# FORM 10-K

Annual report pursuant to section 13 and 15(d)

Filing Date: **1999-03-26** | Period of Report: **1998-12-31**
**SEC Accession No.** 0000950135-99-001519



## FILER

**MASSBANK CORP**
CIK:**799166**| IRS No.: **042930382** | State of Incorp.:**DE** | Fiscal Year End: **1231**
Type: **10-K** | Act: **34** | File No.: **000-15137** | Film No.: **99573494**
SIC: **6022** State commercial banks

Mailing Address
*123 HAVEN STREET*
*READING PA 01867*

Business Address
*123 HAVEN STREET*
*READING MA 01867*
*6179428192*

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, DC 20549
FORM 10-K

[x] ANNUAL REPORT PURSUANT TO SECTION 13 or 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 (Fee Required)

For the fiscal year ended December 31, 1998
OR
[ ] TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 (No Fee Required)

For the transition period from______________to____________

Commission File Number 0-15137

MASSBANK Corp.
(Exact name of registrant as specified in its charter)

| | |
|---|---|
| Delaware | 04-2930382 |
| (State or other jurisdiction of incorporation or organization) | (I.R.S. Employer Identification No.) |
| 123 HAVEN STREET Reading, Massachusetts | 01867 |
| (Address of principal executive offices) | (Zip Code) |

Registrant's telephone number, including area code: (617) 662-0100

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

Securities registered pursuant to Section 12(g) of the Act:
Common Stock, par value $1.00 per share
(Title of Class)

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

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

The aggregate market value of the voting stock held by non-affiliates of the registrant, based on the closing price for the registrant's common stock on March 19, 1999 as reported by NASDAQ, was $121,235,560.

As of March 19, 1999, there were 3,455,959 shares of the registrant's common stock outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the registrant's 1998 Annual Report to Stockholders are incorporated by reference in Parts I, II, III and IV of this Form 10-K. Portions of the Proxy Statement for the 1999 Annual Meeting of Stockholders are incorporated by reference in Part III of this Form 10-K.



Cautionary Statement.

Certain statements contained in this report or incorporated herein by reference are "forward-looking statements." We may also make written or oral forward-looking statements in other documents we file with the SEC, in our annual reports to stockholders, in press releases and other written materials, and in oral statements made by our officers, directors or employees. You can identify forward-looking statements by the use of the words "believe," "expect," "anticipate," "intend," "estimate," "assume" and other similar expressions which predict or indicate future events and trends and which do not relate to historical matters. In addition, information concerning the costs, timing and effectiveness of Year 2000 compliance, are forward-looking statements. You should not rely on forward-looking statements, because they involve known and unknown risks, uncertainties and other factors, some of which are beyond the control of the Company. These risks, uncertainties and other factors may cause the actual results, performance or achievements of the Company to be materially different from the anticipated future results, performance or achievements expressed or implied by the forward-looking statements.

Some of the factors that might cause these differences include the following: fluctuations in interest rates, price volatility in the stock and bond markets, inflation, government regulations and economic conditions and competition in the geographic and business areas in which the Company conducts its operations; and the Company and its customers and suppliers may experience unanticipated delays or expenses in achieving Year 2000 compliance. You should carefully review all of these factors, and you should be aware that there may be other factors that could cause these differences. These forward-looking statements were based on information, plans and estimates at the date of this report, and we do not promise to update any forward-looking statements to reflect changes in underlying assumptions or factors, new information, future events or other changes.

# PART I

## Item 1. Business

### Business of MASSBANK Corp.

General

MASSBANK Corp. (the "Company") is a general business corporation incorporated under the laws of the State of Delaware on August 11, 1986. MASSBANK Corp. was organized for the purpose of becoming the holding company for MASSBANK (the "Bank"). The Company is a one-bank holding company registered with the Federal Reserve Board under the Bank Holding Company Act of 1956, as amended. As of and since December 2, 1986, the effective date of the reorganization whereby MASSBANK Corp. became the holding company for the Bank, the Bank has been a wholly-owned subsidiary of MASSBANK Corp. The only office of MASSBANK Corp., and its principal place of business, is located at the main office of the Bank at 123 Haven Street, Reading, Massachusetts 01867.

MASSBANK Corp. currently has no material assets other than its investment in the Bank. The Company's primary business, therefore, is managing its investment in the stock of the Bank. MASSBANK Corp. is classified by the Commonwealth of Massachusetts as a securities corporation for tax purposes which restricts its business to buying, selling, dealing in, or holding securities on its own behalf. In the future, MASSBANK Corp. may become an operating company or acquire banks or companies engaged in bank-related activities.





MASSBANK Corp.'s principal sources of revenues on an unconsolidated basis are dividends from the Bank and, to a lesser extent, interest income received from its interest-bearing bank deposits. These revenues are used primarily for the payment of dividends to stockholders and for the repurchase of Company stock. MASSBANK Corp.'s assets on an unconsolidated basis at December 31, 1998 were represented by its investment in the Bank of $108.7 million and other assets of $2.4 million. The Company's liabilities consisted of loan indebtedness of $0.6 million and other liabilities of less than $0.1 million. The proceeds of the loan were used to fund stock purchases through the Employee Stock Ownership Plan ("ESOP"). See Note 17 to the Consolidated Financial Statements for parent company only financial information. At December 31, 1998 MASSBANK Corp. on a consolidated basis had total assets of $946.6 million, deposits of $824.0 million, and stockholders' equity of $110.5 million which represents 11.7% of total assets. Book value per share at December 31, 1998 was $31.58.

The Company does not own or lease any real or personal property. Instead it intends to utilize during the immediate future the premises, equipment and furniture of the Bank without the direct payment of rental fees to the Bank.

Competition

The primary business of MASSBANK Corp. currently is the ongoing business of the Bank. Therefore, the competitive conditions faced by MASSBANK Corp. currently are the same as those faced by the Bank. See "Business of MASSBANK - Competition." In addition, many banks and financial institutions have formed holding companies. It is likely that these holding companies will attempt to acquire commercial banks, thrift institutions or companies engaged in bank-related activities. MASSBANK Corp. would face competition in undertaking any such acquisitions and in operating any such entity subsequent to its acquisition.

Employees

MASSBANK Corp. does not employ any persons; its management also serves as management of, and is paid by, the Bank. See "Item 10 - Directors and Executive Officers of the Registrant." MASSBANK Corp. utilizes the support staff of the Bank from time to time and does not pay any separate salaries or expenses in connection therewith.

Dividends

MASSBANK Corp. paid total cash dividends of $1.02 per share in 1998 compared to $0.885 per share in 1997 and $0.69 per share in 1996. The Company's dividend payout ratios (cash dividends paid divided by net income) for 1998, 1997 and 1996 were 33%, 31% and 26%, respectively.

Stock Repurchase Program

In January 1999, the Board of Directors re-authorized the Company's stock repurchase program and added an additional 100,000 shares to the shares of the Company's common stock authorized for repurchase in July 1997. During 1998, the Company repurchased 119,200 of its common shares under its ongoing repurchase program. This leaves 152,198 shares available for repurchase in the current program.

Preferred Stock Purchase Rights

In January 1990, the Board of Directors declared a dividend distribution of one Preferred Stock Purchase Right for each outstanding share of MASSBANK Corp. common stock. These Rights, which expire in January 2000, entitle their holders to purchase from the Company one one-hundredth of a share (a "unit") of Series A Junior Participating Cumulative Preferred Stock, par value $1.00 per share ("preferred stock") at a cash exercise price of $70.00 per unit, subject to adjustment. The Rights will trade separately from the common stock and will become exercisable when a person or group has acquired 15% or more of the outstanding common stock, upon a tender offer that would result in a person or group acquiring 15% or more of the outstanding common stock, or upon the declaration by the Board of Directors that any person holding 10% or more of the outstanding shares of common stock is an "adverse person".

In the event a person or group acquires 15% or more of the outstanding common stock or the Board of Directors declares a person an "adverse person", each Right would entitle its holder (except if the holder is a person or group described above) to receive upon exercise sufficient units of preferred stock to equal a value of two times the exercise price of the Right. In the event the Company is acquired in a merger or other business combination transaction or if 50% or more of the Company's assets or earning power is sold, each holder may receive upon exercise common stock of the acquiring company having a market value equal to two times the exercise price of the Right.

The Rights are redeemable in whole, but not in part, by the Board of Directors at a price of $.01 per Right any time before a person or group acquires 15% or more of the outstanding common stock or the Board of Directors declares a person an "adverse person".





## Business of MASSBANK

General

MASSBANK is a Massachusetts-chartered savings bank founded in 1872 as the Melrose Savings Bank. In 1983, the Reading Savings Bank was merged into the Melrose Savings Bank and the name of the resulting institution was changed to MASSBANK for Savings. In 1986, the Bank converted from mutual to stock form of ownership. In 1996, the name of the bank was changed from "MASSBANK for Savings" to "MASSBANK".

The Bank is primarily engaged in the business of attracting deposits from the general public through its fifteen full service banking offices in Reading, Chelmsford, Dracut, Everett, Lowell, Medford, Melrose, Stoneham, Tewksbury, Westford and Wilmington, and originating residential and commercial real estate mortgages, construction, and a variety of consumer loans. The Bank also invests a significant portion of its funds in U.S. Treasury and Government agency securities, mortgage-backed securities, federal funds sold, and other authorized investments. The Bank's earnings depend largely upon net interest income, which is the difference between the interest and dividend income derived by the Bank from its loans and investments and the interest paid by the Bank on its deposits and borrowed funds. The Company's earnings results are also affected by the provision for loan losses; non-interest income, such as fee-based revenues and net securities gains; non-interest expense; and income taxes.

The Bank's deposits are insured to applicable limits by the Bank Insurance Fund ("BIF") of the Federal Deposit Insurance Corporation (the "FDIC") and excess deposit accounts are insured by the Depositors Insurance Fund ("DIF"), a private industry-sponsored deposit insurer.

The Bank recognizes that loan and investment opportunities change over time and that yields derived from such opportunities can vary significantly even when the risks associated with those opportunities are comparable. By developing a relatively liquid loan and investment portfolio, the Bank has attempted to position itself so as to be able to take advantage of these changing opportunities. Consequently, the Bank expects that the relative mix of its loan and investment portfolios will change over time in response to changing market conditions.





Market Area

The Bank is headquartered in Reading, Massachusetts, which is located approximately 15 miles north of Boston. The Bank's market area includes a significant portion of eastern Massachusetts and is served by a network of 15 branch offices located on a broad arc stretching from Melrose and Everett in the south, Dracut in the north, and Westford in the west.

The Bank's general market area consists of the municipalities in which it operates banking offices and all of the contiguous cities and towns.

The Bank currently operates banking offices in the municipalities of Chelmsford, Dracut, Everett, Lowell, Medford, Melrose, Reading, Stoneham, Tewksbury, Westford and Wilmington.

Lending Activities

The Bank's net loan portfolio totaled $302.5 million at December 31, 1998.

The following table sets forth information concerning the Bank's loan portfolio by type of loan at the dates shown:

<TABLE>
<CAPTION>

| (In thousands) At December 31, | 1998 | 1997 | 1996 | 1995 | 1994 |
|---|---|---|---|---|---|
| Mortgage loans: | | | | | |
| Residential: | | | | | |
| <S> | <C> | <C> | <C> | <C> | <C> |
| Conventional | $280,681 | $243,482 | $216,832 | $209,408 | $207,772 |
| FHA and VA | 1,181 | 1,843 | 2,515 | 3,244 | 4,158 |
| Commercial | 2,257 | 3,861 | 4,121 | 6,975 | 8,155 |
| Construction | 730 | 492 | 1,388 | 1,516 | 603 |
| Total mortgage loans | 284,849 | 249,678 | 224,856 | 221,143 | 220,688 |
| Add: premium on loans | 259 | 343 | 325 | 388 | 452 |
| Less: deferred mortgage loan origination fees | (1,454) | (1,223) | (1,042) | (928) | (871) |
| Mortgage loans, net | 283,654 | 248,798 | 224,139 | 220,603 | 220,269 |
| Other loans: | | | | | |
| Consumer: | | | | | |
| Installment | 1,547 | 2,199 | 1,967 | 1,988 | 1,972 |
| Guaranteed education | 7,967 | 8,934 | 9,729 | 10,420 | 10,152 |
| Other secured | 1,366 | 1,600 | 1,611 | 2,012 | 2,598 |

| | | | | | |
|---|---|---|---|---|---|
| Home equity lines of credit | 10,159 | 10,470 | 11,316 | 13,144 | 14,674 |
| Unsecured | 235 | 266 | 271 | 265 | 269 |
| Total consumer loans | 21,274 | 23,469 | 24,894 | 27,829 | 29,665 |
| Commercial | 61 | 36 | 628 | 753 | 882 |
| Total other loans | 21,335 | 23,505 | 25,522 | 28,582 | 30,547 |
| Total loans | 304,989 | 272,303 | 249,661 | 249,185 | 250,816 |
| Less: Allowance for loan losses | (2,450) | (2,334) | (2,237) | (2,529) | (2,566) |
| Net loans | $302,539 | $269,969 | $247,424 | $246,656 | $248,250 |

</TABLE>





The following table shows the maturity distribution and interest rate sensitivity of the Bank's loan portfolio at December 31, 1998:

<TABLE>
<CAPTION>

| | Maturity/Scheduled Payments (1) | | | | |
|---|---|---|---|---|---|
| (In thousands) | Within one year | One to five years | Five to ten years | After ten years | Total |
| Mortgage loans: | | | | | |
| <S> | <C> | <C> | <C> | <C> | <C> |
| Residential | $ 430 | $10,168 | $73,860 | $196,227 | $280,685 |
| Commercial & construction | 368 | 234 | 1,166 | 1,201 | 2,969 |
| Total mortgage loans | 798 | 10,402 | 75,026 | 197,428 | 283,654 |
| Other loans | 1,536 | 2,942 | 5,477 | 11,380 | 21,335 |
| Total loans | $2,334 | $13,344 | $80,503 | $208,808 | $304,989 |

</TABLE>

(1) Loan amounts are accumulated as if the entire balance came due on the last contractual payment date. Accordingly, the amounts do not reflect proceeds from contractual loan amortization or anticipated prepayments.

The following table shows the amounts, included in the table above, which are due after one year and which have fixed or adjustable interest rates:

<TABLE>
<CAPTION>

| | Total Due After One Year | | |
|---|---|---|---|
| (In thousands) | Fixed Rate | Adjustable Rate | Total |
| Mortgage loans: | | | |
| <S> | <C> | <C> | <C> |
| Residential | $237,657 | $42,598 | $280,255 |
| Commercial & construction | 671 | 1,930 | 2,601 |

| | | | |
|---|---|---|---|
| Total mortgage loans | 238,328 | 44,528 | 282,856 |
| Other loans | 1,681 | 18,118 | 19,799 |
| Total loans | $240,009 | $62,646 | $302,655 |

</TABLE>

Mortgage Lending. The Bank believes that the repayment periods of long-term first mortgage loans, the general resistance of the public to variable rate mortgage instruments and the highly competitive nature of the mortgage industry require a prudent approach to mortgage lending. Consequently, as part of its policy of generally attempting to match the maturities of its assets and its liabilities, the Bank, over several years, has kept its mortgage loan portfolio to a level at which the Bank believed there was an acceptable risk-to-reward ratio in light of opportunities in the marketplace and the Bank's long-term objectives. The Bank's net loan portfolio represented approximately 32.0% and 29.2% of the Company's total assets at December 31, 1998, and 1997, respectively. The Bank realizes that this low level of loans with respect to assets in relation to the securities portfolio results in a reduction in yield; however, the Bank believes that this reduction would be more than offset in risk and loss associated with lending during periods of economic decline. In today's economic climate, the Bank would prefer a more even mix of loans and securities. However, there remains a tremendous amount of competition for mortgages in the Bank's area, and developing a quality loan portfolio takes time. The Bank anticipates that its loan portfolio will grow slowly over the next few years.





