VSB BANCORP INC
Form 10-K
March 15, 2013

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-K

S ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 FOR THE FISCAL YEAR ENDED **DECEMBER 31, 2012**

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

COMMISSION FILE NUMBER 001-33250

VSB Bancorp, Inc.

(Exact name of registrant as specified in its charter)

New York

(State or other jurisdiction of incorporation or organization)

11 - 3680128

(I. R. S. Employer Identification No.)

4142 Hylan Boulevard, Staten Island, New York 10308

(Address of principal executive offices)

(718) 979-1100

Issuer’s telephone number

Common Stock

(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 S

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 S

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes S No £

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

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

Large Accelerated Filer £ Accelerated Filer £ Non-Accelerated Filer £ Smaller Reporting Company S

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act):

Yes £ No S

The aggregate market value of the voting stock held by non-affiliates of the registrant at June 30, 2012 was $14,041,407.

Number of shares of the registrant's common stock outstanding as of March 8, 2013: 1,785,309 shares.

Documents incorporated by reference:

Portions of the registrant's definitive proxy statement filed on or about March 28, 2013 into Part III of this Form 10-K.

Forward-Looking Statements

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

- deterioration in local, regional, national or global economic conditions which could result in, among other things, an increase in loan delinquencies, a decrease in property values, or a change in the real estate turnover rate;
- changes in market interest rates or changes in the speed at which market interest rates change;
- increases in inflation;
- technology changes requiring additional capital investment;
- breaches of security or other criminal acts affecting our operations;
- changes in laws and regulations affecting the financial service industry;
- changes in accounting rules;
- changes in the public's perception of financial institutions in general and banks in particular;
- changes in borrowers' attitudes towards their moral and legal obligations to repay their debts;
- the health and soundness of other financial institutions;
- changes in the securities or real estate markets;
- weather, geologic or climatic conditions;
- changes in government monetary or fiscal policy or other government political changes;
- changes in competition; and
- changes in consumer preferences by our customers or the customers of our business borrowers.

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

PART I

Item 1. Description of Business.

Business of VSB Bancorp, Inc.

VSB Bancorp, Inc. (referred to using terms such as “we,” “us,” or the “Company”) became the holding company for Victory State Bank (the “Bank”), a New York chartered commercial bank, upon the completion of a reorganization of the Bank into the holding company form of organization. The reorganization was effective in May 2003. All the outstanding stock of Victory State Bank was exchanged for stock of VSB Bancorp, Inc. on a three for two basis so that the stockholders of Victory State Bank became the owners of VSB Bancorp, Inc. and VSB Bancorp, Inc. owns all the stock of Victory State Bank. The common stock we issued in the transaction qualifies as exempt securities under Section 3(a)(12) of the Securities Act of 1933. Our primary business is owning all of the issued and outstanding stock of the Bank. Our common stock is listed on the NASDAQ Global Market. We trade under the symbol “VSBN”.

The main office of the Company and the Bank is at 4142 Hylan Boulevard, Staten Island, New York 10308, telephone (718) 979-1100. We maintain an Internet web site at www.victorystatebank.com.

Victory State Bank

Victory State Bank is a New York State chartered commercial bank, founded in November 1997. The Bank is supervised by the New York State Department of Financial Services (“NYSDFS”) and the Federal Deposit Insurance Corporation (“FDIC”). The Bank’s principal business has been and continues to be attracting commercial deposits from primarily the general public and investing those deposits, together with funds generated from operations and repayments on existing investments, primarily in loans for business purposes and investment securities. The Bank’s revenues are derived principally from interest on our commercial loan and investment securities portfolios. The Bank’s primary sources of funds are deposits and principal and interest payments on loans and investment securities.

Victory State Bank serves its primary market of Staten Island, New York through its five banking offices. The Bank opened its original main office in the Oakwood section of Staten Island in November 1997 which was closed in February 2007 as the lease expired at that location; its first branch was opened in the West Brighton section of Staten Island in June 1999; its second branch in the St. George section of Staten Island in January 2000; its third branch in the Dongan Hills section of Staten Island in December 2002 and its fourth branch in the Rosebank section of Staten

Island in April 2006. In February 2007, the Bank opened its new main office in the Great Kills section of Staten Island. The Bank's deposits are insured by the Federal Deposit Insurance Corporation up to the maximum amounts permitted by law. Victory State Bank also serves its customers through its website, www.victorystatebank.com.

Market Area and Competition

Victory State Bank has been, and continues to be, a community-oriented, state-chartered commercial bank offering a variety of traditional financial services to meet the needs of the communities in which it operates. Management considers our reputation for customer service as its major competitive advantage in attracting and retaining customers in its market area.

Our primary market area is concentrated in the neighborhoods surrounding our branches in the New York City Borough of Staten Island. Management believes that our branch offices are located in communities that can generally be characterized as stable, residential neighborhoods of predominantly one- to four-family residences and middle income families.

Staten Island's population grew to an estimated 470,467 in 2011 from 443,728 in 2000, an increase of 6.0%. Although this rate of increase is substantially less than the 17% population increase from 1990 to 2000, it was still greater than the population growth of New York State as a whole, which was an estimated 2.75% from 2000 to 2011. The census data also reflects the aging of the Staten Island population, with the 45 to 64 year age group increasing from 19.8% in 1990 to 23.4% in 2000 and to 27.8% in 2010. The largest age group continued to be the 20 to 44 age group, at 33.7% of total population in 2010, down from 37.0% in 2000.

However, the population news is not all negative when compared to the rest of New York State. Most notably, Staten Island fairs the highest among all 62 New York Counties when natural internal population growth is excluded and migration into the county is estimated. The U.S. Census estimates that net migration into the county was the highest in the entire state. Only 27 counties had an estimated net migration into the county during the period from the end of the 2000 census through July 1, 2009, and Staten Island was the best of those.

Median household income increased to $71,084 from $54,057 during the decade of 2000 to 2010. Per capita income in 2011 was $31,276 in Staten Island, slightly lower than $31,796, the per capita income of New York State. Households in Staten Island that had household income of more than $75,000 was 15.1% in 2009 according to City-data.com. These income levels compare favorably with the national household median of $51,914 and the national per capita median of $27,334. The Census Department has not published comparable data for recent years, but management believes that median household income continues to be strong and that these income levels in Staten Island provide satisfactory support for personal home ownership, in turn supporting the home building industry, which is a major industry focus for Victory State Bank. However, recent economic disruption has had an adverse effect on local income levels because of increased unemployment, a reduction in wage increases, and possible wage reductions for employed persons. Although according to the United States Bureau of Labor Statistics, the unemployment rate in Staten Island and the New York metro area is below the national average, the unemployment rate has stabilized in the past year and may increase in the future as financial service firms and public sector employers report continuing layoffs.

The median sales price of existing single family homes on Staten Island increased from 2000 through approximately 2006, and then began a decline that corresponded to the decline in housing values nationwide . According to the New York State Association of Realtors, the median price on Staten Island increased from $211,000 in 2000 to $370,000 in 2011. According to a report by the Center for an Urban Future, this means that the cost of a single family home on Staten Island is now out of reach to many middle-class families. As the population grew during the 1990s, total housing units increased as well, to 163,993 in 2000, as compared to 139,726 in 1990, an increase of 17.4%. However, perhaps confirming the reduction in affordability to the middle class, the growth in housing units has slowed, with an estimated 176,819 housing units in 2011, an increase of 7.8% since April 1, 2000. This slower growth presents challenges to management because of our focus on the home building industry and related sectors of the local economy.

The decline in the residential housing market in the past few years creates problems faced by Staten Island, its residents and its businesses. According to Zillow.com, a real estate information service, the estimated median home value has increased only 0.2% in the past year. The overall home values are still substantially lower than in 2007. The Center for an Urban Future report already noted an increase in foreclosures on Staten Island during 2006 which exceeded the increase in the rest of New York City. The decline in the price of homes and the economic downturn may accelerate this increase in foreclosed properties, which could exacerbate the decline in real estate values.

The New York City metropolitan area has a high density of financial institutions, many of which are significantly larger and have greater financial resources than we have, and all of which are our competitors to varying degrees. Our competition for loans comes principally from commercial banks, savings banks and insurance companies. Our most direct competition for deposits has come from commercial banks and savings banks. In addition, we face competition for deposits from non-bank institutions such as brokerage firms and insurance companies in such areas as short-term money market funds, corporate and government securities funds, mutual funds and annuities.

Risk Factors

Bank lending is an inherently risky business. A substantial portion of our assets are invested in loans, and loans necessarily present many risks. We must first rely on our borrowers to repay their loans, and if they are unable to do so, we must rely on the value of the collateral, if any, for the loan. Changing business conditions, increases in unemployment, personal problems that a borrower may experience, changes in the regulations that apply to a borrower's business, changes in the political climate or in public policy, and many other factors outside our control, could adversely affect the ability of our borrowers to repay their loans or the value of the collateral we have received. Although we seek to reduce these risks through underwriting procedures that we believe are prudent, it is impossible for us to completely eliminate the risks which arise from making loans except by eliminating our lending operations.

The current turmoil in the economy in general and among financial institutions in particular could adversely affect our customers and thus have an indirect adverse effect on us. The economy in the United States, including the economy in Staten Island, was and may still be in a recession. Although some analysts report that the economy is recovering, the extent and speed of the recovery is far from clear and some analysts predict a darker road ahead. There is substantial stress on many financial institutions and financial products. The federal government has intervened by making hundreds of billions of dollars in capital contributions to the banking industry. We draw a substantial portion of our customer base from local businesses, especially those in the building trades and related industries, and we believe that there continue to be substantial weaknesses in the business economy in our market area. Our customers have been adversely affected by the economic downturn, and if adverse conditions in the local economy continue, it will become more difficult for us to conduct prudent and profitable business in our community.

Making permanent residential mortgage loans is not a material part of our business, and our investments in mortgage-backed securities and collateralized mortgage obligations have been made with a view towards avoiding the types of securities that are backed by low quality mortgage-related assets. However, one of the primary focuses of our local business is receiving deposits from, and making loans to, businesses involved in the construction and building trades industry on Staten Island. Construction loans represented a significant component of our loan portfolio, reaching 39.8% of total loans at year end 2005. As we monitored the economy and the strength of the local construction industry, we elected to reduce our portfolio of construction loans. By December 31, 2012, the percentage had declined to 3.7%. However, developers and builders provide not only a source of loans, but they also provide us with deposits and other business. The weakness in the economy has had an adverse effect on some of our customers and potential customers, making it more difficult for us to find satisfactory loan opportunities. This compelled us to invest in lower yielding securities instead of higher-yielding loans. This has and may continue to reduce our net income.

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

In general, the interest rates we pay on deposits adjust more slowly than the interest rates we earn on loans because our loan portfolio consists primarily of loans with interest rates that fluctuate based upon the prime rate. In contrast, although many of our deposit categories have interest rates that could adjust immediately, such as interest checking accounts and savings accounts, changes in the interest rates on those accounts are at our discretion. Thus, the rates on those accounts, as well as the rates we pay on certificates of deposit, tend to adjust more slowly. As a result, the declines in market interest rates that occurred through the end of 2008 initially had an adverse effect on our net income because the yields we earn on our loans declined more rapidly than our cost of funds. However, many of our prime-based loans have minimum interest rates, or floors, below which the interest rate does not decline despite further decreases in the prime rate. As our loans reached their interest rate floors, our loan yields stabilized while our deposit costs continued to decline. This had a positive effect on our net interest income.

When market interest rates begin increasing, which we expect will occur at some point in the future, we anticipate an initial adverse effect on our net income. We anticipate that this will occur because our deposit rates should begin to rise, while loan yields remain relatively steady until the prime rate increases sufficiently that our loans begin to reprice above their interest rate floors. For most of our prime-rate based loans, this will not occur until the prime rate increases above 6%. Once our loan rates exceed the interest rate floors, increases in market interest rates should increase our net interest income because our cost of deposits should probably increase more slowly than the yields on our loans. However, customer preferences and competitive pressures may negate this positive effect because customers may choose to move funds into higher-earning deposit types as higher interest rates make them more attractive, or competitors offer premium rates to attract deposits. We also have a substantial portfolio of investment securities with fixed rates of interest, most of which are mortgage-backed securities with an estimated average life of not more than 7 years.

The limited trading market for our common stock may make it difficult for stockholders to sell their stock for full value. Our common stock is listed on the NASDAQ Global Market, which listing was effective on August 4, 2008. We continue to trade under the symbol "VSBN." We listed on the Global Market in the hope that it would increase the trading market in our stock and make it easier for individuals to buy and sell our stock. However, our stock does not trade every day and the average daily trading volume is limited. During the twelve months ended February 28, 2013, there were trades reported on only 64 out of 250 trading days, or barely more than one out of every four trading days. Our average daily trading volume during that period was 328 shares for all trading days and 1,280 shares per day for the 64 days on which trades occurred. During the twelve months ended February 28, 2013, 26.9% of all reported trading volume represented our repurchase of 22,000 shares pursuant to our announced stock repurchase programs. We currently have approximately 140 stockholders of record and we believe based upon reports we have received from broker/dealers, that there are approximately an additional 245 stockholders who own their shares in street name.

The geographic concentration of our loans increases the risk that adverse economic conditions could affect our net income. Substantially all of our loans are mortgage loans on property located in Staten Island, New York, or loans to residents of or businesses on Staten Island. Staten Island has experienced an economic down turn in recent years. In addition, due to the importance of the home building trade on Staten Island, the recent adverse conditions in the residential real estate market has had an additional negative impact on many local businesses that make up our core customer base. A continued economic slow-down or decline in the local economy could have an adverse effect on us for a number of reasons. Adverse economic conditions could hurt the ability of our borrowers to repay their loans. If real estate values decline, reductions in the value of real estate collateral could make it more difficult for us to recover the full amount due on loans which go into default. Furthermore, economic difficulties can also increase deposit outflows as customers must use savings to pay bills. This could increase our cost of funds because of the need to replace the deposit outflow. All of these factors might combine to reduce significantly our net income.

Adverse financial results of other financial institutions could adversely affect our net income or our reputation. The Bank is a member of the FDIC. As insurer, the FDIC is authorized to conduct examinations of, and to require reporting by, FDIC-insured institutions. It also may prohibit any FDIC-insured institution from engaging in any activity the FDIC determines by regulation or order to pose a serious threat to the FDIC.

In the past four years, there have been many failures and near-failures among financial institutions. The number of FDIC-insured banks that have failed has declined, with 51 banks having failed during 2012, compared to 92 in 2011, 157 in 2010 and 140 in 2009. The FDIC insurance fund reserve ratio, representing the ratio of the fund to the level of insured deposits, initially declined dramatically due to losses caused by the bank failures. As a result, the FDIC increased its deposit insurance premiums on remaining institutions, including well-capitalized institutions like Victory State Bank, in order to replenish the insurance fund. If bank failures continue to occur, and more so if the level of failures increases, the FDIC insurance fund may further decline, and the FDIC would be required to continue to impose higher premiums on healthy banks. Thus, despite the prudent steps we may take to avoid the mistakes made by other banks, our costs of operations may increase as a result of those mistakes by others.

As required by The Dodd –Frank Wall Street Reform and Consumer Protection Law (the “Dodd-Frank” Act), the FDIC has recently revised its deposit insurance premium assessment rates. Our Bank, even though we are in the lowest regulatory risk category, is subject to an assessment rate between five (5) and nine (9) basis points per annum. In general, the rates are applied to our bank’s total assets less tangible capital, in contrast to the former rule which applied the assessment rate to our level of deposits.

The deposit insurance premium change and the special assessment have begun to replenish the fund created to pay the cost of resolving failed banks and the fund no longer has a negative balance. The Dodd-Frank Act requires that the FDIC must increase the ratio of the FDIC insurance fund to estimated total insured deposits to 1.35% by September 30, 2020. The FDIC believes that most banks will pay a lower total assessment under the new system than under the former system. However, if bank failures in the future exceed FDIC estimates, or other estimates that the FDIC makes turn out to be incorrect, and the losses to the insurance fund increase, the FDIC could be forced to increase insurance premiums. Such an increase would increase our non-interest expense.

As a result of the Dodd-Frank Act, non-interest bearing demand deposits, together with certain attorney trust account deposits commonly known in New York as IOLA accounts, had the benefit of unlimited federal deposit insurance until December 31, 2012. The expiration of the unlimited federal deposit insurance for non-interest bearing checking accounts and IOLAs at the end of 2012 may cause a reduction in our deposit base as customers seek to redistribute their deposits to maintain FDIC insurance above the $250,000 general FDIC insurance limit.

The FDIC may terminate the deposit insurance of any insured depository institution, including the Bank, if it determines, after a hearing, that the institution has engaged or is engaging in unsafe or unsound practices, is in an unsafe or unsound condition to continue operations, or has violated any applicable law, regulation, order or any condition imposed by an agreement with the FDIC. It also may suspend deposit insurance temporarily during the hearing process for the permanent termination of insurance, if the institution has no tangible capital. If insurance of accounts is terminated, the accounts at the institution at the time of the termination, less subsequent withdrawals, shall continue to be insured for a period of six months to two years, as determined by the FDIC. Management is aware of no existing circumstances that would result in termination of the Bank’s deposit insurance.

Changes in the federal or state regulation of financial institutions could have an adverse effect on future operations. Federal and New York State banking laws and regulations have a substantial, regular and every-day effect on our business. Federal and state regulatory authorities have extensive discretion in connection with their supervision of Victory State Bank, such as the right to impose restrictions on operations and the insistence that we increase our allowance for loan losses. Any change in the regulatory structure or statutes or regulations applicable to banks, bank holding companies, or their competitors, whether by the Congress, the FDIC, the Federal Reserve System, the New York State legislature, the New York State Department of Financial Services or any other regulator, could have a material impact on our operations and profitability.

The substantial decline in the national housing market and the advent of the increase in bank failures over the past few years has spawned many statutes and regulations affecting Banks, including the 2,000+ pages of the Dodd-Frank Act and the hundreds of regulations adopted or to be adopted to implement its provisions. There are constantly new proposals to further change the laws that affect our business. Notably, the Dodd-Frank Act creates a Consumer Financial Protection Bureau that has broad authority to restrict our flexibility in dealing with consumer transactions and our ability to charge fees for bank services. The final implementation of the Dodd-Frank Act through regulatory enactments and the actions of the Consumer Financial Protection Bureau could have a significant negative effect on our income and our expenses in a manner and a level that we cannot predict.

There have recently been changes at both the state and the federal level in the laws and regulations applicable to residential mortgage lenders and other entities in the residential real estate business. We are not a residential mortgage lender and we do not expect that new regulations and future expected proposals in the area, if adopted, will have a direct negative effect on us. However, the proposals could reduce residential development, increase the cost of housing, and restrict the ability of small local businesses in that sector to compete with larger companies with greater resources. That could have an adverse effect on our customer base. Furthermore, from time to time, proposals are made to permit what are commonly known as “cram downs” in bankruptcies involving residential mortgage loans. If adopted, such proposals could have a direct adverse effect on the value of the collateral for existing residential mortgage loans, and thus an indirect effect on mortgage-backed securities in which we invest.

Delays in foreclosure proceedings may adversely affect our ability to realize upon the value of collateral. The length of time it takes to prosecute a foreclosure action and be able to sell real estate collateral in New York has substantially lengthened. It is not unusual for it to take more than two years from the date a foreclosure action is commenced until the property is sold even in uncontested cases, and some uncontested cases can take longer. This problem, if it continues or gets worse, could have a substantial adverse effect on the value of our collateral for loans in default. Especially in the case of construction loans, where property value deterioration during a lengthy foreclosure is more likely, the inability to realize upon collateral increases our loss in the event of a default.

We operate in an extremely competitive environment. We operate in one of the most competitive environments for financial products in the world. Many of the world’s largest financial institutions have offices in our local communities, and they have far greater financial resources than we have. Furthermore, in 2010, federal law was changed to allow any bank, regardless of where it is headquartered, to open a branch throughout most of the United States, and now Staten Island is open to unrestricted branching. This could increase competition. Furthermore, as a result of the Dodd-Frank Act, banks are now allowed to pay interest on commercial demand deposits. This has put greater competitive pressure on us as some large banks with greater financial resources are advertising aggressively to obtain interest-bearing checking account deposits.

The loss of key personnel could impair our future success. Our future success depends in part on the service of our executive officer, other key management officers, as well as our staff, and our ability to continue to attract, motivate, and retain additional highly qualified employees. The loss of one or more of our key personnel or our inability to timely recruit replacements for such personnel, or otherwise attract, motivate, or retain qualified personnel could have an adverse effect on our business, operating results and financial condition.

Possible effects of Hurricane Sandy. Hurricane Sandy has had a devastating effect on the homes and businesses of New York City, especially Staten Island. We opened four of five locations (all located in Richmond County) the day after the Hurricane and they are in full operation. We re-opened the fifth location in February 2013 and all retail banking services are fully operational. While Hurricane Sandy did not have a significant effect on our operations, we incurred expenses of approximately $300,000 to remediate and reconstruct one of our branches that suffered sewer backup, water and wind driven rain damage. We also waived deposit service charges and late fees to those customers affected by Hurricane Sandy. This resulted in a reduction in non-interest income of an estimated $50,000.

After Hurricane Sandy, we immediately embarked an outreach program to determine the extent that our borrowers were affected by Hurricane Sandy. We contacted 58 customers that we identified as being located in areas affected by the hurricane who sustained some of, or a combination of, the following issues: substantial water and sewage damage to the business' physical plant, machinery and equipment; extended power loss causing business interruptions; displaced tenants due to the flood and sewage backup; employees unable to report to work due to the loss/damage of their personal homes or cars and the loss of mass transit. We individually assessed their condition and access to resources. The majority of our customers were able to restart their business with little assistance from us.

As we are primarily a commercial lender, we did not have residential loans that were negatively affected. We received 12 requests for either one or two month payment deferrals on commercial loans, which we granted. All twelve resumed their payments but two loans, in the aggregate amount of $732,121 (of which one loan in the amount of in excess of $700,000 was real estate secured) , remain slow and are over 30 days past due.

We operate primarily in Richmond County (Staten Island) and that is where we had the highest impact. We had one loan in Kings County that was affected but has since been current on payments. We had sufficient liquidity and resources to handle the effects of Hurricane Sandy. Our operations center was up and running the day Hurricane Sandy left the region and had full access to all of our resources.

We are still assessing the full impact of Hurricane Sandy, including the effects on the allowance for loan loss and the loan portfolio, and we will address any of the associated issues as they arise.

Lending Activities

Loan Portfolio Composition. Our loan portfolio consists primarily of commercial mortgage loans and unsecured commercial loans. Unsecured commercial loans include loans with personal guaranties or personal obligations in all cases, and, in some cases, may also include loans with illiquid personal property collateral. At December 31, 2012, we had total unsecured commercial loans outstanding of $16,502,920, or 20.1% of total loans, and commercial real estate loans of $56,698,844, or 69.0% of total loans. There was $3,112,477 of construction loans secured by real estate or 3.8% of total loans. Other loans in our portfolio principally included commercial loans secured by assets other than real estate totaling $2,050,728 or 2.5% of total loans at December 31, 2012; residential mortgage loans of $2,498,603, or 3.0% of total loans and consumer non-mortgage loans of $565,573 or 0.7% of total loans. Although we generally do not make traditional permanent residential mortgage loans, we occasionally make residential mortgage loans to the principals of commercial customers. For the year ended December 31, 2012, approximately $57,359,893, or 69.8% of total loans had adjustable interest rates based on the prime rate of interest.

The following table sets forth the composition of our loan portfolio in dollar amounts and in percentages at the dates indicated. None of these loans are loans to or in foreign countries.

	At December 31,								
	2012		2011		2010		2009		2008
	Amount	% of Total	Amount	% of Total	Amount	% of Total	Amount	% of Total	Amount
Commercial loans:									
Commercial secured	$2,050,728	2.5 %	$1,522,639	1.9 %	$1,393,532	1.7 %	$1,138,308	1.4 %	$1,177,796
Commercial unsecured	16,502,920	20.1	12,997,139	15.8	12,924,378	15.8	10,966,874	13.9	9,558,296
Total commercial	18,553,648	22.6	14,519,778	17.7	14,317,910	17.5	12,105,182	15.3	10,736,092

loans									
Real Estate loans:									
Commercial	56,698,844	69.0	59,376,008	72.3	58,204,596	71.1	48,767,729	61.7	39,918,879
Residential	2,498,603	3.0	2,309,899	2.8	2,460,114	3.0	2,914,956	3.7	2,548,159
Total real estate loans	59,197,447	72.0	61,685,907	75.1	60,664,710	74.1	51,682,685	65.4	42,467,038
Construction loans:									
Commercial	2,712,477	3.3	4,610,000	5.6	5,387,500	6.6	10,964,000	13.9	10,996,432
Owner occupied one-to-four family	400,000	0.5	—	—	487,000	0.6	2,294,000	2.9	900,000
Total construction loans	3,112,477	3.8	4,610,000	5.6	5,874,500	7.2	13,258,000	16.8	11,896,432
Other loans:									
Consumer loans	565,573	0.7	602,144	0.7	533,860	0.7	532,498	0.7	599,293
Other loans	768,790	0.9	717,261	0.9	386,750	0.5	1,455,224	1.8	757,481
Total other loans	1,334,363	1.6	1,319,405	1.6	920,610	1.2	1,987,722	2.5	1,356,774
Total loans	82,197,935	100.0%	82,135,090	100.0%	81,777,730	100.0%	79,033,589	100.0%	66,456,336
Less: Unearned discounts, net and deferred loan fees, net	226,364		224,100		239,506		199,433		209,684
Allowance for loan losses	1,753,521		1,343,020		1,277,220		1,063,454		987,876
Loans, net	$80,218,050		$80,567,970		$80,261,004		$77,770,702		$65,258,776

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The following table sets forth our loan originations and principal repayments for the periods indicated. We did not purchase or sell any loans in 2012, 2011 or 2010.

