Holding Company. In a Conversion Transaction, each share of common stock held by stockholders other than the Mutual Holding Company ("Minority Stockholders") would be automatically converted into a number of shares of common stock of the New Holding Company determined pursuant an exchange ratio that ensures that Minority Stockholders own the same percentage of common stock in the New Holding Company as they owned in the Company immediately prior to the Conversion Transaction. Under OTS regulations, Minority Stockholders would not be diluted because of any dividends waived by the Mutual Holding Company (and waived dividends would not be considered in determining an appropriate exchange ratio), in the event the Mutual Holding Company converts to stock form. The total number of shares held by Minority Stockholders after a Conversion Transaction also would be increased by any purchases by Minority Stockholders in the stock offering conducted as part of the Conversion Transaction.

NEW YORK STATE BANK HOLDING COMPANY REGULATION

In addition to the federal regulation, a holding company controlling a state chartered savings bank organized or doing business in New York State also may be subject to regulation under the New York State Banking Law. The term "bank holding company," for the purposes of the New York State Banking Law, is defined generally to include any person, company or trust that directly or indirectly either controls the election of a majority of the directors or owns, controls or holds with power to vote more than 10% of the voting stock of a bank holding company or, if the Company is a banking institution, another banking institution, or 10% or more of the voting stock of each of two or more banking

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institutions. In general, a bank holding company controlling, directly or indirectly, only one banking institution will not be deemed to be a bank holding company for the purposes of the New York State Banking Law. As such, neither the Company nor the Mutual Holding Company is subject to supervision by the Department.

FEDERAL SECURITIES LAW

The common stock of the Company is registered with the SEC under the Exchange Act. The Company is subject to the information, proxy solicitation, insider trading restrictions and other requirements of the SEC under the Exchange Act.

The Company Common Stock held by persons who are affiliates (generally officers, directors and principal stockholders) of the Company may not be resold without registration or unless sold in accordance with certain resale restrictions. If the Company meets specified current public information requirements, each affiliate of the Company is able to sell in the public market, without registration, a limited number of shares in any three-month period.

FEDERAL RESERVE SYSTEM

The Federal Reserve Board requires all depository institutions to maintain noninterest-bearing reserves at specified levels against their transaction accounts (primarily checking, money management and NOW checking accounts). At December 31, 2005, the Bank was in compliance with these reserve requirements.

FEDERAL COMMUNITY REINVESTMENT REGULATION

Under the Community Reinvestment Act, as amended (the "CRA"), as implemented by FDIC regulations, a savings 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 requires the FDIC, in connection with its examination of a savings institution, 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. The CRA requires the FDIC to provide a written evaluation of an institution's CRA performance utilizing a four-tiered descriptive rating system. The Bank's latest CRA rating was "outstanding."

NEW YORK STATE COMMUNITY REINVESTMENT REGULATION

The Bank is also subject to provisions of the New York State Banking Law which impose 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 CRA. Pursuant to the NYCRA, a bank must file an annual NYCRA report and copies of all federal CRA reports with the Department. The NYCRA requires the Department 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.

The Bank's NYCRA rating as of its latest examination was "satisfactory."

THE USA PATRIOT ACT

The USA PATRIOT Act was signed into law on October 26, 2001. The USA PATRIOT Act gives the federal government new 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 also requires the federal banking agencies to take into consideration the effectiveness of controls designed to combat money laundering activities in determining whether to approve a merger or other acquisition application of a member institution. Accordingly, if the Company were to engage in a merger or other acquisitions, its controls designed to combat money laundering would be considered as part of the application process. The Company and the Bank have established policies, procedures and systems designed to comply with these regulations.

SARBANES-OXLEY ACT OF 2002

The Sarbanes-Oxley Act of 2002 was signed into law on July 30, 2002. The Sarbanes-Oxley Act of 2002 is a law that addresses, among other issues, corporate governance, auditing and accounting, executive compensation, and enhanced and timely disclosure of corporate information. As directed by Section 302(a) of Sarbanes-Oxley Act of 2002, the Company Chief Executive Officers and Chief Financial Officer are each required to certify that the company's quarterly and annual reports do not contain any untrue statement of a material fact. The rules have several requirements, including having these officers certify that: they are responsible for establishing, maintaining and regularly evaluating the effectiveness of our internal controls; they have made certain disclosures to our auditors and the audit committee of the Board of Directors about our internal controls; and they have included information in our quarterly and annual reports about their evaluation and whether there have been significant changes in our internal controls or in other factors that could significantly affect internal controls subsequent to the evaluation. We will be subject to further reporting and audit requirements with the year ending December 31, 2007 under the requirements of Sarbanes-Oxley. We have existing policies, procedures and systems designed to comply with these regulations, and are further enhancing and documenting such policies, procedures and systems to ensure continued compliance with these regulations.

The company maintains an Internet website located at WWW.PATHFINDERBANK.COM on which, among other things, the Company makes available, free of charge, various reports that it files with or furnishes to the Securities and Exchange

Commission, including its Annual Report on Form 10-K, quarterly reports on Form 10-Q, and current reports on Form 8-K. The Company has also made available on its website its Audit Committee Charter, Governance Guidelines and Code of Ethics. These reports are made available as soon as reasonably practicable after these reports are filed with or furnished to the Securities and Exchange Commission.

FEDERAL AND STATE TAXATION

FEDERAL TAXATION

The following discussion of federal taxation is intended only to summarize certain pertinent federal income tax matters and is not a comprehensive description of the tax rules applicable to the Company or the Bank.

BAD DEBT RESERVES. Prior to the 1996 Act, the 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 the Bank's taxable income. As a result of the 1996 Act, the Bank must use the small bank experience method in computing its bad debt deduction beginning with its 1996 Federal tax return.

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 should the Bank fail to meet certain thrift asset and definitionaltests. New federal legislation eliminated these thrift related recapture rules. However, under current law, pre-1988 reserves remain subject to recapture should the Bank cease to retain a bank or thrift charter or make certain non-dividend distributions.

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 ("alternative minimum taxable income" or "AMTI"). The AMT is

payable to the extent such AMTI is in excess of an exemption amount. Net operating losses can offset no more than 90% of AMTI. Certain payments of alternative minimum tax may be used as credits against regular tax liabilities in future years.

NET OPERATING LOSS CARRYOVERS. A financial institution may carry back net operating losses to the preceding two taxable years and forward to the succeeding 20 taxable years. This provision applies to losses incurred in taxable years beginning after August 5, 1997.

The Internal Revenue Service has examined the federal income tax return for the fiscal year ended 1992; the New York State fiscal year-end tax returns for 1998 through 1999 are currently under examination by the New York State Department of Taxation and Finance. See Note 13 to the Financial Statements.

STATE TAXATION

NEW YORK TAXATION. The Bank is subject to the New York State Franchise Tax on Banking Corporations in an annual amount equal to the greater of (i) 8.0% of the Bank's "entire net income" allocable to New York State during the taxable year, or (ii) the applicable alternative minimum tax. The alternative minimum tax is generally the greater of (a) 0.01% of the value of the Bank's assets allocable to New York State with certain modifications, (b) 3% of the Bank's "alternative entire net income" allocable to New York State, or (c) $250. Entire net income

is similar to federal taxable income, subject to certain modifications and alternative entire net income is equal to entire net income without certain modifications. Net operating losses arising in the current period can be carried forward to the succeeding 20 taxable years.

The Company's Annual Report on Form 10-K may be accessed on the Company's website at WWW.PATHFINDERBANK.COM.

ITEM 1A: RISK FACTORS

The material risks and uncertainties that management believes affect the Company are described below. The risks and uncertainties described below are not the only ones facing the Company. Additional risks and uncertainties that management is not aware of or that management currently deems immaterial may also impair the Company's business operations. This report is qualified in its entirety by these risk factors. If any of the following risks actually occur, the Company's financial condition and results of operations could be materially and adversely affected.

CHANGES IN INTEREST RATES CAN HAVE AN ADVERSE EFFECT ON PROFITABILITY

The Company's earnings and cash flows are largely dependent upon its net interest income. Net interest income is the difference between interest income earned on interest earning assets such as loans and investment securities and interest expense paid on interest bearing liabilities such as deposits and borrowed funds. Interest rates are highly sensitive to many factors that are beyond the Company's control, including general economic conditions, competition, and policies of various governmental and regulatory agencies and, in particular, the Board of Governors of the Federal Reserve System. Changes in monetary policy, including changes in interest rates, could influence not only the interest the Company receives on loans and investment securities and the amount of interest it pays on deposits and borrowings, but such changes could also affect (i) the Company's ability to originate loans and obtain deposits, (ii) the fair value of the Company's financial assets and liabilities, and (iii) the average duration of the Company's assets and liabilities. If the interest rates paid on deposits and other borrowings increase at a faster rate than the interest rates received on loans and other investments, the Company's net interest income, and therefore earnings, could be adversely affected. Earnings could also be adversely affected if the interest rates received on loans and other investments fall more quickly than the interest rates paid on deposits and other borrowings.

Although management believes it has implemented effective asset and liability management strategies to reduce the potential effects of changes in interest rates on the Company's results of operations, any substantial,

unexpected, prolonged change in market interest rates could have a material adverse effect on the Company's financial condition and results of operations. See Item 7A, "Quantitative and Qualitative Disclosures About Market Risk" located elsewhere in this report for further discussion related to the Company's management of interest rate risk.

ALLOWANCE FOR LOAN LOSSES MAY BE INSUFFICIENT

The Company's loan customers may not repay their loans according to their terms and the collateral securing the payment of these loans may be insufficient to assure repayment. The Company may experience significant loan losses, which would have a material adverse effect on earnings. Management makes various

assumptions and judgments about the collectibility of the loan portfolio, including the creditworthiness of borrowers and the value of the real estate and other assets serving as collateral for the repayment of loans.

The Company maintains an allowance for loan losses in an attempt to cover any loan losses inherent in the portfolio. In determining the size of the allowance, management relies on an analysis of the loan portfolio based on historical loss experience, volume and types of loans, trends in classification, volume and trends in delinquencies and non-accruals, national and local economic conditions and other pertinent information. If those assumptions are incorrect, the allowance may not be sufficient to cover future loan losses and adjustments may be necessary to allow for different economic conditions or adverse developments in the loan portfolio. In addition, regulatory agencies review the Company's allowance for loan losses and may require additions to the allowance based on their judgment about information available to them at the time of their examination. An increase in the Company's allowance for loan losses could reduce its earnings.

EXTENSIVE REGULATION AND SUPERVISION

The Company, primarily through its principal subsidiaries Pathfinder Bank and Pathfinder Commercial Bank and certain non-bank subsidiaries, is subject to extensive federal and state regulation and supervision. Banking regulations are primarily intended to protect depositors' funds, federal deposit insurance funds and the banking system as a whole, not shareholders. These regulations affect the Company's lending practices, capital structure, investment practices, dividend policy and growth, among other things. The Company is also subject to a number of federal laws, which, among other things, require it to lend to various sectors of the economy and population, and establish and maintain comprehensive programs relating to anti-money laundering and customer identification. Congress and federal regulatory agencies continually review banking laws, regulations and policies for possible changes. Changes to statutes, regulations or regulatory policies, including changes in interpretation or implementation of statutes, regulations or policies, could affect the Company in substantial and unpredictable ways. Such changes could subject the Company to additional costs, limit the types of financial services and products it may offer and/or increase the ability of non-banks to offer competing financial services and products, among other things. Failure to comply with laws, regulations or policies could result in sanctions by regulatory agencies, civil money penalties and/or reputation damage, which could have a material adverse effect on the Company's business, financial condition and results of operations. The Company's compliance with certain of these laws will be considered by banking regulators when reviewing bank merger and bank holding company acquisitions. While the Company has policies and procedures designed to prevent any such violations, there can be no assurance that such violations will not occur. See the "Regulation and Supervision" section in Item 1, "Business" and Note 17 to consolidated financial statements included in Item 8, "Financial Statements and Supplementary Data", which are located elsewhere in this report.

LOCAL MARKET ECONOMIES

The Company's business is concentrated in Oswego and parts of Onondaga counties of New York State. The economy in the Company's market area is manufacturing-oriented and dependent on the State University of New York College at Oswego. As a result, its financial condition, results of operations and cash flows are subject to changes if there are changes in the economic conditions in these areas. A prolonged period of economic recession or other adverse economic conditions in one or both of these areas could have a negative impact on the Company. The Company can provide no assurance that conditions in its market area economies will not deteriorate in the future and that such deterioration would not have a material adverse effect on the Company.

COMPETITION IN THE FINANCIAL SERVICES INDUSTRY

The Company faces substantial competition in all areas of its operations from a variety of different competitors, many of which are larger and may have more financial resources. The Company competes with other providers of financial services such as other bank holding companies, commercial and savings banks, savings and loan associations, credit unions, money market and mutual funds, mortgage companies, title agencies, asset managers, insurance companies and a growing list of other local, regional and national institutions which offer financial services. If the Company is unable to compete effectively, it will lose market share and income generated from loans, deposits, and other financial products will decline.

ITEM 1B: UNRESOLVED STAFF COMMENTS

None

ITEM 2: PROPERTIES

The Bank conducts its business through its main office located in Oswego, New York, and six full service branch offices located in Oswego County. The following table sets forth certain information concerning the main office and each branch office of the Bank at December 31, 2005. The aggregate net book value of the Bank's premises and equipment was $8.0 million at December 31, 2005. For additional information regarding the Bank's properties, see Note 7 to Notes to Financial Statements

LOCATION	OPENING DATE	OWNED/LEASED
Main Office 214 West First Street Oswego, New York 13126	1874	Owned
Plaza Branch Route 104, Ames Plaza Oswego, New York 13126	1989	Owned (1)
Mexico Branch Norman & Main Streets Mexico, New York 13114	1978	Owned
Oswego East Branch 34 East Bridge Street Oswego, New York 13126	1994	Owned
Lacona Branch 1897 Harwood Drive Lacona, New York 13083	2002	Owned
Fulton Branch 5 West First Street South	2003	Owned (2)

Fulton, New York 13069

Central Square Branch 2005 Owned
3025 East Ave
Central Square, New York 13036

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(1) The building is owned; the underlying land is leased with an annual rent of $19,000
(2) The building is owned; the underlying land is leased with an annual rent of $23,000

ITEM 3: LEGAL PROCEEDINGS

There are various claims and lawsuits to which the Company is periodically involved incident to the Company's business. In the opinion of management such claims and lawsuits in the aggregate are not expected to have a material adverse impact on the Company's consolidated financial condition and results of operations.

ITEM 4: SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

No matters were submitted during the fourth quarter of fiscal 2005 to a vote of the Company's shareholders.

PART II

ITEM 5: MARKET FOR REGISTRANT'S COMMON STOCK, RELATED SECURITY HOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES

Pathfinder Bancorp, Inc.'s common stock currently trades on the Nasdaq SmallCap market under the symbol "PBHC". There were 415 shareholders of record as of March 3, 2006. The following table sets forth the high and low closing bid prices and dividends paid per share of common stock for the periods indicated:

QUARTER ENDED:	HIGH	LOW	DIVIDEND PAID
December 31, 2005	$15.050	$12.360	$ 0.1025
September 30, 2005	15.250	13.050	0.1025
June 30, 2005	18.000	14.250	0.1025
March 31, 2005	17.950	16.250	0.1025
December 31, 2004	$18.500	$16.250	$ 0.1025
September 30, 2004	16.630	14.770	0.1025
June 30, 2004	19.070	15.050	0.100
March 31, 2004	20.999	17.010	0.100

DIVIDENDS AND DIVIDEND HISTORY

The Company has historically paid regular quarterly cash dividends on its common stock, and the Board of Directors presently intends to continue the payment of

regular quarterly cash dividends, subject to the need for those funds for debt service and other purposes. Payment of dividends on the common stock is subject to determination and declaration by the Board of Directors and will depend upon a number of factors, including capital requirements, regulatory limitations on the payment of dividends, Pathfinder Bank and its subsidiaries results of operations and financial condition, tax considerations, and general economic conditions. The Company's mutual holding company, Pathfinder Bancorp, M.H.C., may elect to waive or receive dividends each time the Company declares a dividend. The election to waive the dividend receipt requires prior non-objection of the Office of Thrift Supervision. Pathfinder Bancorp, M.H.C. elected to waive its dividend for the quarters ended March 31, 2005 and September 30, 2005. During 2006, Pathfinder Bancorp, M.H.C. expects to waive two quarterly dividends.

ITEM 6: SELECTED FINANCIAL DATA

Pathfinder Bancorp, Inc. ("the Company") is the parent company of Pathfinder Bank and Pathfinder Statutory Trust I. Pathfinder Bank has three operating subsidiaries - Pathfinder Commercial Bank, Pathfinder REIT Inc., and Whispering Oaks Development, Inc.

The following selected consolidated financial data sets forth certain financial highlights of the Company and should be read in conjunction with the consolidated financial statements and related notes, and the "Management's Discussion and Analysis of Financial Condition and Results of Operations" included elsewhere in this annual report on Form 10-K.

	2005	2004	2003	2002	2
YEAR END (In thousands)					
Total assets	$296,948	$302,037	$277,940	$279,056	$244,
Loans receivable, net	187,889	185,125	187,002	179,001	162,
Deposits	236,377	236,672	206,894	204,522	169,
Equity	20,928	21,826	21,785	23,230	22,
FOR THE YEAR (In thousands)					
Net interest income	$ 8,742	$ 8,905	$ 9,337	$ 8,789	$ 7,
Noninterest income	2,040	3,047	2,608	2,094	1,
Core noninterest income (a)	2,333	1,996	1,740	1,511	1,
Noninterest expense	10,060	9,307	9,094	7,964	6,
Net income	462	1,405	1,652	1,156	1,
PER SHARE					
Net income (basic)	$ 0.19	$ 0.58	$ 0.68	$ 0.45	$ 0
Book value	8.50	8.91	8.96	8.90	8
Tangible book value (b)	6.77	7.04	7.03	7.02	7
Cash dividends declared	0.410	0.405	0.40	0.30	0
RATIOS					
Return on average assets	0.15%	0.47%	0.59%	0.45%	0
Return on average equity	2.16	6.45	7.61	5.01	7
Return on average tangible equity (b)	2.72	8.17	9.77	7.03	8
Average equity to average assets	6.95	7.29	7.77	8.94	9
Dividend payout ratio (c)	147.84	47.54	39.41	36.76	28
Allowance for loan losses to loans receivable	0.89	0.98	0.91	0.82	1
Net interest rate spread	3.07	3.22	3.53	3.47	3
Noninterest income to average assets	0.66	1.02	0.93	0.81	0
Core noninterest income to average assets (a)	0.76	0.67	0.62	0.59	0

Noninterest expense to average assets	3.28	3.12	3.26	3.09	2
Efficiency ratio (d)	93.30	77.87	76.13	73.18	70

(a) Core noninterest income excludes net (losses) gains on sales and impairment of investment securities and net (losses) gains on sales of loans and foreclosed real estate.