Mortgage Lending (continued)

Loan originations come from a number of sources, including referrals from real estate brokers, walk-in customers, purchasers of property owned by existing customers and refinancing for existing customers. In addition to actively soliciting loan referrals, the Bank conducts an advertising and promotion program, directed both toward the general public and real estate professionals who might refer potential borrowers.

Substantially all of the real estate loans originated by the Bank during 1998 were secured by real estate located in the Bank's primary lending area, reflecting the Bank's commitment to serve the credit needs of the local communities in which it operates banking offices.

The Bank makes both conventional fixed and adjustable-rate loans on one-to-four family residential properties for a term of ten to thirty years. The Bank currently retains all of the mortgages it originates for its own portfolio. These are primarily 10, 12, 15 or 20 year fixed rate mortgages and adjustable rate mortgages. The few long-term (25 or 30 year) fixed rate mortgages the bank originated in 1998 were added to the bank's loan portfolio. However, in prior years, these mortgages were generally sold in the secondary market. Adjustable rate mortgage loans ("ARMs") have rates that are re-set at either 1, 3, 5 or 10 year intervals and provide a margin over various mortgage indices.

The Bank also has a Home Equity Line of Credit product which it hopes will generate new business in the coming year. This product, which was introduced in 1997, offers customers a special introductory interest rate of 7.25% which is fixed until the year 2000. Thereafter, the interest rate will be variable and will be indexed to the 13 week (91 day) Treasury Bill auction rate plus a margin of 3.25%. This indexed variable rate has historically responded more favorably to movements in market interest rates than the PRIME RATE used by many financial institutions and should, therefore, be more attractive to bank customers.

In recent years, the Bank has instituted several other new loan programs which have been well received by customers. It instituted a program featuring a 5/1 and 7/1 year ARM product with an initial fixed rate for 5 or 7 years and a 1 year adjustable rate thereafter. A special First Time Home Buyers Program has also been instituted featuring a discounted 7/1 ARM. This program is designed for first-time home buyers meeting certain income and property location restrictions. The Bank has also introduced the "Home Town Advantage" mortgage program which has produced some good results. This program offers homebuyers a (0.125) percent discount on their mortgage rate if they purchase residential property located in one of the communities where the bank operates a banking office.

At December 31, 1998, 1-4 family residential mortgage loans totaled $280.7 million, or 92.0% of the total loan portfolio, compared to $244.5 million, or 89.8% of the total loan portfolio, at December 31, 1997. Residential mortgage loan originations amounted to $95.7 million during 1998, an increase of 91.4% from $50.0 million in 1997. Origination volumes are sensitive to interest rates and are affected by the interest rate environment. The prevailing low interest rates in 1998 encouraged many borrowers to refinance. This resulted in higher mortgage loan originations for the Bank.

The Bank also originates mortgage loans secured by commercial or investment property such as multifamily housing, strip shopping centers, office buildings and retail buildings. At December 31, 1998, commercial and multifamily real estate mortgages and construction loans totaled approximately $3.0 million, or 1.0% of the total loan portfolio, compared to $4.3 million, or 1.6% of the total loan portfolio, at December 31, 1997. In 1998, commercial and multifamily real estate mortgage loan originations amounted to $0.2 million.





Mortgage Lending (continued)

The total amount of first mortgage loans held by the Bank at December 31, 1998 was $283.7 million as indicated in the maturity distribution table appearing on page six. Of this amount, $44.9 million was subject to interest rate adjustments. The remaining $238.8 million in fixed rate mortgage loans represents 25.2% of the Company's total assets.

Fees received for originating loans and related direct incremental loan origination costs are offset and the resulting net amount is deferred and amortized over the life of the related loans using the level-yield method.

The Bank also receives fees and charges relating to existing loans, primarily late charges and prepayment penalties.

Other Loans. The Bank makes a variety of consumer loans and had a consumer loan portfolio of approximately $21.3 million at December 31, 1998 representing 7.0% of the Bank's total loan portfolio. Of this amount $8.0 million or 2.6% of the total loan portfolio are education loans made under the Massachusetts Higher Education Assistance Corporation. The Bank may sell education loans in the future.

The balance of the Bank's consumer loan portfolio consists of home equity lines of credit and installment consumer credit contracts such as automobile loans, home improvement loans and other secured and unsecured financings. These loans totaled $13.3 million at December 31, 1998, representing 4.4% of the

Bank's total loan portfolio.

At December 31, 1998, the Bank had only $61 thousand in outstanding loans to commercial enterprises not secured by real estate.

Loan Approval. The Bank's loan approval process for all loans generally includes a review of an applicant's financial statements, credit history, banking history and verification of employment. For mortgage loans, the Bank generally obtains an independent appraisal of the subject property. The Bank has a formal lending policy approved by the Board of Directors of the Bank which delegates levels of loan approval authority to Bank personnel. All loans in excess of established limits require approval of the Bank's Board of Directors.

The Bank issues commitments to prospective borrowers to make loans subject to certain conditions for generally up to 60 days. The interest rate applicable to the committed loans is usually the rate in effect at the time the application fee is paid. At December 31, 1998, the Bank had issued commitments on residential first mortgage loans totaling $7,941,000, and had commitments to advance funds on construction loans and unused credit lines, including unused portions of home equity lines of credit, of $281,000 and $29,163,000, respectively.

Loan Delinquencies. It is the Bank's policy to manage its loan portfolio so as to recognize problem loans at an early stage and thereby minimize loan losses. Loans are considered delinquent when any payment of principal or interest is 30 days or more past due. The Bank generally commences collection procedures, however, when accounts are 15 days past due. It is the Bank's practice to generally discontinue accrual of interest on all loans for which payments are more than 90 days past due. Loans delinquent for 90 or more days, as shown in the table on the following page, totaled $1,004,000 at December 31, 1998.





Real Estate Acquired through Foreclosure.

Real estate acquired through foreclosure is comprised of foreclosed properties where the Bank has actually received title and loans determined to be substantially repossessed. Real estate loans that are substantially repossessed include only those loans for which the Bank has taken possession of the collateral but has not completed legal foreclosure proceedings. Loan losses arising from the acquisition of such properties are charged against the allowance for loan losses. Real estate acquired through foreclosure is recorded at the lower of the carrying value of the loan or the fair value of the property constructively or actually received, less estimated costs to sell the property following foreclosure. Operating expenses and any subsequent provisions to reduce the carrying value to fair value are charged to current period earnings. Gains and losses upon disposition are reflected in earnings as realized. As of year-end 1998, MASSBANK had $86 thousand in real estate acquired through foreclosure on its balance sheet.

Non-Performing Assets

The following table shows the composition of non-performing assets at the dates shown:

<TABLE>
<CAPTION>
--------------------------------------------------------------------------------------------------

| (In thousands) At December 31, | 1998 | 1997 | 1996 | 1995 | 1994 |
|---|---|---|---|---|---|
| <S> | <C> | <C> | <C> | <C> | <C> |
| Nonaccrual loans: | | | | | |
| Mortgage loans: | | | | | |
| Residential: | | | | | |
| Conventional | $ 845 | $1,536 | $1,468 | $2,016 | $1,496 |
| FHA and VA | -- | 9 | 13 | 14 | 62 |
| Commercial | -- | -- | -- | -- | 152 |
| Consumer | 159 | 226 | 120 | 398 | 388 |
| Total nonaccrual loans | 1,004 | 1,771 | 1,601 | 2,428 | 2,098 |
| Real estate acquired through foreclosure: | | | | | |
| Residential: | | | | | |
| Conventional | 86 | -- | 503 | 255 | 129 |
| Total real estate acquired through foreclosure | 86 | -- | 503 | 255 | 129 |
| Total non-performing assets | $1,090 | $1,771 | $2,104 | $2,683 | $2,227 |
| Percent of non-performing loans to total loans | 0.33% | 0.65% | 0.64% | 0.97% | 0.84% |
| Percent of non-performing assets to total assets | 0.12% | 0.19% | 0.24% | 0.31% | 0.26% |

</TABLE>

The reduction in interest income associated with nonaccrual loans is as follows:

<TABLE>
<CAPTION>

| (In thousands) Years Ended December 31, | 1998 | 1997 | 1996 | 1995 | 1994 |
|---|---|---|---|---|---|
| <S> | <C> | <C> | <C> | <C> | <C> |
| Interest income that would have been recorded under original terms | $ 84 | $163 | $149 | $204 | $185 |
| Interest income actually recorded | 61 | 97 | 78 | 60 | 88 |
| Reduction in interest income | $ 23 | $ 66 | $ 71 | $144 | $ 97 |

</TABLE>





Allowance for Loan Losses.

The allowance for loan losses is increased by provisions charged to operations based on management's assessment of many factors including the risk characteristics of the portfolio, underlying collateral, current and anticipated economic conditions that may affect the borrower's ability to pay, and trends in loan delinquencies and charge-offs. Realized losses, net of recoveries, are charged directly to the allowance. While management uses the information available in establishing the allowance for loan losses, future adjustments to the allowance may be necessary if economic conditions differ substantially from the assumptions used in making the evaluation. 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.

The following table sets forth the activity in the allowance for loan losses during the years indicated:

<TABLE>
<CAPTION>

| (In thousands) Years ended December 31, | 1998 | 1997 | 1996 | 1995 | 1994 |
|---|---|---|---|---|---|
| <S> | <C> | <C> | <C> | <C> | <C> |
| Balance at beginning of year | $2,334 | $2,237 | $2,529 | $2,566 | $2,261 |
| Glendale Co-Operative Bank acquisition | -- | 105 | -- | -- | -- |
| Provision for loan losses | 193 | 260 | 160 | 170 | 705 |
| Charge-offs: | | | | | |
| Residential real estate | (81) | (221) | (480) | (124) | (339) |
| Consumer loans | (22) | (12) | (25) | (30) | (24) |
| Other loans | -- | (94) | (37) | (95) | (63) |
| Recoveries: | | | | | |
| Residential real estate | 17 | 34 | 83 | 41 | 23 |
| Commercial real estate | -- | 20 | -- | -- | -- |
| Consumer loans | 6 | 1 | 7 | 1 | 3 |
| Other Loans | 3 | 4 | -- | -- | -- |
| Net charge-offs | (77) | (268) | (452) | (207) | (400) |
| Balance at end of year | $2,450 | $2,334 | $2,237 | $2,529 | $2,566 |
| Net loan charge offs as a percent of average loans outstanding during the period | 0.03% | 0.10% | 0.18% | 0.08% | 0.16% |
| Allowance for loan losses as a percent of total loans outstanding at year-end | 0.80% | 0.86% | 0.90% | 1.01% | 1.02% |
| Allowance for loan losses as a percent of nonaccrual loans | 244.0% | 131.8% | 139.7% | 104.2% | 122.3% |

</TABLE>





Investment Activities

The Bank believes that investment opportunities in United States Government, corporate and other securities are at times more attractive than the opportunities present in the loan market. As compared to loans, these investments of the Bank are generally shorter-term and hence more liquid, are subject to lower risk of loss, and present an opportunity for appreciation. In addition, these investments often permit the Bank to better match the maturities of its assets and its liabilities.

The Bank's investment portfolio is managed by its officers in accordance with an investment policy approved by the Bank's Board of Directors. The objectives of that policy are to provide a level of liquidity, earnings and diversification consistent with the exercise of prudent investment judgment. The policy authorizes the senior management of the Bank to make and execute investment decisions and requires that those persons report all investment transactions to the Bank's Board of Directors at each of its regular meetings. In addition, management is required to report all gains or losses on all securities transactions at each meeting of the Bank's Board of Directors. Purchases and sales of securities by the Bank are generally required to be made on a competitive basis and all investments must be permitted by applicable law.

The Bank invests in a wide variety of securities and obligations, including: Federal funds sold (which are sold only to institutions included on the Bank's internally-prepared approved list of adequately capitalized institutions); commercial paper and bankers' acceptances; United States Treasury and Government agency obligations; United States agency guaranteed and other mortgage-backed securities; investment grade corporate debt securities (generally limited to those rated A or better by Standard & Poor's); mutual funds; and equity securities traded on a national securities exchange or quoted on the NASDAQ System.

Under the investment policy management determines the appropriate classification of securities at the time of purchase. Those securities that the Company has the intent and the ability to hold to maturity are classified as securities held to maturity and are carried at amortized historical cost.

Those securities held for indefinite periods of time and not intended to be held to maturity are classified as available for sale. Securities held for indefinite periods of time include securities that management intends to use as part of its asset/liability management strategy and that may be sold in response to changes in interest rates, changes in prepayment risk, the need to increase regulatory capital and other similar factors. Income on debt securities available for sale is accrued and included in interest and dividend income. The specific identification method is used to determine realized gains and losses on sales of securities available for sale which are also reported in non-interest income under the caption "gains on securities." When a security suffers a loss in value which is considered other than temporary, such loss is recognized by a charge to earnings.





Investment Activities (continued)

Investments classified as trading securities are stated at market with unrealized gains or losses included in earnings. Income on debt trading securities is accrued and included in interest and dividend income. All of the Company's mortgage-backed securities are currently classified as available for sale. At times of low loan demand, short-term mortgage-backed securities may be used as substitutes for loans as certain of their financial characteristics are very similar to short-term mortgage loans.

At December 31, 1998, the Company's investments, which consists of securities held to maturity, securities available for sale (including mortgage-backed securities), trading securities, short-term investments, term federal funds sold and interest-bearing deposits in banks totaled $624.1 million, representing 65.9% of the Company's total assets.

The following table sets forth the composition of the Company's investment portfolio as of the dates indicated:

Investment Portfolio

<TABLE>
<CAPTION>

| (In thousands) At December 31, | 1998 | 1997 | 1996 |
|---|---|---|---|
| <S> | <C> | <C> | <C> |
| Federal funds sold: | | | |
| Overnight federal funds | $123,207 | $ 85,241 | $109,902 |
| Term federal funds | 25,000 | 20,000 | 10,000 |
| Total federal funds sold | 148,207 | 105,241 | 119,902 |
| Money market funds | 24,569 | 24,514 | 24,408 |
| Interest-bearing deposits in bank | 2,033 | 2,083 | 1,751 |
| Total federal funds sold and other short-term investments | $174,809 | $131,838 | $146,061 |
| Percent of total assets | 18.5% | 14.2% | 16.4% |

| (In thousands) At December 31, | 1998 | 1997 | 1996 |
|---|---|---|---|
| Securities held to maturity: (a) | | | |
| Other bonds and obligations | $ 354 | $ 372 | $ 160 |
| Total securities held to maturity | $ 354 | $ 372 | $ 160 |
| Securities available for sale: (b) | | | |
| U.S. Treasury obligations | 114,981 | 123,021 | 140,706 |
| U.S. Government agency obligations | 8,992 | 9,813 | 7,877 |
| Other bonds and obligations | -- | -- | 1,000 |
| Marketable equity securities | 21,580 | 17,545 | 15,574 |
| Investments in mutual funds | -- | 1,114 | -- |
| Mortgage-backed securities | 272,573 | 330,731 | 306,595 |
| Total securities available for sale | 418,126 | 482,224 | 471,752 |
| Trading securities: (b) | | | |
| U.S. Treasury obligations | 29,707 | 18,542 | -- |
| Investments in mutual funds | 1,086 | 2,718 | 4,672 |
| Total trading securities | 30,793 | 21,260 | 4,672 |
| Total securities | $449,273 | $503,856 | $476,584 |
| Percent of total assets | 47.5% | 54.4% | 53.7% |
| Total investments | $624,082 | $635,694 | $622,645 |
| Total investments as a percent of total assets | 65.9% | 68.7% | 70.1% |

</TABLE>

(a) At amortized cost.
(b) At market value.