	Year Ended December 31, 2012	Year Ended December 31, 2011	Year Ended December 31, 2010
Commercial Loans (gross):			
At beginning of period	$14,519,778	$14,317,910	$12,105,182
Commercial loans originated:			
Secured	1,998,066	1,269,025	1,484,940
Unsecured	30,307,430	29,289,115	34,313,999
Total commercial loans	32,305,496	30,558,140	35,798,939
Principal repayments	(28,271,626)	(30,356,272)	(33,586,211)
At end of period	$18,553,648	$14,519,778	$14,317,910
Real Estate loans:			
At beginning of period	$61,685,907	$60,664,710	$51,682,685
Real estate loans originated:			
Commercial	10,673,500	17,448,000	21,034,000
Residential	220,000	—	—
Total real estate loans	10,893,500	17,448,000	21,034,000
Principal repayments	(13,381,960)	(16,426,803)	(12,051,975)
At end of period	$59,197,447	$61,685,907	$60,664,710
Construction loans			
At beginning of period	$4,610,000	$5,874,500	$13,258,000
Construction loans originated	5,047,000	1,900,000	4,460,000
Principal repayments	(6,544,523)	(3,164,500)	(11,843,500)
At end of period	$3,112,477	$4,610,000	$5,874,500
Other loans (gross):			
At beginning of period	$1,319,405	$920,610	$1,987,722
Other loans originated	1,188,913	1,010,585	479,555
Principal repayments	(1,173,955)	(611,790)	(1,546,667)
At end of period	$1,334,363	$1,319,405	$920,610

Loan Maturity. The following table shows the contractual maturity of our loans at December 31, 2012. As we have decreased construction loans as a percentage of our loan portfolio and increased other real estate mortgage loans, we have increased the average contractual maturity of our loan portfolio. However, to limit interest rate risk, we have continued to concentrate our efforts principally on the origination of loans with adjustable interest rates and minimum interest rate floors. This table shows a loan as being due in the period in which the final principal payment is due under the loan promissory note or agreement, without regard to prior principal payments or interest rate adjustments.

	At December 31, 2012					
	Commercial Unsecured	Commercial Secured	Construction	Real Estate	Other Loans	Total
Amounts due:						
Within one year	$10,644,251	$1,697,090	$1,267,477	$6,115,194	$849,735	$20,573,747
After one year:						
One to five years	5,058,460	353,638	1,845,000	12,608,589	460,628	20,326,315
After five years	800,209	—	—	40,473,664	24,000	41,297,873
Total amount due	16,502,920	2,050,728	3,112,477	59,197,447	1,334,363	82,197,935
Less:						
Unearned fees	—	112	21,341	204,911	—	226,364
Allowance for loan losses	425,495	18,790	16,282	1,251,727	41,227	1,753,521
Loans, net	$16,077,425	$2,031,826	$3,074,854	$57,740,809	$1,293,136	$80,218,050

The following table sets forth at December 31, 2012, the dollar amount of all loans, due after December 31, 2013, and whether such loans have fixed or variable interest rates.

	Due After December 31, 2013		
	Fixed	Variable	Total
Commercial Business Loans:			
Unsecured	$694,191	$5,164,478	$5,858,669
Secured	353,638	—	353,638
Real Estate			
Commercial	8,801,334	44,176,771	52,978,105
Residential	104,148	—	104,148
Construction	400,000	1,445,000	1,845,000
Other loans	484,628	—	484,628
Total loans	$10,837,939	$50,786,249	$61,624,188

Commercial Business Lending. We originate commercial business loans directly to the professional and business community in our market area. We target small to medium sized businesses and professionals such as lawyers, doctors and accountants. Applications for commercial business loans are obtained primarily from the efforts of our directors and senior management, who have extensive contacts in the local business community, or from branch referrals. As of December 31, 2012, commercial business loans totaled $18,553,648 or 22.6% of total loans.

Commercial business loans we originate generally have terms of five years or less and have adjustable interest rates tied to the Wall Street Journal Prime Rate plus a margin. A majority of our commercial business loans have terms of less than one year and one of the challenges facing management is the constant effort to originate commercial business loans as existing loans are repaid. Such loans may be secured or unsecured. Secured commercial business loans can be collateralized by receivables, inventory and other assets. All these loans are either loans to individuals for which they have personal liability or loans to entities backed by the personal guarantee of principals of the borrower. The loans generally have shorter maturities and higher yields than real estate mortgage loans. Management has extensive experience in originating commercial business loans within our marketplace.

Commercial business loans generally carry the greatest credit risks of the loans in our portfolio because repayment is more dependent on the success of the business operations of the borrower. Some of these loans are unsecured and those that are secured frequently have collateral that rapidly depreciates or is difficult to control in the event of a default.

Commercial Real Estate Lending. We originate commercial real estate loans that are generally secured by properties used for business purposes such as retail stores, other mixed-use (business and residential) properties, restaurants, light industrial buildings and small office buildings located in our primary market area. Our commercial real estate loans are generally made in amounts up to 70% of the appraised value of the property. These loans are most commonly made with terms up to five years with interest rates that adjust to 100 or 150 basis points above the floating prime rate, but we have recently changed our guidelines to include 20 year fully amortizing loans. A significant portion of these loans are subject to an interest rate floor ranging between 7.00% and 8.00%. Our underwriting standards consider the collateral of the borrower, the net operating income of the property and the borrower's expertise, credit history and profitability. We require personal guarantees from the borrower or the principals of the borrowing entity. At December 31, 2012, our commercial real estate loans totaled $59,197,447, or 72.0% of total loans.

Loans secured by commercial real estate are generally larger and have traditionally been considered to involve greater risks than one-to-four family residential mortgage loans, but generally lesser risks than commercial business loans. Because payments on loans secured by commercial real estate properties are often dependent on the successful operation and management of the properties, repayment of such loans may be subject to adverse conditions in the real estate market or the economy, to a greater extent than other types of loans. We seek to minimize these risks through our lending policies and underwriting standards, which restrict new originations of such loans to our primary lending area and qualify such loans on the basis of the property's income stream, collateral value and debt service ratio.

Construction Lending. Our construction loans primarily have been made to builders and developers to finance the construction of one- to four-family residential properties and, to a lesser extent, multi-family residential and commercial use real estate properties. Our policies provide that construction loans may be made in amounts up to the lesser of 80% of the total hard and soft costs of the project. We generally require personal guarantees. Construction loans generally are made with prime-based interest rates with terms up to 18 months. Loan proceeds are disbursed in increments as construction progresses and as inspections warrant. At December 31, 2012, our construction loans totaled $3,112,477 or 3.8% of total loans. This represents a reduction of our construction loan portfolio over the past four years as economic conditions in the construction industry caused us to be more cautious in originating these loans while also reducing the number of satisfactory loan opportunities available to us.

Construction loans on non-owner occupied real estate generally carry greater credit risks than permanent mortgage loans on comparable completed properties because their repayment is more dependent on the borrower's ability to sell or rent units under construction and the general as well as local economic conditions. Because payments on construction loans are often dependent on the successful completion of construction project and the management of the project, repayment of such loans may be subject to adverse conditions in the real estate market or the economy, to a greater extent than other types of loans. In addition, in the event of a default, buildings under construction may deteriorate rapidly and it may be more difficult to realize upon the value of the building compared to an existing building that is ready for occupancy or already rented to third party tenants.

Loan Approval Procedures and Authority. All unsecured loans in excess of $250,000 and all secured loans over $400,000 are reviewed and approved by the Loan Committee, which consists of seven directors of Victory State Bank, prior to commitment. Smaller loans may be approved by underwriters designated by the Bank's Chief Executive Officer. Consumer loans not secured by real estate and unsecured consumer loans, depending on the amount of the loan and the loan to value ratio, where applicable, require the approval of the Bank's Chief Lending Officer and/or Chief Executive Officer.

Upon receipt of a completed loan application from a prospective borrower, we order a credit report and we verify other information. If necessary, we request additional financial information. An independent appraiser we designate performs an appraisal of the real estate intended to secure the proposed loan. The Board of Victory State Bank annually approves the independent appraisers and approves the Bank's appraisal policy. It is our policy to obtain title insurance on all real estate first mortgage loans and on substantially all subordinate mortgage loans. Borrowers must also obtain hazard insurance prior to closing. Some borrowers are required to make monthly escrow deposits which we then use to pay items such as real estate taxes.

Delinquencies and Classified Assets

Delinquent Loans. Our collection procedures for mortgage loans include sending a past due notice at 15 days and a late notice after payment is 30 days past due. In the event that payment is not received after the late notice, letters are sent or phone calls are made to the borrower. We attempt to obtain full payment or work out a repayment schedule with the borrower to avoid foreclosure. Generally, we authorize foreclosure proceedings when a loan is over 90 days delinquent. We record property acquired in foreclosure as real estate owned at the lower of its appraised value less costs to dispose, or cost. We cease to accrue interest on all loans 90 days past due and reverse all accrued but unpaid interest when the loan becomes non-accrual. We continue to accrue interest on construction loans that are 90 days past the maturity date of the loan if we expect the loan to be paid in full in the next 60 days and all interest is paid up to date.

The collection procedures for non-mortgage other loans generally include telephone calls to the borrower after ten days of the delinquency and late notices at 15 and 25 days past due. Letters and telephone calls generally continue until the matter is referred to a collection attorney or resolved. After the loan is 90 days past due, the loan is referred to counsel and is written-off.

Classified Assets. Federal regulations and our Loan Review and Risk Rating Policy provide for the classification of loans and other assets we consider to be of lesser quality as “Substandard”, “Doubtful” or “Loss” assets. An asset is considered “Substandard” if it is inadequately protected by the current net worth and paying capacity of the obligor or of the collateral pledged, if any. “Substandard” assets include those characterized by the “distinct possibility” that the insured institution will sustain “some loss” if the deficiencies are not corrected. Assets classified as “Doubtful” have all of the weaknesses inherent in those classified “Substandard” with the added characteristic that the weaknesses present make “collection or liquidation in full,” on the basis of currently existing facts, conditions, and values, “highly questionable and improbable.” Assets classified as “Loss” are those considered “uncollectible” and of such little value that their continuance as assets without the establishment of a specific loss reserve is not warranted. Assets which do not currently expose us to sufficient risk to warrant classification but which possess weaknesses are designated “Special Mention” by management.

At December 31, 2012, we had eighteen (18) loans, in the aggregate amount of $5,978,673, designated as special mention. We had twenty three (23) loans, in the aggregate amount of $9,212,926, and two (2) real estate owned (“REO”) properties, in the aggregate amount of $342,867, classified as substandard. All twenty three (23) loans classified as substandard are secured by real estate. At December 31, 2011, special mention loans totaled $2,157,308 and substandard loans totaled $11,687,760. The Bank actively monitors all special mention loans to seek to avoid deterioration in the quality of the loan. The Bank is actively collecting the substandard loans and expects to collect substantially all the principal amounts due. We had no loans classified as doubtful or loss at December 31, 2012 and 2011.

Victory State Bank’s Loan Review Officer and Board of Directors regularly review problem loans and review all classified assets on a quarterly basis. In certain cases, our loan workout committee will meet to discuss collection strategy on the larger, more complex loans. We believe our policies are consistent with the regulatory requirements regarding classified assets. Our determination as to the classification of our assets and the amount of our valuation allowances is subject to review by the New York State Department of Financial Services and the FDIC, which can order the establishment of additional general or specific loss allowances.

The following table sets forth delinquencies in our loan portfolio at the dates indicated:

	At December 31, 2012			
	60-89 Days		90 Days or more	
	Number	Principal	Number	Principal
Commercial real estate	1	$150,000	17	$5,923,090
Commercial construction	—	—	2	467,500
Commercial secured	1	91,649	—	—
Other	1	2,903	—	—
Total	3	$244,552	19	$6,390,590
Delinquent loans to total loans		0.30 %		7.77 %

	At December 31, 2011			
	60-89 Days		90 Days or more	
	Number	Principal	Number	Principal
Commercial real estate	1	$359,620	20	$8,265,397
Commercial construction	—	—	1	397,500
Commercial unsecured	1	16,260	—	—
Real Estate - Residential	—	—	2	2,200,000
Total	2	$375,880	23	$10,862,897
Delinquent loans to total loans		0.46 %		13.23 %

	At December 31, 2010			
	60-89 Days		90 Days or more	
	Number	Principal	Number	Principal
Commercial real estate	2	$277,960	12	$4,064,281
Commercial unsecured	2	42,708	2	37,706
Real Estate - Residential	—	—	3	2,276,306
Total	4	$320,668	17	$6,378,293
Delinquent loans to total loans		0.39 %		7.80 %

	At December 31, 2009			
	60-89 Days		90 Days or more	
	Number	Principal	Number	Principal
Commercial real estate	9	$3,848,990	7	$1,176,114
Commercial construction	—	—	2	480,000
Commercial unsecured	4	61,907	1	41,037
Real Estate - Residential	3	2,299,322	—	—
Total	16	$6,210,219	10	$1,697,151

Delinquent loans to total loans	7.86	%	2.15	%

	At December 31, 2008			
	60-89 Days		90 Days or more	
	Number	Principal	Number	Principal
Commercial real estate	2	$207,047	5	$1,453,846
Commercial construction	—	—	2	480,000
Commercial unsecured	—	—	7	345,221
Total	2	$207,047	14	$2,279,067
Delinquent loans to total loans		0.31 %		3.43 %

Loans 90 days or more past due represent non-accrual loans and loans that are contractually past due maturity but are still accruing interest. Loans past due 90 or more and still on accrual were $0 for 2012, 2011, 2010, 2009 and 2008.

Non-performing Assets. The following table sets forth information about our non-performing assets at December 31, 2012, 2011 and 2010.

	At December 31, 2012		At December 31, 2011		At December 31, 2010	
Non-performing assets:						
Commercial loans:						
Unsecured	$—		$—		$37,706	
Commercial real estate	5,923,090		8,265,397		4,064,281	
Residential real estate	—		2,200,000		2,276,306	
Construction	467,500		397,500		—	
Real estate owned	342,867		267,246		—	
Total non-performing assets	$6,733,457		$11,130,143		$6,378,293	
Non-performing loans to total loans	7.77	%	13.23	%	7.80	%
Non-performing loans to total assets	2.37	%	4.49	%	2.71	%
Non-performing assets to total assets	2.50	%	4.60	%	2.71	%

The gross interest income that would have been recorded in 2012 if the non-accrual loans had been current in accordance with their original terms was $478,556. The amount of interest income on those loans that was included in net income for 2012 was $1,554. In 2011, gross interest that would have been recorded if non-accrual loans had been current was $595,946, of which $165,515 was actually received and included in net income.

The following table sets forth the aggregate carrying value of our assets classified as Substandard or Doubtful according to asset type:

	At December 31, 2012			
	Substandard		Doubtful	
	Number	Amount	Number	Amount
Classification of assets:				
Commercial Real Estate	19	$6,570,971	—	$ —
Residential Real Estate	2	2,174,455		
Construction	2	467,500	—	—
Total loans	23	9,212,926	—	—
Real estate owned	2	342,867	—	—

Total Assets	25	$9,555,793	—	$	—

No assets were classified as Loss at year end 2012.

Non-Performing Loans

Management closely monitors non-performing loans and other assets with potential problems on a regular basis. We had nineteen non-performing loans, totaling $6,390,590 at December 31, 2012, compared to twenty three non-performing loans, totaling $10,862,897 at December 31, 2011. Non-performing loans totaled 7.77% of total loans at December 31, 2012 compared to 13.23% at December 31, 2011. We have always followed a hands-on approach to dealing with our past due borrowers that we believe is sufficiently aggressive to maximize recovery.

As noted in the discussion below regarding specific loans, many of our non-performing loans are secured by real estate, and thus we expect substantial if not complete recovery of the loan amount. However, it is inevitable that we will experience some charge-offs of non-performing loans. All of the loans discussed individually below were evaluated separately for impairment under ASC 310 and we have included a component of our allowance for loan and lease losses representing our measurement of the impairment on those loans. However, the process by which we estimate the potential loss on those loans is necessarily imprecise and subject to changing future events, facts that may be unknown to us, and other uncertainties. Thus, although we believe that our allowance for loan losses is appropriate to address the weaknesses in those loans, we may be required to increase our provision for loan losses in the future if actual impairment exceeds our expectations.

The following is information about the seven largest non-performing loans and the associated relationships, totaling $4,992,559, or 78.1% of our non-performing loans, by outstanding principal balance at December 31, 2012. Management believes it has taken appropriate steps with a view towards maximizing recovery and minimizing loss, if any, on these loans.

- $1,362,648 in two commercial real estate loans. One of these loans, in the principal amount of $827,250, is secured by a first mortgage on property in Queens. We have commenced a foreclosure action and we are at the stage of the finalization of a referee's report on the amount due so we can sell the property. However, a guarantor of the loan, who is a party to the foreclosure action, has filed a bankruptcy petition, which automatically stays the foreclosure. The other loan was secured by a second mortgage on property in Staten Island but the holder of the first mortgage has completed a foreclosure action so our second mortgage has been eliminated and we subsequently charged off $535,398 in January 2013. We had previously commenced a separate action seeking a money judgment against the borrower and the guarantors because of the foreclosure action by the first mortgagee. We were granted summary judgment in the money judgment action for $764,226.65, including principal, interest and costs, and have been aggressively pursuing collection but collection proceedings against the principal individual guarantor have been stayed due to the same bankruptcy filing.
- $1,224,198 in two commercial real estate loans. The loans, made to two individuals, are secured by a first mortgage and second mortgage on two pieces of real estate in Staten Island. The borrowers signed a modified repayment agreement in July, 2012. In accordance with the modified repayment arrangement, we received a principal payment of $150,000 in July 2012, and we agreed to allow the borrower six months to sell the property and repay our loan. When that did not occur, we commenced foreclosure proceedings.
- $861,204 in a commercial real estate loan. The loan is secured by a first mortgage on the property in Staten Island. The loan is guaranteed personally by the principals of the borrower. The borrower signed a forbearance agreement during the fourth quarter of 2012 which includes a modified payment arrangement. We received a $145,000 upfront payment and the borrower agreed to make monthly payments. We agreed to hold the previously commenced foreclosure proceedings in abeyance as long as there is performance under the forbearance agreement. The borrower has been making payments according to the forbearance agreement since October, 2012.
- $578,009 in a commercial real estate loan. The loan is secured by a second mortgage on the property in Staten Island. The loan is guaranteed personally by the principals of the borrower. The borrower signed a modified repayment agreement in April, 2012 and we are holding the previously commenced foreclosure action in abeyance as long as it performs under the terms of the modified repayment arrangement. We received a $125,000 upfront payment and the borrower has been making payments under the terms of the modified agreement since May 2012.
- $499,000 in a commercial real estate loan on property in Staten Island that is leased to a restaurant. The loan is secured by a first mortgage on the property and a second mortgage on other commercial real estate collateral. The

loan is guaranteed personally by the principals of the borrower and we have a security interest in the business. We have commenced foreclosure proceedings.

- $467,500 in two construction loans. The loans are secured by a first and second mortgage on property in Staten Island. The loans are guaranteed personally by the principals of the borrower. The borrower signed a forbearance agreement in October, 2012 and has received a certificate of occupancy on the property. Payments are current under the terms of the forbearance agreement.

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

If loans with modifications are on non-accrual status when they are modified, we do not immediately restore them to accruing status. For those loans, as well as other loans on non-accrual status when the borrower makes payments, we initially record payments received either as a reduction of principal or as interest received on a cash basis. The choice between those alternatives depends upon the magnitude of the concessions, if any, we have given to the borrower, the nature of the collateral and the related loan to value ratio, and other factors affecting the likelihood that we will continue to receive regular payments.

Once a loan is categorized as a non-accrual loan, the loan may be restored to accruing status after a period of consistent on-time performance. The length of on-time performance required to restore a loan to accruing status varies from a minimum of six months on loans with minor modifications or less-severe weaknesses to as long as a year or more on loans for which we have granted more significant concessions to the borrower or which otherwise have more significant weaknesses.

Allowance for Loan Losses

It is our policy to provide a valuation allowance for probable incurred losses on loans based on our past loan loss experience, known and inherent risks in the loan portfolio, adverse situations which may affect the borrower's ability to repay, estimated value of underlying collateral and current economic conditions in our lending area. The allowance is increased by provisions for loan losses charged to earnings and is reduced by charge-offs, net of recoveries. While management uses available information to estimate losses on loans, future additions to the allowance may be necessary based upon any changes in economic conditions or if our loan portfolio increases. In addition, various regulatory agencies, as an integral part of their examination process, periodically review the Bank's allowance for loan losses. Such agencies may require the Bank to recognize additions to the allowance based on judgments different from those of management. Management believes, based upon all relevant and available information, that the allowance for loan losses is appropriate.

When analyzing whether the level of the allowance for loan losses is appropriate, management considers performing loans in our loan portfolio that have no material identified weaknesses. Management establishes an amount equal to a fixed percentage of the performing loans in each of our five principal loan categories to be included in the allowance to cover inherent weaknesses in the broad category of loans. The fixed percentages are based upon historical loss experience in each category, the state of the economy, special risks in that particular category, and other factors that management deems relevant.

One important data point in evaluating the appropriateness of the allowance as it relates to impaired real estate loans is the value of the real estate collateral. A loan is considered an impaired loan when we believe it is probable that we will be unable to collect all amounts due according to the contractual terms of the loan agreement. Those loans generally include non-accrual loans and loans categorized as troubled debt restructurings. For impaired real estate loans over \$100,000, we obtain a new appraisal of the real estate at least annually. For smaller loans, we take the original appraisal and adjust the valuation based upon changing conditions, if any. We then adjust the value for costs of sale and carrying costs to measure the weakness in the loan as part of our overall evaluation of the appropriateness of our allowance for loan losses.

For loans impaired loans [over $100,000], we prepare a loan by loan analysis and measure the amount of the impairment on the loan, which then becomes a component of our Allowance for Loan and Lease Losses ("ALLL")**.** This analysis considers both the general factors which are considered in assessing performing loans as well as specific facts pertinent to each loan, such as collateral value, borrower's income and ability to repay, payment history, the reasons for and length of the delinquency, and the value of any credit support.

For Substandard loans that are not impaired, we provide, as part of our general allowance for loan losses, an amount management deems prudent to recognize the risks pertaining to the asset. A general allowance represents a loss allowance which has been established to recognize the inherent risk associated with lending activities, but which, unlike a specific allowance, has not been allocated to particular problem assets. When we classify an asset as "Loss," we either establish a specific allowance for losses equal to 100% of the amount of the asset or charge off that amount.

Although loans may be analyzed individually or in groups to determine the allowance, the entire allowance is available for any losses that occur.

In order to assist in determining the appropriate allowance, an independent loan review firm, senior management and the Bank's Board of Directors review the allowance for loan losses quarterly. If they determine that the allowance is inappropriate, then management increases or decreases the provision for loan losses to bring the allowance to the appropriate level.

As of December 31, 2012, our allowance for loan losses was $1,753,521 or 2.13% of total loans. Based upon all relevant and presently available information, management believes that the allowance for loan losses is appropriate. We continue to monitor and modify the level of the allowance for loan losses in order to maintain the allowance at a level which management considers appropriate.