(b) Tangible equity excludes intangible assets.

(c) The dividend payout ratio is calculated using dividends declared and not waived by the Company's mutual holding company parent, Pathfinder Bancorp, M.H.C., divided by net income.

(d) The efficiency ratio is calculated as noninterest expense divided by the sum of net interest income and noninterest income.

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

INTRODUCTION

Throughout the Management's Discussion and Analysis ("MD&A") the term, "the Company", refers to the consolidated entity of Pathfinder Bancorp, Inc. Pathfinder Bank and Pathfinder Statutory Trust I are wholly owned subsidiaries of Pathfinder Bancorp, Inc., however, Pathfinder Statutory Trust I is deconsolidated for reporting purposes (see Note 10). Pathfinder Commercial Bank, Pathfinder REIT, Inc. and Whispering Oaks Development, Inc. represent wholly owned subsidiaries of Pathfinder Bank. At December 31, 2005, Pathfinder Bancorp, M.H.C, the Company's mutual holding company parent, whose activities are not included in the MD&A, held 64.3% of the Company's outstanding common stock and the public held 35.7%.

When used in this Annual Report the words or phrases "will likely result", "are expected to", "will continue", "is anticipated", "estimate", "project" or similar expression are intended to identify "forward-looking statements" within the meaning of the Private Securities Litigation Reform Act of 1995. Such statements are subject to certain risks and uncertainties, including, among other things, changes in economic conditions in the Company's market area, changes in policies by regulatory agencies, fluctuations in interest rates, demand for loans in the Company's market areas and competition, that could cause actual results to differ materially from historical earnings and those presently anticipated or projected. The Company wishes to caution readers not to place undue reliance on any such forward-looking statements, which speak only as of the date made. The Company wishes to advise readers that the factors listed above could affect the Company's financial performance and could cause the Company's actual results for future periods to differ materially from any opinions or statements expressed with respect to future periods in any current statements.

The Company does not undertake, and specifically declines any obligation, to publicly release the results of any revisions, which may be made to any forward-looking statements to reflect events or circumstances after the date of such statements or to reflect the occurrence of anticipated or unanticipated events.

The Company's business strategy is to operate as a well-capitalized, profitable and independent community bank dedicated to providing value-added products and

services to our customers. Generally, the Company has sought to implement this strategy by emphasizing retail deposits as its primary source of funds and maintaining a substantial part of its assets in locally-originated residential first mortgage loans, loans to business enterprises operating in its markets, and in investment securities. Specifically, the Company's business strategy incorporates the following elements: (i) operating as an independent community-oriented financial institution; (ii) maintaining capital in excess of regulatory requirements; (iii) emphasizing investment in one-to-four family residential mortgage loans, loans to small businesses and investment securities; and (iv) maintaining a strong retail deposit base.

The Company's net income is primarily dependent on its net interest income, which is the difference between interest income earned on its investments in mortgage and other loans, investment securities and other assets, and its cost of funds consisting of interest paid on deposits and other borrowings. The Company's net income also is affected by its provision for loan losses, as well as by the amount of noninterest income, including income from fees, service charges and servicing rights, net gains and losses on sales of securities, loans and foreclosed real estate, and noninterest expense such as employee compensation and benefits, occupancy and equipment costs, data processing costs and income taxes. Earnings of the Company also are affected significantly by general economic and competitive conditions, particularly changes in market interest rates, government policies and actions of regulatory authorities, which events are beyond the control of the Company. In particular, the general level of market rates tends to be highly cyclical.

APPLICATION OF CRITICAL ACCOUNTING POLICIES

The Company's consolidated financial statements are prepared in accordance with accounting principles generally accepted in the United States and follow practices within the banking industry. Application of these principles requires management to make estimates, assumptions and judgments that affect the amounts reported in the financial statements and accompanying notes. These estimates, assumptions and judgments are based on information available as of the date of the financial statements; accordingly, as this information changes, the financial statements could reflect different estimates, assumptions and judgments. Certain policies inherently have a greater reliance on the use of estimates, assumptions and judgments and as such have a greater possibility of producing results that could be materially different than originally reported. Estimates, assumptions and judgments are necessary when assets and liabilities are required to be recorded at fair value or when an asset or liability needs to be recorded contingent upon a future event. Carrying assets and liabilities at fair value inherently results in more financial statement volatility. The fair values and information used to record valuation adjustments for certain assets and liabilities are based on quoted market prices or are provided by other third-party sources, when available. When third party information is not available, valuation adjustments are estimated in good faith by management.

The most significant accounting policies followed by the Company are presented in Note 1 to the consolidated financial statements. These policies, along with the disclosures presented in the other financial statement notes and in this discussion, provide information on how significant assets and liabilities are valued in the financial statements and how those values are determined. Based on the valuation techniques used and the sensitivity of financial statement amounts to the methods, assumptions and estimates underlying those amounts, management has identified the determination of the allowance for loan losses to be the accounting area that requires the most subjective and complex judgments, and as such could be the most subject to revision as new information becomes

available.

The allowance for loan losses represents management's estimate of probable loan losses inherent in the loan portfolio. Determining the amount of the allowance for loan losses is considered a critical accounting estimate because it requires significant judgment and the use of estimates related to the amount and timing of expected future cash flows on impaired loans, estimated losses on pools of homogeneous loans based on historical loss experience, and consideration of current economic trends and conditions, all of which may be susceptible to significant change. The loan portfolio also represents the largest asset type on the consolidated balance sheet. Note 1 to the consolidated financial statements describes the methodology used to determine the allowance for loan losses, and a discussion of the factors driving changes in the amount of the allowance for loan losses is included in this report.

The Company carries all of its security investments at fair value with any unrealized gains or losses reported net of tax as an adjustment to shareholders' equity. Based on management's assessment, at December 31, 2005, the Company did not hold any security that had a fair value decline that is currently expected to be other than temporary. Consequently, any declines in a specific security's fair value below amortized cost have not been provided for in the income statement. The Company's ability to fully realize the value of its investment in various securities, including corporate debt securities, is dependent on the underlying creditworthiness of the issuing organization.

EXECUTIVE SUMMARY

During 2005, the Company focused on expanding its branch network in Oswego County by opening a full service branch in Central Square, New York in June of 2005. Total deposits for the new branch at December 31, 2005 were $6.3 million. Total deposits for the Company remained relatively consistent at $236.4 million at December 31, 2005 while the average balance of deposits increased $8.1 million to $220.5 million at 2005. The Company will continue to focus on building its market share in Central Square and developing more core deposit relationships in its existing markets during 2006.

Total assets decreased 2%, primarily in the investment securities portfolio and interest-earning deposits. The loan portfolio increased 1% as net growth in the commercial real estate, commercial and consumer loan portfolios were partially offset by a decrease in the residential real estate portfolio. Asset quality

continued to improve during 2006. Nonperforming assets to total assets was 0.81% at December 31, 2005 compared to 0.88% in the prior year. The improvement in asset quality is attributable to the enhancement of collection procedures and the resolution through foreclosure and charge-off of two commercial lending relationships. The Company expects to concentrate on continued commercial mortgage and commercial loan growth during 2006.

Net income for 2005 was $462,000, or $0.19 per share, as compared to $1.4 million, or $0.58 per share, in 2004. Net interest margin compression; an impairment charge and strategic losses taken in the investment securities portfolio; the additional costs of operating a new branch; and personnel restructuring charges impacted earnings negatively during 2005. An improvement in asset quality and an increase in service charges on deposit accounts partially offset these charges to income.

The Company experienced net interest margin compression to 3.21% in 2005 from 3.35% in 2004. Net interest income decreased 2% to $8.7 million for the year

ended December 31, 2005. The Company expects continued pressure on core earnings as short-term rates are anticipated to continue to rise and long-term rates are expected to remain relatively unchanged. This interest rate environment impacts the Company's liability sensitive balance sheet negatively as deposits and borrowings reprice more rapidly than loans and investment securities. The Company has implemented an asset/liability management strategy to combat the current interest rate environment including the growth of more rate sensitive commercial real estate and commercial loan portfolio, increasing core deposit relationships and strategies to mitigate the rising cost of deposits.

The Company's efforts to enhance other interest income during 2005 by increasing the customer deposit base and increasing overdraft, returned check and non-sufficient fund charges to be more reflective with local competition resulted in a 36% increase in service charges on deposit accounts during 2005. The Company opened a new branch in Central Square, New York in June of 2005. The branch successfully gathered $6.3 million in deposits in the first seven months. The Company will continue to focus on growing our market share in Central Square. Salaries and employee benefits and building occupancy costs increased primarily from the addition of the new branch combined with fourth quarter personnel realignment costs. The Company expects salaries and benefits and building occupancy to increase, as a full year of Central Square operations will be reflected in 2006. The Company continues to explore cost saving strategies to minimize the growth of other operating expenses.

RESULTS OF OPERATIONS

Net income for 2005 was $462,000, a decrease of $943,000, or 67%, compared to net income of $1.4 million for 2004. Basic earnings per share decreased to $0.19 per share for the year ended December 31, 2005 from $0.58 per share for the year ended December 31, 2004. Return on average equity decreased 67% to 2.16% in 2005 from 6.45% in 2004.

Net interest income, on a tax equivalent basis, decreased $106,000, or 1%, primarily resulting from interest rate spread compression as shorter term cost of funds are repricing at higher rates faster than longer term assets. Provision for loan losses at December 31, 2005 decreased 58% reflecting improved asset quality during 2005, combined with slower loan growth. The Company experienced a 16% increase in other income, net of securities gains and losses, primarily attributable to increased deposit levels and the related service charges associated with checking accounts, combined with an increase in the value of bank owned life insurance. Operating expenses increased 8% due to the hiring of additional staff and related operating costs at the new Central Square branch, which opened in June of 2005, along with increased data processing expenses and an increase in professional and other services.

NET INTEREST INCOME

Net interest income is the Company's primary source of operating income for payment of operating expenses and providing for possible loan losses. It is the amount by which interest earned on interest-earning deposits, loans and investment securities, exceeds the interest paid on deposits and other borrowed money. Changes in net interest income and the net interest margin ratio result from the interaction between the volume and composition of earning assets and interest-bearing liabilities, and their respective yields and funding costs.

Net interest income, on a tax-equivalent basis, decreased $106,000, or 1%, to $9.0 million for the year ended December 31, 2005, as compared to the year ended

December 31, 2004. The Company's net interest margin for 2005 decreased to 3.21% from 3.35% in 2004. The decrease in net interest income is attributable to increased costs of interest-bearing liabilities and was partially offset by an increase in the yields on interest earning assets. The average balance of interest-earning assets grew $8.2 million, or 3%, during 2005 and the average balance of interest-bearing deposits increased by $8.1 million, or 4%. The increase in the average balance of interest-bearing liabilities primarily resulted from an increase in the average balance of retail and municipal deposits. As a result, interest income, on a tax-equivalent basis, increased $677,000 during 2005. Interest expense on deposits increased $680,000, or 19%, as the cost of deposits rose to 1.96% in 2005 from 1.71% in 2004. In addition to the increase in the cost of deposits, interest expense on borrowings also increased by $103,000, or 5%, from the prior year.

In comparison, net interest income decreased $375,000, or 4%, on a tax-equivalent basis, from 2003 to 2004. The decrease in net interest income was comprised of a decrease in interest income of $751,000, or 5%, partially offset by a decrease in interest expense of $375,000, or 6%. The average balance of interest-earning assets grew $14.6 million during 2004 and the average balance of interest-bearing deposits increased by $20.7 million. The increase in the average balance of interest-bearing liabilities primarily resulted from attracting new municipal deposit customers. The decrease in the average yield on interest-earning assets by 60 basis points resulted from the downward repricing of loans from refinancing and originations in the lower interest rate environment and the purchase of $35.6 million in investment securities at lower yields than the existing portfolio.

AVERAGE BALANCES AND RATES

The following table sets forth information concerning average interest-earning assets and interest-bearing liabilities and the yields and rates thereon. Interest income and resultant yield information in the table is on a fully tax-equivalent basis using marginal federal income tax rates of 34%. Averages are computed on the daily average balance for each month in the period divided by the number of days in the period. Yields and amounts earned include loan fees. Non-accrual loans have been included in interest-earning assets for purposes of these calculations.

	2005			2004	
(Dollars in thousands)	Average Balance	Interest	Average Yield / Cost	Average Balance	Interest
Interest-earning assets:					
Real estate loans residential	$121,875	$ 7,092	5.82%	$124,734	$ 7,491
Real estate loans commercial	29,385	2,181	7.42%	30,958	2,254
Commercial loans	17,563	1,135	6.46%	16,060	901
Consumer loans	19,257	1,418	7.36%	17,427	1,194
Taxable investment securities	74,496	2,728	3.66%	65,480	2,220
Tax-exempt investment securities	13,202	681	5.16%	8,603	488
Interest-earning deposits	3,041	71	2.33%	7,338	81
Total interest-earning assets	$278,819	$ 15,306	5.49%	$270,600	$ 14,629
Noninterest-earning assets:					

Other assets	31,455			30,236		
Allowance for loan losses	(1,835)			(1,792)		
Net unrealized gains on available for sale securities	(1,307)			(515)		
Total Assets	$307,132			$298,529		
Interest-bearing liabilities:						
NOW accounts	$ 19,877	$ 107	0.54%	$ 20,808	$ 135	
Money management accounts	41,380	835	2.02%	40,775	567	
Savings and club accounts	65,558	291	0.44%	68,046	453	
Time deposits	93,732	3,086	3.29%	82,769	2,484	
Junior subordinated debentures	5,155	351	6.72%	5,155	251	
Borrowings	37,348	1,686	4.51%	37,674	1,683	
Total Interest-bearing liabilities	$263,050	$ 6,356	2.42%	$255,227	$ 5,573	
Noninterest-bearing liabilities:						
Demand deposits	19,324			17,974		
Other liabilities	3,416			3,556		
Total liabilities	285,790			276,757		
Shareholders' equity	21,342			21,772		
Total liabilities & shareholders' equity	$307,132			$298,529		
Net interest income		$ 8,950			$ 9,056	
Net interest rate spread			3.07%			
Net interest margin			3.21%			
Ratio of average interest-earning assets to average interest-bearing liabilities			105.99%			

	2003		
(Dollars in thousands)	Average Balance	Interest	Average Yield/ Cost
Interest-earning assets:			
Real estate loans residential	$129,687	$ 8,346	6.44%
Real estate loans commercial	31,122	2,480	7.97%
Commercial loans	14,181	798	6.37%
Consumer loans	15,787	1,225	7.76%
Taxable investment securities	54,115	2,193	4.05%
Tax-exempt investment securities	7,869	305	3.87%
Interest-earning deposits	3,252	33	0.99%
Total interest-earning assets	$256,013	$ 15,380	6.01%
Noninterest-earning assets:			
Other assets	24,859		
Allowance for loan losses	(1,591)		
Net unrealized gains on available for sale securities	52		

Total Assets	$279,333		
Interest-bearing liabilities:			
NOW accounts	$ 17,663	$ 140	0.79%
Money management accounts	21,788	248	1.14%
Savings and club accounts	66,481	511	0.77%
Time deposits	85,751	2,852	3.33%
Junior subordinated debentures	5,000	236	4.66%
Borrowings	43,490	1,961	4.51%
Total Interest-bearing liabilities	$240,173	$ 5,948	2.48%
Noninterest-bearing liabilities:			
Demand deposits	16,345		
Other liabilities	1,098		
Total liabilities	257,616		
Shareholders' equity	21,717		
Total liabilities & shareholders' equity	$279,333		
Net interest income		$ 9,432	
Net interest rate spread			3.53%
Net interest margin			3.68%
Ratio of average interest-earning assets to average interest-bearing liabilities			106.60%

INTEREST INCOME

Changes in interest income are derived as a result of the volume of loans and securities, as measured by changes in the respective average balance and by the related yields on those balances. Interest income on a tax-equivalent basis increased $67,000, or 5%. Average loans decreased 1% in 2005, with yields increasing 3 basis points to 6.29% The Company's average residential mortgage loan portfolio decreased $2.9 million, or 2%, when comparing the year 2005 to

2004. The average yield on the residential mortgage loan portfolio decreased 19 basis points to 5.82% in 2005 from 6.01% in 2004. The $20.2 million in residential mortgage originations were made at lower rates than the weighted average yield of the existing portfolio. An increase in the average balance of consumer loans of $1.8 million, or 11%, resulted from an increase in home equity loans. The average yield increased 51 basis points, to 7.36% from 6.85% in 2004, primarily- resulting from the increase in home equity loans, which are based on the Bank's prime rate. Average commercial loans increased 9% while the tax-equivalent yield increased 85 basis points to 6.46% in 2005 compared to 5.61%, in 2004. Increases in the average balance of residential real estate, consumer and commercial loan portfolios were partially offset by a decrease in the average balance of commercial real estate portfolio of $1.6 million, or 5%.

Average loans decreased $1.6 million in 2004, with average yields declining 48 basis points to 6.26%. The interest income on loans decreased $1.0 million, or 8%, in 2004 compared to 2003. For the comparable periods, average residential mortgage loans decreased $5.0 million, or 4%, average consumer loans increased $1.6 million, or 10%, partially offset by a decrease in average commercial loans

by $1.9 million, or 13%, and a decrease in average commercial mortgage loans by $164,000, or 1%. Loans were originated at lower rates than in the prior period and a large volume of existing mortgages had their rates modified downward or were refinanced at lower rates.

Interest income on investment securities increased 26% from 2005, resulting from an increase in the average balance of investment securities (taxable and tax-exempt) by $13.6 million, or 18%, to $87.7 million in 2005 from $74.1 million in 2004. The tax-equivalent yield increased 23 basis points to 3.89% in 2005 from 3.66% in 2004 resulting primarily from the purchase of $23.4 million in investment securities during 2005 at higher yields than the existing investment portfolio combined with the sale of $4.3 million in lower yielding investment securities from the portfolio in the fourth quarter of 2005.

Average investment securities (taxable and tax-exempt) in 2004 increased by $12.1 million, with an increase in tax-equivalent interest income from investments of $210,000, or 8%, compared to 2003. The average tax-equivalent yield of the portfolio declined 37 basis points, to 3.66% from 4.03%. The increase in the average balance of investment securities and the decrease in the tax-equivalent yield resulted from the significant investment purchases at lower yields than the existing investment portfolio.

INTEREST EXPENSE

Changes in interest expense are derived as a result of the volume of deposits and borrowings as measured by changes in the respective average balances and by the related interest costs on those balances. Interest expense increased $783,000, or 14%, in 2005, when compared to 2004. The increase in the cost of funds resulted from an increase in the average cost of interest-bearing liabilities of 24 basis points, to 2.42% in 2005 from 2.18% at 2004, combined with a $7.8 million increase in the average balance of interest-bearing liabilities during 2005. The average cost of deposits increased 25 basis points to 1.96% during 2005 from 1.71% for 2004. The increase in the cost of average deposits resulted from rising short-term interest rates. The average cost of money management accounts increased 63 basis points and the cost of time deposits increased 29 basis points. The average balance of deposits increased $8.1 million to $220.5 million at 2005 from $212.4 million at 2004. The increase in the average balance of deposits primarily resulted from a $2.9 million, or 11%, increase in average balance of municipal deposits as the Company continues to garner new relationships and an increase in the average balance of retail deposits resulting primarily from the new branch in Central Square. The cost of junior subordinated debentures increased 192 basis points, increasing interest expense by $100,000.