The following tables present the carrying value of debt securities held to maturity and available for sale at December 31, 1998 maturing within stated periods with the weighted average interest yield from securities falling within the range of maturities:

Debt Securities Held to Maturity

| (Dollars in thousands) | Other bonds and obligations (1) | Total |
|---|---|---|
| Maturing after 1 but within 5 years | | |
| Amount | $ 230 | $ 230 |
| Yield | 6.79% | 6.79% |
| Maturing after 5 years but within 10 years | | |
| Amount | $ 82 | $ 82 |
| Yield | 9.07% | 9.07% |
| Maturing after 10 years but within 15 years | | |
| Amount | 42 | 42 |
| Yield | 9.69% | 9.69% |
| Total | | |
| Amount | $ 354 | $ 354 |
| Yield | 7.66% | 7.66% |
| Average life in years | 4.20 | 4.20 |

Debt Securities Available for Sale

| (Dollars in thousands) | U. S. Treasury obligations | U.S. Government agency obligations | Mortgage-backed securities (2) | Total |
|---|---|---|---|---|
| Maturing within 1 year | | | | |
| Amount | $ 50,876 | $2,000 | $ 371 | $ 53,247 |
| Yield | 6.24% | 5.62% | 4.50% | 6.21% |
| Maturing after 1 but within 5 years | | | | |
| Amount | 58,790 | 6,771 | 6,014 | 71,575 |
| Yield | 6.24% | 5.99% | 7.70% | 6.34% |
| Maturing after 5 but within 10 years | | | | |
| Amount | 2,961 | -- | 35,087 | 38,048 |
| Yield | 5.85% | -- | 7.10% | 7.00% |
| Maturing after 10 but within 15 years | | | | |
| Amount | -- | -- | 219,579 | 219,579 |
| Yield | | | 6.89% | 6.89% |
| Maturing after 15 years | | | | |
| Amount | -- | 195 | 4,645 | 4,840 |
| Yield | | 7.94% | 6.07% | 6.15% |

| | | | | |
|---|---|---|---|---|
| Total | | | | |
| Amount | $112,627 | $8,966 | $265,696 | $387,289 |
| Yield | 6.23% | 5.95% | 6.89% | 6.68% |
| Average life in years | 1.51 | 2.90 | | |
| Average contractual maturity in years | | | 11.67 | |

</TABLE>





(1) Yields on tax exempt obligations have been computed on a tax equivalent basis.

(2) Mortgage-backed securities are shown at their contractual maturity, but are expected to have shorter lives due to scheduled payments and prepayments.

At December 31, 1998, the Company did not have an investment in any issuer (other than securities of the U.S. government) in excess of 10% of stockholders equity.





Deposits and Other Sources of Funds

General. Deposits have been the primary source of funds of the Bank for making investments and loans. In addition to deposits, the Bank's other major sources of funds are derived from amortization and prepayment of loans and mortgage-backed securities, from sales or maturities of securities, and from operations. Deposit flows can vary significantly and are influenced by prevailing interest rates, money market conditions, economic conditions and competition. The Bank can respond to changing market conditions and competition through the pricing of its deposit accounts. Management can control the level of its deposits to a significant degree through its pricing policies. Another important factor in attracting deposits is convenience. In addition to the Bank's fifteen conveniently located banking offices, customers can access accounts through the Bank's ATM network. The Bank is a member of the Transaxion ("TX"), New York Cash Exchange ("NYCE") and CIRRUS System, Inc. ("CIRRUS") networks which allow access to ATMs in over 100,000 locations worldwide.

Deposits. A substantial amount of the Bank's deposits are derived from customers who live or work within the Bank's market area. The Bank does not solicit deposits through any outside agents. The Bank's deposits consist of regular, silver and smart savings accounts, special notice accounts, NOW and Super NOW accounts, business checking accounts, money market deposit accounts, IRA and Keogh accounts, and term deposit accounts.

The performance of the stock market in 1998, continued to draw savings from bank deposit accounts making it more difficult to grow total bank deposits. As a result, the Bank's deposits increased by $14.1 million or a modest 1.8% during the twelve months ended December 31, 1998, from $809.9 million at year-end 1997 to $824.0 million at the end of 1998.

Borrowed Funds. From time to time the Bank has obtained funds through repurchase agreements with its customers and federal funds purchased. The Bank also has the ability, although it has never exercised it, to borrow from the

Federal Reserve Bank and The Depositors Insurance Fund, Inc. The Company did not have any borrowed funds in 1998 or 1997.





DEPOSITS

The following table shows the composition of the deposits as of the dates indicated:

<TABLE>
<CAPTION>

| (In thousands) at December 31, | 1998 | | 1997 | | 1996 | |
|---|---|---|---|---|---|---|
| | Amount | Percent of Deposits | Amount | Percent of Deposits | Amount | Percent of Deposits |
| <S> | <C> | <C> | <C> | <C> | <C> | <C> |
| Demand and NOW | | | | | | |
| NOW | $ 52,324 | 6.35% | $ 47,944 | 5.92% | $ 45,352 | 5.75% |
| Demand accounts (non interest-bearing) | 23,849 | 2.89 | 18,915 | 2.34 | 17,382 | 2.21 |
| Total demand and NOW | 76,173 | 9.24 | 66,859 | 8.26 | 62,734 | 7.96 |
| Savings: | | | | | | |
| Regular savings and special notice accounts | 326,192 | 39.59 | 329,348 | 40.67 | 333,834 | 42.35 |
| Money market accounts | 21,857 | 2.65 | 23,527 | 2.90 | 23,824 | 3.02 |
| Total savings | 348,049 | 42.24 | 352,875 | 43.57 | 357,658 | 45.37 |
| Time Certificates of deposit: | | | | | | |
| Fixed rate certificates | 318,491 | 38.65 | 316,368 | 39.06 | 303,722 | 38.52 |
| Variable rate certificates | 82,033 | 9.96 | 74,666 | 9.22 | 65,417 | 8.30 |
| Total time certificates of deposit | 400,524 | 48.61 | 391,034 | 48.28 | 369,139 | 46.82 |
| Deposit acquisition premium, net of amortization | (715) | (.09) | (918) | (0.11) | (1,181) | (.15) |
| Total deposits | $824,031 | 100.00% | $809,850 | 100.00% | $788,350 | 100.00% |

</TABLE>

In the following table the average amount of deposits and average rate is shown for each of the years as indicated.

<TABLE>
<CAPTION>

| (In thousands) Years Ended December 31, | 1998 | | 1997 | | 1996 | |
|---|---|---|---|---|---|---|
| | Average Balance | Average Rate | Average Balance | Average Rate | Average Balance | Average Rate |

| | | | | | | |
|---|---|---|---|---|---|---|
| <S> | <C> | <C> | <C> | <C> | <C> | <C> |
| NOW accounts | $ 48,006 | 1.15% | $ 46,580 | 1.14% | $ 47,197 | 1.21% |
| Demand (non interest-bearing) accounts | 21,011 | -- | 18,156 | -- | 15,992 | -- |
| Escrow deposits of borrowers | 1,142 | 0.18 | 1,159 | 0.28 | 780 | 0.19 |
| Money market accounts | 22,299 | 3.07 | 24,186 | 3.07 | 25,205 | 3.20 |
| Regular savings and special notice accounts | 327,338 | 3.44 | 331,209 | 3.47 | 332,851 | 3.44 |
| Time certificates of deposit | 391,816 | 5.57 | 386,062 | 5.67 | 352,385 | 5.74 |
| | ------- | | ------- | | ------- | |
| | 811,612 | 4.23% | 807,352 | 4.30% | $774,410 | 4.27% |

</TABLE>





Investment Management and Trust Services

The Bank's Trust and Investment Services Division offers a variety of investment, trust and estate planning services and also serves as Trustee, Executor, and Executor's Agent for bank customers.

As of December 31, 1998 the Trust Division had approximately $31.7 million (market value) of assets in custody and under management.

Competition

The Bank faces substantial competition both in originating loans and in attracting deposits. Competition in originating loans comes primarily from other thrift institutions, commercial banks, credit unions and mortgage banking companies. The Bank competes for loans principally on the basis of interest rates and loan fees, the types of loans originated and the quality of services provided to borrowers.

In attracting deposits, the Bank's primary competitors are other thrift institutions, commercial banks, mutual funds and credit unions located in its market area. The Bank's attraction and retention of deposits depend on its ability to provide investment opportunities that satisfy the requirements of customers with respect to rate of return, liquidity, risk and other factors. The Bank attracts a significant amount of deposits through its branch offices primarily from the communities in which those branch offices are located. The Bank competes for these deposits by offering competitive rates, convenient branches and ATM locations and convenient business hours.





Supervision and Regulation of the Company and its Subsidiaries

The Company and the Bank are in a heavily regulated industry. As a Delaware business corporation, the Company is subject to all of the federal and state laws and regulations that apply to corporations generally, including the federal and state securities laws and the Delaware Business Corporation Law. In addition, as a company that owns and controls a bank, the Company is regulated as a bank holding company, is subject to supervision, examination and regulation by the Board of Governors of the Federal Reserve System (the "FRB") under the federal Bank Holding Company Act (the "BHC Act"), and is subject to statutes, regulations and policies administered by the FRB relating to, among other things, mergers, acquisitions and changes in controlling ownership, non-bank activities and subsidiaries, capital adequacy, the receipt and payment of dividends, and the provision of financial and managerial support to its subsidiary bank. In addition, the Company is subject to certain state law restrictions administered by the Massachusetts Division of Banks (the "Division"), relating to, among other things, the acquisition of additional banking institutions and the conduct of nonbank activities.

As a Massachusetts-chartered savings bank whose deposits are insured by the Federal Deposit Insurance Corporation (the "FDIC") (and, with respect to any deposits in excess of FDIC limits, by the private, industry-sponsored Depositors Insurance Fund of Massachusetts), the Bank is subject to regulation, supervision and examination by federal and state regulatory authorities, including the FDIC and the Division. This framework of federal and state banking supervision and regulation is administered primarily for the benefit of borrowers, depositors and the respective deposit insurance funds and not for the benefit of the Bank, the Company or its stockholders.

The Bank is subject to extensive federal and state statutes, regulations, policies and standards regarding virtually all aspects of its operations, including capital adequacy, reserves, liquidity, payment of dividends, transactions with affiliates, loans to officers, directors, principal shareholders and their related interests, mergers, acquisitions and changes in controlling ownership, establishment, relocation and closure of branch banking offices, community reinvestment, equal credit opportunity, credit reporting, real estate settlement procedures, funds availability, disclosure to consumers, financial accounting, reporting and recordkeeping, and Year 2000 preparedness. In the event the Bank failed to maintain adequate capital or otherwise failed to operate in accordance with applicable federal and Massachusetts statutes, regulations or policies, the FDIC and the Division have authority to place the Bank in receivership or conservatorship or impose other sanctions, including but not limited to restrictions on dividend or other payments by the Bank to the Company, termination of the Bank's deposit insurance, restrictions on the Bank's growth, issuance of orders to cease and desist from or to take specified actions, assessment of money penalties, and removal of officers or directors.

The Federal Deposit Insurance Corporation Improvement Act of 1991 ("FDICIA") establishes five categories of banking institutions -- in descending order of capital adequacy: "well-capitalized," "adequately capitalized," "undercapitalized," significantly undercapitalized," and "critically undercapitalized" -- and imposes certain restrictions and requires federal bank regulatory agencies to take "prompt corrective action" with respect to banks that are in one of the three "undercapitalized" categories. As of December 31, 1998, the Bank was "well capitalized" as defined under FDICIA. For a discussion of the Bank's capital adequacy, see Note 14 to the Company's Consolidated Financial Statements, on page 42.





FDICIA establishes a system of risk-based deposit insurance assessments that takes a bank's capital level and supervisory risk characteristics into account in calculating the amount of its federal deposit insurance assessment. In addition, FDICIA places certain restrictions on the equity investments and other "principal" activities of all state-chartered banks, including the Bank. FDICIA further requires the FDIC and other federal bank regulatory agencies to establish regulatory "safety and soundness" standards to govern various aspects of bank operations including internal controls, information systems and audit systems, loan documentation, credit underwriting, interest rate risk exposure, asset growth, executive compensation, asset quality, earnings and stock valuation, as the agencies consider appropriate. The FDIC may require a bank that is not in compliance with safety and soundness standards promulgated under FDICIA to submit and implement a written plan to achieve compliance within a specified time period and may impose sanctions on a bank that fails to submit and implement an acceptable plan when required. At December 31, 1998, the Bank's operations were in substantial compliance with all applicable safety and soundness standards promulgated under FDICA.

On September 29, 1994, the Riegle-Neal Interstate Banking and Branching Act of 1994 (the "Interstate Banking Act") was signed into law by President Clinton. In 1996, Massachusetts enacted legislation "opting in" to interstate branch banking and imposing certain limitations and requirements as permitted by the Interstate Banking Act. The Interstate Banking Act and the 1996 Massachusetts legislation permit interstate branching, mergers and bank acquisitions by Massachusetts bank holding companies and banks and permit out-of-state bank holding companies and banks to expand their banking operations into Massachusetts by merger, acquisition or de novo branching subject to certain regulatory approval requirements and other limitations.

From time to time, commencing in June, 1996, the federal bank regulatory agencies jointly issued written statements of guidance (the "Year 2000 Guidance") to federally-insured banks on various aspects of the so-called "Y2K Problem" -- the inability of certain computer components and software to correctly process the millennium date change from 1999 to 2000. On October 15, 1998, the FDIC and the other federal banking agencies promulgated "Interagency Guidelines Establishing Year 2000 Standards for Safety and Soundness" (the "Year 2000 Standards") under FDICIA. Early in 1999, the Division issued regulations applicable to Massachusetts banks incorporating the federal Year 2000 Guidance and Standards. Among other things, the Year 2000 Guidance and Standards require all FDIC-insured banks to involve their management and board of directors in their Year 2000 preparedness efforts, to adopt written project plans for Year 2000 preparedness, to "renovate" "mission critical" data processing systems, to complete testing of renovated systems within specified time frames, to develop contingency plans and to "manage customer-risk."

Under FDICIA, the FDIC may require a bank that is not in compliance with the Year 2000 Standards to submit and implement a written plan to achieve compliance within a specified time period. In addition, substantial failure by a bank to comply with the Year 2000 Guidance and Standards may provide a basis for the FDIC or the Division to take other regulatory actions, including but not limited to placing the bank in receivership, restricting the bank's dividend and other payments to its parent company, terminating the Bank's federal deposit insurance, and directing the bank to cease and desist from or to take specified actions. At December 31, 1998, the Bank's Year 2000 preparedness efforts were believed to be in substantial compliance with the Year 2000 Guidance and Standards. For a discussion of the Company's Year 2000 preparedness efforts, see "Management's Discussion and Analysis of Financial Condition and Results of Operations -- Year 2000 Issue" at page 15.





From time to time the U.S. Congress and the Massachusetts Legislature adopt legislation and the Federal and State bank regulatory agencies issue regulations and policies that may significantly affect the operations of the Bank and the Company. No assurance can be given as to whether or when such additional legislation, regulations or policies may be adopted or as to the effect any such legislation, regulations or policies may have on the Company or the Bank.

Employees

MASSBANK Corp. utilizes the support staff of the Bank from time to time without the payment of any fees. No separate compensation is being paid to the executive officers of MASSBANK Corp., all of whom are executive officers of the Bank and receive compensation as such. As of December 31, 1998, the Bank had 141 full-time employees, including 31 officers, and 66 part-time employees. None of the Bank's employees is represented by a collective bargaining group, and management believes that its employee relations are good. The Bank provides its employees with formal training in product knowledge, sales techniques, fair lending, and motivation. In addition, each supervisor at the Bank receives management training before assuming his or her supervisory duties and periodically thereafter. The Bank maintains a comprehensive employee benefit program for qualified employees that includes a qualified pension plan, an Employee Stock Ownership Plan (ESOP), health and dental insurance, life and long-term disability insurance and tuition assistance.





Subsidiaries

The Bank has three wholly-owned subsidiaries: Readibank Investment Corporation, Melbank Investment Corporation, and Readibank Properties, Inc.