The following table sets forth the activity in our allowance for loan losses:

	For the Year Ended December 31, 2012	2011	2010	2009	2008
Allowance for Loan Losses:					
Balance at beginning of period	$1,343,020	$1,277,220	$1,063,454	$987,876	$927,161
Charge-offs:					
Real estate loans:					
Commercial	(16,675)	(74,512)	—	(110,241)	—
Residential	—	(57,715)	—	—	—
Commercial loans:					
Unsecured	(100,757)	(532,957)	(15,765)	(412,112)	(483,326)
Consumer loan	—	—	(4,863)	(18,606)	(7,959)
Other loans	(10,917)	(3,811)	(2,084)	(15,679)	(3,503)
Total charge-offs	(128,349)	(668,995)	(22,712)	(556,638)	(494,788)
Recoveries	183,850	139,795	96,478	72,216	270,503
Net (charge-offs) / recoveries	55,501	(529,200)	73,766	(484,422)	(224,285)
Provision charged to income	355,000	595,000	140,000	560,000	285,000
Balance at end of period	$1,753,521	$1,343,020	$1,277,220	$1,063,454	$987,876
Ratio of net charge-offs / (recoveries) during the period to average loans outstanding during the period	-0.07%	0.65%	-0.09%	0.68%	0.35%
Ratio of allowance for loan losses to total loans at the end of period	2.13%	1.64%	1.56%	1.35%	1.49%
Ratio of allowance for loan losses to non-performing loans at the end of the period	27.44%	12.36%	20.02%	62.66%	43.35%
Ratio of allowance for loan losses to non-performing assets at the end of the period	26.04%	12.07%	20.02%	62.66%	43.35%

The following table sets forth the allocation of our allowance for loan losses among each of the categories listed.

	At December 31, 2012		At December 31, 2011		At December 31, 2010		At December 31, 2009		At December 31, 2008	
	Amount	% of Loans in Category to Total Loans	Amount	% of Loans in Category to Total Loans	Amount	% of Loans in Category to Total Loans	Amount	% of Loans in Category to Total Loans	Amount	% of Loans in Category to Total Loans
Allowance:										
Commercial loans:										
Unsecured	$425,495	20.1 %	$474,686	15.8 %	$520,953	15.8 %	$460,474	13.9 %	$372,803	14.4 %
Secured	18,790	2.5	12,356	1.9	13,486	1.7	8,124	1.4	7,451	1.8
Commercial real estate	1,247,199	69.0	780,820	72.3	653,362	71.1	418,215	61.7	449,525	60.1
Residential real estate	4,528	3.0	672	2.8	7,174	3.0	40,302	3.7	25,686	3.8
Construction loans	16,282	3.8	34,184	5.6	52,138	7.2	71,968	16.8	100,737	17.9
Other loans	41,227	1.6	40,302	1.6	30,107	1.2	64,371	2.5	31,674	2.0
Total allowances	$1,753,521	100.0%	$1,343,020	100.0%	$1,277,220	100.0%	$1,063,454	100.0%	$987,876	100.0%

Investment Activities

State-chartered banking institutions have the authority to invest in various types of liquid assets, including United States Treasury Obligations, securities of various federal agencies, certain certificates of deposits of insured banks and savings institutions, certain bankers' acceptances, repurchase agreements and federal funds. Additionally, it is appropriate for us to maintain investments for ongoing liquidity needs and we have maintained liquid assets at a level believed to be adequate to meet our normal daily activities.

Our investment policy, established by the Board of Directors of Victory State Bank and implemented by its Asset/Liability Committee, attempts to provide and maintain liquidity, generate a favorable return on investments without incurring undue interest rate and credit risk, and complement our lending activities. Although we classify most of our securities portfolio as available for sale, it is our practice to retain most of our securities until they mature.

Our policies generally limit investments to government and federal agency securities or AAA rated securities, including corporate debt obligations, which are investment grade with weighted average lives of seven years or less. Our policies provide that all investment purchases be ratified by the Bank's Board and may only be initiated by the President or Chief Financial Officer of the Bank. Investment securities consist of collateralized mortgage obligations ("CMO") with estimated average lives, based upon prepayment assumptions that management believes are reasonable, of 4.5 years or less, mortgage-backed securities ("MBS") with maturities of seven years or less , U.S. Agency notes with a maturity of less than 15 years, collateralized loan obligations ("CLO") and asset backed securities. These CMOs and MBSs are backed by federal agencies such as Federal National Mortgage Association ("FNMA") and the Federal Home Loan Mortgage Corporation ("FHLMC") or are "AAA" rated whole loan securities. No investment securities in our portfolio have experienced ratings down grades. At December 31, 2012, we had investment securities with a cost basis of $104,144,167 and a fair value of $106,825,570. All investment securities at December 31, 2012, consisted of CMOs, MBSs, CLOs or asset backed securities. The entire investment portfolio at December 31, 2012 was classified as available for sale and is accounted on a fair value basis with changes in fair value included as other comprehensive income.

The following table sets forth certain information regarding the amortized cost and fair values of the investment securities, available for sale portfolio at the dates indicated. The excess of fair value over amortized cost at year end 2012 is the result of the effect of recent low market interest rates on the value of previously-purchased investment securities. If market interest rates were to increase, we anticipate that this excess would decrease and, under certain circumstances depending upon the timing of securities purchases and the rate of increase in interest rates, amortized cost may exceed fair value.

	At December 31,					
	2012		2011		2010	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value	Amortized Cost	Fair Value
Investments securities, available for sale						
FNMA	$34,168,335	$35,005,261	$5,080,697	$5,189,766	$3,428,696	$3,571,217
GNMA	5,074,518	5,230,424	6,748,239	6,976,344	4,092,912	4,081,112
Whole Loan MBS	473,273	490,125	786,085	806,616	1,212,246	1,235,501
Collateralized mortgage obligations	60,483,873	62,081,070	93,023,287	95,527,763	109,921,495	112,420,077
Collateralized loan obligations	1,000,000	1,000,000	—	—	—	—
Other debt securities	2,944,168	3,018,690	—	—	—	—

$104,144,167	$106,825,570	$105,638,308	$108,500,489	$118,655,349	$121,307,907

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The table below sets forth certain information regarding the amortized cost, weighted average yields and stated maturities of our investment securities at December 31, 2012 and 2011.

	At December 31, 2012								
	Less Than 1 Year	Weighted Average Yield	1 To 5 Years	Weighted Average Yield	5 To 10 Years	Weighted Average Yield	Over 10 Years	Weighted Average Yield	Total
Investment Securities:									
FNMA	$—	—%	$14,472,574	0.95%	$18,806,081	2.21%	$889,680	2.20%	$34,168,335
GNMA	—	—	—	—	513,510	4.48	4,561,008	1.55	5,074,518
Whole Loan MBS	—	—	—	—	473,273	4.81	—	—	473,273
Collateralized Mortgage Obligations	—	—	3,388,279	5.19	4,634,480	4.45	52,461,114	2.68	60,483,873
Collateralized Loan Obligations	—	—	—	—	1,000,000	3.22	—	—	1,000,000
Other debt securities	—	—	—	—	—	—	2,944,168	1.34	2,944,168
Total	$—	—%	$17,860,853	1.75%	$25,427,344	2.75%	$60,855,970	2.52%	$104,144,167

	At December 31, 2011								
	Less Than 1 Year	Weighted Average Yield	1 To 5 Years	Weighted Average Yield	5 To 10 Years	Weighted Average Yield	Over 10 Years	Weighted Average Yield	Total
Investment Securities:									
FNMA	$—	—%	$—	— %	$4,075,669	2.90 %	$1,005,028	2.21 %	$5,080,697
GNMA	—	—	—	—	779,091	4.47	5,969,149	1.68	6,748,240
Whole Loan MBS	—	—	—	—	786,084	4.82	—	—	786,084
Collateralized Mortgage Obligations	—	—	4,828,499	5.23	11,168,269	4.67	77,026,519	2.84	93,023,287
Total	$—	—%	$4,828,499	5.23 %	$16,809,113	4.24 %	$84,000,696	2.75 %	$105,638,308

Source of Funds

General. Deposits are the primary source of our funds for use in lending, investing and for other general purposes. In addition to deposits, we obtain funds from principal repayments and prepayments on loans and securities. Loan and securities repayments are a relatively stable source of funds, while deposit inflows and outflows as well as unscheduled prepayments are influenced by general interest rates and money market conditions.

Deposits. We offer a variety of deposit accounts having a range of interest rates and terms. Our deposits consist of non-interest bearing checking accounts, money market accounts, time deposit ("certificate") accounts, statement savings and NOW accounts. The flow of deposits is influenced significantly by general economic conditions, changes in money market rates, prevailing interest rates and competition. Our deposits are obtained primarily from the areas in which our offices are located. We do not actively solicit certificate accounts in excess of $100,000, nor do we use brokers to obtain deposits. However, in connection with our efforts in establishing banking development districts in Staten Island, we accept large balance municipal deposits as part of the New York State and New York City banking development district programs. These municipal deposits total $35 million, are at a subsidized rate, and mature on a quarterly or an annual basis. There can be no assurance that the Bank will be able to retain these municipal deposits or be able to renew them at subsidized rates as compared to current market rates at that time. Management constantly monitors our deposit accounts and, based on historical experience, management believes it will retain a large portion of such accounts upon maturity. Deposit account terms we offer vary according to the minimum balance required, the time periods that the funds must remain on deposit and the interest rates, among other factors. In determining the characteristics of the deposit account programs we offer, we consider potential profitability, matching terms of the deposits with loan products, the attractiveness to the customers and the rates offered by our competitors.

Our focus on customer service, primarily for the business and professional community in our marketplace, has facilitated our retention of non-interest bearing checking accounts and low costing NOW and savings accounts, which generally have interest rates substantially less than certificate of deposits. At December 31, 2012, these types of low cost deposit accounts amounted to $136,147,551, or 56.6% of total deposits.

The following table presents deposit activity for the periods indicated.

	Year Ended December 31, 2012	Year Ended December 31, 2011	Year Ended December 31, 2010
Beginning balance	$213,222,905	$207,406,657	$210,986,086
Net increase/(decrease) before interest credited	26,682,276	4,957,482	(4,600,492)
Interest credited on deposits	796,025	858,766	1,021,063
Ending balance	$240,701,206	$213,222,905	$207,406,657

The following table provides information regarding the remaining term to maturity of our time deposits over $100,000 at December 31, 2012:

Maturity Period	Amount
Three months or less	$37,731,996
Over three through six months	16,796,288
Over six through 12 months	3,866,039
Over 12 months	1,036,362
Total	$59,430,685

The following table presents by various rate categories, the amounts and periods to maturity of the certificate accounts outstanding at December 31, 2012.

	Six Months And Less	Over Six Mos. Through One Year	Over One Year Through Two Years	Over Two Years Through Three Years	Over Three Years	Total
Certificate accounts:						
0.00% to 0.99%	$58,709,607	$4,339,636	$1,104,464	$260,344	$1,461,000	$65,875,051

1.00% to 1.99%	124,142	942,791	424,212	476,000	814,000	2,781,145
2.00% to 2.99%	55,842	105,000	931,736	1,307,667	124,823	2,525,068
3.00% to 3.99%	80,477	190,963	—	—	—	271,440
	$58,970,068	$5,578,390	$2,460,412	$2,044,011	$2,399,823	$71,452,704

Borrowings

We do not routinely utilize borrowings as a source of funds. At December 31, 2012 and 2011, we had no outstanding borrowings.

Personnel

As of December 31, 2012, we had 43 full-time employees and 12 part-time employees. These employees are not represented by a collective bargaining unit and we consider our relationship with our employees to be good.

REGULATION AND SUPERVISION

Regulation of VSB Bancorp, Inc.

VSB Bancorp, Inc., is a New York corporation and is subject to and governed by the New York Business Corporation Law. It is a bank holding company and thus is subject to regulation, supervision, and examination by the Federal Reserve.

Bank Holding Company Regulation . As a bank holding company, we are required to file periodic reports and other information with the Federal Reserve and the Federal Reserve may conduct examinations of us.

We are subject to capital adequacy guidelines of the Federal Reserve. The guidelines apply on a consolidated basis and require bank holding companies to maintain a minimum ratio of Tier 1 capital to total assets of 4.0%. The minimum ratio is 3.0% for the most highly rated bank holding companies. The Federal Reserve's capital adequacy guidelines also require bank holding companies to maintain a minimum ratio of qualifying total capital to risk-weighted assets of 8.0%, and a minimum ratio of Tier 1 capital to risk-weighted assets of 4.0%. As of December 31, 2012, the ratio of Tier 1 capital to total assets was 9.97%, the ratio of Tier 1 capital to risk-weighted assets was 27.05%, and the ratio of qualifying total capital to risk-weighted assets was 28.30%.

Our ability to pay dividends can be restricted if overall capital falls below levels established by the Federal Reserve's guidelines.

Federal Reserve approval is required if we seek to acquire direct or indirect ownership or control of 5% or more of the voting shares of a bank or bank holding company. We must obtain Federal Reserve approval before we acquire all or substantially all the assets of a bank or merge or consolidate with another bank holding company. These provisions also would apply to a bank holding company that sought to acquire 5% or more of the common stock of or to merge or consolidate with us.

Bank holding companies like us may not engage in activities other than banking and activities so closely related to banking or managing or controlling banks as to be a proper incident thereto. Federal Reserve regulations contain a list of permissible non-banking activities that are closely related to banking or managing or controlling banks and the Federal Reserve has identified a limited number of additional activities by order. These activities include lending activities, certain data processing activities, and securities brokerage and investment advisory services, trust activities and leasing activities. A bank holding company must file an application or a notice with the Federal Reserve prior to acquiring more than 5% of the voting shares of a company engaged in such activities. A bank holding company that is well capitalized and well managed and meets other conditions may provide notice after making the acquisition.

We have the right to elect to be treated as a financial holding company if the Bank is well capitalized and well managed and has at least a satisfactory record of performance under the Community Reinvestment Act. Financial holding companies that meet certain conditions may engage in activities that are financial in nature or incidental to financial activities, or activities that are complementary to a financial activity and do not pose a substantial risk to the safety and soundness of depository institutions or the financial system generally. Federal law identifies certain activities that are deemed to be financial in nature, including non-banking activities currently permissible for bank holding companies to engage in both within and outside the United States, as well as insurance and securities underwriting and merchant banking activities. The Federal Reserve may identify additional activities that are permissible financial activities. No prior notice to the Federal Reserve is required for a financial holding company to acquire a company engaged in these activities or to commence these activities directly or indirectly through a subsidiary.

We have not elected to be treated as a financial holding company since we have no current plans to use the authority to engage in expanded activities. However, we may elect to do so in the future.

The Dodd-Frank Wall Street Reform and Consumer Protection Law

On July 21, 2010, the Dodd-Frank Wall Street Reform and Consumer Protection Law was adopted. It has been described as the greatest legislative change in the supervision of financial institutions since the 1930s. Its effect on Victory State Bank and VSB Bancorp, Inc. cannot now be judged with certainty because the interpretation and implementation of the law, as well as the numerous regulations and studies required or permitted by it, are still evolving. However, we believe that the following areas, among others, will be or may be significant to our future operations:

1. The law exempts smaller reporting companies filing with the Securities and Exchange Commission, such as our company, from the internal controls attestation rules of Section 404(b) of the Sarbanes-Oxley Act. Thus far, we have incurred expenses to prepare for compliance but we have not been governed by Section 404(b) due to temporary SEC extensions of the compliance deadline. The permanent exemption means that we will not be required to incur the expense of actual compliance as long as we continue to qualify as a smaller reporting company.

2. Securities brokers may not vote shares held in “street name” unless they receive instructions from their customers on the election of directors, executive compensation or any other significant matter, as determined by the SEC. This may increase our costs of holding annual stockholder meetings if it becomes necessary for us to retain the services of a proxy solicitor to increase shareholder participation in our meetings or to obtain approval of matters that the Board presents to stockholders. However, we did not experience any difficulties or additional expense related to this issue in connection with our 2011 annual meeting of stockholders.

3. At least every three years, we must submit our executive compensation to our stockholders for a non-binding advisory vote. We will be having our first such advisory vote at our annual meeting in 2013.

4. The law includes a number of changes to expand FDIC insurance coverage, as well as changes to the premiums banks must pay for insurance coverage, and the requirements applicable to the reserve ratio (the ratio of the deposit insurance fund to the amount of insured deposits). One important change is that, in the future, deposit insurance premiums we pay will be based upon total assets minus tangible capital, rather than based upon deposits. Since we do not use material borrowings to provide funds for asset growth, and we do not have material intangible assets that are excluded from capital such as goodwill, our share of the total deposit premiums paid by all banks appears to have declined. However, other factors, such as required replenishment of the current reserve fund, which must be increased to 1.35% of total insured deposits by September 30, 2020, as well as future failures of banks that may further deplete the fund, may result in an increase in our future deposit insurance premium. The FDIC must provide an offset for smaller banks negating the adverse effect of requiring a reserve ratio in excess of 1.15%, but reaching even the 1.15% ratio may require additional burdens on smaller banks. The FDIC approved final regulations implementing these changes on February 25, 2011, effective April 1, 2011. According to the FDIC, the substantial majority of banks will see reduced deposit insurance premiums as a result of the new rules. We believe that will be the case for us as long as all other relevant factors remain unchanged. Our FDIC regular insurance premium was $188,285 in 2012 compared to $238,823 in 2011, a decrease of 21.2%. The decrease was principally the result of the change from a deposit-based premium calculation to an assets-based premium calculation.

5. The law increases the amount of each customer’s deposits that are subject to FDIC insurance. The general limit has been permanently increased from $100,000 to $250,000.

6. The law repeals the prohibition on paying interest on demand deposit accounts, effective in July 2011. Interest-free demand deposits represent a substantial portion of our deposit base. We are not currently offering a demand deposit product that pays interest. Other banks in our community are now offering interest-bearing demand deposits and that competitive pressure may require that we offer interest checking accounts to businesses in order to retain deposits. That could have a direct adverse effect on our cost of funds. Although current market interest rates are very low, and such deposits are unlikely to carry high rates of interest, an increase in market interest rates could result in significant additional costs in order to maintain the level of such deposits.

7. The law makes interstate branching by banks much easier than in the past. We have no plans to branch outside New York State, but the law facilitates out of state banks branching into our market area, thus potentially increasing competition.

8. The law creates a new federal agency – the Consumer Financial Protection Bureau ("Bureau") – which has substantial authority to regulate consumer financial transactions, effective July 21, 2011. Our loans are primarily made to businesses rather than individual consumers, so the Bureau will not have a direct effect on many of our loan transactions. However, the Bureau also has authority to regulate other non-loan consumer transactions, such as deposits and electronic banking transactions. The implementation of new consumer regulations may increase our operating costs in a manner we cannot predict until regulations are adopted.

Statutory Restrictions on Acquisition of VSB Bancorp, Inc., and Victory State Bank

Applicable provisions of the New York Banking Law, the federal Bank Holding Company Act, and other federal statutes, restrict the ability of persons or entities to acquire control of a bank holding company. Under the Change in Bank Control Act, persons who intend to acquire control of a bank holding company, either directly or indirectly or through or in concert with one or more persons must give 60 days' prior written notice to the Federal Reserve. "Control" would exist when an acquiring party directly or indirectly has voting control of at least 25% of our voting securities or the power to direct our management or policies. Under Federal Reserve regulations, a rebuttable presumption of control would arise with respect to an acquisition where, after the transaction, the acquiring party has ownership control, or the power to vote at least 10% (but less than 25%) of our common stock.

The New York Banking Law requires prior approval of the New York Superintendent of Financial Services before any action is taken that causes any company to acquire direct or indirect control of a banking institution that is organized in the State of New York. The term "control" is defined generally to mean the power to direct or cause the direction of the management and policies of the banking institution and is presumed to exist if the company owns, controls or holds with power to vote 10% or more of the voting stock of the banking institution.

Section 912 of the New York Business Corporation Law, known as the New York Anti-Takeover Law, restricts the ability of interested stockholders to engage in business combinations with a New York corporation. In general terms, Section 912 prohibits any New York corporation covered by the statute from merging with an interested shareholder (i.e., one who owns 20% or more of the outstanding voting stock) for five years following the date on which the interested shareholder first acquired 20% of the stock, unless before that date the Board of Directors of the corporation had approved either the merger or the interested shareholder's stock purchase.

Section 912 defines an interested stockholder as the beneficial owner, directly or indirectly, of 20% or more of the outstanding voting stock of a corporation; and certain other entities that have owned 20% or more of a corporation's stock during the past five years. A business combination is defined as a merger, consolidation, sale of 10% or more of the assets, or similar transaction.

Unless an interested stockholder waits five years after becoming an interested stockholder to engage in a business combination, the business combination is prohibited unless our Board of Directors has approved either (a) the business combination or (b) the acquisition of stock by the interested stockholder, before the interested stockholder acquired its 20% interest. Even though the interested stockholder waits five years, the business combination is prohibited unless either:

(i) the business combination or the acquisition of stock by the interested stockholder was approved by the Board of Directors before the interested stockholder acquired its 20% interest;

(ii) the business combination is approved by a majority vote of all outstanding shares of stock not beneficially owned by the interested stockholder or its affiliates or associates at a meeting held at least five years after the interested stockholder becomes an interested stockholder; or

(iii) the price paid for common stock acquired in the business combination is, in general terms, at least as much as the greater of (a) highest price paid by the interested stockholder for any stock since the interested stockholder first owned 5% of the stock of the corporation, or (b) the market value of the stock as of the date of announcement of the business combination; and the price paid for stock other than common stock is subject to comparable minimum standards.

Regulation of Victory State Bank

The Bank is subject to extensive regulation and examination by the New York State Department of Financial Services (“NYSDFS”), as its chartering authority, and by the FDIC, as the insurer of its deposits. The federal and state laws and regulations which are applicable to banks regulate, among other things, the scope of their business, their investments, their reserves against deposits, the timing of the availability of deposited funds and the nature and amount of and collateral for certain loans. The Bank must file reports with the NYSDFS and the FDIC concerning its activities and financial condition, in addition to obtaining regulatory approvals prior to entering into certain transactions such as establishing branches and mergers with, or acquisitions of, other depository institutions. There are periodic examinations by the NYSDFS and the FDIC to test the Bank’s compliance with various regulatory requirements. This regulation and supervision establishes a comprehensive framework of activities in which an institution can engage and is intended primarily for the protection of the insurance fund and depositors. The regulatory structure also gives the regulatory authorities extensive discretion in connection with their supervisory and enforcement activities and examination policies, including policies with respect to the classification of assets and the establishment of adequate loan loss reserves for regulatory purposes. Any change in such regulation, whether by the NYSDFS, the FDIC or as a result of the enactment of legislation, could have a material adverse impact on the Bank and its operations.

Capital Requirements

The FDIC imposes capital adequacy standards on state-chartered banks, which, like the Bank, are not members of the Federal Reserve System.

The FDIC's capital regulations establish a minimum 3.0% Tier I leverage capital requirement for the most highly-rated state-chartered, non-member banks, with an additional cushion of at least 100 basis points for all other state-chartered, non-member banks, which effectively will increase the minimum Tier I leverage ratio for such other banks to 4.0%. Under the FDIC's regulation, the highest-rated banks are those that the FDIC determines are not anticipating or experiencing significant growth and have well diversified risk, including no undue interest rate risk exposure, excellent asset quality, high liquidity, good earnings and, in general, which are considered a strong banking organization and are rated composite 1 under the Uniform Financial Institutions Rating System. Tier I or core capital is defined as the sum of common stockholders' equity (including retained earnings), non-cumulative perpetual preferred stock and related surplus, and minority interests in consolidated subsidiaries, minus all intangible assets other than certain qualifying supervisory goodwill and certain mortgage servicing rights. The FDIC also requires that banks meet a risk-based capital standard. The risk-based capital standard for banks requires the maintenance of a ratio of total capital (which is defined as Tier I capital and supplementary capital) to risk-weighted assets of 8.0% and Tier I capital to risk-weighted assets of 4%. In determining the amount of risk-weighted assets, all assets, plus certain off-balance sheet assets, are multiplied by a risk-weight of 0% to 100%, based on the risks the FDIC believes are inherent in the type of asset or item. The components of Tier I capital are the same as for the leverage capital standard. The components of supplementary capital include certain perpetual preferred stock, certain mandatory convertible securities, certain subordinated debt and intermediate preferred stock and general allowances for loan and lease losses. Allowance for loan and lease losses includable in supplementary capital is limited to a maximum of 1.25% of risk-weighted assets. Overall, the amount of capital counted toward supplementary capital cannot exceed 100% of core capital.

The FDIC has an additional, higher capital level, known as well-capitalized. In order to be classified as well-capitalized, a bank must have a Tier 1 leverage ratio of at least 5%, a Tier 1 risk-based capital ratio of at least 6% and a total risk-based capital ratio of at least 10%. Furthermore, anecdotal evidence indicates that in recent regulatory examinations and in informal discussions with regulators the FDIC has been urging banks to maintain even higher levels of capital during the current period of economic difficulty.

At December 31, 2012, the Bank exceeded all of the capital ratio standards for a well-capitalized bank.

The following table shows the Bank's actual capital amounts and ratios.