Interest expense decreased $375,000, or 6%, in 2004 compared to 2003. The average cost of interest bearing liabilities declined 30 basis points during the 12 months ended December 31, 2004.

RATE/VOLUME ANALYSIS

Net interest income can also be analyzed in terms of the impact of changing interest rates on interest-earning assets and interest-bearing liabilities and changing the volume or amount of these assets and liabilities. The following table represents the extent to which changes in interest rates and changes in the volume of interest-earning assets and interest-bearing liabilities have affected the Company's interest income and interest expense during the periods indicated. Information is provided in each category with respect to: (i) changes attributable to changes in volume (change in volume multiplied by prior rate);

(ii) changes attributable to changes in rate (changes in rate multiplied by prior volume); and (iii) total increase or decrease. Changes attributable to both rate and volume have been allocated ratably.

	YEARS ENDED DECEMBER 31,					
	2005 VS. 2004			2004 VS. 2003		
	INCREASE/(DECREASE) DUE TO			INCREASE/(DECREASE) DUE TO		
In thousands)	VOLUME	RATE	TOTAL INCREASE (DECREASE)	VOLUME	RATE	TOTAL INCREASE (DECREASE)
INTEREST INCOME:						
Real estate loans residential	$(168)	$(231)	$(399)	$(311)	$ (544)	$(855)
Real estate loans commercial	(116)	43	(73)	(13)	(213)	(226)
Commercial loans	89	145	234	81	22	103
Consumer loans	131	93	224	120	(151)	(31)
Taxable investment securities	322	186	508	417	(390)	27
Tax-exempt investment securities	240	(47)	193	31	152	183
Interest-earning deposits	(65)	55	(10)	45	3	48
Total interest income	433	244	677	370	(1,121)	(751)
INTEREST EXPENSE:						
NOW accounts	(6)	(22)	(28)	22	(27)	(5)
Money management accounts	8	260	268	255	64	319
Savings and club accounts	(16)	(146)	(162)	12	(70)	(58)
Time deposits	348	254	602	(96)	(272)	(368)
Junior subordinated debentures	-	100	100	8	7	15
Borrowings	(13)	16	3	(262)	(16)	(278)
Total interest expense	321	462	783	(61)	(314)	(375)
Net change in net interest income	$ 112	$(218)	$(106)	$ 431	$ (807)	$(376)

NONINTEREST INCOME

The Company's noninterest income is primarily comprised of fees on deposit account balances and transactions, loan servicing, commissions, and net gains on securities, loans and foreclosed real estate.

The following table sets forth certain information on noninterest income for the years indicated.

	FOR THE YEARS ENDED DECEMBER 31,		
(In thousands)	2005	2004	2003

Service charges on deposit accounts	$1,318	$ 967	$ 818
Loan servicing fees	215	256	282
Increase in the value of bank owned life insurance	218	175	171
Other charges, commissions and fees	582	598	469
Core noninterest income	$2,333	$1,996	$1,740
Net (losses) gains on sales and impairment of investment securities	(205)	772	542
Net (losses) gains on sales of loans and foreclosed real estate	(88)	279	326
Total noninterest income	$2,040	$3,047	$2,608

Noninterest income in 2005 decreased 33%, when compared to 2004, as a result of a 17% increase in core noninterest income and a 128% decrease in the non-core items, net (losses) gains on sales and impairment of investment securities and net (losses) gains on sales of loans and foreclosed real estate. Service charges on deposit accounts increased 36% as the number of deposit accounts increased, a full year's effect of a fee enhancement program, increased ATM usage fees and increased internet banking usage. The value of bank owned life insurance increased 25%. These reductions in core noninterest income were offset by a decrease in loan servicing fees of 16%, primarily due to a reduction in fees associated with mortgage and commercial loan late charges, and internal mortgage legal fees. Investment security losses increased $977,000, when compared to the 2004 period resulting primarily from net gains recognized in prior years combined with a $193,000 impairment loss recognized on an equity security and fourth quarter investment portfolio restructurings. Net losses on the sale of loans/foreclosed real estate increased $367,000 when compared to the prior year, as a result of a $215,000 reduction in the gain recognized on the sale of loans to the secondary market as the volume of loans sold decreased by 25%, combined with adjustments made to the Fannie Mae custodial accounts to cover additional interest due caused by early pay offs of sold and serviced loans. Additionally, a $74,000 gain was recognized in 2004 on the remaining building lots held by Whispering Oaks Development, Inc.

Noninterest income in 2004 increased 17%, compared to 2003, as a result of a 10% increase in core noninterest income and a 42% increase in the non-core items, net gains on sales and impairment of investment securities. The increase in the number of deposit accounts and the introduction of new services to customers primarily accounted for the $149,000 increase in service charges on deposit accounts when compared to 2003. A $129,000 increase in other charges, commissions and fees primarily resulted from recording $54,000 in New York State grant income associated with a company wide Leadership Training initiative program, along with increased foreign ATM usage fees and fees associated with the company's Visa debit card. Net gains on the sale of loans/foreclosed real estate decreased $47,000, or 14%, resulting primarily from a $40,000 reduction in the gain recognized on the sale of loans to the secondary market as the volume of loans sold decreased 47%. Investment security gains increased $230,000, or 42%, when compared to the 2003 period. Investment security net gains were recorded on the sale of equity and corporate debt securities.

NONINTEREST EXPENSE

The following table sets forth certain information on noninterest expense for the years indicated.

	FOR THE YEARS ENDED DECEMBER 31,		
(In thousands)	2005	2004	2003
Salaries and employee benefits	$ 5,123	$4,798	$4,455
Building occupancy	1,178	1,169	1,159
Data processing expenses	1,226	981	868
Professional and other services	818	682	770
Amortization of intangible asset	223	223	223
Other expenses	1,492	1,454	1,619
Total noninterest expense	$10,060	$9,307	$9,094

Noninterest expenses increased $753,000, or 8%, for the 12 months ended December 31, 2005 when compared to 2004. Salaries and employee benefits increased 7% in 2005 primarily resulting from incremental salary raises, the staffing of a new Central Square branch and fourth quarter personnel realignment costs. The 1% increase in building occupancy is primarily due to the operation of the new Central Square branch for 7 months of 2005. The 25% increase in data processing expenses during 2005 related to increased depreciation expense, an increase in internet banking expense due to increased volume of users, increased check processing charges due to an increase in deposit accounts, and the increased annual maintenance expense on our core processing system. Professional and other services increased 20% due to outside consulting charges for performance management, a process improvement program, and strategic planning projects, along with increased advertising fees for the new Central Square branch. The 3% increase in other operating expenses during 2005 resulted primarily from the charge off of losses on ATM transactions and bad checks, additional ORE expenses associated with taxes and maintenance of properties, the write off of property and equipment at our former Fulton Branch, as well as an increase in audits and exams. These expenses were offset by decreases in postage expense, office supply expense and lower mortgage recording taxes due to decreased loan volume.

Noninterest expenses increased $213,000, or 2%, for the 12 months ended December 31, 2004 when compared to 2003. Salaries and employee benefits increased 8% in 2004 primarily resulting from incremental salary raises and promotions, the hiring of a Human Resource Manager and increased pension and health insurance costs. The 13% increase in data processing expenses during 2004 related to additional depreciation costs associated with a full year's operation of the new Fulton branch, combined with a 15% increase in internet banking usage, additional check processing charges due to a 5% increase in customer volume from a checking account acquisition program, and additional ATM processing charges related to the installation of a new ATM machine and products and supplies resulting from the increase in customer volume. Professional and other services decreased 11% due to a reduction in legal fees relating to a foreclosed property in 2003 not recurring in 2004, and a reduction in mortgage consulting fees as in-house personnel were used to perform work that was originally contracted. These reductions were offset by an increase in consulting fees associated with the checking account acquisition program and expenses associated with a leadership training program. Corresponding grant income recorded in other income offset the leadership training program expenses. The 10% decrease in other operating expenses during 2004 resulted primarily from a $164,000 expense relating to personnel realignment in 2003.

INCOME TAX EXPENSE

In 2005, the Company reported an income tax benefit of $51,000 compared to income tax expense of $502,000 in 2004. The income tax benefit in 2005 resulted

from the reduction in pretax income while income earned on tax-exempt investment securities and bank-owned life insurance increased. The effective tax rate decreased to (12)% in 2005 compared to 26% in 2004. The decrease in the effective tax rate resulted primarily from an increase in tax-exempt interest income in proportion to total taxable income. The Company has reduced its tax

rate from the statutory rate primarily through the ownership of tax-exempt investment securities, bank owned life insurance and other tax saving strategies. Enactment of proposed state tax legislation regarding Real Estate Investment Trusts would increase the state tax rate for the Company.

Income tax expense decreased $99,000 to $502,000 for the year ended December 31, 2004 as compared to $601,000 in the prior year. The decrease in income tax expense reflected lower pre-tax income during the year. The Company's effective tax rate remained at 26% in 2004 and 27% in 2003.

CHANGES IN FINANCIAL CONDITION

INVESTMENT SECURITIES

The investment portfolio represents 29% of the Company's earning assets and is designed to generate a favorable rate of return consistent with safety of principal while assisting the Company in meeting the liquidity needs of the loan and deposit operations and managing the Company's interest rate risk strategies. All of the Company's investments are classified as available for sale. The Company invests in investment securities consisting primarily of mortgage-backed securities, securities issued by United States Government agencies and sponsored enterprises, state and municipal obligations, mutual funds, equity securities, investment grade corporate debt instruments, and common stock issued by the Federal Home Loan Bank of New York (FHLBNY). By investing in these types of assets, the Company reduces the credit risk of its asset base, but must accept lower yields than would typically be available on commercial real estate loans and multi-family real estate loans.

Investment securities decreased $793,000, to $76.0 million at December 31, 2005 from $76.8 million at December 31, 2004. The decrease in investment securities was primarily attributable to the sale of lower yielding investment securities in the fourth quarter of 2005. This decrease was offset by acquisitions of investment securities to collateralize municipal deposits. In comparison, investment securities increased $17.2 million, or 29%, from 2003 to 2004. The increase in investment securities was primarily attributable to the acquisition of investment securities to collateralize municipal deposit accounts.

The following table sets forth the carrying value of the Company's investment portfolio at the dates indicated.

	AT DECEMBER 31,		
(In thousands)	2005	2004	2003
INVESTMENT SECURITIES:			
US Treasury and agencies	$ 20,713	$21,609	$ 6,354
State and political subdivisions	11,177	8,881	7,359
Corporate	5,936	5,919	6,421
Mortgage-backed	31,565	32,213	29,734

Equity securities and FHLB stock	2,626	2,800	2,932
Mutual funds	6,177	5,935	5,712
	78,194	77,357	58,512
Unrealized (loss) gain on available for sale portfolio	(2,150)	(520)	1,095
Total investments in securities	$ 76,044	$76,837	$59,607

The following table sets forth the scheduled maturities, amortized cost, fair values and average yields for the Company's investment securities at December 31, 2005. Yield is calculated on the amortized cost to maturity and adjusted to a fully tax-equivalent basis.

	ONE YEAR OR LESS		ONE TO FIVE YEARS		FIVE TO TEN YE	
(Dollars in thousands)	AMORTIZED COST	ANNUALIZED WEIGHTED AVG YIELD	AMORTIZED COST	ANNUALIZED WEIGHTED AVG YIELD	AMORTIZED COST	ANNUAL WEIGH AVG Y
DEBT INVESTMENT SECURITIES:						
US Treasury and agencies	$ 2,649	1.82%	$10,966	3.31%	$ 7,098	4.1
State and political subdivisions	40	3.89%	2,763	3.04%	3,770	3.5
Corporate	350	6.85%	2,450	4.50%	988	4.9
Total	$ 3,039	2.43%	$16,179	3.44%	$11,856	4.0
EQUITY AND MORTGAGE-BACKED SECURITIES:						
Mutual funds	$ 6,177	1.94%	$ -	-	$ -	
Mortgage-backed	-	-	3,915	3.87%	8,434	4.0
Equity securities and FHLB stock	2,627	4.49%	-	-	-	
Total	8,804	2.70%	3,915	3.87%	$ 8,434	4.0
Total investment securities	$ 11,843	2.63%	$20,094	3.53%	$20,290	4.0

	MORE THAN TEN YEARS		TOTAL INVESTMENT SECURITIES		
(Dollars in thousands)	AMORTIZED COST	ANNUALIZED WEIGHTED AVG YIELD	AMORTIZED COST	FAIR VALUE	ANNUALIZED WEIGHTED AVG YIELD
DEBT INVESTMENT SECURITIES:					
US Treasury and agencies	$ -	-	$ 20,713	$19,967	3.42%
State and political subdivisions	4,604	3.97%	11,177	10,980	3.58%
Corporate	2,148	5.31%	5,936	5,854	5.00%
Total	$ 6,752	4.37%	37,826	$36,801	3.71%

EQUITY AND MORTGAGE-BACKED SECURITIES:					
Mutual funds	-	-	6,177	$ 5,895	1.94%
Mortgage-backed	19,216	4.52%	31,565	30,718	4.30%
Equity securities and FHLB stock	-	-	2,626	2,630	5.08%
Total	19,216	4.52%	40,368	39,243	3.99%
Total investment securities	25,968	4.49%	78,194	$76,044	3.86%

LOANS RECEIVABLE

Loans receivable represent 71% of the Company's earning assets and account for the greatest portion of total interest income. The Company emphasizes residential real estate financing and anticipates a continued commitment to financing the purchase or improvement of residential real estate in its market area. The Company also extends credit to businesses within its marketplace secured by commercial real estate, equipment, inventories and accounts receivable. It is anticipated that small business lending in the form of mortgages, term loans, leases, and lines of credit will provide the most opportunity for balance sheet and revenue growth over the near term. Commercial loans comprise 10% of the total loan portfolio. At December 31, 2005, 89% of the Company's total loan portfolio consisted of loans secured by real estate, of which 17% consisted of commercial real estate loans.

	December 31,				
(In thousands)	2005	2004	2003	2002	2001
Residential real estate (1)	$119,707	$123,898	$128,989	$123,178	$112,110
Commercial real estate	31,845	29,874	31,278	32,657	30,455
Commercial loans	18,334	16,834	15,090	13,196	14,358
Consumer loans	19,682	18,505	16,880	15,068	12,615
	$189,568	$189,111	$192,237	$184,099	$169,538

(1) Includes loans held for sale.

The following table shows the amount of loans outstanding as of December 31, 2005 which, based on remaining scheduled repayments of principal, are due in the periods indicated. Demand loans having no stated schedule of repayments and no stated maturity, and overdrafts are reported as one year or less. Adjustable and floating rate loans are included in the period on which interest rates are next scheduled to adjust rather than the period in which they contractually mature, and fixed rate loans are included in the period in which the final contractual repayment is due.

(In thousands)	Due Under One Year	Due 1-5 Years	Due Over Five Years	Total

Real estate:				
Commercial real estate	$ 8,691	$15,067	$ 8,087	$ 31,845
Construction	40	185	2,382	2,607
Residential real estate	$39,319	48,640	29,141	117,100
	$48,050	$63,892	$39,610	$151,552
Commercial	10,576	7,701	57	18,334
Consumer	10,148	4,900	4,634	19,682
Total loans	$68,774	$76,493	$44,301	$189,568
Interest rates:				
Fixed	18,024	49,993	37,279	105,296
Variable	50,750	26,500	7,022	84,272
Total Loans	$68,774	$76,493	$44,301	$189,568

Total loans receivable remained relatively consistent when compared to the prior year. The commercial real estate, commercial loan and consumer loan portfolios increased $2.0 million, $1.5 million and $1.2 million, respectively. The increases in these portfolios were partially offset by a decrease in the residential real estate loans of $4.2 million. By comparison, loans receivable decreased $3.1 million, or 2%, in 2004 from 2003. The decrease of the loan portfolio from 2003 to 2004 is primarily attributable to the decrease in residential and commercial mortgages as amortization, prepayments and sales outpaced loan originations of $29.3 million during 2004. Decreases in the mortgage portfolios when comparing 2004 to 2003, were partially offset by an increase in municipal loans and consumer loans. The growth in the consumer loan portfolio is primarily home equity loan originations.

Residential real estate loans decreased $4.2 million, or 3%, during 2005. The residential real estate portfolio consists of 58% in fixed-rate mortgages and 42% in adjustable-rate mortgages. The decrease in the residential real estate portfolio is principally due to a net decrease in 15-year fixed rate mortgages of $5.1 million and a $2.1 million decrease in 30-year fixed rate loans held for sale, partially offset by an increase in the adjustable rate mortgage portfolio. The increase in the adjustable rate mortgage portfolio primarily resulted from an increase in customer demand for the Company's hybrid adjustable rate mortgages ("ARM"s). Hybrid ARMs have rates that are fixed for an initial period (principally 3, 5, 7 or 10 years) and then convert to one-year adjustable rate mortgages.

Commercial real estate loans increased $2.0 million, or 7%, from the prior year as new loan products were added to the portfolio. Commercial real estate loans decreased $1.4 million, or 4%, during 2004.

Commercial loans, including loans to municipalities, increased 9% over the prior year to $18.3 million at December 31, 2005. The increase in commercial loans resulted primarily from a $1.8 million net increase in small business loans. In comparison, commercial loans, including municipal loans, increased 12% during 2004 primarily due to the origination of municipal loans.

Consumer loans, which include second mortgage loans, home equity lines of credit, direct installment and revolving credit loans, increased 6% to $19.7 million at December 31, 2005. The increase resulted from an increase in home

equity lines of credit and second mortgage loans. The Company has promoted its home equity products by offering the customer loans with no closing costs and competitive market rates. Management feels these loans are an attractive use of funds and will continue to promote home equity products in 2006. During 2004, consumer loans increased $1.6 million, or 10%, resulting primarily from an increase in home equity products.