Readibank Investment Corporation and Melbank Investment Corporation were established for the purpose of managing portions of the Bank's investment portfolio. Assets of Readibank Investment Corporation and Melbank Investment Corporation totaled $91.9 million and $97.1 million, at December 31, 1998, respectively.

Readibank Properties, Inc. incorporated primarily for the purpose of real estate development, had total assets of $630 thousand at December 31, 1998.

Executive Officers of the Registrant

The executive officers of the Company and the Bank and the age of each officer as of March 4, 1999 are as follows:

| Name | Age | Office |
|---|---|---|
| Gerard H. Brandi | 50 | Chairman of the Board of Directors, President and Chief Executive Officer of the Company and the Bank |
| David F. Carroll | 51 | Vice President of the Bank |
| Reginald E. Cormier | 51 | Vice President, Treasurer and Chief Financial Officer of the Company and the Bank |
| Thomas J. Queeney | 36 | Vice President and Senior Trust Officer of the Bank |
| Donald R. Washburn | 55 | Senior Vice President of the Bank |
| Donna H. West | 53 | Senior Vice President of the Bank and Assistant Secretary of the Company |

Gerard H. Brandi. Mr. Brandi has served in various capacities with MASSBANK since he joined the Bank in 1975 as Vice President of the Lending Division. He served as Senior Vice President from 1978 to 1981, Executive Vice President and Senior Lending Officer from 1981 to 1983, and Executive Vice President and Treasurer from 1983 to 1986. Mr. Brandi was named President of the Company and the Bank in 1986, Chief Executive Officer in 1992 and Chairman in 1993.

David F. Carroll. Mr. Carroll has been employed by the Bank since 1983 and has been Vice President of Operations since 1984. He served as Vice President of the Lending Division for a year before becoming Vice President of Operations.

Reginald E. Cormier. Mr. Cormier joined the Bank as Treasurer in September, 1987 and has served in this capacity until his promotion to Vice President, Treasurer and Chief Financial Officer in January, 1995.

Thomas J. Queeney. Mr. Queeney joined the Bank in 1986 as a Management Trainee in Loan Origination. He became an Assistant Manager in 1987 and was promoted to Assistant Treasurer in 1988. He then served as a Marketing and Investor Relations Representative until his promotion to Loan Servicing Manager in 1990. In 1992, he was promoted to Loan Officer and Commercial Lending Manager. He was promoted to Assistant Vice President, Lending in 1997, where he served until his promotion to AVP/Trust Administrator in July of 1998. In January of 1999, he was promoted to Vice President and Senior Trust Officer.

Donald R. Washburn. Mr. Washburn joined the Bank in 1973 as a Loan Officer. He became an Assistant Vice President in January, 1977 and a Vice President in the Lending Division in June, 1980. Mr. Washburn served as Vice President of the Operations Division from February, 1983 to January, 1984, as Vice President of the Community Banking Division from January, 1984 to January, 1986 and as Vice President of the Lending Division from January, 1986 until his promotion to Senior Vice President of the Lending Division in June, 1994.

Donna H. West. Mrs. West has been employed by the Bank since 1979 and has served as Vice President of the Community Banking Division since October, 1987. Starting at the Bank as an Assistant Branch Manager in 1979, Mrs. West became a Branch Manager in 1981, an Assistant Treasurer and Branch Manager in 1982, an Assistant Treasurer and Regional Branch Administrator in 1984 and an Assistant Vice President and Regional Branch Administrator in 1986. She served in this capacity until her October, 1987 promotion to Vice President of the Community Banking Division. In June, 1994, Mrs. West was promoted to Senior Vice President of the Community Banking Division.





Item 2. Properties

The main office of MASSBANK Corp. and MASSBANK is located at 123 Haven Street, Reading, Massachusetts. Additionally, the Bank has fourteen branches and three operations facilities. The Bank owns its main office, two operations facilities and seven of its branches. All of the remaining branches and other facilities are leased under various leases. At December 31, 1998, management believes that the Bank's existing facilities are adequate for the conduct of its business.

The following table sets forth certain information relating to the Bank's existing facilities.

| Location | | Owned or Leased | Lease Expiration Date | Renewal Option Through |
|---|---|---|---|---|
| MAIN OFFICE: | 123 Haven Street, Reading, MA | Owned | ---- | ---- |
| BRANCH OFFICES: | 296 Chelmsford Street, Chelmsford, MA | Leased | 1998 | ---- |
| | 17 North Road, Chelmsford, MA | Leased | 1999 | (1) |
| | 45 Broadway Road, Dracut, MA | Leased | 2002 | ---- |
| | 738 Broadway, Everett, MA | Owned | ---- | ---- |
| | 50 Central Street, Lowell, MA | Owned | ---- | ---- |
| | 755 Lakeview Avenue, Lowell, MA | Owned | ---- | ---- |
| | 4110 Mystic Valley Pkwy, Medford, MA | Leased | 2001 | ---- |
| | 476 Main Street, Melrose, MA | Owned | ---- | ---- |
| | 27 Melrose Street, Towers Plaza, Melrose, MA | Leased | 2004 | 2014 |
| | 240 Main Street, Stoneham, MA | Leased | 2003 | ---- |
| | 1800 Main Street, Tewksbury, MA | Owned | ---- | ---- |
| | 203 Littleton Road, Westford, MA | Owned | ---- | ---- |
| | 370 Main Street, Wilmington, MA | Owned | ---- | ---- |
| | 219 Lowell Street, Lucci's Plaza, Wilmington, MA | Leased | 2006 | ---- |
| OPERATIONS FACILITIES: | 159 Haven Street, Reading, MA | Owned | ---- | ---- |
| | 169 Haven Street, Reading, MA | Owned | ---- | ---- |
| | 11 North Road, Chelmsford, MA | Leased | 1999 | (1) |

(1) Bank has option to purchase in year 2000.

Item 3. Legal Proceedings

From time to time, MASSBANK Corp. and/or the Bank are involved as a plaintiff or defendant in various legal actions incident to their business. As of December 31, 1998, none of these actions individually or in the aggregate is believed by management to be material to the financial condition of MASSBANK Corp. or the Bank.

Item 4. Submission of Matters to a Vote of Security Holders

None.





PART II

Item 5. Market for Registrant's Common Equity and Related Stockholder Matters

The information contained under the caption "MASSBANK Corp. and Subsidiaries Stockholder Data" in the Registrant's 1998 Annual Report to Stockholders is incorporated herein by reference.

Item 6. Selected Financial Data

The information contained under the caption "MASSBANK Corp. and Subsidiaries - Selected Consolidated Financial Data" in the Registrant's 1998 Annual Report to Stockholders is incorporated herein by reference.

This selected consolidated financial data should be read in conjunction with the consolidated statements and related notes thereto appearing in the Registrant's 1998 Annual Report to Stockholders which are incorporated herein by reference.

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

The information contained under the caption "Management's Discussion and Analysis of Financial Condition and Results of Operations" in the Registrant's 1998 Annual Report to Stockholders is incorporated herein by reference.

Item 8. Financial Statements and Supplementary Data

The Registrant's consolidated financial statements and notes thereto, together with the report of KPMG Peat Marwick LLP, contained in the Registrant's 1998 Annual Report to Stockholders are incorporated herein by reference. The unaudited quarterly financial data set forth on page 48 of such Annual Report is incorporated herein by reference.

Item 9. Changes in and Disagreements with Independent Accountants on Accounting and Financial Disclosure

None

PART III

Item 10. Directors and Executive Officers of the Registrant

The information appearing under the caption "Election of Directors" and "Compliance with Section 16(A) of the Exchange Act" in the Registrant's definitive proxy statement relating to its 1999 Annual Meeting of Stockholders is incorporated herein by reference. Information required by this item concerning the Executive Officers of the Registrant is contained in Part I of this Form 10-K.

Item 11. Executive Compensation

The information appearing under the caption "Executive Compensation" in the Registrant's definitive proxy statement relating to its 1999 Annual Meeting of Stockholders is incorporated herein by reference.





Item 12. Security Ownership of Certain Beneficial Owners and Management

The information appearing under the captions "Election of Directors" and "Principal Stockholders" in the Registrant's definitive proxy statement relating to its 1999 Annual Meeting of Stockholders is incorporated herein by reference.

Item 13. Certain Relationships and Related Transactions

The information contained in Note 5 of the Consolidated Financial Statements under the caption "Loans" in the Registrant's 1998 Annual Report to Stockholders is incorporated herein by reference.

## PART IV

### Item 14. Exhibits, Financial Statement Schedules and Reports on Form 8-K

The following financial statements and financial statement schedules are contained herein or are incorporated herein by reference:

(a)1. Financial Statements



2. Financial Statement Schedules

All schedules are omitted as the required information is either not applicable or is included in the consolidated financial statements or related notes.





3. Exhibits

| Exhibit No. | Description of Exhibit |
|---|---|
| 3.1 | Restated Certificate of Incorporation of the Registrant - incorporated by reference to Exhibit 3.1 of the Registrant's Form S-4 Registration Statement (Reg. No. 33-7916). |
| 3.2 | By-Laws of the Registrant - incorporated by reference to Exhibit 3 of the Registrant's Form 10-Q for the quarter ended September 30, 1991. |
| 4.1 | Shareholder Rights Agreement dated as of January 16, 1990, between the Company and The First National Bank of Boston, as Rights Agent - incorporated herein by reference to the Exhibit to the Company's Current Report on Form 8-K dated as of January 16, 1990. |

| | |
|---|---|
| 10.1 | MASSBANK Corp. 1986 Stock Option Plan, as amended - incorporated by reference to Exhibit 28.1 to the Registrant's Form S-8 Registration Statement (Reg. No. 33-11949). |
| 10.1.2 | Amendment to MASSBANK Corp. 1986 Stock Option Plan dated April 19, 1991 - incorporated by reference to Exhibit 10.1.2 to the Registrant's annual report on Form 10-K for the year ended December 31, 1992. |
| 10.1.3 | MASSBANK Corp. 1994 Stock Incentive Plan - incorporated by reference to Exhibit 10.1 to the Registrant's Form S-8 Registration Statement (Reg. No. 33-82110). |
| 10.1.4 | Amendment to MASSBANK Corp. 1994 Stock Incentive Plan dated April 21, 1998 - incorporated by reference to Exhibit 10.1.4 to the Registrant's annual report on Form 10-K for the year ended December 31, 1997. |
| 10.2 | MASSBANK for Savings Employees' Stock Ownership Plan and Trust Agreement - incorporated by reference to Exhibit 10.2 of the Registrant's Form S-4 Registration Statement (Reg. No. 33-7916). |
| 10.2.1 | Amendments to the MASSBANK for Savings Employee's Stock Ownership Plan and Trust Agreement - incorporated by reference to Exhibit 10.2.1 to the Registrant's annual report on Form 10-K for the year ended December 31, 1993. |
| 10.2.2 | Amendments to the MASSBANK for Savings Employee's Stock Ownership Plan and Trust Agreement - incorporated by reference to Exhibit 10.2.2 to the Registrant's annual report on Form 10-K for the year ended December 31, 1997. |
| 10.3 | Form of Employment Agreement, as amended, with Gerard H. Brandi - incorporated by reference to Exhibit 10.3 of the Registrant's annual report on Form 10-K for the year ended December 31, 1986 and Exhibit 10.3.1 of the Registrant's annual report on Form 10-K for the year ended December 31, 1989. |





| Exhibit No. | Description of Exhibit |
|---|---|
| 10.3.2 | Amendment to the Employment Agreement with Gerard H. Brandi - incorporated by reference to Exhibit 10.3.2 of the Registrant's annual report on Form 10-K for the year ended December 31, 1990. |
| 10.3.3 | Second amendment dated as of February 1, 1993 to the Employment Agreement with Gerard H. Brandi - incorporated by reference to Exhibit 10.3.3. to the Registrant's annual report on Form 10-K for the year ended December 31, 1992. |
| 10.3.7 | Form of Employment Agreement with David F. Carroll dated |

| | |
|---|---|
| | as of February 1, 1993 - incorporated by reference to Exhibit 10.3.7 to the Registrant's annual report on Form 10-K for the year ended December 31, 1992. |
| 10.3.8 | Form of Employment Agreement with Reginald E. Cormier dated as of February 1, 1993 - incorporated by reference to Exhibit 10.3.8 to the Registrant's annual report on Form 10-K for the year ended December 31, 1992. |
| 10.3.9 | Form of Employment Agreement with Donald R. Washburn dated as of February 1, 1993 - incorporated by reference to Exhibit 10.3.9 to the Registrant's annual report on Form 10-K for the year ended December 31, 1992. |
| 10.3.10 | Form of Employment Agreement with Donna H. West dated as of February 1, 1993 - incorporated by reference to Exhibit 10.3.10 to the Registrant's annual report on Form 10-K for the year ended December 31, 1992. |
| 10.3.11 | Executive Severance Agreement with Gerard H. Brandi dated as of January 18, 1994 - incorporated by reference to exhibit 10.3.11 to the Registrant's annual report on Form 10-K for the year ended December 31, 1993. |
| 10.3.12 | Executive Severance Agreement with David F. Carroll dated as of December 23, 1993 - incorporated by reference to exhibit 10.3.12 to the Registrant's annual report on Form 10-K for the year ended December 31, 1993. |
| 10.3.13 | Executive Severance Agreement with Reginald E. Cormier dated as of December 23, 1993 - incorporated by reference to exhibit 10.3.13 to the Registrant's annual report on Form 10-K for the year ended December 31, 1993. |





| Exhibit No. | Description of Exhibit |
|---|---|
| 10.3.14 | Executive Severance Agreement with Donald R. Washburn dated as of December 23, 1993 - incorporated by reference to exhibit 10.3.14 to the Registrant's annual report on Form 10-K for the year ended December 31, 1993. |
| 10.3.15 | Executive Severance Agreement with Donna H. West dated as of December 23, 1993 - incorporated by reference to exhibit 10.3.15 to the Registrant's annual report on Form 10-K for the year ended December 31, 1993. |
| 10.4 | Form of Executive Supplemental Retirement Agreement, as amended, with Gerard H. Brandi - incorporated by reference to Exhibit 10.4 of Registrant's annual report on Form 10-K for the year ended December 31, 1986. |
| 10.4.1 | Amendments to the Executive Supplemental Retirement Agreement with Gerard H. Brandi are incorporated by reference to Exhibit 10.4.1 of the Registrant's annual report on Form 10-K for the year ended December 31, 1996. |

| | |
|---|---|
| 12 | Statement re: Computation of Ratios - Not applicable as MASSBANK Corp. does not have any debt securities registered under Section 12 of the Securities Exchange Act of 1934. |
| 13 | 1998 Annual Report to Stockholders - except for those portions of the 1998 Annual Report to Stockholders which are expressly incorporated by reference in this report, such 1998 Annual Report to Stockholders is furnished for the information of the SEC and is not to be deemed "filed" with the SEC. |
| 22 | Subsidiaries of the Registrant - A list of subsidiaries of the Registrant is attached hereto as Exhibit 22 to this Annual Report. |
| 23 | Consent of Independent Auditors. |
| (b) | Reports on Form 8-K<br>No reports on Form 8-K have been filed during the last quarter of the period covered by this Form 10-K. |
| (c) | Exhibits to this Form 10-K are attached or incorporated by reference as stated in the Index to Exhibits. |
| (d) | Not applicable. |





Signatures

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

MASSBANK CORP.