			For capital adequacy purposes		To be well-capitalized under prompt corrective action provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
As of December 31, 2012						
Tier 1 Capital (to Average Assets)	$25,455,000	9.65 %	$10,155,155	4.00 %	$13,193,943	5.00 %
Tier 1 Capital (to Risk Weighted Assets)	25,455,000	26.03 %	3,911,960	4.00 %	5,867,940	6.00 %
Total Capital (to Risk Weighted Assets)	26,684,000	27.28 %	7,823,920	8.00 %	9,779,900	10.00 %

The Basel Committee on Banking Supervision, consisting of bank regulators from 27 countries, has developed a revised capital framework for banks throughout the world, known as the “Basel III Accord,” which was to have been implemented beginning in 2013. The Federal Reserve has delayed the implementation of the Basel III Accord in the United States and is currently evaluating how and to what extent the new rules should be implemented. Although we cannot know with certainty what the Federal Reserve and other United States bank regulators will finally decide, we believe that the implementation of the Basel III Accord will not have a material effect on our ability to satisfy the regulatory standards for remaining well-capitalized. Our current capital ratios are more than sufficient to satisfy any reasonably anticipated increase. However, the Basel III Accord increases the complexity of the calculation of risk based capital and may increase our operating expenses associated with calculating and monitoring capital compliance. Furthermore, an increase in capital requirements would reduce the amount of leverage that our capital could support. This might adversely affect our ability to increase substantially our level of interest-earning assets.

Activities and Investments of New York-Chartered Banks.

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 New York Superintendent of Financial Services (“Superintendent”) , as limited by FDIC regulations and other federal laws and regulations. See “Activities and Investments of FDIC Insured State-Chartered Banks” below. These New York laws and regulations authorize the Bank to 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, and certain other assets. A bank’s aggregate lending powers are not subject to percentage of asset limitations, although there are limits applicable to single borrowers. A New York-chartered bank may also exercise trust powers upon approval of the New York Superintendent of Financial Services. The Bank does not have trust powers.

The New York Superintendent of Financial Services has the power to adopt regulations that enable state chartered banks to exercise the rights, powers and privileges permitted for a national bank. The Bank has not engaged in material activities authorized by such regulations.

With certain limited exceptions, the Bank may not make loans or extend credit for commercial, corporate or business purposes (including lease financing) to a single borrower, the aggregate amount of which would be in excess of 15% of the Bank’s capital (as adjusted pursuant to the New York Banking Law), on an unsecured basis, and 25% of the adjusted capital if the excess is collateralized by readily marketable collateral or collateral otherwise having a value equal to the amount by which the loan exceeds 15% of the Bank’s net worth. These limits do not apply to loans made by VSB Bancorp, Inc. directly at the holding company level. The Bank currently complies with all applicable loans-to-one-borrower limitations and VSB Bancorp, Inc. has not made any loans in its own name except for its loan to its Employee Stock Ownership Plan.

Activities and Investments of FDIC-Insured State-Chartered Banks.

The activities and equity investments of FDIC-insured, state-chartered banks are generally limited to those that are permissible for national banks. Under regulations dealing with equity investments, an insured state bank generally may not directly or indirectly acquire or retain any equity investment of a type, or in an amount, that is not permissible for a national bank. An insured state bank is not prohibited from, among other things, (i) acquiring or retaining a majority interest in a subsidiary, (ii) investing as a limited partner in a partnership the sole purpose of which is direct or indirect investment in the acquisition, rehabilitation or new construction of a qualified housing project, provided that such limited partnership investments may not exceed 2% of the bank’s total assets, (iii) acquiring up to 10% of the voting stock of a company that solely provides or reinsures directors’, trustees’ and officers’ liability insurance coverage or bankers’ blanket bond group insurance coverage for insured depository institutions, and (iv) acquiring or retaining the voting shares of a depository institution if certain requirements are met. In addition, an FDIC-insured state-chartered bank may not directly, or indirectly through a subsidiary, engage as “principal” in any activity that is not permissible for a national bank unless the FDIC has determined that such activities would pose no risk to the insurance fund of which it is a member and the bank is in compliance with applicable regulatory capital requirements.

Regulatory Enforcement Authority

Applicable banking laws include substantial enforcement powers available to federal banking regulators. This enforcement authority includes, among other things, the ability to assess civil money penalties, to issue cease-and-desist or removal orders and to initiate injunctive actions against banking organizations and institution-affiliated parties, as defined. In general, these enforcement actions may be initiated for violations of laws and regulations and unsafe or unsound practices. Other actions or inactions may provide the basis for enforcement action, including misleading or untimely reports filed with regulatory authorities.

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

Prompt Corrective Action.

Section 38 of the Federal Deposit Insurance Act (“FDIA”) provides the federal banking regulators with broad power to take “prompt corrective action” to resolve the problems of undercapitalized institutions. The extent of the regulators’ powers depends on whether the institution in question is “well capitalized,” “adequately capitalized,” “undercapitalized,” “significantly undercapitalized” or “critically undercapitalized.” A bank is deemed to be (i) “well capitalized” if it has total risk-based capital ratio 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 specified requirements to meet and maintain a specific capital level for any capital measure, (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 less than 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%. The regulations also provide that a federal banking regulator may, after notice and an opportunity for a hearing, reclassify a “well capitalized” institution as “adequately capitalized” and may require an “adequately capitalized” institution or an “undercapitalized” institution to comply with supervisory actions as if it were in the next lower category if the institution is in an unsafe or unsound condition or engaging in an unsafe or unsound practice. The federal banking regulator may not, however, reclassify a “significantly undercapitalized” institution as “critically undercapitalized.”

An institution generally must file a written capital restoration plan which meets specified requirements, as well as a performance guaranty by each company that controls the institution, with an appropriate federal banking regulator within 45 days of the date that the institution receives notice or is deemed to have notice that it is “undercapitalized,” “significantly undercapitalized” or “critically undercapitalized.” Immediately upon becoming undercapitalized, an institution becomes subject to statutory provisions, which, among other things, set forth various mandatory and discretionary restrictions on the operations of such an institution.

At December 31, 2012, the Company and the Bank had capital levels which qualified them as “well-capitalized” institutions.

FDIC Insurance

The Bank is a member of the FDIC and its deposit accounts are insured by the FDIC up to $250,000. As insurer, the FDIC is authorized to conduct examinations of, and to require reporting by, FDIC-insured institutions. It also may prohibit any FDIC-insured institution from engaging in any activity the FDIC determines by regulation or order to pose a serious threat to the FDIC.

In the past four years, there have been many failures and near-failures among financial institutions. As the number of FDIC-insured banks that failed increased, the FDIC insurance fund reserve ratio, representing the ratio of the fund to the level of insured deposits, declined dramatically due to losses caused by bank failures. As a result, the FDIC increased its deposit insurance premiums on remaining institutions, including well-capitalized institutions like Victory State Bank, in order to replenish the insurance fund. If bank failures continue to occur, and more so if the level of failures increases, the FDIC insurance fund may further decline, and the FDIC would be required to continue to impose higher premiums on healthy banks. Thus, despite the prudent steps we may take to avoid the mistakes made by other banks, our costs of operations may increase as a result of those mistakes by others.

Our FDIC insurance premium was $188,285 in 2012 compared to $238,823 in 2011, a decrease of 21.2%, principally due to a reduction in the Bank's non-performing loans and a corresponding reduction in the Bank's risk profile, which is one of the factors used to calculate its FDIC insurance premium. As required by The Dodd –Frank Wall Street Reform and Consumer Protection Law (the "Dodd-Frank" Act), the FDIC has recently revised its deposit insurance premium assessment rates. Our Bank, even though we are in the lowest regulatory risk category, is subject to an assessment rate between five (5) and nine (9) basis points per annum. In general, the rates are applied to our bank's total assets less tangible capital, in contrast to the former rule which applied the assessment rate to our level of deposits.

The deposit insurance premium change and the special assessment have begun to replenish the fund created to pay the cost of resolving failed banks and the fund no longer has a negative balance. The Dodd-Frank Act requires that the FDIC must increase the ratio of the FDIC insurance fund to estimated total insured deposits to 1.35% by September 30, 2020. The FDIC believes that most banks will pay a lower total assessment under the new system than under the former system, and Victory State Bank has paid lower premiums under the new system than under the former system. However, if bank failures in the future exceed FDIC estimates, or other estimates that the FDIC makes turn out to be incorrect, and the losses to the insurance fund increase, the FDIC could be forced to increase insurance premiums. Such an increase would increase our non-interest expense.

The FDIC may terminate the deposit insurance of any insured depository institution, including the Bank, if it determines, after a hearing, that the institution has engaged or is engaging in unsafe or unsound practices, is in an unsafe or unsound condition to continue operations, or has violated any applicable law, regulation, order or any condition imposed by an agreement with the FDIC. It also may suspend deposit insurance temporarily during the hearing process for the permanent termination of insurance, if the institution has no tangible capital. If insurance of accounts is terminated, the accounts at the institution at the time of the termination, less subsequent withdrawals, shall continue to be insured for a period of six months to two years, as determined by the FDIC. Management is aware of no existing circumstances that would result in termination of the Bank's deposit insurance.

Brokered Deposits

Under federal law and applicable regulations, (i) a well capitalized bank may solicit and accept, renew or roll over any brokered deposit without restriction, (ii) an adequately capitalized bank may not accept, renew or roll over any brokered deposit unless it has applied for and been granted a waiver of this prohibition by the FDIC and (iii) an undercapitalized bank may not (x) accept, renew or roll over any brokered deposit or (y) solicit deposits by offering an effective yield that exceeds by more than 75 basis points the prevailing effective yields on insured deposits of comparable maturity in such institution's normal market area or in the market area in which such deposits are being solicited. The term "undercapitalized insured depository institution" is defined to mean any insured depository institution that fails to meet the minimum regulatory capital requirement prescribed by its appropriate federal banking agency. The FDIC may, on a case-by-case basis and upon application by an adequately capitalized insured depository institution, waive the restriction on brokered deposits upon a finding that the acceptance of brokered deposits does not constitute an unsafe or unsound practice with respect to such institution. The Bank had no brokered deposits outstanding at December 31, 2012.

Community Reinvestment and Consumer Protection Laws

In connection with its lending activities, the Bank is subject to a variety of federal laws designed to protect borrowers and promote lending to various sectors of the economy and population. Included among these are the Home Mortgage Disclosure Act, Real Estate Settlement Procedures Act, Truth-in-Lending Act, Equal Credit Opportunity Act, Fair Credit Reporting Act and Community Reinvestment Act ("CRA").

The CRA requires FDIC insured banks to define the assessment areas that they serve, identify the credit needs of those assessment areas and take actions that respond to the credit needs of the community. The FDIC must conduct regular CRA examinations of the Bank and assign it a CRA rating of "outstanding," "satisfactory," "needs improvement" or "unsatisfactory." The Bank is also subject to provisions of the New York State Banking Law which impose similar obligations to serve the credit needs of its assessment areas. The New York State Department of Financial Services makes a biennial written assessment of a bank's compliance, and makes the assessment available to the public. Federal and New York State laws both require consideration of these ratings when reviewing a bank's application to engage in certain transactions, including mergers, asset purchases and the establishment of branch offices. A negative assessment may serve as a basis for the denial of any such application. The Bank has received “Outstanding” rating from the New York State Department of Financial Services and “Satisfactory” from the FDIC.

The Dodd-Frank Act created a new federal Consumer Financial Protection Bureau (“Bureau”) with broad authority to regulate and enforce consumer protection laws. The Bureau assumed those responsibilities on July 21, 2011. The Bureau has the authority to participate in regulatory examinations and to adopt regulations under numerous existing federal consumer protection statutes. The Bureau may also decide that a particular consumer financial product or service, or the manner in which it is offered, is an unfair, deceptive, or abusive act or practice. If the Bureau so decides, it has the authority to outlaw such act or practice. Since the Bureau is just in its formative stages and has not yet exercised any of its authority to regulate, examine or enforce consumer laws, it is impossible to predict its effect on our company.

Limitations on Dividends

The payment of dividends by the Bank to our Company as its sole stockholder is subject to various regulatory requirements. Under New York State Banking Law, a New York-chartered stock bank may declare and pay dividends out of its net profits, unless there is an impairment of capital, but approval of the Superintendent is required if the total of all dividends declared in a calendar year would exceed the total of its net profits for that year combined with its retained net profits of the preceding two years, subject to certain adjustments.

Miscellaneous

The Bank is subject to restrictions on loans to its non-bank subsidiaries, on investments in the stock or securities thereof, on the taking of such stock or securities as collateral for loans to any borrower, and on the issuance of a guarantee or letter of credit on behalf of the Bank or its non-bank subsidiaries. The Bank also is subject to restrictions on most types of transactions with our Company or our non-bank subsidiaries, requiring that the terms of such transactions be substantially equivalent to terms of similar transactions with non-affiliated firms.

Assessments

Banking institutions are required to pay assessments to both the FDIC and the NYSDFS to fund their operations. The assessments are based upon the amount of the Bank's total assets. The Bank must also pay an examination fee to the NYSDFS when they conduct an examination. The Bank paid federal and state assessments and examination fees of $219,455 in 2012.

Transactions with Related Parties

The Bank's authority to engage in transactions with related parties or "affiliates" (i.e., any entity that controls or is under common control with an institution, including the Bank) or to make loans to certain insiders is limited by Sections 23A and 23B of the Federal Reserve Act. Section 23A limits the aggregate amount of transactions with any individual affiliate to 10% of the capital and surplus of the institution and also limits the aggregate amount of transactions with all affiliates to 20% of the institution's capital and surplus.

Loans to affiliates must be secured by collateral with a value that depends on the nature of the collateral. The purchase of low quality assets from affiliates is generally prohibited. Loans and asset purchases with affiliates must be on terms and under circumstances, including credit standards, that are substantially the same or at least as favorable to the institution as those prevailing at the time for comparable transactions with nonaffiliated companies. In the absence of comparable transactions, such transactions may only occur under terms and circumstances, including credit standards, that in good faith would be offered to or would apply to nonaffiliated companies.

The Bank's authority to extend credit to executive officers, directors and 10% shareholders, as well as entities controlled by such persons, is currently governed by Regulation O of the Federal Reserve Board. Regulation O generally requires such loans to be made on terms substantially similar to those offered to unaffiliated individuals (except for preferential loans made in accordance with broad based employee benefit plans), places limits on the amount of loans the Bank may make to such persons based, in part, on the Bank's capital position, and requires certain approval procedures to be followed.

Standards for Safety and Soundness

FDIC regulations require that Victory State Bank adopt procedures and systems designed to foster safe and sound operations in the areas of internal controls, information systems, internal and audit systems, loan documentation, credit underwriting, interest rate risk exposure, asset growth, asset quality, earnings and compensation, fees and benefits. Among other things, these regulations prohibit compensation and benefits and arrangements that are excessive or that could lead to a material financial loss. If Victory State Bank fails to meet any of these standards, it will be required to submit to the FDIC a plan specifying the steps that will be taken to cure the deficiency. If it fails to submit an acceptable plan or fails to implement the plan, FDIC the will require it or VSB Bancorp, Inc. to correct the deficiency and until corrected, may impose restrictions on them.

The FDIC has also adopted regulations that require Victory State Bank to adopt written loan policies and procedures that are consistent with safe and sound operation, are appropriate for the size of the Bank, and must be reviewed by the Bank's Board of Directors annually. Victory State Bank has adopted such policies and procedures, which are discussed above as part of the discussion of our lending operations.

Federal Reserve System

The Federal Reserve Board regulations require banks to maintain non-interest earning reserves against their transaction accounts (primarily regular checking accounts and interest-bearing checking accounts). The first $12.4 million of otherwise reservable deposits are exempted from the reserve requirements. For the next $67.1 million of reservable deposits, the reserve requirement is 3%. For amounts above that level, the reserve requirement 10%. These levels are subject t annual adjustment based upon the rate of increase in total reservable deposits of all financial institutions. The Bank is in compliance with these requirements. The Federal Reserve now permits the payment of interest on reserve deposits so such deposits are now classified as interest-earning assets. However, due to the extremely low target federal funds rate in 2012 as established by the Federal Reserve, the amount of interest we earned on reserve deposits was negligible. This reserve requirement could reduce the amount of our interest-earning assets that we can invest in higher yielding assets, such as loans. However, our level of overnight investments substantially exceeded our reserve requirement, so the reserve requirement did not cause us to forgo material income.

TAXATION

Federal Taxation

General

We are subject to federal income taxation in the same general manner as other corporations with some exceptions discussed below. 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 us. Our federal income tax returns have not been audited or closed without audit by the Internal Revenue Service.

Method of Accounting

We report our income and expenses on the accrual method of accounting and use a tax year ending December 31 for filing our consolidated federal income tax returns. The Company files consolidated tax returns with the Bank.

Bad Debt Reserves

We use the experience method in computing bad debt deductions for federal tax purposes.

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 AMT is in excess of the Company’s regular tax liability. Net operating losses can offset no more than 90% of AMT. Certain payments of alternative minimum tax may be used as credits against regular tax liabilities in future years. We have not been subject to the alternative minimum tax and have no such amounts available as credits.

State and Local Taxation

New York State and New York City Taxation.

New York State Franchise Tax on corporations is imposed in an amount equal to the greater of (a) 7.1% of “entire net income” allocable to New York State (b) 3% of “alternative entire net income” allocable to New York State (c) 0.01% of the average value of assets allocable to New York State or (d) a nominal minimum tax. Entire net income is based on federal taxable income, subject to certain modifications. Alternative entire net income is equal to entire net income without certain modifications. The New York City Corporation Tax is imposed using similar alternative taxable income methods and rates.

A temporary Metropolitan Transportation Business Tax Surcharge on banking corporations doing business in the Metropolitan District has been applied since 1982. We transact a significant portion of our business within this District and thus we are subject to this surcharge. The current surcharge rate is 17% of the State franchise tax liability. New York City does not impose comparable surcharges.

For New York State and City tax purposes, the bad debt deduction conforms to the federal deduction.

Item 2. Properties.

At December 31, 2012, we conducted our business through five banking offices. Our main office and banking facility is at 4142 Hylan Boulevard.

Location	Description	Leased or Owned	Original Date Leased or Acquired	Date of Lease Expiration (2)	Net Book Value of Leasehold Improvements at December 31, 2012
4142 Hylan Boulevard Staten Island, N.Y. 10308	Main Office	Leased	2005	3/25/2020	$ 1,395,669
755 Forest Avenue Staten Island, N.Y. 10310	Branch	Leased	1999	11/30/2018	$ 17,498
One Hyatt Street Staten Island, N.Y. 10301	Branch	Leased	1999	10/30/2014	$ 8,431
1762 Hylan Boulevard Staten Island, N.Y. 10305	Branch	Leased	2001	6/30/2016	$ 48,536
1766 Hylan Boulevard (1) Staten Island, N.Y. 10305	Retail Stores	Leased	2001	6/30/2016	$ 4,560
1065 Bay Street Staten Island, N.Y. 10305	Branch	Leased	2006	04/26/2021	$ 71,020
Total net book value					$ 1,545,714

(1) We leased the retail stores at 1766 Hylan Boulevard as a component of the lease for the 1762 Hylan Boulevard branch and we sublease the property to retail tenants.
(2) We maintain multiple lease extension options that we may elect, in our sole discretion, which will extend the maturity of these leases.

Item 3. Legal Proceedings.

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

Item 4. Mine Safety Disclosures.

Not applicable

PART II

Item 5. Market for Common Equity and Related Stockholder Matters.

Our common stock is quoted on the NASDAQ Global Market ("NASDAQ GM") under the symbol "VSBN".

The following table reflects the high and low bid price for our common stock during each calendar quarter of the last two fiscal years. Such information is derived from quotations published by Bloomberg LP. These quotations reflect inter-dealer prices, without retail mark-up, mark-down or commission and may not represent actual transactions.

	2012			
	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
High Bid	$10.86	$ 10.98	$ 10.98	$ 10.98
Low Bid	$9.84	$ 10.46	$ 10.05	$ 9.65

	2011			
	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
High Bid	$12.74	$ 12.99	$ 11.39	$ 11.28
Low Bid	$11.16	$ 11.72	$ 10.02	$ 9.90

We have approximately 140 stockholders of record. We paid our first cash dividend of $0.06 per common share on January 2, 2008 to stockholders of record on November 29, 2007, and we paid quarterly dividends of $0.06 per share with respect to each calendar quarter thereafter through the end of 2012.

The following table sets forth information regarding our equity compensation plan information, and includes options issued to directors and officers and remaining options or restricted stock issuable to officers and directors.

Equity Compensation Plan Information

Plan category	Number of securities to be issued upon exercise of outstanding options, warrants and rights (a)	Weighted-average exercise price of outstanding options, warrants and rights (b)	Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in column (a)) (c)	
Equity compensation plans approved by security holders	121,623	$ 14.62	28,177	(1)
Equity compensation plans not approved by security holders	None	N/A	None	
Total	121,623	$ 14.62	28,177	(1)

(1) Includes 5,000 shares of restricted stock available to be awarded under the Company's 2010 Retention and Recognition Plan.

ISSUER PURCHASES OF EQUITY SECURITIES

Period	(a) Total Number of Shares Purchased	(b) Average Price Paid Per Share	(c) Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs[(1)(2)]	(d) Maximum Number (or Approximate Dollar Value) of Shares (or Units) that May Yet Be

				Purchased Under the Plans or Programs
October 1, 2012 to October 31, 2012	None	None	None	50,800
November 1, 2012 to November 30, 2012	None	None	None	50,800
December 1, 2012 to December 31, 2012	None	None	None	50,800
Total	None	None	None	50,800

(1) On September 14, 2011, we announced a third stock repurchase program for the repurchase of up to 100,000 shares of our common stock. All purchases shown in the table were pursuant to such plan.

(2) As of December 31, 2012, we had repurchased a total of 49,200 shares of our common stock under the third stock repurchase program. We repurchased 249,200 shares of our common stock under all three stock repurchase programs.

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Item 7. Management’s Discussion and Analysis of Financial Condition and Results of Operations

General

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

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

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

In order to support branch expansion and asset growth, we had not paid cash dividends prior to the fourth quarter of 2007. Our Board of Directors approved our first $0.06 cash dividend to stockholders of record on November 29, 2007, payable on January 2, 2008 and we paid quarterly dividends of $0.06 per share with respect to each calendar quarter thereafter through the end of 2012. We paid $426,571 of dividends out of net income of $1,188,200, for a dividend payout ratio of 36% in 2012 and we paid $433,235 of dividends out of net income of $1,444,451, for a dividend payout ratio of 30% in 2011. Thus, we retained the majority of our net income to increase our capital base to support our efforts to expand our franchise in the future.

During 2012, we continued to face challenges from our level of non-accrual loans and a continuation of low market interest rates that pushed down our yields on assets. Although non-accrual loans declined from 2011 to 2012, they still totaled $6.4 million, or 7.8% of total loans, at December 31, 2012.

Our cost of funds, due to the downward pressure of deposit rates, declined but not as fast as our yield on assets. The real estate market continued to soften, which reduced deposit balances and loan originations from real estate attorneys who form a segment of our customer base. We incurred additional provisions for loan loss due to the increased level of delinquencies.

Management intends to exert efforts to continue growing our company in the future. However, both internal and external factors could adversely affect our future growth. The down turn in the economy has made it more difficult for us to originate new loans that meet our underwriting standards. Not only does that cause us to invest available funds in lower-yielding securities and deposits with other banks, but it also slows the development of non-loan relationships which sometimes flow from cross-selling to loan customers.

A continuation of adverse general economic conditions could make it difficult for us to execute our growth plans. Additionally, an increase in market rates may have a negative impact on our net interest income. Furthermore, regulatory capital requirements could have a negative effect on our ability to grow if growth outpaces our ability to support that growth with increased capital.

Critical Accounting Policies

We are required to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the financial statements and the amounts of revenues and expenses during the reporting period. The allowance for loan losses, the measurement of loan impairment, prepayment estimates on the mortgage-backed securities and collateralized mortgage obligation portfolios, contingencies and fair values of financial instruments are particularly subject to change and to management’s estimates. Actual results or values can differ from those estimates and may have an impact on our financial statements.

Asset/Liability Management

We maintain the interest rate sensitivity of our assets by investing primarily in CMOs and MBSs with short and intermediate average lives to generate cash flows and by originating and retaining primarily loans with interest rates that adjust based on the prime rate. As of December 31, 2012, prime based loans totaled $59,359,893, or 69.8% of total loans. Many of these prime based loans are subject to interest rate floors of 7.00% to 8.00%. We anticipate that we will continue to concentrate on originating prime based loans in our principal market areas. We also expect to continue to invest other available funds that we cannot invest in loans in short-term investment grade securities.

Cash Flow Sensitivity Analysis. The matching of assets and liabilities may be analyzed by examining our cash flow sensitivity "gap." An asset or liability is said to be cash flow sensitive within a specific time period if it will mature or reprice within that time period. The cash flow sensitivity gap is defined as the difference between the amount of interest-earning assets maturing within a specific time period and the amount of interest-bearing liabilities maturing within that time period. A gap is considered positive when the amount of interest earning assets exceeds the amount of interest bearing liabilities. A gap is considered negative when the amount of interest bearing liabilities exceeds the amount of interest earning assets.