NONPERFORMING LOANS AND ASSETS

The following table represents information concerning the aggregate amount of nonperforming assets:

	DECEMBER 31,				
(Dollars in thousands)	2005	2004	2003	2002	2001
Nonaccrual loans:					
Commercial real estate and commercial	$ 757	$ 776	$1,677	$ 603	$ 488
Consumer	89	122	172	166	56
Real estate - construction	-	-	270	-	-
Mortgage	834	953	873	942	1,576
Total nonaccrual loans	$1,680	$1,851	$2,992	$1,711	$2,120
Loans past due 90 days or more and still accruing	-	-	-	-	-
Total non-performing loans	$1,680	$1,851	$2,992	$1,711	$2,120
Foreclosed real estate	743	798	202	1,396	632
Total non-performing assets	$2,423	$2,649	$3,194	$3,107	$2,752
Non-performing loans to total loans	0.89%	0.98%	1.59%	0.95%	1.30%
Non-performing assets to total assets	0.82%	0.88%	1.15%	1.11%	1.13%
Interest income received on nonaccrual loans	-	-	-	-	-
Interest income that would have been recorded under the original terms of the loans	$ 34	$ 64	$ 75	$ 141	$ 118

The asset quality of the Company's loan portfolio has improved during 2005. Residential and consumer delinquencies continue to decline by 14% during 2005 and 18% during 2004, resulting from the institution of a more stringent collection policy. Total nonperforming assets (nonperforming loans and foreclosed real estate) at December 31, 2005 were 0.81% of total assets as compared to 0.88% of total assets at December 31, 2004. Total nonperforming loans (past due 90 days or more) decreased $196,000, or 11%, during 2005 and decreased 38% during 2004. Total delinquent loans (those 30 days or more delinquent) as a percentage of total loans were 2.03% at December 31, 2005 compared to 1.93% at December 31, 2004. Approximately 43% of the Company's nonperforming loans at December 31, 2005 are secured by residential real estate with loss potential expected to be manageable within the allocated reserves.

The Company generally places a loan on nonaccrual status and ceases accruing interest when loan payment performance is deemed unsatisfactory and the loan is

past due 90 days or more. The Company considers a loan impaired when, based on current information and events, it is probable that the Company will be unable to collect the scheduled payments of principal and interest when due according to the contractual terms of the loan.

The measurement of impaired loans is generally based upon the present value of future cash flows discounted at the historical effective interest rate, except that all collateral-dependent loans are measured for impairment based on fair value of the collateral. The Company used the fair value of collateral to measure impairment on commercial and commercial real estate loans in 2005. At December 31, 2005, the Company had $2.5 million in loans which were deemed to be impaired having a valuation allowance of $90,000. Of the impaired loan balance, $2.3 million represents one commercial credit relationship that was restructured during 2004. A $63,000 impairment reserve is recorded on this relationship. The customer has been making payments according to the restructured terms and its financial position has improved significantly.

ALLOWANCE FOR LOAN LOSSES

The allowance for loan losses is a reserve established through charges to expense in the form of a provision for loan losses and reduced by loan charge-offs net of recoveries. Allowance for loan losses represents the amount available for probable credit losses in the Company's loan portfolio as estimated by management. The Company maintains an allowance for loan losses based upon a monthly evaluation of known and inherent risks in the loan portfolio, which includes a review of the balances and composition of the loan portfolio as well as analyzing the level of delinquencies in each segment of the loan portfolio. The Company uses a general allocation method for the residential real estate and the consumer loan pools based upon a methodology that uses loss factors applied to loan balances and reflects actual loss experience, delinquency trends and current economic conditions. The Company reviews individually, commercial real estate and commercial loans greater than $150,000, that are not accruing interest and risk rated under the Company's risk rating system, as special mention, substandard, doubtful or loss to determine if the loans are impaired. If loans are determined to be impaired, the Company establishes a specific reserve allocation. The specific allocation is determined based on the most recent valuation of the loan's collateral and the customer's ability to pay. For all other commercial real estate and commercial loans, the Company uses the general allocation method that establishes a reserve for each risk rating category. The general allocation method for commercial real estate and commercial loans considers the same factors that are considered when evaluating residential real estate and consumer loan pools. The allowance for loan losses reflects management's best estimate of probable loan losses at December 31, 2005.

The allowance for loans losses was $1.7 million at December 31, 2005, an 8% decrease from December 31, 2004. The allowance for loans losses as a percentage of total loans decreased to 0.89% at December 31, 2005 from 0.98% in the prior year. Net loan charge-offs were $459,000 during 2005 compared to $626,000 in 2004. The Company experienced a higher level of charge-offs during 2004 resulting from the charge-off of portions of three commercial lending relationships.

The following table sets forth the analysis of the allowance for loan losses at or for the periods indicated.

	2005		2004		2003		2002	
Dollars in thousands)	AMOUNT	% GROSS LOANS	AMOUNT	% GROSS LOANS	AMOUNT	% GROSS LOANS	AMOUNT	% GROSS LOANS
Commercial real estate and loans	$1,282	26.5%	$1,483	24.7%	$1,218	24.1%	$1,042	24.9%
Consumer loans	289	10.4%	270	9.8%	120	8.8%	136	8.2%
Residential real estate	108	63.1%	74	65.5%	377	67.1%	303	66.9%
Total	$1,679	100.0%	$1,827	100.0%	$1,715	100.0%	$1,481	100.0%

The following table sets forth the allocation of allowance for loan losses by loan category for the periods indicated. The allocation of the allowance by category is not necessarily indicative of future losses and does not restrict the use of the allowance to absorb losses in any category.

(Dollars in thousands)	2005	2004	2003	2002	2001
BALANCE AT BEGINNING OF YEAR	$1,827	$1,715	$1,481	$ 1,679	$1,274
Allowance acquired in branch purchase	-	-	-	57	-
Provisions charged to operating expenses	311	738	598	1,375	708
RECOVERIES OF LOANS PREVIOUSLY CHARGED-OFF:					
Commercial real estate and loans	25	41	3	26	53
Consumer	14	20	17	6	9
Residential real estate	10	-	17	-	-
Total recoveries	49	61	37	32	62
LOANS CHARGED OFF:					
Commercial real estate and loans	(284)	(439)	(128)	(1,285)	(72)
Consumer	(137)	(126)	(189)	(291)	(184)
Residential real estate	(87)	(122)	(84)	(86)	(109)
Total charged-off	(508)	(687)	(401)	(1,662)	(365)
Net charge-offs	(459)	(626)	(364)	(1,630)	(303)
Balance at end of year	$1,679	$1,827	$1,715	$ 1,481	$1,679
Net charge-offs to average loans outstanding	0.24%	0.33%	0.19%	0.92%	0.19%
Allowance for loan losses to year-end loans	0.89%	0.98%	0.91%	0.82%	1.03%

DEPOSITS

The Company's deposit base is drawn from seven full-service offices in its market area. The deposit base consists of demand deposits, money management accounts, savings and time deposits. During 2005, 61% of the Company's average deposit base of $239.9 million consisted of core deposits. Core deposits are considered to be more stable and provide the Company with a lower cost source of funds. The Company will continue to emphasize retail deposits by maintaining its network of full service offices and providing depositors with a full range of deposit product offerings. Pathfinder Commercial Bank will seek business growth by focusing on its local identification and service excellence. The

Commercial Bank had an average balance of $31.0 million in municipal deposits in 2005, primarily concentrated in money market demand accounts.

Average deposits increased $9.5 million, or 4%, when compared to 2004. The increase in average deposits primarily related to a $2.9 million increase in the average balance of municipal deposits combined with an increase in retail deposits. The new branch in Central Square added $3.1 million to the average balance of retail deposits since its opening June of 2005. In comparison, average deposits from 2003 to 2004 increased $22.3 million, or 11%. Deposit growth in 2004 resulted from the growth both in retail and in municipal deposits. The Commercial Bank increased the number of municipal customers to 20

in 2004 from 11 in 2003. The new municipal customers account balances represented $20.2 million of the $30.0 million in municipal deposits outstanding at December 31, 2004.

The Company's average deposit mix in 2005, as compared to 2004, reflected a slight shift from savings and club deposits to time deposits. The Company's average demand deposits, interest and noninterest bearing, represented 16% of total average deposits, which was comparable with 2004. The Company's money management accounts represented 17% of total deposits, down 1 percentage point for the same period in 2004. The Company promotes its money management account by offering competitive rates to retain existing and attract new customers.

The average amount of deposits, average rate paid and percentage of deposits are summarized below for the years indicated.

	FOR THE YEARS ENDED DECEMBER 31,								
	2005			2004			2003		
(Dollars in thousands)	AVG BALANCE	AVG RATE PAID	PERCENT OF DEPOSITS	AVG BALANCE	AVG RATE PAID	PERCENT OF DEPOSITS	AVG BALANCE	AVG RATE PAID	P D
Noninterest bearing demand accounts	$ 19,324	-	8.06%	$ 17,974	-	7.80%	$ 16,345	-	
NOW accounts	19,877	0.54%	8.29%	20,808	0.65%	9.03%	17,663	0.79%	
Money management accounts	41,380	2.02%	17.25%	40,775	1.39%	17.70%	21,788	1.14%	
Savings and club accounts	65,558	0.44%	27.33%	68,046	0.67%	29.54%	66,481	0.77%	
Time deposits	93,732	3.29%	39.07%	82,769	3.00%	35.93%	85,751	3.33%	
Total average deposits	$239,871	1.96%	100.00%	$230,372	1.71%	100.00%	$208,028	1.96%	1

At December 31, 2005, time deposits in excess of $100,000 totaled $24.0 million, or 26%, of time deposits and 10% of total deposits. At December 31, 2004, these deposits totaled $18.3 million, or 22% of time deposits and 8% of total deposits.

The following table indicates the amount of the Bank's certificates of deposit of $100,000 or more time remaining until maturity as of December 31, 2005:

In thousands)	CERTIFICATES OF DEPOSIT OF $100,000 OR MORE
REMAINING MATURITY:	
Three Months or less	$ 6,868
Three through Six months	2,765
Six through twelve months	3,886
Over twelve months	10,515
Total	$24,034

BORROWINGS

Short-term borrowings are comprised primarily of advances and overnight borrowing at the FHLBNY. There were $2.0 million in short-term borrowings outstanding at December 31, 2005 as compared to $1.0 million in 2004.

Information regarding short-term borrowings during 2005, 2004 and 2003 is as follows:

(Dollars in thousands)	2005	2004	2003
Maximum outstanding at any month end	$15,000	$3,100	$12,000
Average amount outstanding during the year	5,692	1,400	2,660
Average interest rate during the year	3.57%	1.31%	1.17%

Long-term borrowed funds consist of advances and repurchase agreements from the FHLBNY and junior subordinated debentures. Long-term borrowed funds totaled $34.5 million at December 31, 2005 as compared to $39.5 million at December 31, 2004.

CAPITAL

Shareholders' equity decreased $898,000 to $20.9 million at December 31, 2005. The Company added $462,000 to retained earnings through net income, which was more than offset by cash dividends returned to its shareholders of $686,000. Other comprehensive loss increased $978,000 to $1.3 million at December 31, 2005. Additional paid in capital increased $268,000 due to the exercise of stock options and the allocation of employee stock ownership plan shares.

The Company's mutual holding company parent, Pathfinder Bancorp, M.H.C., waived its right to receive the dividend for the quarters ended June 30, 2005 and December 31, 2005.

Risk-based capital provides the basis for which all banks are evaluated in terms of capital adequacy. Capital adequacy is evaluated primarily by the use of ratios which measure capital against total assets, as well as against total assets that are weighted based on defined risk characteristics. The Company's

goal is to maintain a strong capital position, consistent with the risk profile of its subsidiary banks that supports growth and expansion activities while at the same time exceeding regulatory standards. At December 31, 2005, Pathfinder Bank exceeded all regulatory required minimum capital ratios and met the regulatory definition of a "well-capitalized" institution, i.e. a leverage capital ratio exceeding 5%, a Tier 1 risk-based capital ratio exceeding 6% and a total risk-based capital ratio exceeding 10%. See Note 17 in the accompanying financial statements for the Company's and the Bank's ratios.

LIQUIDITY

Liquidity management involves the Company's ability to generate cash or otherwise obtain funds at reasonable rates to support asset growth, meet deposit withdrawals, maintain reserve requirements, and otherwise operate the Company on an ongoing basis. The Company's primary sources of funds are deposits, borrowed funds, amortization and prepayment of loans and maturities of investment securities and other short-term investments, and earnings and funds provided from operations. While scheduled principal repayments on loans are a relatively predictable source of funds, deposit flows and loan prepayments are greatly influenced by general interest rates, economic conditions and competition. The Company manages the pricing of deposits to maintain a desired deposit balance. In addition, the Company invests excess funds in short-term interest-earning and other assets, which provide liquidity to meet lending requirements.

The Company's liquidity has been enhanced by its membership in the FHLBNY, whose competitive advance programs and lines of credit provide the Company with a

safe, reliable and convenient source of funds. A significant decrease in deposits in the future could result in the Company having to seek other sources of funds for liquidity purposes. Such sources could include, but are not limited to, additional borrowings, trust preferred security offerings, brokered deposits, negotiated time deposits, the sale of "available-for-sale" investment securities, the sale of securitized loans, or the sale of whole loans. Such actions could result in higher interest expense costs and/or losses on the sale of securities or loans.

The Asset Liability Management Committee (ALCO) of the Company is responsible for implementing the policies and guidelines for the maintenance of prudent levels of liquidity. As of December 31, 2005, the Company is in compliance with its policy guidelines with regard to liquidity.

AGGREGATE CONTRACTUAL OBLIGATIONS

The following table represents the Company's on and off-balance sheet aggregate contractual obligations to make future payments as of December 31, 2005:

(In thousands)	1 YEAR OR LESS	OVER 1 TO 3 YEARS	OVER 3 TO 5 YEARS	OVER 5 YEARS	TOTAL
Time deposits	$ 51,724	$ 30,173	$ 7,690	$ 6,568	$ 96,155
Junior subordinated debentures	-	-	-	5,155	5,155
Borrowings	5,000	17,960	8,400	-	31,360
Operating leases	47	98	102	115	362
Payments under benefit plans	305	697	752	9,181	10,935

Total	$ 57,075	$ 48,928	$ 16,944	$21,020	$143,967

In addition, the Company, in the conduct of ordinary business operations, routinely enters into contracts for services. These contracts may require payment for services to be provided in the future and may also contain penalty clauses for the early termination of the contract. Management is not aware of any additional commitments or contingent liabilities, which may have a material adverse impact on the liquidity or capital resources of the Company.

OFF-BALANCE SHEET ARRANGEMENTS

The Company is also party to financial instruments with off-balance sheet risk in the normal course of business to meet the financing needs of its customers. These financial instruments include commitments to extend credit and standby letters of credit. At December 31, 2005, the Company had $19.5 million in outstanding commitments to extend credit and standby letters of credit. See Note 15 in the accompanying financial statements.

ITEM 7A: QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

The Company's risk of loss arising from adverse changes in the fair value of financial instruments, or market risk, is composed primarily of interest rate risk. The management of interest rate sensitivity seeks to avoid fluctuating net interest margins and to provide consistent net interest income through periods of changing interest rates. The Company has an Asset-Liability Management Committee (ALCO) which is responsible for establishing policies to limit exposure to interest rate risk, and to ensure procedures are established to monitor compliance with those policies. Those procedures include reviewing the Company's asset and liability policies, setting prices and terms on rate-sensitive products, and monitoring and measuring the impact of interest rate changes on the Company's earnings and capital. The Company's Board of Directors reviews the guidelines established by the ALCO.

Since December of 2004, the Federal Reserve has increased short-term target rates 8 times, 25 basis points each time to 4.50% from 2.50%. During this time frame longer-term interest rates have remained relatively unchanged resulting in a flattening and inversion of the yield curve. The short-term interest rate increases have caused continued net interest margin compression as short-term deposits and borrowings on the Company's liability sensitive balance sheet reprice into the current rate environment while security purchases and loan originations and refinances were being done at the stable longer-term rates. During the past 24-month period of rising short-term interest rates, the Company has continued to practice conservative balance sheet management strategies by attempting to extend the maturities of its rate sensitive liabilities and shorten the maturity or repricing term of its rate sensitive assets. This conservative balance sheet management strategy has resulted in additional margin pressure and reduction in net interest income during the prior two years. Management believes this balance sheet strategy best positions the Company and lessens its risk against future interest rate fluctuations.

The primary objective of the Company's asset/liability management process is to maximize earnings and return on capital within acceptable levels of risk. The Company does not believe it is possible to reliably predict future interest rate movements, and it seeks to maintain an appropriate process and set of measurement tools that enable it to identify and quantify sources of interest

rate risk ("IRR") in varying rate environments. The primary tools used by the Company in managing rate risk are income simulation and net portfolio value modeling techniques.

Interest rate risk can result from timing differences in the maturity/repricing of an institution's assets, liabilities and off balance sheet contracts; the effect of embedded options, such as loan prepayments, interest rate caps/floors, and deposit withdrawals; and the difference in the behavior of the various lending and funding rates, sometimes referred to as basis risk.

Given the potential types and differing related characteristics of IRR, it is important that the company maintain an appropriate process and set of measurement tools that enable it to identify and quantify its primary sources of IRR. The Company also recognizes that effective management of IRR includes an understanding of when potential adverse changes in interest rates will flow through its income statements. Accordingly, the Company not only looks at a 12 month horizon when managing its exposure to IRR, it also considers a longer-term strategic horizon.

It is the Company's objective to manage its exposure to interest rate risk, understanding that it is in the business of taking on rate risk and the elimination of such risk is not possible. It is also understood that as exposure to interest rate risk is reduced, it may also result in net interest margin being reduced.

Management believes the modeling and analysis of net interest income (Earnings at Risk) and net portfolio value (Value at Risk) in different interest rate environments provides the most meaningful measure of interest rate risk. Net interest income simulation analysis captures both the potential of all assets and liabilities to mature or reprice and the probability that they will do so. Net interest income simulation also attends to the relative interest rate sensitivities of these items, and projects their behavior over an extended period of time. Finally, net interest income simulation permits management to assess the probable effects on the balance sheet not only of changes in interest rates, but also of proposed strategies for responding to them. Net portfolio value represents the fair value of net assets (determined as the market value of

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assets minus the market value of liabilities using a discounted cash flow technique).

The following table measures the Company's interest rate risk exposure in terms of the percentage change in its net interest income and net portfolio value as a result of hypothetical changes in 100 basis point increments in market interest rates. The table quantifies the changes in net interest income and net portfolio value to parallel shifts in the yield curve. The column "Percentage Change in Net Interest Income" measures the change to the next twelve month's projected net interest income, due to parallel shifts in the yield curve. The column "Percentage Change in Net Portfolio Value" measures changes in the current fair value of assets and liabilities to parallel shifts in the yield curve. The column "NPV Capital Ratio" measures the ratio of the fair value of net assets to the fair value of total assets at the base case and in 100 basis point incremental interest rate shocks. The Company uses these percentage changes as a means to measure interest rate risk exposure and quantifies those changes against guidelines set by the Board of Directors as part of the Company's Interest Rate Risk policy. The Company's current interest rate risk exposure is within those guidelines set forth.