/s/ Gerard H. Brandi

--------------------

Gerard H. Brandi
Chairman, President and Chief Executive 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 and in the capacities and on the dates indicated.

| | | |
|---|---|---|
| /s/ Gerard H. Brandi<br>------------------------------<br>Gerard H. Brandi | Chairman, President, Chief Executive Officer and Director | March 26, 1999 |
| /s/ Reginald E. Cormier | Vice President, Treasurer | |

| | | |
|---|---|---|
| ------------------------------ Reginald E. Cormier | and Chief Financial Officer (Principal Financial and Accounting Officer) | March 26, 1999 |
| /s/ Samuel Altschuler<br>------------------------------<br>Samuel Altschuler | Director | March 26, 1999 |
| /s/ Mathias B. Bedell<br>------------------------------<br>Mathias B. Bedell | Director | March 26, 1999 |
| ------------------------------<br>Allan S. Bufferd | Director | |
| ------------------------------<br>Peter W. Carr | Director | |
| /s/ Alexander S. Costello<br>------------------------------<br>Alexander S. Costello | Director | March 26, 1999 |





| | | |
|---|---|---|
| /s/ Robert S. Cummings<br>------------------------------<br>Robert S. Cummings | Director | March 26, 1999 |
| /s/ Louise A. Hickey<br>------------------------------<br>Louise A. Hickey | Director | March 26, 1999 |
| ------------------------------<br>Leonard Lapidus | Director | |
| /s/ Stephen E. Marshall<br>------------------------------<br>Stephen E. Marshall | Director | March 26, 1999 |

| | | |
|---|---|---|
| /s/ Arthur W. McPherson<br>------------------------------<br>Arthur W. McPherson | Director | March 26, 1999 |
| /s/ Nancy L. Pettinelli<br>------------------------------<br>Nancy L. Pettinelli | Director | March 26, 1999 |
| /s/ Herbert G. Schurian<br>------------------------------<br>Herbert G. Schurian | Director | March 26, 1999 |
| /s/ Donald B. Stackhouse<br>------------------------------<br>Donald B. Stackhouse | Director | March 26, 1999 |

# FINANCIAL HIGHLIGHTS

MASSBANK CORP. AND SUBSIDIARIES
SELECTED CONSOLIDATED FINANCIAL DATA

| (IN THOUSANDS) YEARS ENDED DECEMBER 31, | 1998 | 1997 | 1996 | 1995 | 1994 |
|---|---|---|---|---|---|
| BALANCE SHEET DATA: | | | | | |
| Total assets | $946,625 | $925,403 | $888,237 | $854,542 | $843,647 |
| Mortgage loans | 283,654 | 248,798 | 224,139 | 220,603 | 220,269 |
| Other loans | 21,335 | 23,505 | 25,522 | 28,582 | 30,547 |
| Allowance for loan losses | 2,450 | 2,334 | 2,237 | 2,529 | 2,566 |
| Investments(1) | 624,082 | 635,694 | 622,645 | 586,768 | 568,635 |
| Real estate acquired through foreclosure | 86 | -- | 503 | 255 | 129 |
| Deposits | 824,031 | 809,850 | 788,350 | 753,657 | 759,676 |
| Stockholders' equity | 110,489 | 103,779 | 92,250 | 90,817 | 74,504 |

| (IN THOUSANDS) YEARS ENDED DECEMBER 31, | 1998 | 1997 | 1996 | 1995 | 1994 |
|---|---|---|---|---|---|
| OPERATING DATA: | | | | | |
| Interest and dividend income | $ 59,834 | $ 60,733 | $ 58,109 | $ 56,611 | $ 51,451 |
| Interest expense | 34,320 | 34,681 | 33,062 | 30,896 | 26,152 |
| Net interest income | 25,514 | 26,052 | 25,047 | 25,715 | 25,299 |
| Provision for loan losses | 193 | 260 | 160 | 170 | 705 |
| Gains (losses) on securities, net | 2,893 | 1,939 | 868 | 92 | (533) |
| Other non-interest income | 1,697 | 1,859 | 1,797 | 1,856 | 3,070 |
| Non-interest expense | 12,515 | 13,425 | 12,124 | 13,178 | 14,213 |
| Income before income taxes | 17,396 | 16,165 | 15,428 | 14,315 | 12,918 |
| Income tax expense | 6,482 | 5,998 | 6,001 | 5,556 | 4,733 |
| Net income | $ 10,914 | $ 10,167 | $ 9,427 | $ 8,759 | $ 8,185 |

| YEARS ENDED DECEMBER 31, | 1998 | 1997 | 1996 | 1995 | 1994 |
|---|---|---|---|---|---|
| OTHER DATA: | | | | | |
| Yield on average interest-earning assets | 6.56% | 6.81% | 6.84% | 6.90% | 6.22% |
| Cost of average interest-bearing liabilities | 4.23 | 4.30 | 4.27 | 4.11 | 3.41 |
| Interest rate spread | 2.33 | 2.51 | 2.57 | 2.79 | 2.81 |
| Net interest margin | 2.81 | 2.93 | 2.96 | 3.15 | 3.07 |
| Non-interest expense to average assets(5) | 1.35 | 1.39 | 1.40 | 1.57 | 1.67 |
| Efficiency ratio(2)(5)(6) | 41.4 | 43.0 | 43.5 | 47.4 | 50.8 |
| Return on assets (net income/average assets) | 1.17 | 1.12 | 1.08 | 1.04 | 0.96 |
| Return on equity (net income/average stockholders' equity) | 10.05 | 10.51 | 10.65 | 10.65 | 10.62 |
| Return on average realized equity(3) | 11.08 | 11.11 | 11.01 | 10.81 | 10.62 |
| Percent non-performing loans to total loans | 0.33 | 0.65 | 0.64 | 0.97 | 0.84 |
| Percent non-performing assets to total assets | 0.12 | 0.19 | 0.24 | 0.31 | 0.26 |
| Stockholders' equity to assets, at year-end | 11.67 | 11.21 | 10.39 | 10.63 | 8.83 |
| Book value per share, at year-end(4) | $ 31.58 | $ 29.06 | $ 25.75 | $ 24.84 | $ 20.09 |
| Earnings per share:(4) | | | | | |
| Basic | 3.09 | 2.88 | 2.65 | 2.43 | 2.19 |
| Diluted | 2.97 | 2.77 | 2.58 | 2.34 | 2.13 |
| Cash dividends declared per share(4) | 1.02 | 0.885 | 0.69 | 0.5475 | 0.45 |
| Dividend payout ratio | 33% | 31% | 26% | 23% | 21% |

(1) Consists of securities held to maturity and available for sale, trading securities, short-term investments, term federal funds sold and interest-bearing deposits in banks.
(2) Determined by dividing non-interest expense by fully taxable equivalent net interest income plus non-interest income.
(3) Excludes average net unrealized gains or losses on securities available for sale.
(4) All share information presented has been adjusted to reflect the 4-for-3 and 3-for-2 split of the Company's common stock effective September 15, 1997 and September 9, 1994, respectively.
(5) Excludes non-recurring non-interest expense of $778 thousand in 1997.
(6) Excludes $620 thousand in market appreciation on securities contributed to

the Massbank Charitable Foundation in 1997.



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

GENERAL

The following discussion should be read in conjunction with the consolidated financial statements and related notes included in this report. Certain amounts reported for prior years have been reclassified to conform to the 1998 presentation. The discussion contains certain forward-looking statements regarding the future performance of the Company. All forward-looking information is inherently uncertain and actual results may differ substantially from the assumptions, estimates, or expectations reflected or contained in the forward-looking information.

The financial condition and results of operations of MASSBANK Corp. (the "Company") essentially reflect the operations of its subsidiary, MASSBANK (the "Bank").

The Company's consolidated net income depends largely upon net interest income, which is the difference between interest income from loans and investments ("interest-earning assets") and interest expense on deposits and borrowed funds ("interest-bearing liabilities"). Net interest income is significantly affected by general economic conditions, policies established by regulatory authorities and competition.

The Company's earnings results are also affected by the provision for loan losses; non-interest income, such as fee-based revenues and net securities gains; non-interest expense; and income taxes.

FINANCIAL CONDITION

Total assets at December 31, 1998 were $946.6 million, up $21.2 million or 2.3% from $925.4 million a year ago. The growth in total assets was driven by $32.7 million growth in the loan portfolio, offset by a decline of $11.6 million in the investment portfolio. Other assets increased by $0.1 million in 1998.

The Bank's total loan portfolio at December 31, 1998 amounted to $305.0 million compared with $272.3 million at December 31, 1997, an increase of $32.7 million or 12.0%. MASSBANK benefited from the favorable mortgage interest rate environment in 1998. Loan originations reached record levels in 1998 due to an increased volume of home mortgage refinancing. Loan originations totaled $105.2 million in 1998, up 79.5% or $46.6 million, compared with $58.6 million in 1997.

The increase in the total loan portfolio was achieved despite a continued high level of principal amortization and payoffs in the Bank's loan portfolio, making it more difficult to grow the portfolio. This is due in part to the shorter term mortgages the Bank originates and the prevailing low interest rates which encourage borrowers to prepay higher rate mortgages.

Total investments consisting of investment securities and other short-term investments, including term federal funds sold and interest-bearing deposits, decreased from $635.7 million at December 31, 1997 to $624.1 million at December 31, 1998. The decrease is mainly attributable to a decrease in mortgage-backed securities and U.S. Treasury and government agency securities, offset by an increase in trading and equity securities, and term federal funds sold. The primary component of the Bank's investment securities portfolio, mortgage-backed securities, accounted for 43.7% of total investments at December 31, 1998, down from 52.0% at year-end 1997. Mortgage-backed securities which totaled $330.7 million at year-end 1997 decreased to $272.6 million at year-end 1998 due primarily to the significant pre-payments received during 1998.

This decrease in total investments was offset in part by a change in net unrealized gains on securities available for sale from $15.5 million at December 31, 1997 to $19.8 million at December 31, 1998, a net increase in market value of $4.3 million. The increase in market value of the Bank's investment securities available for sale portfolio is directly related to the upward movement in both bond and stock prices in 1998.

The change in the market value of the Bank's securities available for sale also had the effect of increasing stockholders' equity by $2.6 million since year-end 1997. The net unrealized gains on securities available for sale, net of tax effect reported as part of stockholders' equity totaled $11.7 million at year-end 1998, up from $9.1 million at December 31, 1997. Total stockholder s' equity was $110.5 million at December 31, 1998, up $6.7 million from $103.8 million at December 31, 1997. Also contributing to the increase in stockholders' equity was the Company's record net income of $10.9 million in 1998 and the issuance of common stock under the Company's stock option plan. These were partially offset by the payment of $3.6 million in dividends to stockholders and the cost of additional shares of treasury stock repurchased during the year in the amount of $4.7 million. The Company's book value per share at December 31, 1998 was $31.58, up $2.52 or 8.7% from the prior year.

Deposit accounts of all types have traditionally been the primary source of funds for the Bank's lending and investment activities. The Bank's deposit flows are influenced by prevailing interest rates, competition and other market conditions. The Bank's management attempts to manage its deposits through selective pricing and marketing. Total deposits increased $14.1 million during 1998 to $824.0 million at December 31, 1998 from $809.9 million at year-end 1997.





ASSET QUALITY

Asset quality continued to improve during 1998. Nonaccrual loans, generally those loans which are 90 days or more delinquent, amounted to only $1.0 million at December 31, 1998, compared to $1.8 million at December 31, 1997. The bank's provision for loan losses, which amounted to $260 thousand in 1997, decreased by $67 thousand to $193 thousand in 1998, partially as a result of lower net loan charge-offs. Loan charge-offs, net of recoveries, amounted to $77 thousand in 1998, down from $268 thousand in 1997 and $452 thousand in 1996.

The Bank continued to add to its allowance for loan losses in 1998 in response to increased residential lending. The bank's allowance for loan losses at December 31, 1998 totaled approximately $2.5 million, representing 244.0% of nonaccrual loans and 0.80% of total loans. The bank believes that its allowance for loan losses is adequate to cover the risks inherent in the loan portfolio under current conditions. Real estate acquired through foreclosure totaled $86 thousand at year-end 1998.

RESULTS OF OPERATIONS

COMPARISON OF THE YEARS 1998 AND 1997

MASSBANK Corp. recorded net income for the year ended December 31, 1998 of $10.9 million or $3.09 in basic earnings per share compared to $10.2 million or $2.88 in basic earnings per share for the year ended December 31, 1997. This was the sixth consecutive year of record net income for the Company. Diluted earnings per share for 1998 increased to $2.97 from $2.77 in the prior year.

In 1998, MASSBANK's return on average assets rose to 1.17% from 1.12% in the prior year. Return on average realized equity was 11.08% in 1998, down slightly from 11.11% in 1997. The Company's favorable earnings performance in 1998 is mainly attributable to higher securities gains and lower non-interest expenses and provision for loan losses, partially offset by a decrease in net interest income and non-interest income (exclusive of securities gains).

NET INTEREST INCOME

The Company's net interest income on a fully taxable equivalent ("FTE") basis was $25.7 million in 1998, a decrease of $0.5 million from the prior year. The decrease is the result of a lower net interest margin, due mainly to the flattening of the yield curve which was seen in 1998, partially offset by the positive effect of earning asset growth. The Company's net interest margin was 2.81% in 1998, down from its prior year net interest margin of 2.93%. The Company's average earning assets increased $18.3 million or 2.0% to $912.9 million in 1998, from $894.6 million in 1997.

The tables on pages 19 and 20 set forth, among other things, the extent to which changes in interest rates and changes in the average balances of interest-earning assets and interest-bearing liabilities have effected interest income and expense during the years indicated. For each category of interest-earning assets and interest-bearing liabilities, information is provided on changes due to (1) changes in volume and (2) changes in interest rates.

INTEREST AND DIVIDEND INCOME

Interest and dividend income on a fully taxable equivalent basis was $60.0 million for the year ended December 31, 1998, compared to $60.9 million for the year ended December 31, 1997. The average total earning assets of the Company increased to $912.9 million in 1998, up $18.3 million from $894.6 million in 1997. As reflected in the table on page 19, the Company saw a decline in yield in all categories of earning assets this past year. This resulted in an overall decline in yield on total average earning assets of 25 basis points in 1998. The yield on average earning assets for the year ended December 31, 1998 was 6.56% compared to 6.81% in the prior year.

As exhibited in the rate volume analysis table on page 20, the total effect of lower market interest rates on interest income in 1998 was a $1.9 million decline from 1997. Conversely, the total effect of higher average earning assets on interest income in 1998 was a $1.0 million increase over 1997, resulting in a net decrease in total interest and dividend income of $899 thousand from 1997.

INTEREST EXPENSE

Total interest expense decreased 1.0% to $34.3 million for the year ended December 31, 1998 from $34.7 million for the year ended December 31, 1997. This decrease is due to a decrease in the Company's average cost of funds from 4.30% in 1997 to 4.23% in 1998, partially offset by the higher interest expense resulting from an increase in the Company's average total deposits, from $807.3 million in 1997 to $811.6 million in 1998.

The principal reason for the Company's lower cost of funds was lower market interest rates in 1998.





INTEREST EXPENSE (CONTINUED)

As exhibited in the rate/volume analysis table on page 20, the effect on total interest expense from changes in interest-bearing deposit rates from a year ago was a $522 thousand decrease from 1997. Conversely, the total effect of higher average deposits on interest expense in 1998 was a $161 thousand increase over 1997, resulting in a net decrease in total interest expense of $361 thousand from 1997.

PROVISION FOR LOAN LOSSES

The provision for loan losses in 1998 was $193 thousand compared to $260 thousand in 1997. In determining the amount to provide for loan losses, the key factor is the adequacy of the allowance for loan losses. In making its decision, management considers a number of factors, including the risk characteristics of the loan portfolio, underlying collateral, current and anticipated economic conditions, and trends in loan delinquencies and charge-offs. At December 31, 1998, the allowance for loan losses was approximately $2.5 million representing 244.0% of non-performing loans. The Bank's non-performing loans totaled $1.0 million at December 31, 1998 compared to $1.8 million a year earlier. Net charge-offs totaled $77 thousand in 1998 compared to $268 thousand in 1997. Management believes that the allowance for loan losses is adequate to cover the risks inherent in the loan portfolio under current conditions.

NON-INTEREST INCOME

Non-interest income consists of gains or losses on securities, deposit account service fees, and other non-interest income.

Non-interest income increased to $4.6 million for the year ended December 31, 1998, from $3.8 million for the year ended December 31, 1997. This improvement is due to an increase in securities gains in 1998.