During a period of falling interest rates, the net income of an institution with a positive gap can be expected to be adversely affected because the yield on its interest-earning assets should reprice downward faster than the decline in its cost of funds. Conversely, during a period of rising interest rates, the net income of an institution with a positive gap position can be expected to increase as it is able to invest in higher yielding interest-earning assets at a more rapid rate than its interest-earning liabilities reprice. A positive gap may not protect an institution with a large portfolio of adjustable rate based loans or mortgage-backed securities from increases in interest rates for extended time periods if such loans or securities have annual and lifetime interest rate caps. In a low interest rate environment, such as the one that we are experiencing, once the yields on assets reach their interest rate floors, the yields do not further decline even if the index used to determine the interest rate continues to decline. When market interest rates then increase, the assets that have floors will not reprice upwards until the index rises sufficiently to cause the interest rates to exceed their floors. This delay in the upward adjustment of the interest rate may negatively affect net interest income. Our prime rate based loans and our securities investments generally do not have any annual or lifetime maximum interest rates, or caps. Caps can adversely affect net interest income if market interest rates rise substantially.

In the current interest rate environment, we generally have been investing available funds not needed for lending in CMOs and MBSs with estimated average lives of five years or less and we invested the increase in funds resulting from our growth in deposits in overnight liquid investments to the extent not needed to fund an increase in loans. As a result of this strategy, and based upon the assumptions used in the following table at December 31, 2012, our total interest-bearing assets maturing within one year exceeded our total interest-bearing liabilities maturing in the same period by $26,603,537, representing a one year cumulative positive gap ratio of 10.53%. In many cases, a positive gap ratio means that in an increasing rate environment, the interest that we earn on assets will reprice upward faster than the rates we pay on deposits. However, for a number of important reasons, that may not be the results we will experience if market interest rates begin to rise.

- As explained above, an increase in the target federal funds rate, which normally presages an immediate increase in the prime rate, will not have an immediate positive effect on most of our adjustable rate loans because they have interest rate floors that must be surpassed before yields on those assets begin to increase. However, the increase in the prime rate is likely to put prompt upward pressure on the rates we pay to depositors, at least in the case of certificates of deposit.
- The gap table does not consider the effects of customer discretion. When market interest rates are very low, the difference between the rates paid on different deposit types is relatively small, and customers may elect to keep funds in very liquid deposits with the lowest interest rates because those deposits provide the greatest flexibility when market rates increase. Those customers may elect to switch a deposit to a higher cost category, such as from NOW accounts to a time deposit, if the increase in market rates makes the difference in rates between those two deposit types more meaningful. Our cost of a specific customer's deposit could go up faster than market rates are rising if the customer decides to do so.
- The gap table does not take into account discretion by the Bank in making deposit pricing decisions. Other external factors, such as changes in competition or the decision by a local competitor to aggressively seek local deposits by offering premium rates on deposits, may cause the Bank to increase deposit rates more rapidly to match competitors.

We closely monitor our interest rate risk as such risk relates to our operational strategies. The Company and the Victory State Bank Boards of Directors have established Asset/Liability Committees, responsible for reviewing our asset/liability policies and interest rate risk position, which generally meets quarterly and reports back to the Boards on interest rate risk and trends on a quarterly basis. In light of the current interest rate environment, we are attempting to maintain a position in which our assets reprice more quickly than our liabilities. There can be no assurance, however, that we will be able to achieve that result or that we will be able to avoid further spread compression or avoid negative consequences from interest rate fluctuations. Although we have not experienced a material runoff in our core deposits, there can be no assurances that such a runoff will not occur in the future if depositors seek higher yielding investments.

Our substantial level of non-interest-bearing demand deposits also furthers our goal of maintaining a positive gap because the interest cost of those deposits will not increase as market rates increase. However an increase in market interest rates could cause our customers to shift funds from demand deposits into interest earning deposits if interest rates are high enough to justify maintaining multiple accounts. Furthermore, effective July 2011, banks were permitted to pay interest on commercial demand deposits. This could have a significant effect on our net income by forcing us to pay interest on business demand deposits to maintain parity with our competitors.

The following table sets forth the amounts of interest-earning assets and interest-bearing liabilities outstanding at December 31, 2012 which we estimate, based upon certain assumptions, will mature in each of the future time periods shown. Except as stated below, the amount of assets and liabilities shown which mature during a particular period were determined in accordance with the earlier of estimated repayment or runoff or the contractual terms of the asset or liability. There can be no assurance that deposits would reprice to peer bank’s historical levels if interest rates were to increase. Certain shortcomings are inherent in the method of analysis presented in the foregoing table. For example, although certain assets and liabilities may have similar maturities, they may react in different degrees to changes in market interest rates. The table reflects only whether a yield or cost is expected to adjust without measuring whether the magnitude of the adjustment is the same for different types of assets or liabilities. Also, the interest rates on certain types of assets and liabilities may fluctuate in advance of changes in market interest rates, while interest rates on other types may lag behind changes in market rates. Additionally, certain assets may have features which restrict changes in interest rates on a short-term basis and over the life of the asset. For example, if a prime rate loan has a minimum interest rate of 7.0%, an increase in a very low prime rate might not be sufficient to increase the interest rate on the loan to more than the minimum. Further, in the event of a change in interest rates, prepayment and early withdrawal levels may deviate significantly, in a manner we cannot predict, from those assumed in calculating the table. Finally, the ability of many borrowers to service their prime rate loans may decrease in the event of interest rate increases.

	At December 31, 2012				
	Three months or less	Four to twelve months	More than One year to five years	More than five years	Total
Interest-earning assets:					
Commercial loans (1)	$59,425,745	$1,027,010	$5,117,777	$6,003,846	$71,574,378
Consumer loans (1)	808,316	2,427,108	869,628	128,148	4,233,200
Mortgage-backed securities	10,308,014	30,924,042	61,580,776	—	102,812,832
Other interest-earning assets	74,005,295	—	—	—	74,005,295
Total interest-earning assets	144,547,370	34,378,160	67,568,181	6,131,994	252,625,705
Unamortized premium , unearned (discount) and deferred fees(2)	76,889	230,666	797,417	—	1,104,972
Net interest-earning assets	144,624,259	34,608,826	68,365,598	6,131,994	253,730,677
Interest-bearing liabilities:					
Savings accounts	20,871,593	—	—	—	20,871,593
NOW accounts	33,394,785	—	—	—	33,394,785
Money market accounts	33,814,712	—	—	—	33,814,712
Certificate accounts	40,654,269	23,894,189	6,904,246	—	71,452,704
Total interest-bearing liabilities	128,735,359	23,894,189	6,904,246	—	159,533,794
Interest sensitivity gap	$15,888,900	$10,714,637	$61,461,352	$6,131,994	$94,196,883
Cumulative gap	$15,888,900	$26,603,537	$88,064,889	$94,196,883	$94,196,883
Cumulative gap as a percentage of total interest-earning assets	6.29 %	10.53 %	34.86 %	37.29 %	37.29 %
Cumulative net interest-earning assets as a percentage of total interest-bearing liabilities	112.34 %	117.43 %	155.20 %	159.05 %	159.05 %

(1) For purposes of the gap analysis, mortgage and other loans are reduced by non-performing loans but are not reduced by the allowance for possible loan losses.

(2) For purposes of the gap analysis, unearned discount and deferred fees are pro-rated.

Analysis of Net Interest Income

Our profitability is primarily dependent upon net interest income. Net interest income represents the difference between interest income on interest-earning assets and the interest expense on interest-bearing liabilities. Net interest income depends primarily upon the volume of interest-earning assets and interest-bearing liabilities and the interest rates earned or paid on them.

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Average Balance Sheet

The following table sets forth certain information relating to our consolidated statements of financial condition and the consolidated statements of earnings for the fiscal years ended December 31, 2012, 2011 and 2010 and reflects the average yield on assets and average cost of liabilities for the period indicated. Such yields and costs are derived by dividing income or expense by the average balance of assets or liabilities, respectively, for the periods shown. Average balances are derived from average daily balances. The average balance of loans receivable include loans on which we have discontinued accruing interest. The yields and costs include net fees, which are considered adjustments to yields. No tax equivalent adjustments have been made.

	Year Ended December 31, 2012			Year Ended December 31, 2011			Year Ended December 31, 2010	
	Average Balance	Interest[1]	Yield/ Cost	Average Balance	Interest[1]	Yield/ Cost	Average Balance	Yield/ Interest[1]
Assets:								
Interest-earning assets:								
Loans receivable	$83,241,277	$5,902,637	7.09 %	$81,755,097	$5,683,399	6.95 %	$78,995,376	$5,800,691
Other interest earning assets	52,090,223	115,098	0.22	36,675,684	66,713	0.18	39,091,176	61,124
Investment securities	113,305,714	2,988,980	2.64	116,211,595	3,797,049	3.27	114,319,832	4,401,547
Total interest-earning assets	248,637,214	9,006,715	3.62	234,642,376	9,547,161	4.07	232,406,384	10,263,362
Non-interest earning assets	6,667,017			6,757,109			8,380,147	
Total assets	$255,304,231			$241,399,485			$240,786,531	
Liabilities and equity:								
Interest-bearing liabilities:								
Savings accounts	$19,111,205	53,318	0.28	$16,803,092	46,719	0.28	$15,262,470	47,445
Time accounts	64,519,056	436,374	0.68	64,184,904	479,705	0.75	65,196,898	572,292
Money market accounts	31,362,621	226,515	0.72	27,865,123	235,581	0.85	27,820,065	240,461
Now accounts	32,885,018	79,818	0.24	29,411,515	96,761	0.33	35,273,971	160,865
Total interest-bearing liabilities	147,877,900	796,025	0.54	138,264,634	858,766	0.62	143,553,404	1,021,063

Checking accounts	78,286,944			73,971,400			68,686,944		
Escrow Deposits	364,996			384,468			437,880		
Total	226,529,840			212,620,502			212,678,228		
Other liabilities	1,234,657			1,784,938			2,169,130		
Total liabilities	227,764,497			214,405,440			214,847,358		
Equity	27,539,734			26,994,045			25,939,173		
Total liabilities and equity	$255,304,231			$241,399,485			$240,786,531		
Net interest income/net interest rate spread		$8,210,690	3.08 %		$8,688,395	3.45 %		$9,242,299	
Net interest earning assets/net interest margin	$100,759,314		3.30 %	$96,377,742		3.70 %	$88,852,980		
Ratio of interest-earning assets to interest-bearing liabilities	1.68 x			1.70 x			1.62 x		
Return On Average Assets:			0.47 %			0.60 %			
Return On Average Equity:			4.31 %			5.35 %			
Equity To Assets:			10.29%			11.21%			
Dividend Payout Ratio			35.90%			29.99%			

1 - Interest on loans includes $201,071 in 2012, $130,341 in 2011 and $25,261 in 2010 representing interest received during the year on non-accrual loans that is attributable to prior years. Those amounts were excluded in calculating the average loan yield for the year in which they were received but were not added to the prior period interest in calculating the yield in the prior period.

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Rate/Volume Analysis

The following table presents the extent to which changes in interest rates and changes in the volume of interest-earning assets and interest-bearing liabilities have affected our 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 (changes in volume multiplied by prior rate), (ii) changes attributable to changes in rate (changes in rate multiplied by prior volume), and (iii) the net change. The changes attributable to the combined impact of volume and rate have been allocated proportionately to the changes due to volume and the changes due to rate.

	Year Ended December 31, 2012 Compared to December 31, 2011 Increase/(Decrease) In Net Interest Income Due to			Year Ended December 31, 2011 Compared to December 31, 2010 Increase/(Decrease) In Net Interest Income Due to			Year Ended December 31, 2010 Compared to December 31, 2009 Increase/(Decrease) In Net Interest Income Due to		
	Volume	Rate	Net	Volume	Rate	Net	Volume	Rate	Net
Interest-earning assets:									
Loans receivable	$ 103,290	$ 115,948	$ 219,238	$202,564	($319,856)	($117,292)	$560,019	($224,696)	$ 335
Other interest-earning assets	27,746	20,639	48,385	(3,865)	9,454	5,589	13,981	14,093	28,
Investment securities, afs	(95,022)	(713,047)	(808,069)	72,833	(677,331)	(604,498)	(180,771)	(567,452)	(74
Total	36,013	(576,459)	(540,446)	271,532	(987,733)	(716,201)	393,229	(778,055)	(38
Interest-bearing liabilities:									
Savings accounts	6,463	136	6,599	4,776	(5,502)	(726)	5,655	(8,355)	(2,7
Time accounts	2,506	(45,837)	(43,331)	(8,906)	(83,681)	(92,587)	(14,740)	(338,761)	(35
Money market accounts	29,729	(38,795)	(9,066)	387	(5,267)	(4,880)	23,599	(30,004)	(6,
Now accounts	11,463	(28,406)	(16,943)	(26,967)	(37,137)	(64,104)	29,250	(10,790)	18,
Total	50,160	(112,901)	(62,741)	(30,709)	(131,588)	(162,297)	43,765	(387,911)	(34
Net change in net interest income	($14,147)	($463,558)	($477,705)	$302,241	($856,145)	($553,904)	$349,464	($390,144)	($40,

Effect of Adverse Conditions in the Real Estate Market

We rarely make residential mortgage loans to consumers to finance or refinance their home ownership. At December 31, 2012, we owned $102.8 million of securities that are either collateralized by residential mortgage loans or that represent shares in pools of such loans. However, 99.5% of those securities are issued or guaranteed by FNMA, GNMA or FHLMC. The remainder of the securities' portfolio consist of investment grade securities rated AAA. None of those securities have experienced ratings downgrades. We do not hold any loans in our portfolio of the type that are commonly known as subprime residential mortgage loans.

However, many of our customers, both loan and deposit customers, are involved in the residential construction business in Staten Island. We believe that the turmoil in the national housing and residential mortgage markets has had an adverse effect on some of our customers and has contributed to the increase in our level of past due loans. Weaknesses in the real estate market in general have also reduced the value of real estate collateral for some of our loans, which reduces our ability to recover loans in full when customers default in making regular payments.

The previous slowdown in the local housing market, which now may have stabilized but at lower value levels, seems to have reduced the business activity of our customers. We believe that this, in turn, has caused a reduction in their demand for loans from us, such as construction loans to build new homes. It also appears to have reduced the level of deposits they maintain. Furthermore, as the housing market has slumped, we have become more selective in our origination of construction loans, making it more difficult to deploy funds from lower yielding securities investments into higher yielding loans.

The Effect of a Future Increase in Market Interest Rates.

The Federal Reserve Open Market Committee, after its January 2012 meeting, announced that "economic conditions--including low rates of resource utilization and a subdued outlook for inflation over the medium run--are likely to warrant exceptionally low levels for the federal funds rate at least through late 2014." After its January 2013 meeting, the Committee said that it "expects that a highly accommodative stance of monetary policy will remain appropriate for a considerable time after the asset purchase program ends and the economic recovery strengthens." This appears to indicate that the Federal Reserve plans to maintain interest rates at low levels for an extended period of time. If this occurs, then the rates we charge on loans based upon market interest rates are likely to remain at low levels for the next few years. However, it is considered inevitable that market interest rates will eventually increase, and when this occurs, the increase appears likely to have a negative effect on our net interest income, at least in the short term after rates begin to rise.

Most of our loans are now at their interest rate floors and a substantial portion of our investment securities portfolio purchased at higher yields before interest rates began to decline has been repaid, with the proceeds reinvested at lower yields. Both of these factors are likely to slow the increase in our asset yields when market rates rise above their current historic lows. Specifically, the yields on most of our loans with interest rate floors will not begin to increase until the prime rate exceeds 6%, which is 275 basis points above the current prime rate. Furthermore, most of our securities investments with lower yields will retain those yields despite increases in market rates until we receive principal payments and we reinvest the payments at higher yields.

The cost of deposits initially declined more rapidly than our asset yields as interest rates declined. If market interest rate trend upward, the rates we pay on interest-bearing deposits, because of their lower starting point, can increase more in step with the basis point increases in market rates because of the need to maintain customer relationships, competitive pressures, and other factors.

As a result, although most of our loans are technically considered to be interest rate sensitive because they are tied to the prime rate, their sensitivity to market interest rate increases may lag behind our deposits, depending upon how fast interest rates increase. This could have an adverse effect on net interest income as interest rates increase. In addition, customers may exercise discretion in moving funds between different types of deposits to maximize their interest earnings when interest rates rise and they perceive a greater advantage in managing the movement of funds between accounts with different interest rates.

One tool we use to manage market interest rate increases is to increase overnight investments, as these investments are highly correlated with the change in market interest rates. Additionally, approximately one-third of our deposits are interest-free checking accounts and the rates on those accounts do not rise as market rates increase.

We have some flexibility in allocating our investment choices between the three categories of earning assets – loans, investment securities and other investments (principally overnight investments). As interest rates declined, we elected to invest more of our available liquid assets into investment securities instead of overnight investments. This shift in the mix of our investments allowed us to reduce the effect of declining interest rates because investment securities tend to have higher yields than overnight investments. We reinvested the payments we received on existing investment securities in securities with rates that were lower than the rates we were earning on the securities being repaid because many of the securities being repaid were purchased a number of years ago before market interest rates reached their current extremely low levels.

Comparative Results for the Years Ended December 31, 2012 and December 31, 2011

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

General. We had net income of $1,188,200 for the year ended December 31, 2012, compared to net income of $1,444,451 for the comparable period in 2011. The principal categories which make up the 2012 net income are:

- Interest income of $9,006,715
- Reduced by interest expense of $796,025
- Reduced by a provision for loan losses of $355,000
- Increased by non-interest income of $2,428,973
- Reduced by non-interest expense of $8,094,349
- Reduced by income tax expense of $1,002,114

We discuss each of these categories individually and the reasons for the differences between the years ended December 31, 2012 and 2011 in the following paragraphs.

Interest Income. Interest income was $9,006,715 for the year ended December 31, 2012, compared to $9,547,161 for the year ended December 31, 2011, a decrease of $540,446 or 5.7%. The main reason for the decline was a 63 basis point decrease in the yield and a $2,905,881 decrease in average balance on investment securities between the periods, which combined to cause an $808,069 decline in interest income on investment securities. This was partially offset by the $219,238 increase in interest income on loans.

Interest income on loans increased by $219,238 as a result of an increase of $70,730 in interest collected on loans previously on non-accrual, from $130,347 in 2011 to $201,071 in 2012. Also contributing to the increase in income on loans was a $1.5 million increase in the average balance of loans and a 14 basis point increase in the average yield, from the year ended 2011 to the year ended 2012. The increase in the average balance was the result of our efforts to increase our loan portfolio, which represents our highest yielding asset category. There was a $264,109 decrease in our average non-performing loans, from $7.6 million in the year ended 2011 to $7.3 million in the year ended 2012. During the period in which interest is not being paid, non-performing loans continue to be included in the calculation of average loan yield, but with an effective yield of zero. We estimate that if all non-performing loans were performing according to their contractual terms during the year ended 2012, our average loan yield would have been approximately 24 basis points higher. In contrast, we estimate that the comparable effect in 2011 period would have been approximately a 53 basis point increase in average loan yield. Substantially all of the non-accrual loans are secured by mortgages on real estate.

Interest rate floors on most of our loans have helped to stabilize interest income from the loan portfolio, but these floors will have the effect of limiting increases in our income until the prime rate rises above 6%.

We experienced a 63 basis point decrease in the average yield on our investment securities portfolio, from 3.27% to 2.64%, due to the purchase of new investment securities at lower market rates than the rates we had been earning on the investment securities previously purchased that were gradually being repaid. The average balance of our investment portfolio decreased by $2.9 million, or 2.5%, between the periods. The investment securities portfolio represented 68.5% of average non-loan interest earning assets in the 2012 period compared to 76.0% in the 2011 period.

Interest income from other interest earning assets (principally overnight investments) increased by $48,385 due to an increase in the yield of 4 basis points from 0.18% for the year ended December 31, 2011 to 0.22% for the same period ended December 31, 2012. In addition, the average balance of our other interest earning assets increased by $15.4 million between the periods because we elected to invest available funds in overnight investments rather than tie them up in longer term investment securities which were available only at relatively low yields.

Interest Expense. Interest expense was $796,025 for the year ended December 31, 2012, compared to $858,766 for the year ended December 31, 2011, a decrease of $62,741 or 7.3%. The decrease was primarily the result of a reduction in the rates we paid on deposits between the periods, principally a 13 basis point decrease in money market account rates and a 9 basis point decrease in the cost of Now account deposits, due to the continuing low market interest rates. As a result, our average cost of funds, excluding the effect of interest-free demand deposits, decreased to 0.54% from 0.62% between the periods.

Net Interest Income Before Provision for Loan Losses. Net interest income before the provision for loan losses was $8,210,690 for the year ended December 31, 2012, compared to $8,688,395 for the year ended December 31, 2011, a decrease of $477,705, or 5.5%. The decrease was because the reduction in our interest income was greater than the reduction in our cost of funds when comparing the year ended December 31, 2012 to the same period ended 2011. The average yield on interest earning assets declined by 45 basis points, while the average cost of funds declined by 8 basis points. The reduction in the yield on assets was principally due to the 63 basis point drop in the yield on investment securities, and the increase in low yielding overnight investments as a percentage of total interest-earning assets, partially offset by the 14 basis point increase in the yield on loans. The decline in the cost of funds was driven principally by the 13 basis point decrease in money market accounts and the 9 basis point decrease in the cost of NOW account deposits. Overall, our interest rate spread declined 37 basis points, from 3.45% to 3.08% between the periods. Correspondingly, our net interest margin decreased to 3.30% for the year ended December 31, 2012 from 3.70% in the same period of 2011. The margin is higher than the spread because it takes into account the effect of interest free demand deposits and capital.

The spread and margin both decreased because of the combined effect of the decline in earnings we were able to obtain on our investments securities and the adverse effect of the decrease in interest received on problem loans. These declines could not be offset by corresponding declines in the cost of deposits because the rates we paid on deposits were already low due to low markets rates so that we could not reduce them as much as the decline in the earnings on investment securities. In addition, we continued to incur interest expense on deposits that funded the non-performing loans that did not earn interest and on other interest earning assets, our lowest yielding asset class.

Provision for Loan Losses. The provision for loan losses in any period depends upon the amount necessary to bring the allowance for loan losses to the level management believes is appropriate, after taking into account charge offs and recoveries. We took a provision for loan losses of $355,000 for the year ended December 31, 2012 compared to a provision for loan losses of $595,000 for the year ended December 31, 2011. The $240,000 decrease in the provision was a result of a higher level of recoveries and a lower level of charge-offs between the periods.

We charged-off $128,349 of loans for the year ended December 31, 2012 as compared to charge-offs of $668,995 for the year ended December 31, 2011. We also had recoveries (which are added back to the allowance for loan losses) of $183,850 for the year ended December 31, 2012 as compared to $139,795 in the same period of 2011. After decreasing the provision for loan losses for the year ended December 31, 2012 compared to the same period in 2011, and considering other matters that increased or decreased the allowance, we determined that the level of our allowance at December 31, 2012 was appropriate to address inherent losses.

Non-interest Income. Non-interest income was $2,428,973 for the year ended December 31, 2012, compared to $2,472,078 during the same period last year. The $43,105, or 1.7%, decrease in non-interest income was a direct result of a $12,027 decrease in service charges on deposits and a $36,184 decrease in other income due to the recovery in 2011 of a contingency previously set aside . Service charges on deposits consist mainly of insufficient fund fees, which are inherently volatile, and are based upon the number of items being presented for payment against insufficient funds.

Non-interest Expense. Non-interest expense was $8,094,349 for the year ended December 31, 2012, compared to $7,936,962 for the year ended December 31, 2012, an increase of $157,387 or 2.0%. The principal shifts in the individual categories were:

- a $100,838 increase in other non-interest expenses due to a $38,236 increase in the cost of holding real estate acquired in the collection of mortgage loans, a $21,828 increase in checkbook printing charges; a $17,667 increase in the costs of operating our ATM's and a $17,322 increase in the costs of preparing regulatory filings;

- a $47,679 increase in professional fees due to higher costs and the hiring of a consultant;
- a $46,709 increase in occupancy expense due primarily to the 2012 remediation at a branch that sustained damage during Hurricane Sandy;
- a $44,463 increase in legal

expense due to a higher level of collections and a recovery of legal fees in 2011 previously expensed on a settled lawsuit;

- a $13,250 increase in director's fee due to increased frequency of meetings, partially offset by
- a $81,274 decrease in salaries and benefits due to reduced staff; and
- a $14,278 decrease in computer expenses due to reduced contract expense.

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

Income Tax Expense. Income tax expense was $1,002,114 for the year ended December 31, 2012, compared to income tax expense of $1,184,060 for the same period ended 2011. The decrease in income tax expense was due to the $438,197 decrease in income before income taxes in the 2012 period. Our effective tax rate for the year ended December 31, 2012 and 2011 was 45.8%.