CHANGE IN INTEREST RATES	NPV CAPITAL RATIO	PERCENTAGE CHANGE IN NET INTEREST INCOME	PERCENTAGE CHANGE IN NET PORTFOLIO VALUE
300	8.77%	-12.75%	-27.56%
200	9.63%	-8.36%	-18.54%
100	10.48%	-4.10%	-9.21%
0	11.26%	---	----
-100	11.55%	1.18%	4.91%
-200	11.20%	-3.26%	3.60%
-300	10.60%	-8.72%	-0.30%

An interest rate sensitive asset or liability is one that, within a defined time period, either matures or experiences an interest rate change in line with general market interest rates. Historically, the most common method of estimating interest rate risk was to measure the maturity and repricing relationships between interest-earning assets and interest-bearing liabilities at a specific point in time ("GAP"), typically one year. Under this method, a company is considered liability sensitive when the amount of its interest-bearing liabilities exceeds the amount of its interest-earning assets within the one-year horizon. However, assets and liabilities with similar repricing characteristics may not reprice at the same time or to the same degree. As a result, the Company's GAP does not necessarily predict the impact of changes in general levels of interest rates on net interest income.

The following table shows the GAP position for the Company as of December 31, 2005.

(Dollars in thousands)	WITHIN 3 MONTHS	3 TO 12 MONTHS	1 TO 3 YEARS	3 TO 5 YEARS
INTEREST-EARNING ASSETS:				
Interest earning deposits	$ 586	$ -	$ -	$ -
Investment securities and FHLB stock	12,744	6,675	18,017	15,071
Loans receivable	33,355	35,348	46,886	29,098
Total interest-earning assets	$ 46,685	$ 42,023	$ 64,903	$ 44,169
INTEREST-BEARING LIABILITIES:				
Transaction deposit accounts (1)	$ 9,450	$ 28,347	$ 19,471	$ -
Savings deposits (1)	274	6,075	13,513	10,097
Certificates of deposit	19,333	32,130	30,265	7,858
Borrowings	2,000	3,000	17,960	8,400
Junior subordinated debentures	5,155	-	-	-
Total interest-bearing liabilities	$ 36,212	$ 69,552	$ 81,209	$ 26,355
Interest-earning assets less interest-bearing liabilities ("interest rate sensitivity gap")	$ 10,473	$(27,529)	$(16,306)	$ 17,814

Cumulative excess (deficiency) of interest-sensitive assets over interest-sensitive liabilities	$ 10,473	$(17,056)	$(33,362)	$(15,548
Interest sensitivity gap to total assets	3.53%	-9.27%	-5.49%	6.00
Cumulative interest sensitivity gap to total assets	3.53%	-5.74%	-11.23%	-5.24
Ratio of interest-earning assets to interest-bearing liabilities	128.92%	60.42%	79.92%	167.59
Cumulative ratio of interest-earning assets to interest-bearing liabilities	128.92%	83.87%	82.16%	92.71

(Dollars in thousands)	TOTAL
INTEREST-EARNING ASSETS:	
Interest earning deposits	$ 586
Investment securities and FHLB stock	76,044
Loans receivable	189,568
Total interest-earning assets	$266,198
INTEREST-BEARING LIABILITIES:	
Transaction deposit accounts (1)	$ 57,268
Savings deposits (1)	60,169
Certificates of deposit	96,155
Borrowings	31,360
Junior subordinated debentures	5,155
Total interest-bearing liabilities	$250,107
Interest-earning assets less interest-bearing liabilities ("interest rate sensitivity gap")	
Cumulative excess (deficiency) of interest-sensitive assets over interest-sensitive liabilities	
Interest sensitivity gap to total assets	
Cumulative interest sensitivity gap to total assets	
Ratio of interest-earning assets to interest-bearing liabilities	
Cumulative ratio of interest-earning assets to interest-bearing liabilities	

(1) The following assumptions have been used when analyzing non-maturity deposits for GAP Table purposes: 14% of savings deposits are assumed to reprice or mature within one year, 22% within 1 to 3 years, 16% within 3 to 5 years, and 24% within each of the remaining time periods. Transaction deposits - 66% of the NOW account balances are assumed to reprice or mature within one year, and the remaining 34% is assumed to reprice or mature within the 1 to 3 year time frame. 100% of the money management accounts are assumed to reprice within the first three months

ITEM 8: FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

INDEX TO CONSOLIDATED FINANCIAL STATEMENTS

PATHFINDER BANCORP, INC Page

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

[GRAPHIC OMITED]

To the Board of Directors and Shareholders
Pathfinder Bancorp, Inc.
Oswego, New York

We have audited the accompanying consolidated statements of condition of Pathfinder Bancorp, Inc. and subsidiaries as of December 31, 2005 and 2004, and the related consolidated statements of income, changes in shareholders' equity and cash flows for each of the three years in the period ended December 31, 2005. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

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

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Pathfinder Bancorp, Inc. and subsidiaries as of December 31, 2005 and 2004, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2005, in conformity with accounting principles

generally accepted in the United States of America.

/s/ BEARD MILLER COMPANY LLP

Beard Miller Company LLP
Harrisburg, Pennsylvania
February 3, 2006

CONSOLIDATED STATEMENTS OF CONDITION

(In thousands, except share data)	DECEMBER 2005	
ASSETS:		
Cash and due from banks	$ 7,309	$
Interest earning deposits	586	
Total cash and cash equivalents	7,895	
Investment securities, at fair value	74,239	
Federal Home Loan Bank stock, at cost	1,805	
Mortgage loans held-for-sale	0	
Loans	189,568	
Less: Allowance for loan losses	1,679	
Loans receivable, net	187,889	
Premises and equipment, net	8,020	
Accrued interest receivable	1,678	
Foreclosed real estate	743	
Goodwill	3,840	
Intangible asset, net	404	
Bank owned life insurance	5,987	
Other assets	4,448	
Total assets	$ 296,948	$
LIABILITIES AND SHAREHOLDERS' EQUITY:		
Deposits:		
Interest-bearing	$ 216,136	$
Noninterest-bearing	20,241	
Total deposits	236,377	
Short-term borrowings	2,000	
Long-term borrowings	29,360	
Junior subordinated debentures	5,155	
Other liabilities	3,128	
Total liabilities	276,020	
Shareholders' equity:		
Preferred stock, authorized shares 1,000,000; no shares issued or outstanding		
Common stock, par value $.01; authorized 10,000,000 shares;		

2,950,419 and 2,937,419 shares issued; and 2,463,132 and 2,450,132 shares outstanding, respectively.	29
Additional paid-in-capital	7,721
Retained earnings	20,965
Accumulated other comprehensive loss	(1,285)
Unearned ESOP shares	-
Treasury Stock, at cost; 487,287 shares	(6,502)
Total shareholders' equity	20,928
Total liabilities and shareholders' equity	$ 296,948 $

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

CONSOLIDATED STATEMENTS OF INCOME

	YEARS ENDED DECEMBER 31,		
(In thousands, except per share data)	2005	2004	2003
INTEREST AND DIVIDEND INCOME:			
Loans, including fees	$ 11,794	$11,815	$12,83
Debt securities:			
Taxable	2,481	2,075	2,03
Tax-exempt	505	362	22
Dividends	247	145	15
Other	71	81	3
Total interest income	15,098	14,478	15,28
INTEREST EXPENSE:			
Interest on deposits	4,319	3,639	3,75
Interest on short-term borrowings	204	17	3
Interest on long-term borrowings	1,833	1,917	2,16
Total interest expense	6,356	5,573	5,94
Net interest income	8,742	8,905	9,33
PROVISION FOR LOAN LOSSES	311	738	59
Net interest income after provision for loan losses	8,431	8,167	8,73
NONINTEREST INCOME:			
Service charges on deposit accounts	1,318	967	81
Increase in value of bank owned life insurance	218	175	17
Loan servicing fees	215	256	28
Net (losses) gains on sales and impairment of investment securities	(205)	772	54
Net (losses) gains on sales of loans and foreclosed real estate	(88)	279	32
Other charges, commissions & fees	582	598	46
Total other income	2,040	3,047	2,60

NONINTEREST EXPENSE:			
Salaries and employee benefits	5,123	4,798	4,45
Building occupancy	1,178	1,169	1,15
Data processing expenses	1,226	981	86
Professional and other services	818	682	77
Amortization of intangible asset	223	223	22
Other expenses	2,492	1,454	1,61
Total other expenses	10,060	9,307	9,09
Income before income taxes	411	1,907	2,25
(Benefit)/Provision for income taxes	(51)	502	60
Net income	462	$ 1,405	$ 1,65
Net income per share - basic	$ 0.19	$ 0.58	$ 0.6
Net income per share - diluted	$ 0.19	$ 0.57	$ 0.6
Dividends per share	$ 0.41	$ 0.405	$ 0.4

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

CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY

(In thousands, except per share data)	COMMON STOCK ISSUED SHARES	AMOUNT	ADDITIONAL PAID-IN CAPITAL	RETAINED EARNINGS	ACCUMULATED OTHER COMPREHENSI INCOME (LO
BALANCE, DECEMBER 31, 2002	2,914,669	$ 29	$ 7,114	$ 19,448	$
Comprehensive income:					
Net income					1,6
Other comprehensive income, net of tax					
Unrealized net gains on securities					
TOTAL COMPREHENSIVE INCOME:					
ESOP shares earned				76	
Stock option exercised	4,717	-	35		
Treasury stock purchased					
Dividends declared ($.40 per share)					(6
BALANCE, DECEMBER 31, 2003	2,919,386	$ 29	$ 7,225	$ 20,4	
Comprehensive income:					
Net income					1,4
Other comprehensive loss, net of tax					
Unrealized net losses on securities					
TOTAL COMPREHENSIVE INCOME:					

ESOP shares earned				88	
Stock option exercised		18,033	-	140	
Dividends declared ($.405 per share)					(6
BALANCE, DECEMBER 31, 2004		2,937,419	$ 29	$ 7,453	$ 21,1
Comprehensive loss:					
Net income					4
Other comprehensive income, net of tax					
Unrealized net gains on securities					
TOTAL COMPREHENSIVE LOSS:					
ESOP shares earned				55	
Stock option exercised		13,000	-	213	
Dividends declared ($.41 per share)					(6
BALANCE, DECEMBER 31, 2005		2,950,419	$ 29	$ 7,721	$ 20,9

(In thousands, except per share data)	TREASURY STOCK	TOTAL
BALANCE, DECEMBER 31, 2002	$(3,815)	$23,231
Comprehensive income:		
Net income		1,652
Other comprehensive income, net of tax		
Unrealized net gains on securities		83
TOTAL COMPREHENSIVE INCOME:		1,735
ESOP shares earned		122
Stock option exercised		35
Treasury stock purchased	(2,687)	(2,687)
Dividends declared ($.40 per share)		(651)
BALANCE, DECEMBER 31, 2003	$(6,502)	$21,785
Comprehensive income:		
Net income		1,405
Other comprehensive loss, net of tax		
Unrealized net losses on securities		(969)
TOTAL COMPREHENSIVE INCOME:		436
ESOP shares earned		133
Stock option exercised		140
Dividends declared ($.405 per share)		(668)
BALANCE, DECEMBER 31, 2004	$(6,502)	$21,826
Comprehensive loss:		
Net income		462
Other comprehensive income, net of tax		
Unrealized net gains on securities		(978)
TOTAL COMPREHENSIVE LOSS:		(516)

ESOP shares earned		88
Stock option exercised		213
Dividends declared ($.41 per share)		(683)
BALANCE, DECEMBER 31, 2005	$(6,502)	$20,928

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

CONSOLIDATED STATEMENTS OF CASH FLOWS

	Years Ende	
(In thousands)	2005	
OPERATING ACTIVITIES:		
Net Income	$ 462	$ 1
Adjustments to reconcile net income to net cash provided by (used in) operating activities:		
Provision for loan losses	311	
ESOP shares earned	88	
Deferred income tax expense	107	
Proceeds from sale of loans	8,795	12
Originations of loans held-for-sale	-	(10
Realized losses (gains) on sales of:		
Foreclosed real estate	23	
Loans	65	
Available-for-sale investment securities	205	
Depreciation	697	
Amortization of intangible asset	223	
Amortization of deferred financing costs	30	
Amortization of mortgage servicing rights	123	
Increase in value of bank owned life insurance	(218)	
Net amortization of premiums and discounts on investment securities	364	
(Increase) decrease in interest receivable	(173)	
Net change in other assets and liabilities	(480)	(1
Net cash provided by operating activities	10,622	2
INVESTING ACTIVITIES:		
Purchase of investment securities available-for-sale and Federal Home Loan Bank Stock	(23,361)	(35
Proceeds from maturities and principal reductions of investment securities available-for-sale	15,361	9
Proceeds from sale:		
Available-for-sale investment securities	6,593	7
Real estate acquired through foreclosure	770	
Purchase of bank owned life insurance	-	(1
Net (increase) decrease in loans	(10,514)	
Purchase of premises and equipment	(1,137)	(1
Net cash used in investing activities	(12,288)	(20
FINANCING ACTIVITIES:		

Net (decrease) increase in demand deposits, NOW accounts, savings accounts, money management deposit accounts and escrow deposits	(12,067)	28
Net increase (decrease) in time deposits	11,772	1
Net proceeds from (repayments on) short-term borrowings	1,000	(1
Payments on long-term borrowings	(10,000)	(4
Proceeds from long-term borrowings	5,000	
Proceeds from exercise of stock options	213	
Cash dividends	(682)	
Treasury stock purchased	-	
Net cash (used in) provided by financing activities	(4,764)	23
(Decrease) increase in cash and cash equivalents	(6,430)	5
Cash and cash equivalents at beginning of period	14,325	8
Cash and cash equivalents at end of period	$ 7,895	$ 14
CASH PAID DURING THE PERIOD FOR:		
Interest	$ 6,338	$ 5
Income taxes paid	95	
NON-CASH INVESTING ACTIVITY:		
Transfer of loans to foreclosed real estate	738	
Transfer of loans to loans held-for-sale	6,701	

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

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

NATURE OF OPERATIONS

The accompanying 2005 and 2004 consolidated financial statements include the accounts of Pathfinder Bancorp, Inc. (the "Company") and its wholly owned subsidiary, Pathfinder Bank (the "Bank"). The 2003 consolidated financial statements also include the Company's other subsidiary, Pathfinder Statutory Trust I (the "Trust"). The Trust was formed in 2002 for the purpose of issuing mandatorily redeemable convertible securities, which are considered Tier I capital under regulatory capital adequacy requirements. The Trust was deconsolidated upon adoption of Financial Accounting Standards Board Interpretation No. 46, "Consolidation of Variable Interest Entities," and Interpretation of ARB No 51 (FIN 46), which was revised in December 2003 (See Note 10). The Bank has three wholly owned operating subsidiaries, Pathfinder Commercial Bank, Whispering Oaks Development Inc. and Pathfinder REIT, Inc. All inter-company accounts and activity have been eliminated in consolidation. The Company has seven full service offices located in Oswego County. The Company is primarily engaged in the business of attracting deposits from the general public in the Company's market area, and investing such deposits, together with other sources of funds, in loans secured by one-to-four family residential real estate, commercial real estate, business assets and investment securities.

Pathfinder Bancorp, M.H.C., (the "Holding Company") a mutual holding company whose activity is not included in the accompanying financial statements, owns approximately 64.3% of the outstanding common stock of the Company. Salaries, employee benefits and rent approximating $135,000, $130,000 and $124,000, were allocated from the Company to Pathfinder Bancorp, M.H.C. during 2005, 2004 and

2003, respectively.

USE OF ESTIMATES IN THE PREPARATION OF FINANCIAL STATEMENTS

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. Management has identified the allowance for loan losses and the evaluation of securities for other than temporary impairment to be the accounting areas that require the most subjective and complex judgments, and as such, could be the most subject to revision as new information becomes available.

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 primarily in Oswego and parts of Onondaga counties of New York State. Note 3 discusses the types of securities that the Company invests in. Note 4 discusses the types of lending that the Company engages in. The Company does not have any significant concentrations to any one industry or customer.

ADVERTISING

The Company follows the policy of charging the costs of advertising to expense as incurred. Advertising costs included in other operating expenses were $249,000, $224,000 and $245,000 for the year ended December 31, 2005, 2004 and 2003, respectively.

CASH AND CASH EQUIVALENTS

Cash and cash equivalents include cash on hand, amounts due from banks and interest-bearing deposits (with original maturity of three months or less).

INVESTMENT SECURITIES

The Company classifies investment securities as available-for-sale. Available-for-sale securities are reported at fair value, with net unrealized gains and losses reflected as a separate component of shareholders' equity, net of the applicable income tax effect. None of the Company's investment securities have been classified as trading or held-to-maturity securities.

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 first call or maturity.

The Company monitors investment securities for impairment on a quarterly basis. Declines in the fair value of investment securities below cost that are deemed to be other-than-temporary are reflected in earnings as realized losses. In

estimating other-than-temporary impairment losses, management considers (1) the length of time and the extent to which the fair value has been less than cost, (2) the financial condition and near-term prospects of the issuer, and (3) the intent and ability of the Company to retain its investment in the issuer for a period of time sufficient to allow for any anticipated recovery in fair value.

FEDERAL HOME LOAN BANK STOCK

Federal law requires a member institution of the Federal Home Loan Bank ("FHLB") system to hold stock of its district FHLB according to a predetermined formula. The stock is carried at cost.

MORTGAGE LOANS HELD-FOR-SALE

Mortgage loans held-for-sale are carried at the lower of cost or fair value. Fair value is determined in the aggregate. As of December 31, 2005, there were no forward commitments outstanding. As of December 31, 2004, the Company had approximately $1,000,000 of mortgage loan forward commitments outstanding to hedge interest rate risk on certain committed and originated loans. The differences between the settlement value of the forward commitments and the fair value of these commitments were not significant at December 31, 2004.

TRANSFERS OF FINANCIAL ASSETS

Transfers of financial assets, including sales of loans and loan participations, 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.

LOANS

The Company grants mortgage, commercial and consumer loans to customers. Loans that management has the intent and ability to hold for the foreseeable future or until maturity or pay-off, generally are stated at unpaid principal balances, less the allowance for loan losses and net deferred loan origination fees and costs. The ability of the Company's debtors to honor their contracts is dependent upon the real estate and general economic conditions in the market area. Interest income is generally recognized when income is earned using the interest method. Nonrefundable loan fees received and related direct origination costs incurred are deferred and amortized over the life of the loan using the interest method, resulting in a constant effective yield over the loan term. Deferred fees are recognized into income and deferred costs are charged to income immediately upon prepayment of the related loan.

ALLOWANCE FOR LOAN LOSSES

The allowance for loan losses is established as losses are estimated to have occurred through a provision for loan losses charged to earnings. Loan losses are charged against the allowance when management believes the uncollectibility of a loan balance is confirmed. Subsequent recoveries, if any, are credited to the allowance. The Company periodically evaluates the adequacy of the allowance for loan losses in order to maintain the allowance at a level that is sufficient to absorb probable credit losses. Management's evaluation of the adequacy of the allowance is based on a review of the Company's historical loss experience,

known and inherent risks in the loan portfolio and an analysis of the levels and trends of delinquencies and charge-offs. 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 and general and unallocated components. The specific component relates to loans that are classified as impaired. For impaired loans, an allowance is established when the discounted cash flows (or collateral value or observable market price) 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, based on current information and events, if it is probable the Company will be unable to collect the scheduled payments of principal or interest when due according to the contractual terms of the loan agreement. The measurement of impaired loans is generally based upon the present value of future cash flows discounted at the historical effective rate, except that all collateral-dependent loans are measured for impairment based on fair values of collateral.