Net gains on securities totaled $2.9 million in 1998 compared to $1.9 million in the prior year. The bank's equity securities portfolio continued to contribute significant returns in 1998 through a combination of gains on the sale of securities in the amount of $2.6 million and unrealized gains. The pretax unrealized gains in the bank's equity securities portfolio amounted to $10.5 million at year-end 1998, up from $8.2 million at December 31, 1997. All other non-interest income combined decreased $162 thousand to $1.7 million from $1.9 million in the prior year.

NON-INTEREST EXPENSE

One measure often used in the banking industry to assess the level of non-interest expense is the efficiency ratio. The efficiency ratio measures how much it cost to generate one dollar of revenue. MASSBANK's efficiency ratio continued its steady improvement of the past several years, reaching 41.4% in 1998.

MASSBANK's non-interest expenses (i.e., operating expenses) decreased by $910 thousand to $12.5 million in 1998, from $13.4 million a year ago. This decrease is due largely to non-recurring expenses incurred in 1997, summarized below, and to a decrease in compensation expenses which are tied to the Company's stock performance.

Salaries and employee benefits decreased by $317 thousand or 4.1%, to $7.4 million in 1998, from $7.7 million in 1997. The decrease reflects a reduction of $311 thousand in Deferred Compensation Plan expenses which are tied to the Company's stock performance. The price of MASSBANK Corp. stock decreased by $8.50 or 17.8% in 1998, from $47.62 at December 31, 1997 to $39.12 at December 31, 1998. Conversely, in 1997 the Company saw the price of it's common stock increase by $19.03 or 66.6%. This significantly increased Deferred Compensation

Plan expenses in 1997. Normal salary increases and higher employee benefit costs, in 1998, were partly offset by staff reductions and more loan origination related salary expenses (which are amortized over the life of the loan) being deferred due to increased residential lending activity in 1998.

Occupancy and equipment expense decreased by $37 thousand to $2.1 million in 1998. This decrease reflects a reduction in utilities expenses and a drop in real estate tax expenses due to real estate tax abatements received in 1998.

Data processing expenses increased by $72 thousand to $510 thousand in 1998, from $438 thousand in the previous year. 1997 expenses, however, reflect a reduction $150 thousand due to a one-time credit the bank negotiated as part of its initial contract with a new service bureau. This temporary reduction in data processing expense was used in part to defray nonrecurring expenses the bank incurred in converting to the new service bureau.

Professional services expenses increased by $54 thousand to $461 thousand in 1998, from $407 thousand in 1997. This increase was due mostly to higher legal fees.

In 1998, the Company did not incur any merger and acquisition related expenses. As a result, 1998 expenses when compared to the prior year, show a decrease of $156 thousand due to the nonrecurring merger and acquisition related expenses incurred in 1997 in connection with the bank's acquisition of the Glendale Co-operative Bank ("Glendale").

Advertising and marketing expenses declined slightly in 1998 to $171 thousand, from $187 thousand in the prior year.

The amortization of intangibles expense increased by $51 thousand to $302 thousand in 1998, from $251 thousand in 1997. The increase reflects the additional amortization of goodwill recorded in 1998 in connection with the Glendale acquisition. In 1997, the goodwill was only amortized for a partial year since the acquisition was completed in July of that year.





NON-INTEREST EXPENSE (CONTINUED)

Deposit insurance expense totaled $116 thousand in 1998, unchanged from the prior year.

The bank's contributions expense decreased by $650 thousand to $14 thousand in 1998, from $664 thousand in the prior year. This decrease is due to a significant contribution made in the prior year. The bank, in 1997, contributed appreciated securities valued at $622 thousand to establish and endow a tax exempt private foundation. The establishment of the MASSBANK Charitable Foundation benefits the bank by reducing its contributions expense in 1998 and future years, since many of the contributions previously made by the bank are now made by the Foundation.

Other expenses increased by $89 thousand to $1.5 million in 1998, from $1.4 million in 1997 due to increases in several other non-interest expense categories.

INCOME TAX EXPENSE

The Company recorded a tax expense of $6.5 million in 1998 compared to $6.0 million in 1997. The increase in income tax expense is due primarily to higher pretax earnings and a slight increase in the Company's effective income tax rate. The effective income tax rate for the year ended December 31, 1998 was 37.3%, up from 37.1% in the prior year. The increase in the Company's effective income tax rate in 1998 was due to a non-recurring tax benefit in the amount of $260 thousand the Company recorded in 1997 as a result of having donated appreciated securities to establish and endow a tax exempt private foundation. This reduced the effective income tax rate for 1997. In 1998, there were two factors which reduced the effective income tax rate for the year. The Company, in 1998, received a state tax refund, net of federal tax, of approximately $44 thousand due to the settlement of a state tax issue from prior years. It also changed its year-end for tax filing purposes from October 31 to December 31. This change, because of the bank tax reform legislation signed into law in 1995 which lowered the bank tax rate from 12.54% to 10.50% over five years, accelerated the scheduled reduction in the Bank's state excise tax rate by one full year from 11.32% to 10.91%. For years beginning after 1998, the rate is 10.50%. For further information on income taxes, see Note 12 of Notes to Consolidated Financial Statements.

RESULTS OF OPERATIONS

Comparison of the Years 1997 and 1996

MASSBANK Corp. recorded record net income for the year ended December 31, 1997 of $10.2 million or $2.88 in basic earnings per share compared to $9.4

million or $2.65 in basic earnings per share for the year ended December 31, 1996. On a diluted basis, the Company earned $2.77 per share in 1997, up 7.4% or $0.19 per share from the $2.58 in diluted earnings per share reported in 1996.

In 1997, MASSBANK achieved record breaking results in net income, earnings per share and return on average realized equity, and increased its return on average assets. Return on average realized equity and return on average assets improved to 11.11% and 1.12% in 1997 from 11.01% and 1.08% in 1996, respectively. The Company's favorable financial performance in 1997 can be attributed to an improvement in net interest income and higher securities gains, partially offset by an increase in non-interest expenses and provision for loan losses. Also, in 1997, the Bank received a non-recurring tax benefit of approximately $260 thousand from a donation of appreciated securities made to endow the Massbank Charitable Foundation, a tax exempt private foundation established for the purpose of making grants in future years to benefit the Bank's local communities.

NET INTEREST INCOME

The Company's net interest income on a fully taxable equivalent ("FTE") basis was $26.2 million in 1997, an increase of $1.0 million over the prior year. This year's improvement in net interest income reflects the positive effect of earning asset growth exceeding the negative effect of a slightly lower net interest margin. The Company's average earning assets increased $42.3 million or 5% to $894.6 million in 1997, up from $852.3 million in 1996. The Company's net interest margin was 2.93% in 1997, slightly below its 1996 net interest margin of 2.96%.

The tables on pages 19 and 20 set forth, among other things, the extent to which changes in interest rates and changes in the average balances of interest-earning assets and interest-bearing liabilities have affected interest income and expense during the years indicated. For each category of interest-earning assets and interest-bearing liabilities, information is provided on changes due to (1) changes in volume and (2) changes in interest rates.

INTEREST AND DIVIDEND INCOME

Interest and dividend income on a fully taxable equivalent basis was $60.9 million for the year ended December 31, 1997, compared to $58.3 million for the year ended December 31, 1996. The average total earning assets of the Company increased to $894.6 million in 1997, up $42.3 million from $852.3 million in 1996. As reflected in the table on page 19, the combination of yield declines in loans and investment securities, partially offset by yield increases in federal funds sold and short-term investments, resulted in an overall decline in yield on total average earning assets of 3 basis points. The weighted average yield on earning assets for the year ended December 31, 1997 was 6.81% compared to 6.84% in the prior year.





INTEREST AND DIVIDEND INCOME (CONTINUED)

As exhibited in the rate/volume analysis table on page 20, the total effect of lower market interest rates on interest income in 1997 was a $270 thousand decline from 1996. Conversely, the total effect of higher average earning assets on interest income in 1997 was a $2.9 million increase over 1996, resulting in a net increase in total interest and dividend income of $2.6 million over 1996.

INTEREST EXPENSE

Total interest expense increased 4.9% to $34.7 million for the year ended December 31, 1997 from $33.1 million for the year ended December 31, 1996. This increase is due to an increase in the Company's average deposits, from $774.4 million in 1996 to $807.3 million in 1997, coupled with an increase in the Company's average cost of funds from 4.27% in 1996 to 4.30% in 1997. The increase in the Company's average total deposits in 1997 is attributable to the deposits acquired in connection with the Glendale purchase and internal growth.

As reflected in the table on page 19, the migration from lower cost savings deposits to higher cost CDs, combined with the growth in CDs in 1997, contributed significantly to the Company's increased cost of funds in 1997.

As exhibited in the rate/volume analysis table on page 20, the effect on total interest expense from changes in interest bearing deposit rates from a year ago was a $219 thousand decrease from 1996. Conversely, the total effect of higher average deposits on interest expense in 1997 was a $1.8 million increase over 1996, resulting in a net increase in total interest expense of $1.6 million over 1996.

PROVISION FOR LOAN LOSSES

The provision for loan losses in 1997 was $260 thousand compared to $160 thousand in 1996. In determining the amount to provide for loan losses, the key factor is the adequacy of the allowance for loan losses. In making its decision, management considers a number of factors, including the risk characteristics of the portfolio, underlying collateral, current and anticipated economic conditions, and trends in loan delinquencies and charge-offs. At December 31, 1997, the allowance for loan losses was $2.3 million representing 131.8% of non-performing loans. The Bank's non-performing loans totaled $1.8 million at December 31, 1997 compared to $1.6 million a year earlier. Net charge-offs totaled $268 thousand in 1997 compared to $452 thousand in 1996. Management believes that the allowance for loan losses is adequate to cover the risks inherent in the loan portfolio under current conditions.

NON-INTEREST INCOME

Non-interest income consists of gains or losses on securities, deposit account service fees, and other non-interest income.

Non-interest income increased to $3.8 million for the year ended December 31, 1997, from $2.7 million for the year ended December 31, 1996. This improvement is due to an increase in securities gains in 1997.

Net gains on securities totaled $1.9 million in 1997 compared to $868 thousand in 1996. Included in the $1.9 million in securities gains is $620 thousand in market appreciation on securities contributed to the Massbank Charitable Foundation. All other non-interest income combined increased $62 thousand to $1.9 million from $1.8 million in the prior year.

NON-INTEREST EXPENSE

Non-interest expenses (i.e., operating expenses) increased by $1.3 million in 1997, from $12.1 million a year ago. This increase is due largely to an increase in those expenses which are tied to the Company's stock performance and non-recurring expenses incurred in 1997 which are summarized below:

Salaries and employee benefits increased by $528 thousand or 7.3%, to $7.7 million in 1997, from $7.2 million in 1996. The increase reflects a $247 thousand increase in Employee Stock Ownership Plan ("ESOP") and Deferred Compensation Plan expenses which are tied to MASSBANK Corp.'s stock performance. The price of MASSBANK Corp. stock increased by $19.03 or 66.6% in 1997, from $28.59 at December 31, 1996 to $47.62 at December 31, 1997. In addition, salaries increased by $289 thousand due primarily to normal salary increases granted to employees. These increases were partially offset by a decrease in the costs of employee retirement benefits of $86 thousand. The expense for all other employee benefits combined increased $78 thousand over 1996.

Occupancy and equipment expense increased by $119 thousand to $2.1 million in 1997. This is due largely to an increase in depreciation expense resulting from building and leasehold improvements and the computer equipment that the bank purchased in conjunction with its computer conversion in July, 1997. The Bank made this change to its computer systems to enhance its technological capabilities in order to better service its customers and continue to provide increased efficiencies throughout the bank.

Data processing expenses were reduced by $170 thousand to $438 thousand in 1997, from $608 the previous year. This decrease reflects $150 thousand in total credits the bank negotiated as part of its initial contract with a new data center which it converted to in July, 1997. The temporary reduction in data processing expense was used to defray nonrecurring expenses which the bank incurred in converting to the new data center.





NON-INTEREST EXPENSE (CONTINUED)

Professional services expenses increased by $67 thousand to $407 thousand in 1997, from $340 thousand in 1996. This increase was due mostly to an increase of $40 thousand in legal fees.

The non-recurring merger and acquisition related expenses incurred in connection with the acquisition of the Glendale Co-operative Bank totaled $156 thousand in 1997.

Advertising and marketing expenses were reduced by $33 thousand to $187 thousand in 1997, from $220 thousand in 1996.

The amortization of intangibles expense was $251 thousand in 1997, up from $230 thousand in 1996. This increase is due to the Glendale acquisition.

Deposit insurance expense in 1997 increased $103 thousand over 1996 due to increases in the FDIC deposit insurance and Depositors Insurance Fund ("DIF") assessments. The DIF insures customer deposits in excess of the FDIC insurance limits. The increased assessments are attributable to higher deposit volume and the FDIC's Financing Corporation (FICO) debt service assessment which became applicable to all insured institutions as of January 1, 1997, in accordance with the Deposit Insurance Act of 1996.

The bank's contributions expense increased to $664 thousand in 1997, from $60 thousand in the prior year. In the second quarter 1997, the bank established and endowed a tax exempt private foundation the "MASSBANK Charitable Foundation" for the purpose of making grants in future years to benefit the bank's local communities. The bank contributed appreciated equity securities valued at $622 thousand. This expense will benefit the bank by reducing its contributions expense in future years, since many of the contributions previously made by the bank will now be made by the Foundation.

Other expenses were reduced by $94 thousand to $1.4 million in 1997, from $1.5 million in 1996. This decrease is essentially due to a reduction in real estate acquired through foreclosure expenses.

## INCOME TAX EXPENSE

The Company recorded a tax expense of $6.0 million in 1997 and 1996. The effective income tax rate for the year ended December 31, 1997 was 37.1%, a decrease from 38.9% in 1996. In 1997, the Bank received a non-recurring tax benefit of approximately $260 thousand as a result of having donated appreciated securities to establish and endow the MASSBANK Charitable Foundation. For further information on income taxes, see Note 12 of Notes to Consolidated Financial Statements.

## LIQUIDITY AND CAPITAL RESOURCES

The Bank must maintain a sufficient level of cash and assets which can readily be converted into cash in order to meet cash outflows from normal depositor requirements and loan demands. The Bank's primary sources of funds are deposits, loan amortization and prepayments, sales or maturities of investment securities and income on earning assets. In addition to loan payments and maturing investment securities, which are relatively predictable sources of funds, the Bank maintains a high percentage of its assets invested in overnight federal funds sold, which can be immediately converted into cash, and United States Treasury and Government agency securities, which can be sold or pledged to raise funds. At December 31, 1998, the Bank had $123.2 million or 13.0% of total assets and $124.0 million or 13.1% of total assets invested, respectively, in overnight federal funds sold and United States obligations.

The Bank is a Federal Deposit Insurance Corporation insured institution subject to the FDIC regulatory capital requirements. The FDIC regulations require all FDIC insured institutions to maintain minimum levels of Tier I capital. Highly rated banks (i.e., those with a composite rating of 1 under the CAMELS rating system) are required to maintain a minimum leverage ratio of Tier I capital to total average assets of at least 3.00%. An additional 100 to 200 basis points are required for all but these most highly rated institutions. The Bank is also required to maintain a minimum level of risk-based capital. Under the new risk-based capital standards, FDIC insured institutions must maintain a Tier I capital to risk-weighted assets ratio of 4.00% and are generally expected to meet a minimum total qualifying capital to risk-weighted assets ratio of 8.00%. The new risk-based capital guidelines take into consideration risk factors, as defined by the regulators, associated with various categories of assets, both on and off the balance sheet. Under the guidelines, capital strength is measured in two tiers which are used in conjunction with risk adjusted assets to determine the risk-based capital ratios. Tier II capital components include supplemental capital components such as qualifying allowance for loan losses, qualifying subordinated debt and up to 45 percent of the pretax net unrealized holding gains on certain available for sale equity securities. Tier I capital plus the Tier II capital components are referred to as total qualifying capital.