Changes in Financial Condition

Total assets were $269,704,371 at December 31, 2012, an increase of $27,857,916, or 11.5%, from December 31, 2011. The increase resulted from the investment of funds available to us as the result of retained earnings and an increase in deposits. The deposit increase was caused generally by our efforts to grow our franchise and specifically by the deposit increases at our branch offices. We invested these funds primarily in cash and cash equivalents. The principal changes resulting in the net increase in assets can be summarized as follows:

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- $29,620,753 net increase in cash and cash equivalents partially offset by
- $1,674,919 net decrease in investment securities available for sale.

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

Our deposits (including escrow deposits) were $240,701,206 at December 31, 2012, an increase of $27,478,301 or 12.9%, from December 31, 2011 as a result of our active solicitation of retail deposits to increase funds for investment. The aggregate increase in deposits resulted from increases of $9,373,618 in non-interest demand deposits, $6,114,153 in money market accounts, $5,558,168 in time deposits, $3,693,068 in savings accounts and $2,841,782 in NOW accounts, partially offset by a decrease of $102,488 in escrow deposits.

Total stockholders' equity was $27,753,971 at December 31, 2012, an increase of $651,711, or 2.40%, from December 31, 2011. The increase reflected: (i) a $761, 629 increase in retained earnings due to net income of $1,188,200 for the year ended December 31, 2012, partially offset by $426,571 of dividends paid in 2012; (ii) a reduction of $169,078 in Unearned ESOP shares reflecting the gradual payment of the loan we made to fund the ESOP's purchase of our stock. We awarded 9,500 shares from a stockholder-approved restricted stock award plan the was implemented in 2010, which resulted in a $101,175 decrease in additional paid in capital and a corresponding reduction in Treasury shares, with no net change in stockholders' equity and (iii) a decrease in the net unrealized gain on securities available for sale of $98,072. Additionally, there was a $234,477 increase in Treasury shares representing the cost of 22,000 shares of common stock we repurchased during the year ended 2012 under our Company's third stock repurchase plan.

The unrealized gain on securities available for sale is excluded from the calculation of regulatory capital. Management does not anticipate selling securities in this portfolio, but changes in market interest rates or in the demand for funds may change management's plans with respect to the securities portfolio. If there is a material increase in interest rates, the market value of the available for sale portfolio may decline. Management believes that the principal and interest payments on this portfolio, combined with the existing liquidity, will be sufficient to fund loan growth and potential deposit outflow.

Liquidity and Capital Resources

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

During the year ended December 31, 2012, we had a net increase in total deposits of $27,478,301 due to increases of $9,373,618 in non-interest demand deposits, $6,114,153 in money market accounts, $5,558,168 in time deposits, $3,693,068 in savings accounts and $2,841,782 in NOW accounts, partially offset by a decrease of $102,488 in escrow deposits. These are all what are commonly known as "retail" deposits that we obtain through the efforts of our branch network rather than "wholesale" deposits that some banks obtain from deposit brokers. We also received proceeds from repayment of investment securities of $37,429,264. We used $36,396,894 of available funds to purchase new investment securities and we had a net loan increase of $9,428. These changes resulted in an overall increase in cash and cash equivalents of $29,620,753. Total cash and cash equivalents at December 31, 2012 were $77,728,426.

In contrast, in 2011, we had a net increase in total deposits of $5,816,248 due to increases of $6,100,330 in non-interest demand deposits, $2,249,573 in time deposits, $2,240,085 in savings accounts, partially offset by a decrease of $4,585,864 in NOW accounts, $148,412 in money market accounts and $39,464 in escrow deposits. These are all "retail" deposits. We also received proceeds from repayment of investment securities of $34,482,147. We used $21,774,024 of available funds to purchase new investment securities and we had a net loan increase of $306,966. These changes resulted in an overall increase in cash and cash equivalents of $19,342,686. Total cash and equivalents at December 31, 2011 were $48,107,673.

At December 31, 2012, cash and cash equivalents represented 28.8% of total assets. Our cash and cash equivalents increased as we deployed more funds into short term overnight funds which will enable us to take advantage of future opportunities and investment securities. We maintain a higher level of cash and cash equivalents to help buffer the adverse effects of potential, future rising interest rates. We anticipate, based upon historical experience that these funds, combined with cash inflows we anticipate from payments on our loan and investment securities portfolios, will be sufficient to fund loan growth and unanticipated deposit outflows. The federal legal prohibition on paying interest on demand deposit accounts was repealed effective July 2011. Depending upon competitive pressures, we may need to implement interest-paying business checking in order to maintain demand deposits at historical levels or to increase such deposits.

As a secondary source of liquidity, at December 31, 2012 we had $106.8 million of investment securities classified available for sale. The disposition of these securities prior to maturity is an option available to us in the event, which we believe is unlikely, that our primary sources of liquidity and expected cash flows are insufficient to meet our need for funds. Additionally, we have the ability to borrow funds at the Federal Home Loan Bank of New York and the Federal Reserve Bank of New York using securities in our investment portfolio as collateral if the need arises. Based upon our asset size and the amount of our securities portfolio that qualifies as eligible collateral, we had more than $72.3 million of unused borrowing capability from the FHLBNY at December 31, 2012. Victory State Bank also has a $2 million unsecured credit facility with Atlantic Central Bankers Bank, which the Bank has not drawn upon. We do not anticipate a need for additional capital resources and do not expect to raise funds through a stock offering in the near future. We have sufficient resources to allow us to continue to make loans as appropriate opportunities arise without having to rely on government funds to support our lending activities.

Victory State Bank satisfied all capital ratio requirements of the Federal Deposit Insurance Corporation at December 31, 2012, with a Tier I Leverage Capital ratio of 9.65%, a Tier I Capital to Risk-Weighted Assets ratio of 26.03%, and a Total Capital to Risk-Weighted Assets ratio of 27.28%.

The following table sets forth our contractual obligations and commitments for future lease payments, time deposit maturities and loan commitments.

Contractual Obligations and Commitments at December 31, 2012

Contractual Obligations	Payment due by Period				
	Less than One Year	One to three years	Four to five years	After five years	Total Amounts committed
Minimum annual rental payments under non-cancelable operating leases	$430,035	$848,457	$587,919	$603,085	$2,469,496
Remaining contractual maturities of time deposits	64,548,458	4,504,423	2,399,823	—	71,452,704
Total contractual cash obligations	$64,978,493	$5,352,880	$2,987,742	$603,085	$73,922,200

Other commitments	Amount of commitment Expiration by Period				
	Less than One Year	One to three years	Four to five years	After five years	Total Amounts committed
Loan commitments	$20,577,784	$3,090,776	$645,000	$—	$24,313,560

Impact of Inflation and Changing Prices

The consolidated financial statements and related notes presented herein have been prepared in accordance with accounting principles generally accepted in the United States, which require the measurement of financial position and operating results in terms of historical dollars without considering the changes in the relative purchasing power of money over time and due to inflation. Unlike industrial companies, nearly all of our assets and liabilities are monetary. As a result, interest rates have a greater impact on our performance than do the general levels of inflation. Interest rates do not necessarily move in the same direction or to the same extent as the price of goods and services.

Item 8.

The company’s financial statements appear on the following pages:

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Report of Independent Registered Public Accounting Firm

Board of Directors and Stockholders

VSB Bancorp, Inc.

Staten Island, New York

We have audited the accompanying consolidated statements of financial condition of VSB Bancorp, Inc. as of December 31, 2012 and 2011, and the related consolidated statements of earnings, comprehensive income, stockholders' equity and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these 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 financial statements are free of material misstatement. The Company is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. Our audit included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes 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 VSB Bancorp, Inc. as of December 31, 2012 and 2011, and the results of its operations and its cash flows for the years then ended in conformity with U.S. generally accepted accounting principles.

/s/Crowe Horwath LLP

New York, New York

March 15, 2013

VSB BANCORP, INC.

CONSOLIDATED STATEMENTS OF FINANCIAL CONDITION

DECEMBER 31, 2012 AND 2011

ASSETS	2012	2011
Cash and cash equivalents	$77,728,426	$48,107,673
Investment securities, available for sale	106,825,570	108,500,489
Loans receivable (net of allowance for loan losses of $1,753,521 and $1,343,020, respectively)	80,218,050	80,567,970
Accrued interest receivable	617,833	582,942
Premises and equipment, net	2,097,356	2,332,727
Prepaid and other assets	2,217,136	1,754,654
Total assets	$269,704,371	$241,846,455
LIABILITIES AND STOCKHOLDERS' EQUITY		
LIABILITIES:		
Deposits		
Non-interest bearing	$81,958,751	$72,687,621
Interest bearing	158,742,455	140,535,284
Total deposits	240,701,206	213,222,905
Accounts payable, accrued expenses and other liabilities	1,249,194	1,521,290
Total liabilities	241,950,400	214,744,195
Commitments and contigent liabilities (Note 12)	—	—
STOCKHOLDERS' EQUITY		
Common stock ($.0001 par value, 10,000,000 shares authorized. 1,989,509 issued, 1,785,309 outstanding at December 31, 2012 and 1,797,809 outstanding at December 31, 2011)	199	199
Additional paid-in capital	9,257,167	9,304,789
Retained earnings	19,336,280	18,574,651
Treasury stock, at cost (204,200 shares at December 31, 2012 and 191,700 shares at December 31, 2011)	(2,068,898)	(1,935,596)
Unearned Employee Stock Ownership Plan shares	(225,438)	(394,516)
Accumulated other comprehensive gains, net of taxes of $1,226,742 and $1,309,447, respectively	1,454,661	1,552,733

Total stockholders' equity	27,753,971	27,102,260
Total liabilities and stockholders' equity	$269,704,371	$241,846,455

See notes to consolidated financial statements.

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VSB BANCORP, INC.

CONSOLIDATED STATEMENTS OF EARNINGS FOR THE YEARS ENDED DECEMBER 31, 2012 AND 2011

	2012	2011
INTEREST INCOME:		
Loans receivable	$5,902,637	$5,683,399
Investment securities	2,988,980	3,797,049
Other interest income	115,098	66,713
Total interest income	9,006,715	9,547,161
INTEREST EXPENSE:		
Deposits	796,025	858,766
Total interest expense	796,025	858,766
Net interest income	8,210,690	8,688,395
PROVISION FOR LOAN LOSSES	355,000	595,000
Net interest income after provision for loan losses	7,855,690	8,093,395
NON-INTEREST INCOME:		
Deposit service fees	2,110,240	2,122,267
Other income	318,733	349,811
Total non-interest income	2,428,973	2,472,078
NON-INTEREST EXPENSES:		
Salaries and employee benefits	3,821,060	3,902,334
Occupancy and equipment	1,521,501	1,474,792
Data processing service fees	253,241	267,519
Legal fees	259,982	215,519
Professional fees	338,980	291,301
Director fees	267,950	254,700
FDIC and NYSBD assessments	235,500	235,500
Supplies and service	312,549	350,959
Checkbook charges	161,571	139,743
Other	922,015	804,595
Total non-interest expenses	8,094,349	7,936,962
INCOME BEFORE INCOME TAXES	2,190,314	2,628,511

PROVISION/(BENEFIT) FOR INCOME TAXES:		
Current	1,351,205	1,610,151
Deferred	(349,091)	(426,091)
Total income taxes	1,002,114	1,184,060
NET INCOME	$1,188,200	$1,444,451
Earnings per share:		
Basic	$0.67	$0.80
Diluted	$0.67	$0.80
Comprehensive income	$1,090,128	$1,558,171

See notes to consolidated financial statements.

VSB Bancorp, Inc.

Consolidated Statements of Comprehensive Income

For the years ended December 31, 2012 and 2011

	2012	2011
Net Income	$1,188,200	$1,444,451
Other comprehensive income:		
Unrealized gains on securities:		
Change in unrealized gain on securties available for sale	(180,778)	209,622
Tax effects	(82,706)	95,902
Net of tax	(98,072)	113,720
Comprehensive income	$1,090,128	$1,558,171

See notes to consolidated financial statements.

VSB BANCORP, INC.

CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY FOR THE YEARS ENDED DECEMBER 31, 2012 AND 2011

	Number of Common Shares	Common Stock	Additional Paid-in Capital	Retained Earnings	Treasury Stock, at cost	Unearned ESOP Shares	Accumulated Other Comprehensive Gain	Total Stockholders' Equity
Balance at January 1, 2011	1,825,009	$199	$9,249,600	$17,563,435	$(1,643,797)	$(563,594)	$1,439,013	$26,044,856
Stock-based compensation			95,952					95,952
Amortization of earned portion of ESOP common stock						169,078		169,078
Amortization of cost over fair value - ESOP			(40,763)					(40,763)
Cash dividends declared ($0.24 per share)				(433,235)				(433,235)
Purchase of treasury stock, at cost	(27,200)				(291,799)			(291,799)
Net income				1,444,451				1,444,451
Other comprehensive income	—	—	—	—	—	—	113,720	113,720
								1,558,171
Balance at December 31, 2011	1,797,809	$199	$9,304,789	$18,574,651	$(1,935,596)	$(394,516)	$1,552,733	$27,102,260
Stock-based compensation			101,672					101,672
						169,078		169,078

Amortization of earned portion of ESOP common stock								
Amortization of cost over fair value - ESOP			(48,119)					(48,119)
Cash dividends declared ($0.24 per share)				(426,571)				(426,571)
Purchase of treasury stock, at cost	(22,000)				(234,477)			(234,477)
Contribution to RRP Trust from treasury shares	9,500		(101,175)		101,175			—
Net income				1,188,200				1,188,200
Other comprehensive income	—	—	—	—	—	—	(98,072)	(98,072)
								1,090,128
Balance at December 31, 2012	1,785,309	$199	$9,257,167	$19,336,280	$(2,068,898)	$(225,438)	$1,454,661	$27,753,971

See notes to consolidated financial statements.

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VSB BANCORP, INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS FOR THE YEARS ENDED DECEMBER 31, 2012 and 2011

	2012	2011
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income	$1,188,200	$1,444,451
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	580,253	600,362
Amortization of premium/(accretion of income), net	385,044	184,063
ESOP compensation expense	120,959	128,315
Stock-based compensation expense	101,672	95,952
Provision for loan losses	355,000	595,000
Changes in operating assets and liabilities:		
Decrease in prepaid and other assets	50,390	356,385
(Increase)/decrease in accrued interest receivable	(34,891)	91,025
Increase in deferred income taxes	(349,091)	(426,091)
Decrease in accrued expenses, income tax payable and other liabilities	(272,096)	(280,896)
Net cash provided by operating activities	2,125,440	2,788,566
CASH FLOWS FROM INVESTING ACTIVITIES:		
Net change in loans receivable	(9,428)	(1,044,357)
Proceeds from repayments and calls of investment securities, available for sale	37,429,264	34,482,147
Purchase of investment securities, available for sale	(36,396,894)	(21,774,024)
Purchases of premises and equipment, net	(344,882)	(200,860)
Net provided by investing activities	678,060	11,462,906
CASH FLOWS FROM FINANCING ACTIVITIES:		
Net increase in deposits	27,478,301	5,816,248
Cash dividends paid	(426,571)	(433,235)
Purchase of treasury stock, at cost	(234,477)	(291,799)
Net cash provided by financing activities	26,817,253	5,091,214
NET INCREASE IN CASH AND CASH EQUIVALENTS	29,620,753	19,342,686
CASH AND CASH EQUIVALENTS, BEGINNING OF YEAR	48,107,673	28,764,987
CASH AND CASH EQUIVALENTS, END OF YEAR	$77,728,426	$48,107,673
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION:		
Cash paid during the period for:		
Interest	$802,539	$860,794

Income taxes	$1,302,153	$1,691,717
SUPPLEMENTAL NONCASH DISCLOSURE:		
Transfer from loans to real estate owned	$81,075	$267,246

See notes to consolidated financial statements.

VSB BANCORP, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEARS ENDED DECEMBER 31, 2012 and 2011

1. GENERAL

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

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

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

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

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

Use of Estimates - The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the financial statements and the amounts of revenues and expenses during the reporting period. Actual results can differ from those estimates. The allowance for loan losses, prepayment estimates on the mortgage-backed securities and collateralized mortgage obligation portfolios, contingencies and fair values of financial instruments are particularly subject to change.

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

Cash and Cash Equivalents – Cash and cash equivalents consist of cash on hand, due from banks and interest-bearing deposits. Interest-bearing deposits with original maturities of 90 days or less are included in this category. Customer loan and deposit transactions are reported on a net cash basis. Regulation D of the Board of Governors of the Federal Reserve System requires that Victory State Bank maintain interest-bearing deposits or cash on hand as reserves against its demand deposits. The amount of reserves which Victory State Bank is required to maintain depends upon its level of transaction accounts. During the fourteen day period from December 27, 2012 through January 9, 2013, Victory State Bank was required to maintain reserves, after deducting vault cash, of $5,177,000. Reserves are required to be maintained on a fourteen day basis, so, from time to time, Victory State Bank may use available cash reserves on a day to day basis, so long as the fourteen day average reserves satisfy Regulation D requirements. Victory State Bank is required to report transaction account levels to the Federal Reserve on a weekly basis.

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

Investment Securities, Available for Sale - Investment securities, available for sale, are to be held for an unspecified period of time and include securities that management intends to use as part of its asset/liability strategy. These securities may be sold in response to changes in interest rates, prepayments or other factors and are carried at estimated fair value. Gains or losses on the sale of such securities are determined by the specific identification method. Interest income includes amortization of purchase premium and accretion of purchase discount. Premiums and discounts are recognized in interest income using a method that approximates the level yield method without anticipating prepayments, except for mortgage-backed securities where prepayments are estimated. Unrealized holding gains or losses, net of deferred income taxes, are excluded from earnings and reported as other comprehensive income in a separate component of stockholders' equity until realized. For debt securities with other than temporary impairment (OTTI) that management does not intend to sell or expect to be required to sell, the amount of impairment is split into two components as follows: 1) OTTI related to credit loss, which must be recognized in the income statement and 2) OTTI related to other factors, which is recognized in other comprehensive income. The credit loss is defined as the difference between the present value of the cash flows expected to be collected and the amortized cost basis.

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

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

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

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

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

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

Long-Lived Assets - The Company periodically evaluates the recoverability of long-lived assets, such as premises and equipment, to ensure the carrying value has not been impaired. In performing the review for recoverability, the Company would estimate the future cash flows expected to result from the use of the asset. If the sum of the expected future cash flows is less than the carrying amount, an impairment will be recognized. The Company reports these assets at the lower of the carrying value or fair value.

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

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

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

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

Financial Instruments - In the ordinary course of business, the Company has entered into off-balance sheet financial instruments, primarily consisting of commitments to extend credit.

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

Basic net income per share of common stock is based on 1,743,595 shares and 1,767,689 shares, the weighted average number of common shares outstanding for the years ended December 31, 2012 and 2011, respectively. Diluted net income per share of common stock is based on 1,743,595 and 1,767,760, the weighted average number of common shares outstanding plus potentially dilutive common shares for the years ended December 31, 2012 and 2011, respectively. The weighted average number of potentially dilutive common shares excluded in calculating diluted net income per common share due to the anti-dilutive effect is 47,506 and 36,902 shares for the years ended December 31, 2012 and 2011, respectively. Common stock equivalents were calculated using the treasury stock method.

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

Reconciliation of EPS

	Year Ended December 31, 2012	Year Ended December 31, 2011
Basic		
Distributed earnings allocated to common stock	$418,463	$424,245
Undistributed earnings allocated to common sock	752,789	995,275
Net earnings allocated to common stock	$1,171,252	$1,419,520
Weighted common shares outstanding including participating securities	1,768,825	1,798,735
Less: Participating securities	(25,230)	(31,046)
Weighted average shares	1,743,595	1,767,689
Basic EPS	$0.67	$0.80
Diluted		
Net earnings allocated to common stock	$1,171,252	$1,419,520
Weighted average shares for basic	1,743,595	1,767,689
Dilutive effects of:		
Stock Options	—	71
Unvested shares not considered particpating securtities	—	—
	1,743,595	1,767,760
Diluted EPS	$0.67	$0.80

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

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

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

Stock Repurchase Programs – On September 8, 2008, the Company announced that its Board of Directors had authorized a Rule 10b5-1 stock repurchase program for the repurchase of up to 100,000 shares of the Company's common stock. On April 21, 2009, the Company announced that its Board of Directors had authorized a second Rule 10b5-1 stock repurchase program for the repurchase of up to an additional 100,000 shares of the Company's common stock. The Company has repurchased a total of 200,000 shares of its common stock under these stock repurchase programs, which were completed by the end of 2010. On September 14, 2011, the Company announced that its Board of Directors had authorized a third Rule 10b5-1 stock repurchase program for the repurchase of up to an additional 100,000 shares of the Company's common stock. At December 31, 2012, the Company had repurchased a total of 49,200 shares of its common stock under this third stock repurchase program. Stock repurchases under the programs have been accounted for using the cost method, in which the Company will reflect the entire cost of repurchased shares as a separate reduction of stockholders' equity on its balance sheet.

Retention and Recognition Plan – At the April 27, 2010 Annual Meeting, the stockholders of VSB Bancorp, Inc. approved the adoption of the 2010 Retention and Recognition Plan (the "RRP"). The RRP authorizes the award of up to 50,000 shares of its common stock to directors, officers and employees. In conjunction with the approval the RRP, stockholders approved the award of 4,000 shares of stock to each of its eight directors who had at least five years of service. The director awards will vest over five years, with 20% vesting annually for each of the first five years after the award is made, subject to acceleration and forfeiture. On April 27, 2011, 6,400 shares or 20% of the 32,000 shares of stock awarded to its eight directors who had at least five years of service had vested. On April 27, 2012, an additional 6,400 shares or 20% of the 32,000 shares of stock awarded to its eight directors who had at least five years of service had vested. On June 8, 2010, an additional 3,500 shares of stock were awarded to the President and CEO of the Company, which will vest over a 65 month period, with 20% vesting annually for each of the first five years starting in November 2011, subject to acceleration and forfeiture. On November 16, 2011, 700 shares or 20% of the 3,500 shares of stock awarded to the President and CEO of the Company had vested. On November 16, 2012, an additional 700 shares or 20% of the 3,500 shares of stock awarded to the President and CEO of the Company had vested. On November 13, 2012, an additional 2,500 shares of stock were awarded to the President and CEO of the Company on an equal two year vesting beginning November 13, 2013. Also, on November 13, 2012, an additional 1,000 shares were awarded to seven non-employee directors on an equal two year vesting beginning November 13, 2013. The recipient of an award will not be required to make any payment to receive the award or the stock covered by the award. The Company recognizes compensation expense for the shares awarded under the RRP gradually as the shares vest, based upon the market price of the shares on the date of the award.

Comprehensive Income - Comprehensive income consists of net income and other comprehensive income. Other comprehensive income includes unrealized gains and losses, net of taxes, on securities available for sale which are also recognized as separate components of equity.

3. INVESTMENT SECURITIES, AVAILABLE FOR SALE

The following table summarizes the amortized cost and fair value of the available-for-sale investment securities portfolio at December 31, 2012 and December 31, 2011 and the corresponding amounts of unrealized gains and losses herein:

	December 31, 2012			
	Amortized Cost	Unrealized Gains	Unrealized Losses	Fair Value
FNMA MBS - Residential	$34,168,335	$869,590	$(32,664)	$35,005,261
GNMA MBS - Residential	5,074,518	155,906	—	5,230,424
Whole Loan MBS - Residential	473,273	16,852	—	490,125
Collateralized mortgage obligations	60,483,873	1,597,293	(96)	62,081,070
Collateralized loan obligations	1,000,000	—	—	1,000,000
Other debt securities	2,944,168	74,522	—	3,018,690

	$104,144,167	$2,714,163	$(32,760)	$106,825,570

	December 31, 2011			
	Amortized Cost	Unrealized Gains	Unrealized Losses	Fair Value
FNMA MBS - Residential	$5,080,697	$109,069	$—	$5,189,766
GNMA MBS - Residential	6,748,239	228,105	—	6,976,344
Whole Loan MBS - Residential	786,085	20,531	—	806,616
Collateralized mortgage obligations	93,023,287	2,504,478	(2)	95,527,763
	$105,638,308	$2,862,183	$(2)	$108,500,489

There were no sales of investment securities for the years ended December 31, 2012 and 2011.

The amortized cost and fair value of the investment securities portfolio are shown by expected maturity. Expected maturities may differ from contractual maturities, especially for collateralized mortgage obligations, if borrowers have the right to call or prepay obligations with or without call or prepayment penalties.