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 such loans are the subject of a restructuring agreement.

INCOME RECOGNITION ON IMPAIRED AND NON-ACCRUAL LOANS

Loans, including impaired loans, are generally classified as non-accrual if they are past due as to maturity or payment of principal or interest for a period of more than 90 days. When a loan is classified as non-accrual and the future collectibility of the recorded loan balance is doubtful, collections of interest and principal are generally applied as a reduction to principal outstanding.

When future collectibility of the recorded loan balance is expected, interest income may be recognized on a cash basis. In the case where a non-accrual loan had been partially charged off, recognition of interest on a cash basis is limited to that which would have been recognized on the recorded loan balance at the contractual interest rate. Cash interest receipts in excess of that amount are recorded as recoveries to the allowance for loan losses until prior charge-offs have been fully recovered.

OFF-BALANCE SHEET CREDIT RELATED FINANCIAL INSTRUMENTS

In the ordinary course of business, the Company has entered into commitments to extend credit, including commitments under standby letters of credit. Such financial instruments are recorded when they are funded.

PREMISES AND EQUIPMENT

Premises and equipment are stated at cost, less accumulated depreciation. Depreciation is computed on a straight-line basis over the estimated useful lives of the related assets, ranging up to 39 years for premises and 10 years for equipment. Maintenance and repairs are charged to operating expenses as

incurred. The asset cost and accumulated depreciation are removed from the accounts for assets sold or retired and any resulting gain or loss is included in the determination of income.

FORECLOSED REAL ESTATE

Properties acquired through foreclosure, or by deed in lieu of foreclosure, are carried at their fair value less estimated disposal costs. Write downs of, and expenses related to, foreclosed real estate holdings included in noninterest expense were $155,000, $85,000 and $124,000 in 2005, 2004 and 2003, respectively.

INTANGIBLE ASSETS

Intangible assets represent core deposit intangibles and goodwill arising from acquisitions. Core deposit intangibles represent the premium the Company has paid for deposits acquired in excess of the cost incurred had the funds been purchased in the capital markets. Core deposit intangibles are amortized on a straight-line basis over a period of five years. Goodwill represents the excess cost of an acquisition over the fair value of the net assets acquired. Goodwill is not amortized but is evaluated annually for impairment.

MORTGAGE SERVICING RIGHTS

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

STOCK-BASED COMPENSATION

The Company accounts for stock awards issued to directors, officers and key employees using the intrinsic value method in accordance with Accounting Principles Board Opinion No. 25. This method requires that compensation expense be recognized to the extent that the fair value of the stock exceeds the exercise price of the stock award at the grant date. The Company generally does not recognize compensation expense related to stock awards because the stock awards generally have fixed terms and exercise prices that are equal to or greater than the fair value of the Company's common stock at the grant date.

There is no pro forma expense reported for 2005 as stock options were fully vested during 2003. Pro forma amounts of net income and earnings per share under Statement of Financial Accounting Standards No. 123 are as follows:

(Dollars in thousands)	2003
NET INCOME:	
As reported	$ 1,652
Total stock-based compensation cost, net of tax, that would have been included in the determination of net income if the fair value based method had been applied to all awards	28
Pro forma	$ 1,624

EARNINGS PER SHARE:	BASIC	DILUTED
As reported	$ 0.68	$ 0.67
Pro forma	$ 0.67	$ 0.66

The fair value of these options was estimated at the date of grant in July 2001 using the Black-Scholes options pricing model with the following assumptions: risk free interest rate - 5.0%; dividend yield - 2.0%; market price volatility - 52.4%. An assumed weighted average option life of 6 years has been utilized. For purposes of pro forma disclosures, the estimated fair value of the options is amortized to expense over the options' vesting period. No options were granted during 2005, 2004 and 2003.

RETIREMENT BENEFITS

The Company has established tax qualified retirement plans covering substantially all full-time employees and certain part-time employees. Pension expense under these plans is charged to current operations and consists of several components of net pension cost based on various actuarial assumptions regarding future experience under the plans. In addition, the Company has unfunded deferred compensation and supplemental executive retirement plans for selected current and former employees and officers that provide benefits that cannot be paid from a qualified retirement plan due to Internal Revenue Code restrictions. These plans are nonqualified under the Internal Revenue Code, and assets used to fund benefit payments are not segregated from other assets of the Company, therefore, in general, a participant's or beneficiary's claim to benefits under these plans is as a general creditor.

TREASURY STOCK

Treasury stock purchases are recorded at cost. There were no treasury stock purchases in 2005 and 2004. In 2003, the Company purchased 183,114 shares of treasury stock at an average cost of $14.67 per share, respectively. 160,114 of the shares purchased by the Company in 2003 related to a privately negotiated stock repurchase from Jewelcor Management Inc. The shares were purchased at $14.60 per share and represented approximately 6.1% of the Company's outstanding common stock as of December 31, 2002. The privately negotiated transaction was not part of the share repurchase program in effect for that period. The Company believes repurchase programs to be in the best interest of its shareholders as a method to enhance long-term shareholder value.

INCOME TAXES

Provisions for income taxes are based on taxes currently payable or refundable and deferred income taxes on temporary differences between the tax basis of assets and liabilities and their reported amounts in the financial statements. Deferred tax assets and liabilities are reported in the financial statements at currently enacted income tax rates applicable to the period in which the deferred tax assets and liabilities are expected to be realized or settled.

EARNINGS PER SHARE

Basic earnings per share are computed by dividing net income by the weighted average number of common shares outstanding throughout each year. Diluted earnings per share gives effect to weighted average shares that would be outstanding assuming the exercise of issued stock options using the treasury

stock method.

COMPREHENSIVE INCOME (LOSS)

Accounting principles generally require that recognized revenue, expenses, gains and losses be included in net income. 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 equity section of the statement of condition, such items, along with net income, are components of comprehensive income.

The components of other comprehensive income (loss) and related tax effects for the years ended:

	FOR THE YEARS ENDED DECEMBER 31,		
(In thousands)	2005	2004	2003
Gross change in unrealized gains on securities available for sale	$ (1,835)	$ (843)	$ 681
Reclassification adjustment for (gains) losses included in net income	205	(772)	(542)
	(1,630)	(1,615)	139
Tax effect	652	646	(56)
Net of tax amount	$ (978)	$ (969)	$ 83

RECLASSIFICATIONS

Certain amounts in the 2004 and 2003 consolidated financial statements have been reclassified to conform to the current year presentation. These reclassifications had no effect on net income as previously reported.

NOTE 2: NEW ACCOUNTING PRONOUNCEMENTS

In December 2004, the Financial Accounting Standards Board (FASB) issued Statement No. 123(R), "Share-Based Payment." Statement No. 123(R) revised Statement No. 123, "Accounting for Stock-Based Compensation," and supersedes APB Opinion No. 25, "Accounting for Stock Issued to Employees," and its related implementation guidance. Statement No. 123(R) will require compensation costs related to share-based payment transactions to be recognized in the financial statements (with limited exceptions). The amount of compensation cost will be measured based on the grant-date fair value of the equity or liability instruments issued. Compensation cost will be recognized over the period that an employee provides service in exchange for the award.

On April 14, 2005, the Securities and Exchange Commission ("SEC") adopted a rule that amends the compliance dates for Financial Accounting Standards Board's Statement of Financial Accounting Standards No. 123 (revised 2004), "Share-Based Payment" ("SFAS No. 123R"). Under the rule, the Company is required to adopt SFAS No. 123R in the first annual period beginning after June 15, 2005. Since

the Company's options are fully granted and vested, the Company does not anticipate the adoption will have any impact on the consolidated financial statements.

In March 2005, the SEC issued Staff Accounting Bulletin No. 107 ("SAB No. 107"), "Share-Based Payment", providing guidance on option valuation methods, the accounting for income tax effects of share-based payment arrangements upon adoption of SFAS No. 123(R), and the disclosures in MD&A subsequent to the adoption. The Company will provide SAB No. 107 required disclosures upon adoption of SFAS No. 123(R).

In January 2003, the FASB's Emerging Issues Task Force (EITF) issued EITF Issue No. 03-1, "The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investors" ("EITF 03-1"), and in March 2004, the EITF issued an update. EITF 03-1 addresses the meaning of other-than-temporary impairment and its application to certain debt and equity securities. EITF 03-1 aids in the determination of impairment of an investment and gives guidance as to the measurement of impairment loss and the recognition and disclosures of other-than-temporary investments. EITF 03-1 also provides a model to determine other-than-temporary impairment using evidence-based judgment about the recovery of the fair value up to the cost of the investment by considering the severity and duration of the impairment in relation to the forecasted recovery of the fair value. In July 2005, FASB adopted the recommendation of its staff to nullify key parts of EITF 03-1. The staff's recommendations were to nullify the guidance on the determination of whether an investment is impaired as set forth in paragraphs 10-18 of Issue 03-1 and not to provide additional guidance on the meaning of other-than-temporary impairment. Instead, the staff recommends entities recognize other-than-temporary impairments by applying existing accounting literature such as paragraph 16 of SFAS 115.

In July 2005, the FASB issued a proposed interpretation of FAS 109, "Accounting for Income Taxes", to clarify certain aspects of accounting for uncertain tax positions, including issues related to the recognition and measurement of those tax positions. If adopted as proposed, any adjustments required to be recorded as a result of adopting the interpretation would be reflected as a cumulative effect from a change in accounting principle. We are currently in the process of determining the impact of adoption of the interpretation as proposed on our financial position and results of operations.

NOTE 3: INVESTMENT SECURITIES - AVAILABLE-FOR-SALE

The amortized cost and estimated fair value of investment securities are summarized as follows:

	DECEMBER 31, 2005			
(In thousands)	AMORTIZED COST	GROSS UNREALIZED GAINS	GROSS UNREALIZED LOSSES	ESTIMATED FAIR VALUE
Bond investment securities:				
US Treasury and agencies	$ 20,713	$ -	$ (746)	$ 19,967
State and political subdivisions	11,177	2	(199)	10,980
Corporate	5,936	24	(106)	5,854
Mortgage-backed	31,565	67	(914)	30,718

Total	69,391	93	(1,965)	67,519
Equity investments	6,998	14	(292)	6,720
Total investment securities	$ 76,389	$ 107	$(2,257)	$ 74,239

	DECEMBER 31, 2004			
(In thousands)	AMORTIZED COST	GROSS UNREALIZED GAINS	GROSS UNREALIZED LOSSES	ESTIMATED FAIR VALUE
Bond investment securities:				
US Treasury and agencies	$ 21,609	$ 4	$ (401)	$ 21,212
State and political subdivisions	8,881	162	(31)	9,012
Corporate	5,919	92	(52)	5,959
Mortgage-backed	32,213	92	(278)	32,027
Total	68,622	350	(762)	68,210
Equity investments	6,967	5	(113)	6,859
Total investment securities	$ 75,589	$ 355	$ (875)	$ 75,069

Gross gains of $190,000, $828,000 and $581,000 for 2005, 2004 and 2003, respectively and gross losses of $395,000, $56,000 and $38,000 for 2005, 2004 and 2003, respectively were realized on sales and calls of securities. The tax benefit related to net losses on investment securities was $80,000 for 2005. Tax expense related to net gains on investment securities was $301,000 and $211,000 for 2004 and 2003, respectively. The $395,000 loss in 2005 represented impairment losses recognized on equity investments and the loss recognized from the sale of commercial bank portfolio securities.

Investment securities with a carrying value of approximately $38,899,000 at December 31, 2005 were pledged to collateralize certain deposit and borrowing arrangements.

The amortized cost and estimated fair value of debt investments at December 31, 2005 by contractual maturity are shown below. Expected maturities may differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without penalties.

(In thousands)	AMORTIZED COST	ESTIMATED FAIR VALUE
Due in one year or less	$ 3,039	$ 3,008
Due after one year through five years	16,179	15,699
Due after five years through ten years	11,856	11,432
Due after ten years	6,752	6,662
Mortgage-backed securities	31,565	30,718
Totals	$ 69,391	$ 67,519

The Company's investment securities' gross unrealized losses and fair value, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position is as follows:

	DECEMBER 31, 2005				
	LESS THAN TWELVE MONTHS		TWELVE MONTHS OR MORE		T
(In thousands)	UNREALIZED LOSSES	FAIR VALUE	UNREALIZED LOSSES	FAIR VALUE	UNREALI LOSS
US Treasury and agency securities	$ (106)	$ 4,130	$ (639)	$15,837	$ (74
State and political subdivision securities	(152)	8,872	(47)	1,491	(19
Corporate securities	(35)	1,965	(71)	1,896	(10
Mortgage-backed securities	(322)	13,814	(593)	15,073	(91
Equity investment securities	-	-	(292)	6,135	(29
	$ (615)	$28,781	$ (1,642)	$40,432	$(2,25

	DECEMBER 31, 2004				
	LESS THAN TWELVE MONTHS		TWELVE MONTHS OR MORE		T
(In thousands)	UNREALIZED LOSSES	FAIR VALUE	UNREALIZED LOSSES	FAIR VALUE	UNREALI LOSS
US Treasury and agency securities	$ (370)	$18,903	$ (31)	$ 981	$ (40
State and political subdivision securities	(31)	2,411	-	56	(3
Corporate securities	(11)	976	(41)	936	(5
Mortgage-backed securities	(215)	19,949	(63)	3,301	(27
Equity investment securities	(10)	240	(103)	3,547	(11
	$ (637)	$42,479	$ (238)	$ 8,821	$ (87

The Company reviews its securities for impairment at least quarterly, and as a result of this review, impairment charges of $196,000 were recorded during December 31, 2005. No impairment losses were recognized in 2004 and 2003.

At December 31, 2005 59 mortgage-backed and 33 US treasury and agency securities have unrealized losses. These unrealized losses relate principally to changes in interest rates subsequent to the acquisition of specific securities. None of the securities in this category had an unrealized loss that exceeded 6% of book value and a majority had unrealized losses totaling less than 3% of book value. The Company has the intent and ability to hold the individual securities to maturity or market price recovery.

At December 31, 2005, 32 state and political subdivision securities and 4 corporate securities have unrealized losses. In analyzing the issuer's financial condition, management considers the industry analyst's reports, financial performance and projected target prices of investment analysts within a one-year time frame. None of the securities in this category had an unrealized loss that exceeded 5% of book value and a majority had unrealized losses totaling less than 2% of book value. The Company has the intent and ability to hold the individual securities to maturity or market price recovery.

At December 31, 2005, 3 equity securities had unrealized losses. One of these securities is a mutual fund backed by adjustable rate mortgage-backed securities and has an unrealized loss of 3% of book value. The unrealized loss relates principally to changes in interest rates subsequent to the acquisition of the mutual fund. A second equity security is a mutual fund consisting primarily of investment grade dividend-paying common stocks of large capitalization companies, i.e., companies with market capitalization in excess of $5 billion. A review of the underlying securities indicates no individually impaired holdings and there is no indication that the profitability of these corporations is impaired beyond the economic cycle. As such, the decline in market value is not considered to be other-than-temporarily impaired. The third equity security has unrealized losses totaling $10,000, which is deemed to be immaterial to the consolidated financial statements.

NOTE 4: LOANS

Major classifications of loans at December 31, are as follows:

(In thousands)	2005	2004
REAL ESTATE MORTGAGES:		
Conventional	$116,423	$117,608
Construction	2,607	3,497
Commercial	31,845	29,874
	150,875	150,979
OTHER LOANS:		
Consumer	3,363	3,484
Home Equity/2nd Mortgage	16,319	15,021
Lease financing	334	715
Commercial	14,741	12,605
Municipal loans	3,259	3,514
	38,016	35,339
Total loans	188,891	186,318
Net deferred loan costs	677	634
Less allowance for loan losses	(1,679)	(1,827)
Loans receivable, net	$187,889	$185,125

The Company grants mortgage and consumer loans to customers throughout Oswego and parts of Onondaga counties. Although the Company has a diversified loan portfolio, a substantial portion of its debtor's ability to honor their contracts is dependent upon the counties' employment and economic conditions.

The following represents the approximate activity associated with loans to officers and directors during the fiscal year ending December 31, 2005:

(In thousands)	
Balance at beginning of year	$ 4,910
Originations	3,065
Principal payments	(2,394)
Balance at end of year	$ 5,581

NOTE 5: ALLOWANCE FOR LOAN LOSSES

Changes in the allowance for loan losses for the year ended December 31, are summarized as follows:

(In thousands)	2005	2004	2003
Balance at beginning of year	$1,827	$1,715	$1,481
Recoveries credited	49	61	37
Provision for loan losses	311	738	598
Loans charged-off	(508)	(687)	(401)
Balance at end of year	$1,679	$1,827	$1,715

The following is a summary of information pertaining to impaired loans for the years ending December 31,:

(In thousands)	2005	2004	2003
Impaired loans without a valuation allowance	$ -	$ -	$ -
Impaired loans with a valuation allowance	2,452	3,110	3,804
Total impaired loans	$2,452	$3,110	$3,804
Valuation allowance related to impaired loans	$ 90	$ 760	$ 527
Average investment in impaired loans	$2,856	$3,611	$3,446
Interest income recognized on impaired loans	$ 175	$ 153	$ 139
Interest income recognized on a cash basis on impaired loans	$ -	$ -	$ 93

As of December 31, 2005, no additional funds are committed to be advanced in connection with impaired loans.

The amount of loans on which the Company has ceased accruing interest aggregated approximately $1,655,000 and $1,851,000 at December 31, 2005 and 2004, respectively. There were no loans past due ninety days or more and still accruing interest at December 31, 2005 or 2004.

NOTE 6: SERVICING

Loans serviced for others are not included in the accompanying consolidated statements of condition. The unpaid principal balances of mortgage and other loans serviced for others were $56,300,000, 53,000,000 and $47,600,000 at December 31, 2005, 2004 and 2003, respectively.

The balance of capitalized servicing rights included in other assets at December 31, 2005 and 2004, was $146,000 and $198,000, respectively.

The following summarizes mortgage-servicing rights capitalized and amortized:

(In thousands)	2005	2004	2003
Mortgage servicing rights capitalized	$ 70	$ 99	$ 179
Mortgage servicing rights amortized	$ 123	$ 158	$ 122

NOTE 7: PREMISES AND EQUIPMENT

A summary of premises and equipment at December 31, is as follows:

(In thousands)	2005	2004
Land	$ 1,150	$ 1,150
Buildings	6,590	5,587
Furniture, fixture and equipment	6,120	5,597
Construction in progress	119	508
	$13,979	$12,842
Less: Accumulated depreciation	5,959	5,262
	$ 8,020	$ 7,580

NOTE 8: GOODWILL AND INTANGIBLE ASSETS

A summary of intangible assets is as follows:

	2005		2004	
(In thousands)	GROSS CARRYING AMOUNT	ACCUMULATED AMORTIZATION	GROSS CARRYING AMOUNT	ACCUMULATED AMORTIZATION
Core deposit intangible	$ 1,111	$ (707)	$ 1,111	$ (484)

Amortization expense related to core deposit intangibles is estimated to total $223,000 and $181,000 for the years ending December 31, 2006 and 2007, respectively. Amortization of goodwill and the core deposit intangible is deductible for tax purposes.