The capital ratios of the Bank and the Company currently exceed the minimum regulatory requirements. At December 31, 1998, the Bank had a leverage Tier I capital to average assets ratio of 10.34%, a Tier I capital to risk-weighted assets ratio of 31.59% and a total capital to risk-weighted assets ratio of 34.00%. The Company, on a consolidated basis, had ratios of leverage Tier I capital to average assets of 10.61%, Tier I capital to risk-weighted assets of 32.40% and total capital to risk-weighted assets of 34.81% at December 31, 1998.





## YEAR 2000 ISSUE

As we near the 21st century, MASSBANK is taking important steps to tackle the computer glitch dubbed the Year 2000 Problem, Y2K, or Millennium Bug. The problem originated from software designers' attempt to save memory by recording years in a two digit format "98" instead of "1998" for example which didn't take into account that the year 2000, or "00" could also be interpreted, by any system that has time sensitive software, as the year 1900 rather than the year 2000. This could result in a system failure or in miscalculations.

In May 1997, the Company organized a Year 2000 project team to address the Y2K critical issues in order to resolve its Year 2000 computer problems. The project team provides direct oversight of the Year 2000 initiative. The Company's Board of Directors receives project updates on a quarterly basis and the Bank's Board of Directors receives a monthly project update.

The project team has completed its assessment of the Company's technology and non-information technology systems, such as vault doors, elevators, and security systems, to identify the systems that could be affected by the Year 2000 issue and has developed a plan to address this issue. The project plan, which incorporates the Federal Financial Institutions Examination Council ("FFIEC") recommended guidelines, encompasses a service bureau for systems that are outsourced, in-house systems, vendors, customers and suppliers (including correspondent banks). In addition to addressing the Company's technology issues, the project plan includes a customer awareness program designed to keep the bank's customers informed about the Year 2000 issue and the Company's state of readiness.

The Company has incurred and will continue to incur expenses in connection with the testing and upgrading of its computer systems to prepare for the Year 2000. Year 2000 project expenditures approximated $53 thousand in 1998. Approximately $33 thousand of the expenditures were expensed as incurred, while the cost of new hardware and software of approximately $20 thousand was capitalized and will be amortized over the software and hardware's useful life. The capitalized expenditures represent the cost of a new general ledger system and the replacement of some personal computers that were not Year 2000 ready. Expenses for the remainder of the Year 2000 project are not expected to exceed $300 thousand. This includes an estimated $150 thousand to upgrade the Bank's check processing equipment. Since the majority of these expenditures will be to replace or upgrade existing hardware and software, the majority of these expenditures will be capitalized and amortized in accordance with the Company's standard accounting practices.

The Company relies on a third party service bureau for its primary business processes (e.g., loans and deposits applications). It continues to work closely with the service bureau to monitor the progress of their Year 2000 efforts. The service bureau's Y2K remediation efforts are also being monitored by the federal banking regulators. The service bureau expects to have substantially completed the remediation and testing of all its applications by the end of the first quarter of 1999. The Company's testing with the service bureau that began April 1998 is expected to be substantially completed by the end of the second quarter of 1999. However, the Company expects to continue testing into the third quarter of 1999.

The Company has made significant progress in testing, upgrading, and/or replacing its information systems to assure Y2K compliance. The testing of all of the Company's computer hardware and mission critical internal information systems has been substantially completed, with the exception of its trust and items processing department systems. These systems are being replaced with hardware and software that is Year 2000 ready. The delivery of these systems is expected by May 1999 and the Company expects testing to be substantially completed by the end of the second quarter of 1999.

Most of the Company's other date sensitive systems operate on software supported by outside vendors. The Company continues to monitor the progress of their Year 2000 efforts and is seeking to receive written verification from these vendors as to their Year 2000 readiness.

Testing of the Company's non-mission critical internal information systems and interfaces is expected to be substantially completed by June 30, 1999. Examination of the Company's non-information technology systems indicated that no significant replacements are required for Year 2000 readiness.

While the Company continues to receive written verification from its service bureau and vendors as to their Year 2000 compliance, and continues to test their systems, there is no guarantee that these systems will not fail in the Year 2000. Also, there can be no assurance that the systems of other companies, banks, government agencies, etc. that interface with the Company will be timely remediated. If they are not successful, the Year 2000 problem could have a material effect on the Company's operations. The Company, therefore, has drafted contingency and business resumption plans for its primary lines of business. These plans are being enhanced to address potential Year 2000 scenarios. This process will be completed by the end of the second quarter of 1999.

The expenditures of the project and the dates on which the Bank plans to complete Year 2000 testing and contingency and business resumption plans, are based on management's best estimates, which were derived utilizing numerous assumptions of future events including the continued availablility of certain resources, third party modification plans and other factors.

Management presently does not believe that the Year 2000 issue will result in significant operational problems for the Company. In addition, the Company's efforts to address the Year 2000 issue are being monitored by its federal banking regulators. Failure to be Year 2000 compliant on a timely basis could subject the Company to formal supervisory or enforcement actions.





ASSET AND LIABILITY MANAGEMENT

The goal of asset/liability management is to ensure that liquidity, capital and market risk are prudently managed. Asset/liability management is governed by policies reviewed and approved annually by the Bank's Board of Directors (the "Board"). The Board establishes policy limits for long-term interest rate risk assumption and delegates responsibility for monitoring and measuring the Company's exposure to interest rate risk to the Asset/Liability Committee ("ALCO"). The ALCO which is comprised of members of the Company's Board of Directors, members of senior management and the bank's comptroller, generally meets quarterly to review the economic environment and the volume, mix and maturity of the Company's assets and liabilities.

INTEREST RATE RISK

The primary goal of interest-rate risk management is to control the Company's exposure to interest rate risk both within limits approved by the Board and within narrower guidelines approved by ALCO. These limits and guidelines reflect the Company's tolerance for interest rate risk over both short-term and long-term time horizons. The Company monitors its interest rate exposures using a variety of financial tools. It also produces a GAP analysis quarterly, reflecting the known or assumed maturity, repricing and other cash flow characteristics of the Company's interest-earning assets and interest-bearing liabilities.

Interest rate risk materializes in two forms, market value risk and reinvestment risk.

Financial instruments calling for future cash flows show market value increases or decreases when rates change. Management monitors the potential change in market value of the Company's debt securities assuming an immediate (parallel) shift in interest rates of up to 200 basis points up or down. Results are calculated using industry standard modeling analytics and securities data from The Bloomberg. The Company uses the results to review the potential changes in market value resulting from immediate rate shifts and to manage the effect of market value changes on the Company's capital position.

Reinvestment risk occurs when an asset and the liability funding the asset do not reprice and/or mature at the same time. The difference or mismatch with respect to repricing frequency and/or maturity is a risk to net interest income.

Complicating management's efforts to control the Company's exposure to interest rate risk is the fundamental uncertainty of the maturity, repricing and/or runoff characteristics of a significant portion of the Company's assets and liabilities. This uncertainty often reflects optional features embedded in these financial instruments. The most important optional features are embedded in the Company's deposits, loans and mortgage-backed securities.

For example, many of the Company's interest-bearing deposit products (e.g., savings, money market deposit accounts and NOW accounts) have no contractual maturity. Customers have the right to withdraw funds from these deposit accounts freely. Deposit balances may therefore run off unexpectedly due to changes in competitive or market conditions. In addition, when market interest rates rise, customers with time certificates of deposit ("CDs") often pay a penalty to redeem their CDs and reinvest at higher rates. Given the uncertainties surrounding deposit runoff and repricing, the interest rate sensitivity of the Company's liabilities cannot be determined precisely.

Similarly, customers have the right to prepay loans, particularly residential mortgage loans, usually without penalty. As a result, the Company's mortgage based assets (i.e., mortgage loans and mortgage-backed securities) are subject to prepayment risk. This risk tends to increase when interest rates fall due to the benefits of refinancing. Since the future prepayment behavior of the Company's customers is uncertain, the interest rate sensitivity of mortgage based assets cannot be determined exactly.

Management monitors and adjusts the difference between the Company's interest-earning assets and interest-bearing liabilities repricing within various time frames ("GAP position").

GAP analysis provides a static view of the maturity and repricing characteristics of the Company's balance sheet positions. The interest rate GAP is prepared by scheduling all interest-earning assets and interest-bearing liabilities according to scheduled or anticipated repricing or maturity. The GAP analysis identifies the difference between an institution's assets and liabilities that will react to a change in market rates. GAP analysis theory postulates that if the GAP is positive and rates increase, profits will increase as more assets than liabilities react to the rate change. If the GAP is negative, more liabilities than assets will react to a change in market rates. If rates rise, the institution's profits will fall as more liabilities react to market rates than assets.

In contrast, however, the Company's one-year GAP position in recent years has been negative and its net interest income has moved in the same direction as the change in market rates rather than in the opposite direction as GAP analysis theory postulates. One of the more significant reasons for this is the fact that a GAP presentation does not reflect the degrees to which interest earning assets and deposit costs respond to changes in market interest rates. The rates on all financial instruments do not always move by the same amount as the general change in market rates. In addition, the Company has elected, in recent years, either not to raise rates or to raise rates by a modest amount on its savings and transaction-oriented accounts in response to a change in market rates. It should be noted that for the above two reasons, among others, the Company's net interest income has moved in the same direction as market interest rates in the past and are likely to in the near future despite having a negative cumulative one-year GAP position.





INTEREST RATE RISK (CONTINUED)

The Company's policy is to limit its one-year GAP position to 15 percent of total assets. The Company has historically managed its interest rate GAP primarily by lengthening or shortening the maturity structure of its securities portfolio, by continually modifying the composition of its securities portfolio and by selectively pricing and marketing its various deposit products.

The following table summarizes the Company's GAP position at December 31, 1998. As of this date, the Company's one-year cumulative GAP position was negative $21.6 million, or approximately 2.28% of total assets. The cumulative GAP-asset ratio measures the direction and extent of imbalance between an institution's assets and liabilities repricing through the end of a particular period.

| | INTEREST SENSITIVITY PERIODS | | | | | |
|---|---|---|---|---|---|---|
| (IN THOUSANDS) | 3 MONTHS OR LESS | 3 TO 6 MONTHS | 6 MONTHS TO 1 YEAR | 1 TO 5 YEARS | OVER 5 YEARS | TOTAL |
| INTEREST-EARNING ASSETS: | | | | | | |
| Loans | $ 32,525 | $ 14,469 | $ 30,637 | $165,685 | $ 61,673 | $304,989 |
| Short-term investments: | | | | | | |
| Federal funds sold | 123,207 | -- | -- | -- | -- | 123,207 |
| Investment in money market funds | 24,569 | -- | -- | -- | -- | 24,569 |
| Term federal funds sold | 25,000 | -- | -- | -- | -- | 25,000 |
| Interest-bearing deposits in banks | 544 | 749 | -- | 740 | -- | 2,033 |
| Securities held to maturity | 42 | 82 | -- | 230 | -- | 354 |
| Securities available for sale | 60,306 | 27,401 | 48,818 | 212,210 | 69,391 | 418,126 |
| Trading securities | 30,793 | -- | -- | -- | -- | 30,793 |
| Total interest-earning assets | $296,986 | $ 42,701 | $ 79,455 | $378,865 | $131,064 | $929,071 |
| INTEREST-BEARING LIABILITIES: | | | | | | |
| Deposits | $277,176 | $ 83,556 | $ 79,989 | $ 99,968 | $260,931 | $801,620 |
| Total interest-bearing liabilities | $277,176 | $ 83,556 | $ 79,989 | $ 99,968 | $260,931 | $801,620 |
| GAP for period | $ 19,810 | $(40,855) | $ (534) | $278,897 | $129,867) | $127,451 |
| Cumulative GAP | $ 19,810 | $(21,045) | $(21,579) | $257,318 | $127,451 | |
| Cumulative GAP as a percent of total assets | 2.09% | (2.22%) | (2.28%) | 27.18% | 13.46% | |
| Cumulative GAP - December 31, 1997 | $(52,503) | $(85,716) | $(99,394) | $186,310 | $115,560 | |

INTEREST RATE RISK (CONTINUED)

The following table shows the Company's financial instruments that are sensitive to changes in interest rates, categorized by expected maturity, and the instruments' fair values as of December 31, 1998.

<TABLE>
<CAPTION>

| | EXPECTED MATURITY DATE AT DECEMBER 31, 1998 | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| (IN THOUSANDS) | 1998 | 1999 | 2000 | 2001 | 2002 | THEREAFTER | TOTAL | FAIR VALUE AT 12/31/98 |
| <S> | <C> | <C> | <C> | <C> | <C> | <C> | <C> | <C> |
| INTEREST SENSITIVE ASSETS: | | | | | | | | |
| Fixed rate securities | $111,888 | $ 81,582 | $56,145 | $48,685 | $26,028 | $ 69,391 | $393,719 | $393,719 |
| Average interest rate(1) | 6.40% | 6.56% | 6.54% | 6.58% | 6.77% | 6.61% | 6.54% | |
| Variable rate securities | 52,373 | 979 | -- | -- | -- | 2,202 | 55,554 | 55,554 |
| Average interest rate(1) | 4.18% | 4.61% | -- | -- | -- | 6.49% | 4.28% | |
| Fixed rate loans | 50,443 | 39,631 | 32,807 | 28,677 | 30,437 | 59,948 | 241,943 | 248,997 |
| Average interest rate | 6.99% | 6.99% | 7.01% | 7.04% | 6.99% | 6.93% | 6.98% | |
| Variable rate loans | 13,313 | 10,501 | 7,562 | 5,720 | 4,353 | 21,597 | 63,046 | 63,841 |
| Average interest rate | 7.64% | 7.61% | 7.62% | 7.67% | 7.74% | 8.13% | 7.81% | |
| Other fixed rate assets | 26,293 | 639 | 101 | -- | -- | -- | 27,033 | 27,033 |
| Average interest rate | 5.54% | 6.11% | 5.50% | -- | -- | -- | 5.55% | |
| Other variable rate assets | 147,776 | -- | -- | -- | -- | -- | 147,776 | 147,776 |
| Average interest rate | 4.96% | -- | -- | -- | -- | -- | 4.96% | |
| Total interest sensitive assets | $402,086 | $133,332 | $96,615 | $83,082 | $60,818 | $153,138 | $929,071 | $936,920 |
| INTEREST SENSITIVE LIABILITIES: | | | | | | | | |
| Savings and money market deposit accounts | $ 5,504 | $ 3,901 | $ 3,804 | $ 3,714 | $ 3,631 | $327,495 | $348,049 | $348,049 |
| Average interest rate | 3.23% | 3.20% | 3.21% | 3.21% | 3.22% | 3.44% | 3.43% | |
| Fixed rate certificates of deposit | 251,132 | 56,103 | 9,428 | 1,134 | 538 | 156 | 318,491 | 320,007 |
| Average interest rate | 5.22% | 5.26% | 5.25% | 5.40% | 5.19% | 4.92% | 5.23% | |
| Variable rate certificates of deposit | 33,730 | 28,772 | 19,415 | 116 | -- | -- | 82,033 | 82,033 |
| Average interest rate | 5.79% | 5.90% | 6.02% | 6.02% | -- | -- | 5.88% | |
| NOW accounts | -- | -- | -- | -- | -- | 52,324 | 52,324 | 52,324 |
| Average interest rate | -- | -- | -- | -- | -- | 1.16% | 1.16% | |
| Escrow deposits of borrowers | 1,438 | -- | -- | -- | -- | -- | 1,438 | 1,438 |
| Average interest rate | 0.25% | -- | -- | -- | -- | -- | 0.25% | |
| Deposit acquisition premium, net of amortization | (226) | (230) | (230) | (29) | -- | -- | (715) | -- |
| Total interest sensitive liabilities | $291,578 | $ 88,546 | $32,417 | $ 4,935 | $ 4,169 | $379,975 | $801,620 | $803,851 |

</TABLE>

(1) Securities rates presented are on a tax equivalent basis.