	December 31, 2012	
	Amortized Cost	Fair Value
Less than one year	$—	$—
Due after one year through five years	17,860,853	17,958,309
Due after five years through ten years	25,427,344	26,435,640
Due after ten years	60,855,970	62,431,621
	$104,144,167	$106,825,570

The following table summarizes the investment securities with unrealized losses at December 31, 2012 and December 31, 2011 by aggregated major security type and length of time in a continuous unrealized loss position:

December 31, 2012	Less than 12 months		More than 12 months		Total	
	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss
FNMA MBS	$4,499,561	$(32,664)	$—	$—	$4,499,561	$(32,664)
GNMA MBS	—	—	—	—	—	—
Whole Loan MBS	—	—	—	—	—	—
Collateralized mortgage obligations	101,543	(96)	—	—	101,543	(96)
Collateralized loan obligations	—	—	—	—	—	—
Other debt securities	—	—	—	—	—	—
	$4,601,104	$(32,760)	$—	$—	$4,601,104	$(32,760)

December 31, 2011	Less than 12 months		More than 12 months		Total	
	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss
FNMA MBS	$—	$—	$—	$—	$—	$—
GNMA MBS	—	—	—	—	—	—
Whole Loan MBS	—	—	—	—	—	—
Collateralized mortgage obligations	5,038	(2)	—	—	5,038	(2)
	$5,038	$(2)	$—	$—	$5,038	$(2)

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

At December 31, 2012, the unrealized loss on investment securities was caused by average life increases. We expect that these securities, at maturity, will be settled for at least the amortized cost of the investment. Because the decline in fair value is attributable to changes in average life and not credit quality, and because the Company does not intend to sell the securities and it is not more likely than not that the Company will be required to sell the securities before recovery of the amortized cost basis less any current-period loss, these investments are not considered other-than-temporarily impaired. At December 31, 2012, there were no debt securities with unrealized losses with aggregate depreciation of 5% or more from the Company's amortized cost basis.

Securities pledged had a fair value of $66,043,504 and $55,080,059 at December 31, 2012 and December 31, 2011, respectively and were pledged to secure public deposits and balances in excess of the deposit insurance limit on certain customer accounts.

4. LOANS RECEIVABLE, NET

Loans receivable, net at December 31, 2012 and 2011 are summarized as follows:

	2012	2011
Commercial loans (principally variable rate):		
Secured	$2,050,728	$1,522,639
Unsecured	16,502,920	12,997,139
Total commercial loans	18,553,648	14,519,778
Real estate loans:		
Commercial	56,698,844	59,376,008
Residential	2,498,603	2,309,899
Total real estate loans	59,197,447	61,685,907
Construction loans (net of undisbursed funds of $2,854,500 and $2,644,500, respectively)	3,112,477	4,610,000
Consumer loans	565,573	602,144
Other loans	768,790	717,261
	1,334,363	1,319,405
Total loans receivable	82,197,935	82,135,090
Less:		
Unearned loans fees, net	(226,364)	(224,100)
Allowance for loan losses	(1,753,521)	(1,343,020)
Total	$80,218,050	$80,567,970

Nonaccrual loans outstanding at December 31, 2012 and 2011 are summarized as follows:

	2012	2011
Nonaccrual loans:		

Commercial real estate	$5,923,090	$8,265,397
Residential real estate	—	2,200,000
Construction	467,500	397,500
Total nonaccrual loans	$6,390,590	$10,862,897

	2012	2011
Interest income that would have been recorded during the period on nonaccrual loans outstanding in accordance with original terms	$478,556	$595,946

At December 31, 2012 and 2011, there were no loans 90 days past due and still accruing interest.

The following table presents the aging of the past due loan balances as of December 31, 2012 and 2011 by class of loans:

December 31, 2012	Total	30-59 Days Past Due	60-89 Days Past Due	Greater than 90 Days Past Due	Total Past Due	Loans Not Past Due
Commercial loans:						
Unsecured	$16,502,920	$4,599	$—	$—	$4,599	$16,498,321
Secured	2,050,728	—	91,649	—	91,649	1,959,079
Real Estate loans						
Commercial	56,698,844	1,946,281	150,000	5,923,090	8,019,371	48,679,473
Residential	2,498,603	—	—	—	—	2,498,603
Construction loans	3,112,477	—	—	467,500	467,500	2,644,977
Consumer loans	565,573	—	2,903	—	2,903	562,670
Other loans	768,790	—	—	—	—	768,790
Total loans	$82,197,935	$1,950,880	$244,552	$6,390,590	$8,586,022	$73,611,913

December 31, 2011	Total	30-59 Days Past Due	60-89 Days Past Due	Greater than 90 Days Past Due	Total Past Due	Not Past Due
Commercial loans:						
Unsecured	$12,997,139	$84,529	$16,260	$—	$100,789	$12,896,350
Secured	1,522,639	—	—	—	—	1,522,639
Real Estate loans						
Commercial	59,376,008	997,740	359,620	8,265,397	9,622,757	49,753,251
Residential	2,309,899	—	—	2,200,000	2,200,000	109,899
Construction loans	4,610,000	—	—	397,500	397,500	4,212,500
Consumer loans	602,144	678	—	—	678	601,466
Other loans	717,261	—	—	—	—	717,261
Total loans	$82,135,090	$1,082,947	$375,880	$10,862,897	$12,321,724	$69,813,366

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

Loans individually evaluated for impairment were as follows:

	December 31, 2012	December 31, 2011
Loans with no allocated allowance for loan losses:		
Commercial real estate	$3,924,469	$6,662,331
Construction	467,500	397,500
Residential real estate	—	2,200,000
Loans with allocated allowance for loan losses:		
Commercial real estate	1,772,565	1,350,374
	$6,164,534	$10,610,205
Amount of the allowance for loan losses allocated:		
Commercial real estate	$838,531	$346,095
	$838,531	$346,095

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

	Year Ended December 31, 2012	Year Ended December 31, 2011
Average of individually impaired loans during period:		
Commercial real estate	$6,383,255	$3,630,540
Construction	177,292	198,750
Commercial unsecured	23	94,278
Residential real estate	366,667	1,650,000
	$6,927,237	$5,573,568
Interest income recognized during time period that loans were impaired, either using accrual or cash-basis method of accounting	$1,554	$165,515

Troubled Debt Restructurings:

The Company has allocated $63,329 and $3,412 of specific reserves to customers whose loan terms have been modified in troubled debt restructurings ("TDRs") as of December 31, 2012 and 2011, respectively. The Company has not committed to lend any additional amounts to customers with outstanding loans that are classified as TDRs.

The outstanding principal balance of trouble debt restructurings at December 31, 2012 was $5,826,633 and at December 31, 2011 was $4,576,997. None of the loans currently classified as TDRs have defaulted during this period. These TDRs are all current and are paying under the modified arrangements.

The terms of certain other loans were modified during the year ended December 31, 2012 that did not meet the definition of a TDR. These loans have a total recorded investment as of December 31, 2012 of $105,972. The modification of these loans involved either a modification of the terms of a loan to borrowers who were not experiencing financial difficulties or a delay in a payment that was considered to be insignificant.

In order to determine whether a borrower is experiencing financial difficulty, an evaluation is performed of the probability that the borrower will be in payment default on any of its debt in the foreseeable future without the modification.

The following table presents loans by class modified as troubled debt restructurings that occurred during the year ending December 31, 2012:

	Number of Loans	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment
Troubled Debt Restructurings:			
Commerical real estate	6	$ 3,193,700	$ 3,193,700

The troubled debt restructurings described above required an additional allowance of $24,778 during the period ending December 31, 2012.

Credit Quality Indicators:

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

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

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

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

The following table sets forth at December 31, 2012 and 2011, the aggregate carrying value of our assets categorized as Special Mention, Substandard and Doubtful according to asset type:

	At December 31, 2012				
	Special Mention	Substandard	Doubtful	Not Classified	Total
Commercial Loans:					
Secured	$91,649	$—	$—	$1,959,079	$2,050,728
Unsecured	63,032	—	—	16,439,888	16,502,920
Commercial Real Estate	5,820,246	6,570,971	—	44,307,627	56,698,844
Residential Real Estate	—	2,174,455	—	324,148	2,498,603
Construction	—	467,500	—	2,644,977	3,112,477
Consumer	—	—	—	565,573	565,573

Other	3,746	—	—	765,044	768,790
Total loans	$5,978,673	$9,212,926	$—	$67,006,336	$82,197,935
Real estate owned	—	342,867	—	—	342,867
Total assets	$5,978,673	$9,555,793	$—	$67,006,336	$82,540,802

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	At December 31, 2011				
	Special Mention	Substandard	Doubtful	Not Classified	Total
Commercial Loans:					
Secured	$—	$—	$—	$1,522,639	$1,522,639
Unsecured	127,132	50,379	—	12,819,628	12,997,139
Commercial Real Estate	2,012,188	9,039,881	—	48,323,939	59,376,008
Residential Real Estate	—	2,200,000	—	109,899	2,309,899
Construction	—	397,500	—	4,212,500	4,610,000
Consumer	12,682	—	—	589,462	602,144
Other	5,306	—	—	711,955	717,261
Total loans	$2,157,308	$11,687,760	$—	$68,290,022	$82,135,090
Real estate owned	—	267,246	—	—	267,246
Total assets	$2,157,308	$11,955,006	$—	$68,290,022	$82,402,336

The following table presents the balance in the allowance for loan losses and the recorded balance in loans, by portfolio segment, and based on impairment method as of December 31, 2012 and 2011:

December 31, 2012							
	Commercial Unsecured	Commercial Secured	Construction	Commerical Real Estate	Residential Real Estate	Other Loans	Total
Allowance for loan losses:							
Ending allowance balance attributable to loans							
Individually evaluated for impairment	$—	$—	$—	$853,108	$—	$—	$853,108
Collectively evaluated for impairment	425,495	18,790	16,282	394,091	4,528	41,227	900,413
Total ending allowance balance	$425,495	$18,790	$16,282	$1,247,199	$4,528	$41,227	$1,753,521
Loans:							
Individually evaluated for	$—	$—	$467,500	$6,570,971	$2,174,455	$—	$9,212,926

impairment							
Collectively evaluated for impairment	16,502,920	2,050,728	2,644,977	50,127,873	324,148	1,334,363	72,985,009
Total ending loans balance	$16,502,920	$2,050,728	$3,112,477	$56,698,844	$2,498,603	$1,334,363	$82,197,935

December 31, 2011

	Commercial Unsecured	Commercial Secured	Construction	Commerical Real Estate	Residential Real Estate	Other Loans	Total
Allowance for loan losses:							
Ending allowance balance attributable to loans							
Individually evaluated for impairment	$6,664	$—	$—	$363,520	$—	$—	$370,184
Collectively evaluated for impairment	468,022	12,356	34,184	417,300	672	40,302	972,836
Total ending allowance balance	$474,686	$12,356	$34,184	$780,820	$672	$40,302	$1,343,020
Loans:							
Individually evaluated for impairment	$50,379	$—	$397,500	$9,039,881	$2,200,000	$—	$11,687,760
Collectively evaluated for impairment	12,946,760	1,522,639	4,212,500	50,336,127	109,899	1,319,405	70,447,330
Total ending loans balance	$12,997,139	$1,522,639	$4,610,000	$59,376,008	$2,309,899	$1,319,405	$82,135,090

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The following table presents the activity in the allowance for loan losses by portfolio segment for the years ended December 31, 2012 and 2011.

Year ended December 31, 2012

	Commercial Unsecured	Commercial Secured	Construction	Commerical Real Estate	Residential Real Estate	Other Loans	Total
Allowance for loan losses:							
Beginning balance	$ 474,686	$ 12,356	$ 34,184	$ 780,820	$ 672	$ 40,302	$ 1,343,020
Provision for loan losses	(59,686)	6,434	(17,902)	440,304	(23,785)	9,635	355,000
Loans charged-off	(100,757)	—	—	(16,675)	—	(10,917)	(128,349)
Recoveries	111,252	—	—	42,750	27,641	2,207	183,850
Total ending allowance balance	$ 425,495	$ 18,790	$ 16,282	$ 1,247,199	$ 4,528	$ 41,227	$ 1,753,521

Year ended December 31, 2011

	Commercial Unsecured	Commercial Secured	Construction	Commerical Real Estate	Residential Real Estate	Other Loans	Total
Allowance for loan losses:							
Beginning balance	$ 520,953	$ 13,486	$ 52,138	$ 653,362	$ 7,174	$ 30,107	$ 1,277,220
Provision for loan losses	368,559	(1,130)	(17,954)	196,470	38,713	10,342	595,000
Loans charged-off	(532,957)	—	—	(74,512)	(57,715)	(3,811)	(668,995)
Recoveries	118,131	—	—	5,500	12,500	3,664	139,795
Total ending allowance balance	$ 474,686	$ 12,356	$ 34,184	$ 780,820	$ 672	$ 40,302	$ 1,343,020

Many of our loans are made in the Borough of Staten Island and we are still assessing the impact of Hurricane Sandy on the allowance for loan loss and the loan portfolio.

5. ACCRUED INTEREST RECEIVABLE

Accrued interest receivable at December 31, 2012 and 2011 are summarized as follows:

	2012	2011
Due from banks	$9,289	$4,742
Loans receivable	353,919	267,182
Investment securities, available for sale	254,625	311,018
Total	$617,833	$582,942

6. PREMISES AND EQUIPMENT

Premises and equipment at December 31, 2012 and 2011 are summarized as follows:

	2012	2011
Leasehold improvements	$2,688,276	$3,811,977
Computer equipment and software	292,689	322,171
Furniture, fixtures and equipment	1,145,595	1,116,208
Other	52,697	52,697
	4,179,257	5,303,053
Less accumulated depreciation and amortization	(2,081,901)	(2,970,326)
Total	$2,097,356	$2,332,727

Depreciation and amortization expense amounted to $580,253 and $600,362 for the years ended December 31, 2012 and 2011, respectively.

At December 31, 2012 and 2011, the Company was obligated under five non-cancelable operating leases on property used for banking purposes. Rental expense under these leases was $407,002 for each of the years ended December 31, 2012 and 2011.

The projected minimum rental payments under the terms of the leases at December 31, 2012 are summarized as follows:

Year Ending December 31,	Amount
2013	$430,035
2014	432,917
2015	415,540
2016	335,023
2017	252,896
Thereafter	603,085
Total	$2,469,496

7. PREPAID AND OTHER ASSETS

Prepaid and other assets at December 31, 2012 and 2011 are summarized as follows:

	2012	2011
Accounts receivable and other assets	$204,008	$140,373
Security deposit receivable	11,200	11,200
Prepaid assets	582,672	636,822
Equity securities, primarily FHLB stock	351,500	377,500
Income tax receivable	130,007	179,059
Deferred income taxes, net	530,397	98,600
Late charges receivable	64,485	43,854
Other real estate owned	342,867	267,246
	$2,217,136	$1,754,654

8. DEPOSITS

Deposits are summarized, according to their original terms, at December 31, 2012 and 2011 as follows:

	2012			2011		
	Amount	Percent	Weighted Average Stated Rate	Amount	Percent	Weighted Average Stated Rate
Checking	$81,881,173	34.02 %	— %	$72,507,555	34.01 %	— %
Variable-rate money market	33,023,373	13.72	0.43	26,909,220	12.62	0.54
Statement savings	20,871,593	8.67	0.20	17,178,525	8.06	0.26
Interest-bearing checking	33,394,785	13.87	0.06	30,553,003	14.33	0.15
	169,170,924	70.28	0.12	147,148,303	69.02	0.16
Time deposits:						
Less than six months	22,204,696	9.23	0.53	14,208,686	6.66	0.48
Six months to one year	40,848,688	16.97	0.87	44,107,482	20.69	1.08
More than one year	8,399,320	3.49	1.74	7,578,368	3.55	1.99
	71,452,704	29.69	0.87	65,894,536	30.90	1.06
Other deposits	77,578	0.03	—	180,066	0.08	—
Total	$240,701,206	100.00%	0.34 %	$213,222,905	100.00%	0.44 %

The aggregate amount of jumbo time deposit with a minimum denomination of $100,000 was approximately $59,431,000 and $53,999,000 at December 31, 2012 and 2011 respectively.

Scheduled maturities of time deposits at December 31, 2012 are as follows:

	Amount	Percent
Within six months	$58,970,068	82.53 %
Six months to one year	5,578,390	7.81
Over one year to two years	2,460,412	3.44
Over two years to three years	2,044,011	2.86

Over three years to four years	814,000	1.14
Over four years to five years	1,585,823	2.22
Total	$71,452,704	100.00%

9. INCOME TAXES

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

The basis for the determination of state and local tax is the greater of a tax on entire net income, a tax on an alternative entire net income, or a tax computed on taxable assets. Federal, state and city income tax provisions were determined based on the tax computed on net income for the years ended December 31, 2012 and 2011.

The components of the income tax expense/(benefit) for the years ended December 31, 2012 and 2011 are summarized as follows:

	2012	2011
Current:		
Federal	$932,755	$1,001,173
State and local	418,450	608,978
	1,351,205	1,610,151
Deferred:		
Federal	(303,030)	(265,334)
State and local	(46,061)	(160,757)
	(349,091)	(426,091)
	$1,002,114	$1,184,060

The components of the deferred income tax asset/(liability), net as of December 31, 2012 and 2011 are summarized as follows:

	2012	2011
Deferred tax assets:		
Deferred loan fees	$102,143	$101,458
Excess book allowance for loan losses	666,048	426,310
Nonaccrual loan interest income	418,068	272,614
Other	570,879	607,665
	1,757,138	1,408,047
Deferred tax liabilities:		
Unrealized gain on available for sale investment securities	(1,226,741)	(1,309,447)
Net deferred tax asset/(liability):	$530,397	$98,600

Management has determined that it is not required to establish a valuation allowance against remaining deferred tax assets in accordance with GAAP since it is more likely than not that the deferred tax assets will be fully utilized in future periods. In assessing the need for a valuation allowance, management considers the scheduled reversal of deferred tax liabilities, the level of historical taxable income, and the projected future taxable income over the periods in which the temporary differences comprising the deferred tax assets will be deductible.

At December 31, 2012 and December 31, 2011, the Company had no unrecognized tax benefits recorded. The Company does not expect the total amount of unrecognized tax benefits to significantly increase in the next twelve months. The Company recognizes interest and penalties on unrecognized tax benefits as a component of income tax expense.

The Company is subject to United States Federal income tax, New York State income tax and New York City income tax.

The Company is no longer subject to examination by taxing authorities for years before 2009.

The Company's effective tax rates differ from the statutory Federal tax rate for the years ended December 31, 2012 and 2011 and are as follows:

	2012		2011	
Federal income tax provision at statutory rates	$744,707	34.0%	$893,694	34.0%
State and local taxes, net of Federal income tax benefit	245,777	11.2	295,826	11.3
Other	11,630	0.5	(5,460)	(0.2)
	$1,002,114	45.7%	$1,184,060	45.1%

10. REGULATORY MATTERS

The Bank is a New York State chartered stock form commercial bank. The Bank's deposits are insured by the Federal Deposit Insurance Corporation ("FDIC"). The Bank is subject to certain FDIC capital requirements. Failure to meet minimum capital requirements can initiate certain mandatory and possibly discretionary actions by the regulators that, if undertaken, could have a direct material effect on the Bank's financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, the Bank must meet certain specific capital guidelines that involve quantitative measures of the Bank's assets, liabilities and certain off-balance sheet items calculated under regulatory accounting practices. The Bank's capital amounts and classification are also subject to qualitative judgments by the regulators about components, risk weightings and other factors.

As of the latest notification from the FDIC, the Bank was classified as "well capitalized" under the regulatory framework for prompt corrective action. To be categorized as "well capitalized," the Bank must maintain Tier 1 Leverage, Tier 1 Risk-Based and minimum Total Risk-based ratios as set forth in the table below. There are no conditions or events since that notification that management believes have changed the Bank's category. Management believes, as of December 31, 2012, that the Bank meets all capital adequacy requirements to which it is subject.

The Bank is subject to certain restrictions on the availability of its undistributed earnings for payment of dividends to stockholders, including prior regulatory approval.

In accordance with the New York State Banking Law and the New York State Superintendent of Financial Services Regulations, the Bank credits 10% of quarterly net income to regulatory surplus and is required to do so until such time as shareholders' equity is equal to 10% of amounts due to depositors. As of December 31, 2012, regulatory surplus equals 10% of deposits.

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

	Actual		For capital adequacy purposes		To be well-capitalized under prompt corrective action provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
As of December 31, 2012:						
Tier 1 Capital (to Average Assets)	$25,455,000	9.65 %	$10,155,155	4.00 %	$13,193,943	5.00 %
Tier 1 Capital (to Risk Weighted Assets)	25,455,000	26.03	3,911,960	4.00	5,867,940	6.00
Total Capital (to Risk Weighted Assets)	26,684,000	27.28	7,823,920	8.00	9,779,900	10.00

	Actual		For capital adequacy purposes		To be well-capitalized under prompt corrective action provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
As of December 31, 2011:						
Tier 1 Capital (to Average Assets)	$25,137,000	10.30%	$9,761,983	4.00 %	$12,202,479	5.00 %
Tier 1 Capital (to Risk Weighted Assets)	25,137,000	26.65	3,773,200	4.00	5,659,800	6.00
Total Capital (to Risk Weighted Assets)	26,318,000	27.90	7,546,400	8.00	9,433,000	10.00

The Company is subject to comparable capital ratio requirements of the Board of Governors of the Federal Reserve system. The Company's consolidated capital ratios as of December 31, 2012 were as follows: Tier 1 Capital to Average Assets of 9.97%; Tier 1 Capital to Risk Weighted Assets of 27.05%; and Total Capital to Risk Weighted Assets of 28.30%, which are not substantially different than the Bank's capital ratios at December 31, 2012 and therefore are not presented separately.

11. EMPLOYEE BENEFITS

The Company sponsors an incentive savings plan (401(k) plan) which started March 1, 1999. All eligible employees, who have reached the age of 21, have at least one year of service and work a minimum of 1,000 hours per year will be permitted to make tax deferred contributions up to certain limits. The Bank may reduce or cease matching contributions if it is determined that the current or accumulated net earnings or undivided profits of the Bank are insufficient to pay the full contributions in a plan year. The Bank contributed $137,896 to the 401(k) plan in 2012 and $138,127 in 2011.

Stock Options

The Company has granted options pursuant to six different stock option plans. Options to buy stock are granted to directors, officers and employees under the VSB Bancorp, Inc. 2010 Incentive Plan, the 2000 Incentive Plan, the 1998 Incentive Plan, the 2004 Directors' Plan, the 2000 Directors' Plan and the 1998 Directors' Plan which, in the aggregate, provide for issue up to 293,750 options. Exercise price is the market price at the date of grant, and compensation expense will be recognized in the income statement over the vesting period. The maximum option term is ten years, and the options vesting period is up to five years.

Total compensation expense for the stock option plans charged against income for 2012 and 2011 was $12,395 and $12,984.

In January 2010, 5,977 options were granted from the 2000 Incentive Plan at an exercise price of $11.10. In April 2010, 12,000 options were granted from the 2004 Director's Plan at an exercise price of $12.09. Also, in April 2010, the 2010 Incentive Stock Option Plan was approved for issue up to 50,000 options. In June 2010, 34,073 options were granted from the 2010 Incentive Plan.   There were no stock options granted in 2012.

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

The stock option components of the 2000 Incentive Plan, the 1998 Incentive Plan, the 2010 Incentive Plan and the 2004 Directors' Plan, the 2000 Directors' Plan and the 1998 Directors' Plan, as of December 31, 2012, and changes during the year ended, consist of the following:

	2012		
	Shares	Weighted Average Exercise Price	Aggregate Intrinsic Value
Options outstanding at the beginning of the year	123,423	$14.27	
Forfeited	(1,800)	12.60	
Options outstanding at the end of the year	121,623	$14.62	$ —
Options exercisable at the end of the year	90,393	$16.12	$ —
Weighted average remaining contractual life of options outstanding at the end of the year		3.6 Years	

All non-vested options are expected to vest. The exercise price exceeds stock price for all options outstanding and exercisable.

During the year ended December 31, 2012, no stock options were exercised.

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Described below is the range of exercise prices for options granted and outstanding under the following option plans at December 31, 2012:

Plan Description	Number of Exercisable Shares	Weighted Average Exercise Price	Weighted Average Contractual Life
1998 Director Stock Option Plan	—	$ —	—
1998 Incentive Stock Option Plan	3,250	11.75	4.92
2000 Director Stock Option Plan	—	—	—
2000 Incentive Stock Option Plan	24,850	14.54	2.41
2004 Director Stock Option Plan	60,750	16.51	2.19
2010 Incentive Stock Option Plan	32,773	11.45	7.17
All Plans	121,623	$ 14.62	3.64

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

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

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

	2012 Amount	2011 Amount
Commitments to fund secured construction loans	$2,854,500	$2,215,000
Commitments to fund all other commercial loans	21,459,060	16,811,822
	$24,313,560	$19,026,822

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

Victory State Bank currently has a $2 million unsecured credit facility with Atlantic Central Bankers Bank which the Bank has not drawn upon.

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

13. FAIR VALUE

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

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

Interest-bearing Bank Balances – Interest-bearing bank balances mature within one year and are carried at cost, which are estimated to be reasonably close to fair value.

Money Market Investments – The fair value of these securities approximates their carrying value due to the relatively short time to maturity

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

Federal Home Loan Bank Stock - It is not practical to determine the fair value of FHLB stock due to restrictions placed on its transferability.