NOTE 9: DEPOSITS

A summary of deposits at December 31, is as follows:

(In thousands)	2005	2004
Savings accounts	$ 60,176	$ 66,265
Time accounts	72,121	66,133
Time accounts over $100,000	24,034	18,250
Money management accounts	39,009	44,189
Demand deposit interest-bearing	18,259	20,339
Demand deposit noninterest-bearing	20,241	19,159
Mortgage escrow funds	2,537	2,337
	$236,377	$236,672

At December 31, 2005, the scheduled maturities of time deposits are as follows:

(In thousands)	
YEAR OF MATURITY:	
2006	$51,724
2007	21,221
2008	8,952
2009	5,780
2010	1,910
Thereafter	6,568
	$96,155

NOTE 10: BORROWED FUNDS

The composition of borrowings at December 31 is as follows:

(In thousands)	2005	2004
SHORT-TERM FHLB ADVANCES:		
FHLB Advances	$ 2,000	$ 1,000
Total short-term borrowings	$ 2,000	$ 1,000
LONG-TERM:		
FHLB Repurchase agreements	$ 3,400	$ 3,400
FHLB advances	25,960	30,960
Total long-term borrowings	$29,360	$34,360

The principal balance, interest rate and maturity of the above borrowings at December 31, 2005 is as follows:

TERM	PRINCIPAL	RATES
(Dollars in thousands)		
Short-term advances with FHLB	$ 2,000	3.97%-4.13%
Long-term:		
Repurchase agreements (due in 2006 and 2009)	3,400	5.56% -5.85%
Advances with FHLB		
due within 1 year	2,000	4.72%-5.32%
due within 2 years	11,350	3.00%-5.04%
due within 3 years	6,610	2.67%-5.98%
due within 4 years	1,000	6.00%
due within 5 years	5,000	4.39%
Total advances with FHLB	$ 25,960	
Total long-term borrowings	$ 29,360	

The repurchase agreements with the Federal Home Loan Bank ("FHLB") are collateralized by certain investment securities having a carrying value of $3,689,000 at December 31, 2005. The collateral is under the Company's control. The line of credit agreement with the FHLB is used for liquidity purposes. Interest on this line is determined at the time of borrowing. The average rate paid on the overnight line during 2005 approximated 3.57%. At December 31, 2005, $28,725,000 was available under the line of credit. In addition to the overnight line of credit program, the Company also has access to the FHLB's Term Advance Program under which it can borrow at various terms and interest rates. Residential mortgage loans with a carrying value of $84,899,000 and FHLB stock with a carrying value of $1,805,000 have been pledged by the Company under a blanket collateral agreement to secure the Company's line of credit and term

borrowings. The Company also maintains a $5,000,000 line of credit with a correspondent bank. Interest on the line is determined at the time of borrowing. The Company did not draw on the line during 2005. Investment securities with a carrying value of $6,384,000 at December 31, 2005 collateralize the line of credit.

The Company has a non-consolidated subsidiary trust, Pathfinder Statutory Trust I, of which 100% of the common equity is owned by the Company. The Trust issued $5,000,000 of 30 year floating rate Company-obligated pooled capital securities of Pathfinder Statutory Trust I. The Company borrowed the proceeds of the capital securities from its subsidiary by issuing floating rate junior subordinated deferrable interest debentures having substantially similar terms. The capital securities mature in 2032 and are treated as Tier 1 capital by the Federal Deposit Insurance Company and the Office of Thrift Supervision. The capital securities of the trust are a pooled trust preferred fund of Preferred Term Securities VI, Ltd. and are tied to the 3-month LIBOR plus 3.45% (7.97% at December 31, 2005 and 6.00% at December 31, 2004) with a five-year call provision. The Company guarantees all of these securities. The Company capitalized $151,000 of deferred financing costs associated with the debt issuance, which are being amortized on a straight-line basis over the 5-year period to call date.

The Company's equity interest in the trust subsidiary of $155,000 is reported in "Other assets". For regulatory reporting purposes, the Federal Reserve Board has indicated that the preferred securities will continue to qualify as Tier 1 Capital subject to previously specified limitations, until further notice. If regulators make a determination that Trust Preferred Securities can no longer be considered in regulatory capital, the securities become callable and the Company may redeem them.

NOTE 11: EMPLOYEE BENEFITS AND DEFERRED COMPENSATION AND SUPPLEMENTAL RETIREMENT PLANS

The Company has a noncontributory defined benefit pension plan covering substantially all employees. The plan provides defined benefits based on years of service and final average salary. In addition, the Company provides certain health and life insurance benefits for eligible retired employees. The healthcare plan is contributory with participants' contributions adjusted annually; the life insurance plan is noncontributory. Employees with less than 14 years of service as of January 1, 1995, are not eligible for the health and life insurance retirement benefits.

The Company uses an October 1 measurement date for the defined benefit plan and postretirement benefit plan.

The following tables set forth the changes in the plan's benefit obligation, fair value of plan assets and prepaid (accrued) benefit (cost) as of December 31:

	PENSION BENEFITS		POSTRETIREMENT BENEFITS	
(In thousands)	2005	2004	2005	2004
CHANGE IN BENEFIT OBLIGATIONS:				

Benefit obligation at beginning of year	$ 3,745	$ 3,382	$ 309	$ 367
Service cost	151	155	2	2
Interest cost	229	207	18	19
Actuarial gain (loss)	378	153	46	(58)
Plan participants' contributions	-	-	6	12
Benefit paid	(142)	(152)	(27)	(33)
Benefit obligation at end of year	$ 4,361	$ 3,745	$ 354	$ 309
CHANGE IN PLAN ASSETS:				
Fair value of plan assets at beginning of year	$ 3,154	$ 2,792	$ -	$ -
Actual return on plan assets	388	236	-	-
Plan participants' contributions	-	-	6	12
Benefits paid	(142)	(152)	(27)	(33)
Employer contributions	670	278	21	21
Fair value of plan assets at end of year	$ 4,070	$ 3,154	$ -	$ -
COMPONENTS OF PREPAID/ACCRUED BENEFIT COST:				
Unfunded status	$ (291)	$ (591)	$(354)	$(309)
Unrecognized transition obligation	-	-	115	134
Unrecognized actuarial net loss/(gain)	1,656	1,478	34	(13)
Prepaid/(accrued) benefit/(cost)	$ 1,365	$ 887	$(205)	$(188)

The accumulated benefit obligation for the defined benefit plan was $3,602,000 and $3,042,000 at December 31, 2005 and 2004, respectively.

The significant assumptions used in determining the benefit obligation as of December 31, 2005, 2004 and 2003 are as follows:

	PENSION BENEFITS			POSTRETIREMENT BENEFITS		
	2005	2004	2003	2005	2004	2003
Weighted average discount rate	5.88%	6.25%	6.50%	5.88%	6.25%	6.00%
Expected long term rate of return on plan assets	9.00%	9.00%	9.00%	-	-	-
Rate of increase in future compensation levels	3.00%	3.50%	4.00%	-	-	-

Assumed health care cost trend rates have a significant effect on the amounts reported for the postretirement health care plans. The annual rates of increase in the per capita cost of covered medical and prescription drug benefits for year-end calculations were assumed to be 9.5% and 10.0%, respectively. The rates were assumed to decrease gradually to 3.75% in 2011 and remain at that level thereafter. A one-percentage point change in the health care cost trend rates would have the following effects:

(In thousands)	1 PERCENTAGE POINT INCREASE	1 PERCENTAGE POINT DECREASE

Effect on total of service and interest cost components	$ 21	$ (20)
Effect on post retirement benefit obligation	15	(11)

The composition of the net periodic benefit plan cost for the years ended December 31, 2005, 2004 and 2003 is as follows:

	PENSION BENEFITS			POSTRETIREMENT BENEFITS		
(In thousands)	2005	2004	2003	2005	2004	2003
Service cost	$ 151	$ 155	$ 154	$ 2	$ 2	$ 2
Interest cost	229	207	200	18	19	21
Amortization of transition obligation	-	-	-	19	18	18
Amortization of gains and losses	96	94	106	-	-	1
Expected return on plan assets	(285)	(254)	(227)	-	-	-
Net periodic benefit plan cost	$ 191	$ 202	$ 233	$ 39	$ 39	$ 42

The significant assumptions used in determining the net periodic benefit plan cost for years ended December 31:

	PENSION BENEFITS			POSTRETIREMENT BENEFITS		
	2005	2004	2003	2005	2004	2003
Weighted average discount rate	5.88%	6.25%	6.50%	5.88%	6.25%	6.00%
Expected long term rate of return on plan assets	9.00%	9.00%	9.00%	-	-	-
Rate of increase in future compensation levels	3.00%	3.50%	4.00%	-	-	-

The long-term rate-of-return-on-assets assumption was set based on historical returns earned by equities and fixed income securities, adjusted to reflect expectations of future returns as applied to the plan's target allocation of asset classes. Equities and fixed income securities were assumed to earn real rates of return in the ranges of 5-9.0% and 2-6.0%, respectively. The long-term inflation rate was estimated to be 3.0%. When these overall return expectations are applied to the plan's target allocation, the expected rate of return is determined to be 9.0%, which is roughly the midpoint of the range of expected return.

The Company's pension plan weighted-average asset allocations at October 1, the measurement date, by asset category

ASSET CATEGORY	2005	2004

Equity securities	72%	69%
Debt securities	28%	31%
Total	100%	100%

Plan assets are invested in six diversified investment funds of the RSI Retirement Trust (the "Trust"), a no load series open-ended mutual fund. The investment funds include four equity mutual funds and two bond mutual funds, each with its own investment objectives, investment strategies and risks, as detailed in the Trust's prospectus. The Trust has been given discretion by the Plan Sponsor to determine the appropriate strategic asset allocation versus plan liabilities, as governed by the Trust's Statement of Investment Objectives and Guidelines (the "Guidelines").

The long-term investment objective is to be invested 65% in equity securities (equity mutual funds) and 35% in debt securities (bond mutual funds). If the plan is underfunded under the Guidelines, the bond fund portion will be temporarily increased to 50% in order to lessen asset value volatility. When the plan is no longer underfunded, the bond fund portion will be decreased back to 35%. Asset rebalancing is performed at least annually, with interim adjustments made when the investment mix varies more than 5% from the target (i.e., a 10% target range).

The investment goal is to achieve investment results that will contribute to the proper funding of the pension plan by exceeding the rate of inflation over the long-term. In addition, investment managers for the Trust are expected to

provide above average performance when compared to their peer managers. Performance volatility is also monitored. Risk/volatility is further managed by the distinct investment objectives of each of the Trust funds and the diversification within each fund.

For the fiscal year ending December 31, 2006, the Bank expects to contribute approximately $192,000 to the Plan.

The following benefit payments, which reflect expected future service, as appropriate, are expected to be paid.

YEARS ENDING DECEMBER 31:	
(In thousands)	
2006	$148
2007	148
2008	145
2009	148
2010	152
Years 2011 - 2015	981

The Company also offers a 401(k) plan to its employees. Contributions to this plan by the Company were $145,000, $92,000 and $84,000 for 2005, 2004 and 2003, respectively.

The Company maintains optional deferred compensation plans for its directors whereby fees normally received are deferred and paid by the Company based upon a payment schedule commencing at age 65 and continue monthly for 10 years. Directors must serve on the board for a minimum of 5 years to be eligible for the Plan. At December 31, 2005 and 2004, other liabilities include approximately $1,412,0000 and $1,276,000, respectively, relating to deferred compensation. Deferred compensation expense for the years ended December 31, 2005, 2004 and 2003 amounted to approximately $211,000, $185,000 and $116,000, respectively.

The Company has a supplemental executive retirement plan for the benefit of certain executive officers. At December 31, 2005 and 2004, other liabilities include approximately $424,000 and $449,000 accrued under these plans. Compensation expense includes approximately $56,000, $53,000 and $68,000 relating to the supplemental executive retirement plan for 2005, 2004 and 2003, respectively.

To fund the benefits under these plans, the Company is the owner of single premium life insurance policies on participants in the non-qualified retirement plans. At December 31, 2005 and 2004, the cash value of these policies was $5,987,000 and $5,768,000, respectively.

NOTE 12: STOCK BASED COMPENSATION PLANS

In February 1997, the Board of Directors approved an option plan and granted options there under with an exercise price equal to the market value of the Company's shares at the date of grant. Under the Stock Option Plan, up to 132,249 options have been authorized for grant of incentive stock options and nonqualified stock options.

In July 2001, the Board approved the issuance of 38,499 stock options remaining in the 1997 Stock Option Plan. The exercise price is equal to the market value of the Company's shares at the date of grant ($8.34). The options granted under the issuance have a 10-year term with one-third vesting upon grant date and the remaining vesting and becoming exercisable ratably over a 2-year period.

Activity in the Stock Option Plan is as follows:

(Shares in thousands)	OPTIONS OUTSTANDING	WEIGHTED AVERAGE EXERCISE PRICE	SHARES EXERCISABLE
Outstanding at December 31, 2002	93	$ 7.27	80
Exercised	(5)	7.49	
Outstanding at December 31, 2003	88	$ 7.25	88
Exercised	(18)	7.75	
Outstanding at December 31, 2004	70	$ 7.12	70
Exercised	(13)	6.58	

Expired	(11)	6.58	
Outstanding at December 31, 2005	46	$ 7.41	46

The Bank sponsors an Employee Stock Ownership Plan (ESOP) for employees who have attained the age of 21 and who have completed a 12 month period of employment with the Bank during which they worked at least 1,000 hours. The Bank purchased 92,574 shares of common stock on behalf of the ESOP. The purchase of the shares was funded by a loan from the Company and the unearned shares are pledged as collateral for the borrowing. As the loan was repaid, earned shares were released from collateral and allocated to the participants. As shares were earned, the Bank records compensation expense at the average market price of the shares during the period. Cash dividends received on unearned shares were allocated among the participants and were reported as compensation expense. ESOP compensation expense, including cash dividends received on unearned shares, approximated $88,000, $136,000 and $129,000 for the years ended December 31, 2005, 2004 and 2003, respectively. Total earned shares at December 31, 2005, 2004 and 2003 were 92,574, 86,998 and 79,367, respectively. Unearned ESOP shares are not considered outstanding for purposes of computing earnings per share. All shares were earned at December 31, 2005.

NOTE 13: INCOME TAXES

The provision for income taxes for the years ended December 31, is as follows:

(In thousands)	2005	2004	2003
Current	$(160)	$ -	$ 294
Deferred	109	502	307
	$ (51)	$ 502	$ 601

The provision for income taxes includes the following:

(In thousands)	2005	2004	2003
Federal Income Tax	$ (29)	$ 520	$ 631
New York State Franchise Tax	(22)	(18)	(30)
	$ (51)	$ 502	$ 601

The components of net deferred tax asset, included in other assets for the years ended December 31, are as follows:

(In thousands)	2005	2004

ASSETS:		
Deferred compensation	$ 715	$ 672
Allowance for loan losses	654	712
Postretirement benefits	82	74
Mortgage recording tax credit carryforward	361	304
Investment securities	865	213
Other	121	49
	$ 2,798	$ 2,024
LIABILITIES:		
Prepaid pension	(532)	(345)
Depreciation	(647)	(671)
Accretion	(37)	(47)
Loan origination fees	(250)	(236)
Intangible assets	(432)	(328)
Prepaid expenses	(79)	(119)
	$(1,977)	$(1,746)
Net deferred tax asset	$ 821	$ 278

The Company has a New York State mortgage recording tax credit that has no carry forward limitations. The Company has determined that no valuation allowance is necessary as it is more likely than not deferred tax assets will be realized through carryback to taxable income in prior years, future reversals of existing temporary differences and through future taxable income. A reconciliation of the federal statutory income tax rate to the effective income tax rate for the years ended December 31, is as follows:

	2005	2004	2003
Federal statutory income tax rate	34.0%	34.0%	34.0%
State tax	(3.0)	(0.9)	(0.6)
Tax-exempt interest income, net of TEFRA	(44.8)	(6.0)	(5.1)
Increase in value of life insurance	(18.1)	(3.1)	(2.6)
Other	19.5	2.3	1.0
Effective income tax rate	(12.4)%	26.3%	26.7%

The following is a reconciliation of basic to diluted earnings per share for the years ended December 31:

(Dollars in thousands, except per share data)	EARNINGS	SHARES	EPS
2005 Net Income	$ 462		

Basic EPS	462	2,456	$0.19
Effect of dilutive securities			
Stock options	-	25	
Diluted EPS	$ 462	2,481	$0.19
2004 Net Income	$ 1,405		
Basic EPS	1,405	2,435	$0.58
Effect of dilutive securities			
Stock options	-	44	
Diluted EPS	$ 1,405	2,479	$0.57
2003 Net Income	$ 1,652		
Basic EPS	1,652	2,424	$0.68
Effect of dilutive securities			
Stock options	-	48	
Diluted EPS	$ 1,652	2,472	$0.67

NOTE 15: COMMITMENTS AND CONTINGENCIES

The Company is a party to financial instruments with off-balance sheet risk in the normal course of business to meet the financing needs of its customers. These financial instruments include commitments to extend credit and standby letters of credit. Such commitments involve, to varying degrees, elements of credit risk in excess of the amount recognized in the consolidated statement of condition. The contractual amount of those commitments to extend credit reflects the extent of involvement the commitment has in this particular class of financial instrument. The Company'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 the instrument.

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

At December 31, 2005 and 2004, the following financial instruments were outstanding whose contract amounts represent credit risk:

	CONTRACT AMOUNT	
(In thousands)	2005	2004
Commitments to grant loans	$ 6,371	$ 5,120
Unfunded commitments under lines of credit	12,361	12,021
Standby letters of credit	798	1,106

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 some of the commitment amounts are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. The Company evaluates each customer's creditworthiness on a case-by-case basis. The amount of collateral obtained, if deemed necessary by the Company upon extension of credit, is based on management's credit evaluation of the counter party. Collateral held varies but may include residential real estate and income-producing commercial properties.

Unfunded commitments under standby letters of credit, revolving credit lines and overdraft protection agreements are commitments for possible future extensions of credit to existing customers. These lines of credit usually do not contain a specified maturity date and may not be drawn upon to the total extent to which the Company is committed.

Outstanding letters of credit written are conditional commitments issued by the Bank to guarantee the performance of a customer to a third party. The majority of these standby letters of credit expire within the next twelve months. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending other loan commitments. The Bank requires collateral supporting these letters of credit as deemed necessary. Management believes that the proceeds obtained through a liquidation of such collateral would be sufficient to cover the maximum potential amount of future payments required under the corresponding guarantees. The amount of the liability as of December 31, 2005 and 2004 or guarantees under standby letters of credit issued is not material.

The Company leases land and leasehold improvements under agreements that expire in various years with renewal options over the next 30 years. Rental expense, included in operating expenses, amounted to $42,000, $41,000 and $41,000 in 2005, 2004 and 2003, respectively. In October 2002, the Company entered into a land lease with one of its directors on an arms-length basis. The rent expense paid to the related party during 2005, 2004 and 2003 was $23,000, $21,000 and $21,000, respectively. Approximate minimum rental commitments for the noncancelable operating leases are as follows:

YEARS ENDING DECEMBER 31:	
(In thousands)	
2006	$ 47
2007	47
2008	51
2009	51
2010	51
Thereafter	115
Total minimum lease payments	$362

NOTE 16: DIVIDENDS AND RESTRICTIONS

The board of directors of Pathfinder Bancorp, M.H.C., determines whether the Holding Company will waive or receive dividends declared by the Company each time the Company declares a dividend, which is expected to be on a quarterly basis. The Holding Company may elect to receive dividends and utilize such funds

to pay expenses or for other allowable purposes. The Office of Thrift Supervision ("OTS") has indicated that (i) the Holding Company shall provide the OTS annually with written notice of its intent to waive its dividends prior to the proposed date of the dividend, and the OTS shall have the authority to approve or deny any dividend waiver request; (ii) if a waiver is granted, dividends waived by the Holding Company will be excluded from the Company's capital accounts for purposes of calculating dividend payments to minority shareholders; (iii) the Company shall establish a restricted capital account in the amount of any dividends waived by the Holding Company, and the amount of any dividend waived by the Holding Company shall be available for declaration as a dividend solely to the Holding Company. During 2005, the Company paid cash dividends totaling $325,000 to the Holding Company. For the second and fourth quarters ending June 30, 2005 and December 31, 2005, respectively, the Holding Company waived the right to receive its portion of the cash dividends declared on June 28, 2005 and December 27, 2005, respectively, which totaled $325,000. The Company maintains a restricted capital account with a $1,532,000 balance, representing the Holding Company's portion of dividends waived as of December 31, 2005. During 2004 and 2003, the Holding Company waived dividends totaling $320,000 and $317,000, respectively.

The Company's ability to pay dividends to its shareholders is largely dependent on the Bank's ability to pay dividends to the Company. In addition to state law requirements and the capital requirements discussed in Note 17 the circumstances under which the Bank may pay dividends are limited by federal statutes, regulations and policies. The amount of retained earnings legally available under these regulations approximated $1,670,000 as of December 31, 2005. Dividends paid by the Bank to the Company would be prohibited if the effect thereof would cause the Bank's capital to be reduced below applicable minimum capital requirements.

NOTE 17: REGULATORY MATTERS

The Company (on a consolidated basis) and the Bank are subject to various regulatory capital requirements administered by the federal banking agencies. 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 Bank's financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, the Company and the Bank must meet specific capital guidelines that involve quantitative measures of the their assets, liabilities, and certain off-balance sheet items as calculated under regulatory accounting practices. The capital amounts and classifications are also subject to qualitative judgments by the regulators about components, risk weightings, and other factors. Prompt corrective action provisions are not applicable to bank holding companies.

Quantitative measures established by regulation to ensure capital adequacy require the Bank to maintain amounts and ratios (set forth in the table below) of total and Tier 1 capital (as defined in the regulations) to risk-weighted assets (as defined), and of Tier 1 capital (as defined) to average assets (as defined). Management believes, as of December 31, 2005, that the Bank meets all capital adequacy requirements to which it is subject.

As of December 31, 2005, the Bank's most recent notification from the Federal Deposit Insurance Corporation categorized the Bank as "well-capitalized", under

the regulatory framework for prompt corrective action. To be categorized as "well-capitalized", the Bank must maintain total risk based, Tier 1 risk-based and Tier 1 leverage ratios as set forth in the tables below. There are no conditions or events since that notification that management believes have changed the Bank's category. The Company's and the Bank's actual capital amounts and ratios as of December 31, 2005and 2004 are also presented in the following table.

	Actual		For Capital Adequacy Purposes		"To Be Well Capitalized" Under Prompt Corrective Provisi	
(Dollars in thousands)	Amount	Ratio	Amount	Ratio	Amount	Ratio
COMPANY						
As of December 31, 2005:						
Total Core Capital (to Risk-Weighted Assets)	$24,802	13.5%	$14,706	8.0%	N/A	N/A
Tier 1 Capital (to Risk-Weighted Assets)	$23,123	12.6%	$ 7,353	4.0%	N/A	N/A
Tier 1 Capital (to Average Assets)	$23,123	7.6%	$12,167	4.0%	N/A	N/A
BANK						
As of December 31, 2005:						
Total Core Capital (to Risk-Weighted Assets)	$22,957	12.6%	$14,615	8.0%	$18,269	10.0%
Tier 1 Capital (to Risk-Weighted Assets)	$21,278	11.7%	$ 7,307	4.0%	$10,961	6.0%
Tier 1 Capital (to Average Assets)	$21,278	7.1%	$11,927	4.0%	$14,909	5.0%
COMPANY						
As of December 31, 2004:						
Total Core Capital (to Risk-Weighted Assets)	$24,493	13.5%	$14,472	8.0%	N/A	N/A
Tier 1 Capital (to Risk-Weighted Assets)	$22,666	12.5%	$ 7,236	4.0%	N/A	N/A
Tier 1 Capital (to Average Assets)	$22,666	7.7%	$11,775	4.0%	N/A	N/A
BANK						
As of December 31, 2004:						
Total Core Capital (to Risk-Weighted Assets)	$22,974	12.8%	$14,416	8.0%	$18,020	10.0%
Tier 1 Capital (to Risk-Weighted Assets)	$21,147	11.7%	$ 7,208	4.0%	$10,812	6.0%
Tier 1 Capital (to Average Assets)	$21,147	7.1%	$11,947	4.0%	$14,934	5.0%

The Bank is required to maintain average balances on hand or with the Federal Reserve Bank. At December 31, 2005 and 2004, these reserve balances amounted to $1,608,000 and $2,419,000, respectively.

NOTE 18: FAIR VALUES OF FINANCIAL INSTRUMENTS

SFAS No. 107, "Disclosure About Fair Value of Financial Instruments," requires disclosure of fair value information of financial instruments, whether or not recognized in the consolidated statement of condition, 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 derived 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.

Management uses its best judgment in estimating the fair value of the Company's

financial instruments; however, there are inherent weaknesses in any estimation technique. Therefore, for substantially all financial instruments, the fair value estimates herein are not necessarily indicative of the amounts the Company could have realized in a sales transaction on the dates indicated. The

estimated fair value amounts have been measured as of their respective year-ends, and have not been re-evaluated or updated for purposes of these financial statements subsequent to those respective dates. As such, the estimated fair values of these financial instruments subsequent to the respective reporting dates may be different than the amounts reported at each year-end.

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

CASH AND CASH EQUIVALENTS - the carrying amounts approximate fair value.

INVESTMENT SECURITIES - fair values of securities are based on quoted market prices, where available. If quoted market prices are not available, fair values are based on quoted market prices of comparable instruments.

LOANS AND MORTGAGE LOANS HELD-FOR-SALE - for variable rate loans that reprice frequently and with no significant credit risk, fair values approximate carrying values. Fair values for fixed rate loans are estimated using discounted cash flow analysis, using interest rates currently being offered for loans with similar terms to borrowers of similar credit quality.

FEDERAL HOME LOAN BANK STOCK - the carrying amounts reported approximate fair value.

MORTGAGE SERVICING RIGHTS - the carrying amount approximates fair value.

ACCRUED INTEREST RECEIVABLE AND PAYABLE - the carrying amounts of accrued interest receivable and payable approximate their fair values.

DEPOSIT LIABILITIES - The fair values disclosed for demand deposits (e.g., interest-bearing and noninterest-bearing checking, passbook savings and certain types of money management accounts) are, by definition, equal to the amount payable on demand at the reporting date (i.e., their carrying amounts). Fair values for fixed-rate certificates of deposit are estimated using a discounted cash flow calculation that applies interest rates currently being offered on certificates of deposits to a schedule of aggregated expected monthly maturities on time deposits.

BORROWINGS - the fair values for short-term borrowings and junior subordinated debentures approximate the carrying amounts. The fair values for long-term borrowings were estimated using discounted cash flow analysis based on the Company's current incremental borrowing rates for similar types of borrowing arrangements.

OFF-BALANCE SHEET INSTRUMENTS - Fair values for the Company's off-balance sheet instruments are based on fees currently charged to enter into similar

agreements, taking into account the remaining terms of the agreements and the counterparties' credit standing.

The carrying amounts and fair values of the Company's financial instruments as of December 31 are presented in the following table:

	2005		2004	
(Dollars in thousands)	CARRYING AMOUNTS	ESTIMATED FAIR VALUES	CARRYING AMOUNTS	ESTIMATED FAIR VALUES
FINANCIAL ASSETS:				
Cash and cash equivalents	$ 7,895	$ 7,895	$ 14,325	$ 14,325
Investment securities	74,239	74,239	75,069	75,069
Mortgage loans held-for-sale	-	-	2,159	2,329
Net Loans	187,889	189,598	185,125	190,034
Federal Home Loan Bank Stock	1,805	1,805	1,768	1,768
Accrued interest receivable	1,678	1,678	1,505	1,505
Mortgage servicing rights	146	146	198	198
FINANCIAL LIABILITIES:				
Deposits	$ 236,377	$ 236,552	$ 236,672	$ 237,410
Borrowed funds	31,360	33,883	35,360	36,360
Junior subordinated debentures	5,155	5,155	5,155	5,155
Accrued interest payable	161	161	143	143
OFF-BALANCE SHEET INSTRUMENTS:				
Standby letter of credit	$ -	$ -	$ -	$ -
Commitments to extend credit	-	-	-	-
Forward rate lock commitments	-	-	-	-

NOTE 19: PARENT COMPANY - FINANCIAL INFORMATION

The following represents the condensed financial information of Pathfinder Bancorp, Inc. for years ended December 31:

STATEMENTS OF CONDITION	2005	2004
(In thousands)		
ASSETS		
Cash	$ 245	$ 982
Investments	19	-
Receivable from bank subsidiary	-	41
Investment in subsidiaries	24,602	25,698
Due from subsidiaries	1,125	240
Other assets	207	243
Total assets	$26,198	$27,204

LIABILITIES AND SHAREHOLDERS' EQUITY		
Accrued liabilities	115	223
Junior subordinated debentures	5,155	5,155
Shareholders' equity	20,928	21,826
Total liabilities and shareholders' equity	$26,198	$27,204

STATEMENTS OF INCOME	2005	2004	2003
(In thousands)			
Interest income	$ 14	$ 9	$ 16
Interest expense	352	259	243
Net interest expense	(338)	(250)	(227)
Operating expense	(92)	(130)	(106)
Realized gain on sale of investment security	-	330	104
Amortization of deferred financing costs	(30)	(30)	(30)
Loss before tax benefit and equity in undistributed net income of subsidiaries	(460)	(80)	(259)
Tax benefit	128	20	73
Loss before equity in undistributed net income of subsidiaries	(332)	(60)	(186)
Equity in undistributed net income of subsidiaries	794	1,465	1,837
Net income	$ 462	$ 1,405	$ 1,652

STATEMENTS OF CASH FLOWS	2005	2004	2003
(In thousands)			
OPERATING ACTIVITIES			
Net Income	$ 462	$ 1,405	$ 1,652
Equity in undistributed earnings of subsidiaries	(794)	(1,465)	(1,837)
Realized gain on sale of investment security	-	(330)	(104)
ESOP shares earned	88	133	122
Amortization of deferred financing costs	30	30	30
Other operating activities	(987)	(304)	81
Net cash used in operating activities	(1,201)	(531)	(56)
INVESTING ACTIVITIES			
Proceeds from loan to subsidiary	41	56	56
Dividends receivable	911	8	7
Purchase of investments	(18)	-	-
Proceeds from sale of investments	-	430	154
Net cash provided by investing activities	934	494	217
FINANCING ACTIVITIES			
Proceeds from exercise of stock options	213	140	35
Dividend received from subsidiary	-	-	1,500
Cash dividends	(683)	(664)	(651)
Treasury stock purchased	-	-	(2,687)

Net used in financing activities	(470)	(524)	(1,803)
Decrease in cash and cash equivalents	(737)	(561)	(1,643)
Cash and cash equivalents at beginning of year	982	1,543	3,186
Cash and cash equivalents at end of year	$ 245	$ 982	$ 1,543

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

None.

ITEM 9A: CONTROLS AND PROCEDURES

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 the end of the period covered by this annual report. Based upon that evaluation, the Chief Executive Officer and Chief Financial Officer concluded that, as of the end of the period covered by this report, 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 Securities Exchange Act of 1934 is recorded, processed, summarized and reported, within the time periods specified in the Securities and Exchange Commission's rules and forms. There has been no change in the Company's internal control over financial reporting during the most recent fiscal quarter that has materially affected, or is reasonable likely to materially affect, the Company's internal control over financial reporting.

ITEM 9B: OTHER INFORMATION

None

PART III

ITEM 10: DIRECTORS AND EXECUTIVE OFFICERS OF THE COMPANY

(a) Information concerning the directors of the Company is incorporated by reference hereunder in the Company's Proxy Materials for the Annual Meeting of Stockholders.

(b) Set forth below is information concerning the Executive Officers of the Company at December 31, 2005

NAME	AGE	POSITIONS HELD WITH THE COMPANY
Thomas W. Schneider	44	President and Chief Executive Officer
James A. Dowd, CPA	38	Vice President, Chief Financial Officer
Edward A. Mervine	49	Vice President, General Counsel
John F. Devlin	41	Vice President, Senior Commercial Lender
Melissa A. Miller	48	Vice President, Chief Operating Officer
Rhonda Hutchis	47	Vice President, Retail Lending

ITEM 11: EXECUTIVE COMPENSATION

Information with respect to management compensation and transactions required under this item is incorporated by reference hereunder in the Company's Proxy Materials for the Annual Meeting of Stockholders under the caption "Compensation".

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

The information contained under the sections captioned "Stock Ownership of Management" is incorporated by reference to the Company's Proxy Materials for its Annual Meeting of Stockholders.

ITEM 13: CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS

The information required by this item is set forth under the caption "Certain Transactions" in the Definitive Proxy Materials for the Annual Meeting of Stockholders and is incorporated herein by reference.

ITEM 14: PRINCIPAL ACCOUNTANT FEES AND SERVICES

The information required by this item is set forth under the caption "Audit and Related Fees" in the Definitive Proxy Materials for the Annual Meeting of Stockholders and is incorporated herein by reference.

ITEM 15. EXHIBITS, FINANCIAL STATEMENT SCHEDULES

(a)(1) Financial Statements - The Company's consolidated financial statements, for the years ended December 31, 2005, 2004 and 2003, together with the Report of Independent Registered Public Accounting Firm are filed as part of this Form 10-K report. See "Item 8: Financial Statements and Supplementary Data." The supplemental financial information listed and appearing hereafter should be read in conjunction with the financial statements included in this report.

(a)(2) Financial Statement Schedules - All financial statement schedules have been omitted as the required information is inapplicable or has been included in "Item 7: Management Discussion and Analysis."

(b) Exhibits

3.1 Certificate of Incorporation of Pathfinder Bancorp, Inc. (Incorporated herein by reference to the Company's Current Report on Form 8-K dated June 25, 2001)

3.2 Bylaws of Pathfinder Bancorp, Inc. (Incorporated herein by reference to the Company's Quarterly Report on Form 10Q dated August 15, 2005)

4 Form of Stock Certificate of Pathfinder Bancorp, Inc. (Incorporated herein by reference to the Company's Current Report on Form 8-K dated June

25, 2001)

10.1 Form of Pathfinder Bank 1997 Stock Option Plan (Incorporated herein by reference to the Company's S-8 file no. 333-53027)

10.2 Form of Pathfinder Bank 1997 Recognition and Retention Plan (Incorporated by reference to the Company's S-8 file no. 333-53027)

10.3 2003 Executive Deferred Compensation Plan (Incorporated by herein by reference to the Company's Quarterly Report on Form 10-Q for the quarter ended March 31, 2004 file no. 000-23601)

10.4 2003 Trustee Deferred Fee Plan (Incorporated by herein by reference to the Company's Quarterly Report on Form 10-Q for the quarter ended March 31, 2004 file no. 000-23601)

10.5 Employment Agreement between the Bank and Thomas W. Schneider, President and Chief Executive Officer (Incorporated by reference to the Company's Quarterly Report on Form 10-Q for the quarter ended June 30, 2004 file no. 000-23601)

10.6 Employment Agreement between the Bank and Edward A. Mervine, Corporate Counsel (Incorporated by reference to the Company's Quarterly Report on Form 10-Q for the quarter ended June 30, 2004 file no. 000-23601)

21 Subsidiaries of Company

23 Consent of Beard Miller Company LLP

31.1 Rule 13a-14(a) / 15d-14(a) Certification of the Chief Executive Officer

31.2 Rule 13a-14(a) / 15d-14(a) Certification of the Chief Financial Officer

32.1 Section 1350 Certification of the Chief Executive and Chief Financial Officer

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SIGNATURES

Pursuant to the requirements of Section 13 of the Securities Exchange Act of 1934, the Company has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

Pathfinder Bancorp, Inc.

Date: March 30, 2006

By: /s/ Thomas W. Schneider
Thomas W. Schneider
President and Chief Executive Officer

Pursuant to the requirement of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the Registrant and in the capacities and on the dates indicated.

By: /s/ Janette Resnick
Janette Resnick, Chairman of the Board
Date: March 30, 2006

By:	/s/ Thomas W. Schneider Thomas W. Schneider, President and Chief Executive Officer	By:/s/	Chris R. Burritt Chris R. Burritt, Director
Date:	March 30, 2006	Date:	March 30, 2006
By:	/s/ James A. Dowd James A. Dowd, Vice President, Chief Financial Officer and Trust Officer	By:/s/	George P. Joyce George P. Joyce, Director
Date:	March 30, 2006	Date:	March 30, 2006
By:	/s/ Bruce E. Manwaring Bruce E. Manwaring, Director	By:/s/	Corte J. Spencer Corte J. Spencer, Director
Date:	March 30, 2006	Date:	March 30, 2006
By:	/s/ L. William Nelson, Jr. L. William Nelson, Jr. Director	By:/s/	Chris C. Gagas Chris C. Gagas, Director
Date:	March 30, 2006	Date:	March 30, 2006
By:	/s/ Steven W. Thomas Steven W. Thomas, Director	By:/s/	Lloyd Stemple Lloyd Stemple, Director
Date:	March 30, 2006	Date:	March 30, 2006