Loans Receivable - The fair value of commercial and construction loans is approximated by the carrying value as the loans are tied directly to the Prime Rate and are subject to change on a daily basis, subject to the applicable interest rate floors. The fair value of the remainder of the portfolio is determined by discounting the future cash flows of the loans using the appropriate discount rate.

Other Financial Assets - The fair value of these assets, principally accrued interest receivable, approximates their carrying value due to their short maturity.

Non-Interest Bearing and Interest Bearing Deposits - The fair value disclosed for non-interest bearing deposits is equal to the amount payable on demand at the reporting date. The fair value of interest bearing deposits is based upon the current rates for instruments of the same remaining maturity. Interest bearing deposits with a maturity of greater than one year are estimated using a discounted cash flow approach that applies interest rates currently being offered.

Other Liabilities - The estimated fair value of other liabilities, which primarily include accrued interest payable, approximates their carrying amount.

The carrying amounts and estimated fair values of financial instruments, at December 31, 2012 and 2011 are as follows:

Fair Value Measurements at December 31, 2012 Using			
Carrying	Quoted Prices in	Significant Other	Significant Unobservable

	Value	Active Markets for Identical Assets (Level 1)	Observable Inputs (Level 2)	Inputs (Level 3)	Total
Financial Assets:					
Cash and cash equivalents	$77,728,426	$3,723,131	$74,005,295	$ —	$77,728,426
Investment securities, available for sale	106,825,570	—	105,825,570	1,000,000	106,825,570
Loans receivable	80,218,050	—	—	80,432,242	80,432,242
Accrued interest receivable	617,833	—	262,577	355,256	617,833
Total Financial Assets	$265,389,879	$3,723,131	$180,093,442	$ 81,787,498	$265,604,071
Financial Liabilities:					
Deposits	$240,701,206	$81,881,173	$158,706,059	$ —	$240,587,232
Accrued interest payable	13,920	—	13,920	—	13,920
Total Financial Liabilities	$240,715,126	$81,881,173	$158,719,979	$ —	$240,601,152

	Fair Value Measurements at December 31, 2011 Using				
	Carrying Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total
Financial Assets:					
Cash and cash equivalents	$48,107,673	$3,384,186	$44,723,487	$—	$48,107,673
Investment securities, available for sale	108,500,489	—	108,500,489	—	108,500,489
Loans receivable	80,567,970	—	—	81,722,136	81,722,136
Accrued interest receivable	582,942	—	315,760	267,182	582,942
Total Financial Assets	$237,759,074	$3,384,186	$153,539,736	$81,989,318	$238,913,240
Financial Liabilities:					
Deposits	$213,222,905	$72,687,621	$140,454,934	$—	$213,142,555
Accrued interest payable	17,011	—	17,011	—	17,011
Total Financial Liabilities	$213,239,916	$72,687,621	$140,471,945	$—	$213,159,566

ASC 820 establishes a fair value hierarchy which requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. The standard describes three levels of inputs that may be used to measure fair value:

Level 1: Quoted prices (unadjusted) for identical assets or liabilities in active markets that the entity has the ability to access as of the measurement date.

Level 2: Significant other observable inputs other than Level 1 prices such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data.

Level 3: Significant unobservable inputs that reflect a reporting entity’s own assumptions about the assumptions that market participants would use in pricing and asset or liability.

The fair value of securities available for sale is determined by obtaining quoted prices on nationally recognized securities exchanges (Level 1 inputs) or using matrix pricing, which is a mathematical technique widely used in the industry to value debt securities without relying exclusively on quoted prices for the specific securities but rather by relying on the securities’ relationship to other benchmark quoted securities (Level 2 inputs). For securities where quoted prices or market prices of similar securities are not available, fair values are calculated using discounted cash flows or other market indicators (Level 3).

	Fair Value Measurements at December 31, 2012 Using			
	Total	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets:				
FNMA MBS - Residential	$35,005,261	$ —	$35,005,261	$ —
GNMA MBS - Residential	5,230,424	—	5,230,424	—
Whole Loan MBS-Residential	490,125	—	490,125	—
Collateralized mortgage obligations	62,081,070	—	62,081,070	—
Collateralized loan obligations	1,000,000	—	—	1,000,000
Other debt securities	3,018,690	—	3,018,690	—
Total Available for sale Securities	$106,825,570	$ —	$105,825,570	$ 1,000,000

	Fair Value Measurements at December 31, 2011 Using			
	Total	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets:				
FNMA MBS - Residential	$5,189,766	$ —	$5,189,766	$ —
GNMA MBS - Residential	6,976,344	—	6,976,344	—
Whole Loan MBS-Residential	806,616	—	806,616	—
Collateralized mortgage obligations	95,527,763	—	95,527,763	—
Total Available for sale Securities	$108,500,489	$ —	$108,500,489	$ —

The table below presents a reconciliation of all assets measured at fair value on a recurring basis using significant unobservable inputs (Level 3) for the year ended December 31, 2012:

	Collateralized Loan Obligations 2012
Balance of recurring Level 3 assets at January 1:	
Total gains or losses for the period:	$ —
Included in earnings	—
Included in other comprehensive income	—
Purchases	1,000,000
Sales	—
Issuances	—
Settlements	
Transfers into Level 3	—
Transfers out of Level 3	—
Balance of recurring Level 3 assets at December 31:	$ 1,000,000

The following table presents quantitative information about recurring Level 3 fair value measurement at December 31, 2012:

	Fair Value	Valuation Techniques	Unobservable Inputs	Range
Collateralized loan obligations	$1,000,000	Discounted cash flow	Collateral default rate	0%-2%
			Recovery probability	70%-100%

There were no transfers between levels from December 31, 2011 to December 31, 2012.

<u>Assets Measured on a Non-Recurring</u>

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

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

Impaired Loans: The fair value of impaired loans with specific allocations of the allowance for loan losses is generally based on recent real estate appraisals. These appraisals may utilize a single valuation approach or a combination of approaches including comparable sales and the income approach. Adjustments are routinely made in the appraisal process by the independent appraisers to adjust for differences between the comparable sales and income data available. Such adjustments are usually significant and typically result in a Level 3 classification of the inputs for determining fair value.

Real Estate Owned: Assets acquired through or instead of loan foreclosure are initially recorded at fair value less costs to sell when acquired, establishing a new cost basis. These assets are subsequently accounted for at lower of cost or fair value less estimated costs to sell. Fair value is commonly based on recent real estate appraisals which are updated no less frequently than annually. These appraisals may utilize a single valuation approach or a combination of approaches including comparable sales and the income approach. Adjustments are routinely made in the appraisal process by the independent appraisers to adjust for differences between the comparable sales and income data available. Such adjustments are usually significant and typically result in a Level 3 classification of the inputs for determining fair value.

	Fair Value Measurements at December 31, 2012 Using			
	Total	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets:				
Impaired loans				
Commercial Real Estate	$934,034	—	—	$934,034
Other real estate owned	342,867	—	—	342,867

	Fair Value Measurements at December 31, 2011 Using			
	Total	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets:				
Impaired loans				
Commercial Real Estate	$1,004,279	—	—	$1,004,279
Other real estate owned	267,246	—	—	267,246

As of December 31, 2012, we had four impaired loans with specific reserves that were collateral dependent. Collateral dependent impaired loans, which are measured for impairment using the fair value of the collateral, had a carrying amount of $1,772,565, with a valuation allowance of $838,531 at that date. The valuation allowance increased $492,436 from December 31, 2011 to December 31, 2012.

As of December 31, 2011, we had four impaired loans with specific reserves that were collateral dependent. Collateral dependent impaired loans, which are measured for impairment using the fair value of the collateral, had a carrying amount of $1,350,374, with a valuation allowance of $346,095 at that date.

The following table presents quantitative information about level 3 fair value measurements for financial instruments measured at fair value on a non-recurring basis at December 31, 2012.

	Fair Value	Valuation Techniques	Unobservable Inputs	Range	
Impaired loans-					
Commercial real estate	$553,695	Third Party Appraisal	Discount adjustment for differences in various costs.	0.01	%
	65,152	Third Party Appraisal	Adjustments for differences between comparable sales.	2% - 4	%
	172,027	Third Party Appraisal	Adjustments for differences in net operating income expectations	17% - 38	%
			Adjustments for differences between comparable sales.	7% - 11	%
	143,160	Third Party Appraisal	Adjustments for differences in net operating income expectations	1% - 46	%
			Capitalization Rate	8.20	%
Other real estate owned - commercial	261,792	Third Party Appraisal	Adjustments for differences in net operating income expectations	7% - 10	%
			Capitalization Rate	9.00	%
			Adjustments for differences between comparable sales	7% - 10	%
Other real estate owned - residential	81,075	Third Party Appraisal	Adjustments for differences between comparable sales	2% - 6	%

14. RELATED PARTIES

The Bank at times has had loans, and other financial transactions, with its executive officers and directors. At December 31, 2012, the aggregate amount of loans outstanding to directors was $0. There were no loans granted to executive officers.

The change in aggregate amount of loans outstanding to directors as of December 31, 2012 and 2011 are as follows:

	2012	2011
Beginning balance	$8,618	$11,995
Originations	78,797	436,189
Payments	(87,415)	(439,566)
Ending balance	$—	$8,618

The interest income that was paid on these loans was $283 and $3,259 for 2012 and 2011, respectively.

Executive officers and directors own, in the aggregate, 30.0% and 29.2% of the common shares outstanding at December 31, 2012 and 2011, respectively.

15. CONDENSED FINANCIAL STATEMENTS OF THE PARENT COMPANY ONLY

VSB BANCORP, INC.

STATEMENTS OF FINANCIAL CONDITION

DECEMBER 31, 2012 and 2011

	2012	2011
ASSETS		
Cash and cash equivalents	$1,100	$—
Money market	791,339	352,608
Investment in subsidiaries	26,909,760	26,689,568
Deferred taxes	48,359	49,679
Other assets	37,464	36,017
Total assets	$27,788,022	$27,127,872
LIABILITIES AND STOCKHOLDERS' EQUITY		
LIABILITIES:		
Accounts payable, accrued expenses and other liabilities	$34,051	$25,612
Total liabilities	34,051	25,612
COMMITMENTS AND CONTINGENT LIABILITIES		
STOCKHOLDERS' EQUITY		
Common stock ($.0001 par value, 10,000,000 shares authorized 1,989,509 issued, 1,785,309 outstanding at December 31, 2012 and 1,797,809 outstanding at December 31, 2011)	199	199
Additional paid-in capital	9,257,167	9,304,789
Retained earnings	19,336,280	18,574,651
Treasury stock, at cost (204,200 shares at December 31, 2012 and 191,700 shares at December 31, 2011)	(2,068,898)	(1,935,596)
Unearned Employee Stock Ownership Plan shares	(225,438)	(394,516)
Accumulated other comprehensive gain, net of taxes of $1,226,742 and $1,309,447, respectively	1,454,661	1,552,733
Total stockholders' equity	27,753,971	27,102,260

Total liabilities and stockholders’ equity	$27,788,022	$27,127,872

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VSB BANCORP, INC.

STATEMENTS OF OPERATIONS

FOR THE YEARS ENDED DECEMBER 31, 2012 AND 2011

	2012	2011
INTEREST INCOME:		
Loans recievable	$15,762	$22,525
Other interest income	3,423	3,761
Total interest income	19,185	26,286
INTEREST EXPENSE:		
Total interest expense	—	—
Net interest income	19,185	26,286
NON-INTEREST INCOME:		
Dividend income	1,000,000	500,000
Other	—	—
	1,000,000	500,000
NON-INTEREST EXPENSES:		
Salaries and benefits	101,672	93,727
Legal fees	30,000	57,000
Other	111,207	91,514
Total non-interest expenses	242,879	242,241
INCOME BEFORE INCOME TAXES	776,306	284,045
PROVISION/(BENEFIT) FROM INCOME TAXES:		
Current	(110,712)	(112,860)
Deferred	1,320	5,217
Total income taxes	(109,392)	(107,643)
EQUITY IN UNDISTRIBUTED EARNINGS, NET OF TAXES	302,502	1,052,763
NET INCOME	$1,188,200	$1,444,451

VSB BANCORP, INC.

STATEMENTS OF CASH FLOWS FOR THE YEARS ENDED DECEMBER 31, 2012 AND 2011

	2012	2011
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income	$1,188,200	$1,444,451
Adjustments to reconcile net income to net cash used in operating activities:		
Changes in operating assets and liabilities:		
ESOP compensation expense	(81,162)	(71,855)
Stock-based compensation expense	101,672	95,952
Undistributed income of subsidiaries	(302,502)	(1,052,763)
Increase in other assets	(1,447)	3,076
Decrease/(increase) in deferred income taxes	1,320	5,217
Increase/(decrease) in accounts payable, accrued expenses, and other liabilities	25,720	20,654
Net cash provided by operating activities	931,801	444,732
CASH FLOWS FROM INVESTING ACTIVITIES:		
Net decrease in loan receivable	169,078	169,078
Net decrease/(increase) in money market deposit	(438,731)	111,215
Net cash provided by investing activities	(269,653)	280,293
CASH FLOWS FROM FINANCING ACTIVITIES:		
Purchase of treasury stock, at cost	(234,477)	(291,799)
Payment of dividends	(426,571)	(433,235)
Net cash used in financing activities	(661,048)	(725,034)
NET (DECREASE)/INCREASE IN CASH AND CASH EQUIVALENTS	1,100	(9)
CASH AND CASH EQUIVALENTS, BEGINNING OF YEAR	—	9
CASH AND CASH EQUIVALENTS, END OF YEAR	$1,100	$—
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION:		
Cash paid during the period for:		
Interest	$—	$—
Income taxes	$—	$—

16. EMPLOYEE STOCK OWNERSHIP PLAN

Employees participate in an Employee Stock Ownership Plan ("ESOP"). VSB Bancorp, Inc. ESOP Trust was formed on May 1, 2004. The ESOP borrowed from the Company to purchase 92,900 shares of stock at $18.20 per share. The Company makes discretionary contributions to the ESOP, as well as paying dividends on unallocated shares to the ESOP, and the ESOP uses funds it receives to repay the loan. When loan payments are made, ESOP shares are allocated to participants based on relative compensation and expense is recorded. Dividends on allocated shares increase participant accounts.

Shares allocated to each participant, to the extent vested, are distributed to the participant upon termination of employment. As required by federal law, a participant may require the Company to repurchase shares so distributed unless the stock is traded on an established market.

The contribution to the ESOP was $169,078 for each of the years ended December 31, 2012 and 2011. ESOP expense was $87,916 and $97,223 for the years ended December 31, 2012 and 2011, respectively.

Shares held by the ESOP at December 31, 2012 and 2011 were as follows:

	2012	2011
Shares allocated to participants	82,301	73,971
Shares released to participants	(12,759)	(10,747)
Unearned shares	10,599	18,929
Total ESOP Shares	80,141	82,153
Fair value of unearned shares	$105,354	$197,240

17. RETENTION AND RECOGNITION PLAN

At the April 27, 2010 Annual Meeting, the stockholders of VSB Bancorp, Inc. approved the adoption of the 2010 Retention and Recognition Plan (the "RRP"). The RRP authorizes the award of up to 50,000 shares of its common stock to directors, officers and employees. In conjunction with the approval the RRP, stockholders approved the award of 4,000 shares of stock to each of its eight directors who had at least five years of service. The director awards will vest over five years, with 20% vesting annually for each of the first five years after the award is made, subject to acceleration and forfeiture. In April 2011, 6,400 shares or 20% of the 32,000 shares of stock awarded to its eight directors who had at least five years of service had vested. In April 2012, an additional 6,400 shares or 20% of the 32,000 shares of stock awarded to its eight directors who had at least five years of service had vested. In June 2010, an additional 3,500 shares of stock were awarded to the President and CEO of the Company, which will vest over a 65 month period, with 20% vesting annually for each of the first five years starting in November 2011, subject to acceleration and forfeiture. In November 2011, 700 shares or 20% of the 3,500 shares of stock awarded to the President and CEO of the Company had vested. In November 2012, an additional 700 shares or 20% of the 3,500 shares of stock awarded to the President and CEO of the Company had vested. In November 2012, an additional 2,500 shares of stock were awarded to the President and CEO of the Company on an equal two year vesting beginning November 2013. Also, in November 2012, an additional 1,000 shares were awarded to each non-employee director on an equal two year vesting beginning November 2013.

The recipient of an award will not be required to make any payment to receive the award or the stock covered by the award. As of December 31, 2012, 45,000 shares of the RRP have been awarded. The Company recognizes compensation expense for the shares awarded under the RRP gradually as the shares vest, based upon the market price of the shares on the date of the award. For the year ended December 31, 2012, the Company recognized $89,277 of compensation expense related to the shares awarded. The income tax benefit resulting from this expense was $40,844. As of December 31, 2012, there was approximately $265,193 of unrecognized compensation costs related to the shares awarded. These costs are expected to be recognized over the next 2.25 years.

A summary of the status of the Company's non-vested plan shares as of December 31, 2012 is as follows:

For the Year Ended December 31, 2012:

	Shares	Weighted Average Grant Date Share Value
Non vested at beginning of period	28,400	$ 11.46
Granted	9,500	10.78
Vested	7,100	—
Non vested at end of period	30,800	$ 11.25

Item 9. Changes In and Disagreements With Accountants on Accounting and Financial Disclosure

Not applicable.

Item 9a Controls and Procedures

Disclosure Controls and Procedures

Our principal executive and principal financial officer evaluated our disclosure controls and procedures (as such term is defined in Rule 13a-15(e) promulgated under the Securities Exchange Act of 1934, as amended (the “Exchange Act”), as of the end of the period covered by this Annual Report, as required by paragraph (b) of Rule 13a-15 of the Exchange Act. Based on such evaluation, our principal executive and principal financial officer concluded that, as of the end of the period covered by this Annual Report, our disclosure controls and procedures are effective.

Management’s Annual Report on Internal Control Over Financial Reporting

Our management is responsible for establishing and maintaining adequate internal control over financial reporting as defined in Rule 13a-15(f) under the Securities Exchange Act of 1934. Our internal control over financial reporting is designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles in the United States.

All internal control systems, no matter how well designed, have inherent limitations. Therefore, even those systems determined to be effective can provide only reasonable assurance with respect to financial statement preparation and presentation.

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

Management assessed the effectiveness of our internal control over financial reporting as of December 31, 2011. In making this assessment, management used the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) in *Internal Control-Integrated Framework* as amplified by the *Guidance for Smaller Public Companies.* The five principal components of the Framework that management analyzed in connection with its assessment were our Control Environment, Risk Assessment, Control Activities, Information and Communication, and Monitoring. Based on that assessment, management believes that we maintained effective internal control over financial reporting as of December 31, 2012.

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

Item 9B. Other Information.

Not applicable.

PART III

Item 10. Directors, Executive Officers, Promoters and Control Persons; Compliance with Section 16(a) of the Exchange Act

Incorporated by reference to pages 4 through 6 of the Proxy Statement under the caption "General Information Regarding Nominees and Our Other Directors;" page 17 of the Proxy Statement under the caption "Section 16a Beneficial Ownership Reporting Compliance;" and pages 7 and 8of the Proxy Statement under the caption "Audit Committee."

The Company has a Code of Ethics that applies to all officers and employees. The Code of Ethics is posted on our web site – www.victorystatebank.com – and can be found under the "Investor Relations" tab.

Item 11. Executive Compensation

The information required by this Item is incorporated by reference to pages 10 through 14 of the Proxy Statement under the caption Compensation through and including the sub-caption “Directors Compensation.”

Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters

The information required by this Item is incorporated by reference to pages 15 through 16 of the Proxy Statement under the caption "Security Ownership of Management and Certain Beneficial Owners."

Item 13. Certain Relationships and Related Transactions, and Director Independence

The information required by this Item is incorporated by reference to pages 16 through 17 of the Proxy Statement under the caption "Transactions with Directors and Officers and Their Related Interests."

Item 14. Principal Accounting Fees and Services.

The information required by this Item is incorporated by reference to page 19 of the Proxy Statement under the caption "Audit and Other Fees."

Item 15. Exhibits, Financial Statement Schedules

(a) Financial Statements

Report of Independent Registered Public Accounting Firm	F-1
Consolidated Statements of Financial Condition as of December 31, 2012 and 2011	F-2
Consolidated Statements of Earnings for the Years Ended December 31, 2012 and 2011	F-3
Consolidated Statements of Comprehensive Income for the Years Ended December 31, 2012 and 2011	F-4
Consolidated Statements of Stockholders' Equity for the Years Ended December 31, 2012 and 2011	F-5
Consolidated Statements of Cash Flows for the Years Ended December 31, 2012 and 2011	F-6
Notes to Consolidated Financial Statements	F-7

(b) Exhibits

Exhibit No.	Title of Exhibit
3.1	Restated Certificate of Incorporation of VSB Bancorp, Inc.*
3.2	Amended Bylaws of VSB Bancorp, Inc.****
3.3	VSB Bancorp, Inc., Certificate of Amendment of Certificate of Incorporation******
10.1	VSB Bancorp, Inc. Restated 2000 Incentive Stock Option Plan*
10.2	VSB Bancorp, Inc. Restated 2000 Directors Stock Option Plan*
10.3	VSB Bancorp, Inc. Restated 1998 Incentive Stock Option Plan*
10.4	VSB Bancorp, Inc. Restated 1998 Directors Stock Option Plan*
10.5	VSB Bancorp, Inc. 2004 Directors Stock Option Plan**
10.6	VSB Bancorp, Inc. 2010 Retention and Recognition Plan *****
10.7	VSB Bancorp, Inc. 2010 Incentive Stock Option Plan *****
10.8	Employment Agreement among Raffaele M. Branca, VSB Bancorp, Inc. and Victory State Bank***
21.	Subsidiaries of the Registrant
23.	Consent of Independent Registered Public Accounting Firm
31.1	Rule 13A-14(a)/15D-14(a) Certification of Chief Executive Officer
31.2	Rule 13A-14(a)/15D-14(a) Certification of Principal Accounting Officer
32.1	Certification by CEO pursuant to 18 U.S.C. 1350
32.2	Certification by Principal Accounting Officer pursuant to 18 U.S.C. 1350
101.INS	XBRL Instance Document (furnished herewith)
101.SCH	XBRL Taxonomy Extension Schema Document (furnished herewith)
101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document (furnished herewith)
101.DEF	XBRL Taxonomy Extension Definition Linkbase Document (furnished herewith)
101.LAB	XBRL Taxonomy Extension Label Linkbase Document (furnished herewith)
101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document (furnished herewith)

* - previously filed as an exhibit on Form 10-KSB (File No. 001-33250) as filed with the Securities and Exchange Commission on March 26, 2008.

** - previously filed as an exhibit included in the Issuer's proxy statement for its 2004 Annual Meeting of Stockholders on Form 14A on March 24, 2004, SEC Accession Number 0001019056-04-000401, Film Number 04685677.

*** - previously filed as an exhibit on Form 8-K (File No. 001-33250) as filed with the Securities and Exchange Commission on June 24, 2010.

**** - previously filed as an exhibit on Form 8-K (File No. 001-33250) as filed with the Securities and Exchange Commission on January 18, 2011.

***** - previously filed as an exhibit included in the Issuer's proxy statement for its 2010 Annual Meeting of Stockholders on Form 14A on March 26, 2010, SEC Accession Number 0001019056-10-000360, Film Number 10706769.

****** - previously filed as an exhibit on Form 10-K (File No. 001-33250) as filed with the Securities and Exchange Commission on March 26, 2012.

SIGNATURES

Pursuant to the requirements of Section 12 of the Securities Exchange Act of 1934, the registrant has duly caused this registration statement to be signed on its behalf by the undersigned, thereunto duly authorized.

	VSB Bancorp, Inc. (Registrant)	
Date: March 15, 2013	By:	/s/Raffaele M. Branca Raffaele M. Branca, President & CEO, Principal Executive Officer and Principal Financial Officer
Date: March 15, 2013		/s/ Jonathan B. Lipschitz Jonathan B. Lipschitz Vice President, Controller and Principal Accounting Officer

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

/s/Raffaele M. Branca Raffaele M. Branca, President and Chief Executive Officer and Director	March 15, 2013 Date
/s/Joseph J. LiBassi Joseph J, LiBassi, Chairman of the Board	March 15, 2013 Date
/s/Joan Nerlino Caddell Joan Nerlino Caddell, Director	March 15, 2013 Date
/s/Robert S. Cutrona, Sr. Robert S. Cutrona, Sr., Director	March 15, 2013 Date
/s/Chaim Farkas Chaim Farkas, Director	March 15, 2013 Date
/s/Alfred C. Johnsen Alfred C. Johnsen, Director	March 15, 2013 Date
/s/Robert P. Moore	March 15, 2013

Robert P. Moore, Director	Date
/s/Carlos Perez	March 15, 2013
Carlos Perez, Director	Date
/s/Bruno Savo	March 15, 2013
Bruno Savo, Director	Date