The Company uses certain assumptions to estimate fair values and expected maturities. For interest-sensitive assets, expected maturities are based upon contractual maturity, and projected repayments and prepayments of principal. For interest-sensitive deposit liabilities, maturities are based on contractual maturity and estimated deposit runoff based on the Bank's own historical experience. The actual maturity of the Company's financial instruments could vary significantly from what has been presented in the above table if actual experience differs from the assumptions used.

OTHER MARKET RISKS

The Company's investment securities portfolio includes equity securities with a market value of approximately $21.6 million at December 31, 1998. The net unrealized gains on these securities totaled $10.5 million at year-end 1998. Movements in equity prices may effect the amount of securities gains or losses which the Company realizes from the sale of these securities and thus may have an impact on earnings.





AVERAGE BALANCE SHEETS

<TABLE>
<CAPTION>

| (IN THOUSANDS) YEARS ENDED DECEMBER 31, | 1998 | | | 1997 | | | 1996 | | |
|---|---|---|---|---|---|---|---|---|---|
| | AVERAGE BALANCE(4) | INTEREST INCOME/ EXPENSE | AVERAGE YIELD/ RATE(4) | AVERAGE BALANCE(4) | INTEREST INCOME/ EXPENSE | AVERAGE YIELD/ RATE(4) | AVERAGE BALANCE(4) | INTEREST INCOME/ EXPENSE | AVERAGE YIELD/ RATE(4) |

| | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| <S> | <C> | <C> | <C> | <C> | <C> | <C> | <C> | <C> | <C> |
| ASSETS: | | | | | | | | | |
| Earning assets: | | | | | | | | | |
| Federal funds sold | $ 137,123 | $ 7,316 | 5.34% | $106,890 | $ 5,840 | 5.46% | $ 95,253 | $ 5,084 | 5.34% |
| Short-term investments(2) | 26,792 | 1,440 | 5.37 | 26,369 | 1,459 | 5.53 | 23,656 | 1,259 | 5.32 |
| Investment securities | 145,863 | 8,473 | 5.81 | 166,949 | 10,554 | 6.32 | 194,229 | 12,586 | 6.48 |
| Mortgage-backed securities | 299,368 | 20,496 | 6.85 | 321,521 | 22,368 | 6.96 | 277,409 | 19,353 | 6.98 |
| Trading securities | 16,460 | 819 | 4.98 | 12,741 | 735 | 5.77 | 9,719 | 563 | 5.79 |
| Mortgage loans(1) | 264,898 | 19,413 | 7.33 | 235,587 | 17,704 | 7.51 | 225,005 | 16,933 | 7.53 |
| Other loans(1) | 22,375 | 2,021 | 9.03 | 24,584 | 2,224 | 9.05 | 26,993 | 2,481 | 9.19 |
| Total earning assets | 912,879 | 59,978 | 6.56% | 894,641 | 60,884 | 6.81% | 852,264 | 58,259 | 6.84% |
| Allowance for loan losses | (2,375) | | | (2,245) | | | (2,414) | | |
| Total earning assets less allowance for loan losses | 910,504 | | | 892,396 | | | 849,850 | | |
| Other assets | 19,512 | | | 18,956 | | | 19,194 | | |
| Total assets | $ 930,016 | | | $911,352 | | | $869,044 | | |
| LIABILITIES: | | | | | | | | | |
| Deposits: | | | | | | | | | |
| Demand and NOW | $ 70,159 | 554 | 0.79% | $ 65,895 | 536 | 0.81% | $ 63,969 | 574 | 0.90% |
| Savings | 349,637 | 11,959 | 3.42 | 355,395 | 12,240 | 3.44 | 358,056 | 12,268 | 3.43 |
| Time certificates of deposit | 391,816 | 21,807 | 5.57 | 386,062 | 21,905 | 5.67 | 352,385 | 20,220 | 5.74 |
| Total deposits | 811,612 | 34,320 | 4.23 | 807,352 | 34,681 | 4.30 | 774,410 | 33,062 | 4.27 |
| Other liabilities | 9,776 | | | 7,296 | | | 6,106 | | |
| Total liabilities | 821,388 | | | 814,648 | | | 780,516 | | |
| STOCKHOLDERS' EQUITY: | 108,628 | | | 96,704 | | | 88,528 | | |
| Total liabilities and stockholders' equity | $ 930,016 | | | $911,352 | | | $869,044 | | |
| Net interest income (tax-equivalent basis) | 25,658 | | | 26,203 | | | 25,197 | | |
| Less adjustment of tax-exempt interest income | (144) | | | (151) | | | (150) | | |
| Net interest income | $ 25,514 | | | $ 26,052 | | | $ 25,047 | | |
| Interest rate spread | | 2.33% | | | 2.51% | | | | 2.57% |
| Net interest margin(3) | | 2.81% | | | 2.93% | | | | 2.96% |

</TABLE>

(1) Loans on nonaccrual status are included in the average balance.
(2) Short-term investments consist of interest-bearing deposits in banks and investments in money market funds.
(3) Net interest income (tax equivalent basis) before provision for loan losses divided by average interest-earning assets.
(4) Includes the effects of SFAS No. 115.





RATE/VOLUME ANALYSIS

The following table presents, for the years indicated, the changes in interest and dividend income and the changes in interest expense attributable to changes in interest rates and changes in the volume of earning assets and interest-bearing liabilities. A change attributable to both volume and rate has been allocated proportionately to the change due to volume and the change due to rate.

<TABLE>
<CAPTION>

| (IN THOUSANDS) YEARS ENDED DECEMBER 31, | 1998 COMPARED TO 1997 INCREASE (DECREASE) DUE TO | 1997 COMPARED TO 1996 INCREASE (DECREASE) DUE TO |
|---|---|---|

| | VOLUME | RATE | TOTAL | VOLUME | RATE | TOTAL |
|---|---|---|---|---|---|---|
| <S> | <C> | <C> | <C> | <C> | <C> | <C> |
| INTEREST AND DIVIDEND INCOME: | | | | | | |
| Federal funds sold | $ 1,616 | $ (140) | $ 1,476 | $ 634 | $ 122 | $ 756 |
| Short-term investments | 23 | (42) | (19) | 148 | 52 | 200 |
| Investment securities | (1,248) | (826) | (2,074) | (1,708) | (325) | (2,033) |
| Trading securities | 194 | (110) | 84 | 174 | (2) | 172 |
| Mortgage-backed securities | (1,521) | (351) | (1,872) | 3,069 | (54) | 3,015 |
| Mortgage loans | 2,157 | (448) | 1,709 | 795 | (24) | 771 |
| Other loans | (200) | (3) | (203) | (218) | (39) | (257) |
| Total interest and dividend income | 1,021 | (1,920) | (899) | 2,894 | (270) | 2,624 |
| INTEREST EXPENSE: | | | | | | |
| Deposits: | | | | | | |
| Demand and NOW | 34 | (16) | 18 | 17 | (55) | (38) |
| Savings | (197) | (84) | (281) | (92) | 64 | (28) |
| Time certificates of deposit | 324 | (422) | (98) | 1,913 | (228) | 1,685 |
| Total interest expense | 161 | (522) | (361) | 1,838 | (219) | 1,619 |
| Net interest income | $ 860 | $(1,398) | $ (538) | $ 1,056 | $ (51) | $ 1,005 |

</TABLE>

IMPACT OF INFLATION AND CHANGING PRICES

MASSBANK Corp.'s financial statements presented herein have been prepared in accordance with generally accepted accounting principles which require the measurement of financial position and operating results in terms of historical dollars, without considering changes in the relative purchasing power of money over time, due to the fact that substantially all of the assets and liabilities of a financial institution are monetary in nature. As a result, interest rates have a more significant impact on a financial institution's performance than the effects of general levels of inflation. Interest rates do not necessarily move in the same direction or in the same magnitude as the prices of goods and services.

RECENT ACCOUNTING PRONOUNCEMENTS

ACCOUNTING FOR DERIVATIVE INSTRUMENTS AND HEDGING ACTIVITIES

In June 1998, the Financial Accounting Standards Board ("FASB") issued SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities." This Statement establishes accounting and reporting standards for derivative instruments, including certain derivative instruments embedded in other contracts, (collectively referred to as derivatives) and for hedging activities. It requires that an entity recognize all derivatives as either assets or liabilities in its balance sheet and measure those instruments at fair market value. Under this Statement, an entity that elects to apply hedge accounting is required to establish at the inception of the hedge the method it will use for assessing the effectiveness of the hedging derivative and the measurement approach for determining the ineffective aspect of the hedge. This Statement is effective for all fiscal quarters of fiscal years beginning after June 15, 1999. This Statement is not expected to have a material effect on the Company's consolidated financial statements.





INDEPENDENT AUDITORS' REPORT

[KPMG PEAT MARWICK LLP LOGO OMITTED]

The Board of Directors and Stockholders
MASSBANK Corp.:

We have audited the accompanying consolidated balance sheets of MASSBANK Corp. and subsidiaries as of December 31, 1998 and 1997, and the related consolidated statements of income, changes in stockholders' equity and cash flows for each of the years in the three-year period ended December 31, 1998. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. 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 MASSBANK Corp. and subsidiaries at December 31, 1998 and 1997, and the results of their operations and their cash flows for each of the years in the three-year period ended December 31, 1998, in conformity with generally accepted accounting principles.

/s/ KPMG Peat Marwick LLP

Boston, Massachusetts
January 11, 1999





MASSBANK CORP. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS

<TABLE>
<CAPTION>

| (IN THOUSANDS EXCEPT SHARE DATA) AT DECEMBER 31, | 1998 | 1997 |
|---|---|---|
| <S> | <C> | <C> |
| ASSETS: | | |
| Cash and due from banks | $ 7,038 | $ 6,808 |
| Short-term investments (Note 2) | 147,776 | 109,755 |
| Total cash and cash equivalents | 154,814 | 116,563 |
| Term federal funds sold | 25,000 | 20,000 |
| Interest-bearing deposits in banks | 2,033 | 2,083 |
| Securities held to maturity, at amortized cost (market value of $354 in 1998 and $372 in 1997) (Note 3) | 354 | 372 |
| Securities available for sale, at market value (amortized cost of $398,343 in 1998 and $466,749 in 1997) (Note 3) | 418,126 | 482,224 |
| Trading securities, at market value (Note 4) | 30,793 | 21,260 |
| Loans (Notes 5, 7 and 11): | | |
| Mortgage loans | 283,654 | 248,798 |
| Other loans | 21,335 | 23,505 |
| Total loans | 304,989 | 272,303 |
| Less: allowance for loan losses (Note 6) | (2,450) | (2,334) |
| Net loans | 302,539 | 269,969 |
| Premises and equipment (Note 9) | 4,320 | 4,369 |
| Real estate acquired through foreclosure (Note 7) | 86 | -- |
| Accrued interest receivable | 5,058 | 5,395 |
| Goodwill | 1,387 | 1,487 |
| Other assets | 2,115 | 1,681 |
| Total assets | $946,625 | $925,403 |
| LIABILITIES AND STOCKHOLDERS' EQUITY: | | |
| Deposits (Notes 10 and 11): | | |
| Demand and NOW | $ 76,173 | $ 66,859 |
| Savings | 348,049 | 352,875 |
| Time certificates of deposit | 400,524 | 391,034 |
| Deposit acquisition premium, net of amortization | (715) | (918) |
| Total deposits | 824,031 | 809,850 |
| Escrow deposits of borrowers | 1,438 | 1,502 |
| Employee stock ownership plan liability (Note 15) | 625 | 781 |
| Accrued and deferred income taxes payable (Note 12) | 7,484 | 6,167 |
| Other liabilities | 2,558 | 3,324 |
| Total liabilities | 836,136 | 821,624 |
| Commitments and contingent liabilities (Notes 8 and 9) | | |
| Stockholders' equity (Notes 12, 14, 15 and 16): | -- | -- |
| Preferred stock, par value $1.00 per share; 2,000,000 shares authorized, none issued | -- | -- |
| Common stock, par value $1.00 per share; 10,000,000 shares authorized, 7,384,332 and 7,336,800 shares issued, respectively | 7,384 | 7,337 |
| Additional paid-in capital | 60,003 | 58,737 |
| Retained earnings | 78,308 | 70,984 |
| | 145,695 | 137,058 |
| Treasury stock at cost, 3,885,222 and 3,766,022 shares, respectively | (46,272) | (41,569) |

| | | |
|---|---|---|
| Accumulated other comprehensive income (Note 1) | 11,691 | 9,071 |
| Common stock acquired by ESOP (Note 15) | (625) | (781) |
| Total stockholders' equity | 110,489 | 103,779 |
| Total liabilities and stockholders' equity | $946,625 | $925,403 |

</TABLE>
See accompanying notes to consolidated financial statements.





MASSBANK CORP. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF INCOME

<TABLE>
<CAPTION>

| (IN THOUSANDS EXCEPT SHARE DATA) YEARS ENDED DECEMBER 31, | 1998 | 1997 | 1996 |
|---|---|---|---|
| <S> | <C> | <C> | <C> |
| INTEREST AND DIVIDEND INCOME: | | | |
| Mortgage loans | $ 19,413 | $ 17,704 | $ 16,933 |
| Other loans | 2,021 | 2,224 | 2,481 |
| Securities available for sale: | | | |
| Mortgage-backed securities | 20,496 | 22,368 | 19,353 |
| Other securities | 8,310 | 10,385 | 12,425 |
| Trading securities | 819 | 735 | 563 |
| Federal funds sold | 7,316 | 5,840 | 5,084 |
| Other investments | 1,459 | 1,477 | 1,270 |
| Total interest and dividend income | 9,834 | 60,733 | 58,109 |
| INTEREST EXPENSE: | | | |
| Deposits: | | | |
| NOW | 554 | 536 | 574 |
| Savings | 11,959 | 12,240 | 12,268 |
| Time certificates of deposit | 21,807 | 21,905 | 20,220 |
| Total interest expense | 34,320 | 34,681 | 33,062 |
| Net interest income | 25,514 | 26,052 | 25,047 |
| PROVISION FOR LOAN LOSSES (NOTE 6) | 193 | 260 | 160 |
| Net interest income after provision for loan losses | 25,321 | 25,792 | 24,887 |
| NON-INTEREST INCOME: | | | |
| Deposit account service fees | 811 | 924 | 932 |
| Gains on securities, net | 2,893 | 1,939 | 868 |
| Other | 886 | 935 | 865 |
| Total non-interest income | 4,590 | 3,798 | 2,665 |
| NON-INTEREST EXPENSE: | | | |
| Salaries and employee benefits | 7,426 | 7,743 | 7,215 |
| Occupancy and equipment | 2,059 | 2,096 | 1,977 |
| Data processing | 510 | 438 | 608 |
| Professional services | 461 | 407 | 340 |
| Merger and acquisition related expense | -- | 156 | -- |
| Advertising and marketing | 171 | 187 | 220 |
| Amortization of intangibles | 302 | 251 | 230 |
| Deposit insurance | 116 | 116 | 13 |
| Contributions | 14 | 664 | 60 |
| Other | 1,456 | 1,367 | 1,461 |
| Total non-interest expense | 12,515 | 13,425 | 12,124 |
| Income before income taxes | 17,396 | 16,165 | 15,428 |
| INCOME TAX EXPENSE (NOTE 12) | 6,482 | 5,998 | 6,001 |
| Net income | $ 10,914 | $ 10,167 | $ 9,427 |
| WEIGHTED AVERAGE COMMON SHARES OUTSTANDING: | | | |
| Basic | 3,528,817 | 3,524,657 | 3,556,660 |
| Diluted | 3,676,642 | 3,663,310 | 3,658,505 |
| EARNINGS PER SHARE (IN DOLLARS): | | | |
| Basic | $ 3.09 | $ 2.88 | $ 2.65 |
| Diluted | 2.97 | 2.77 | 2.58 |

</TABLE>
See accompanying notes to consolidated financial statements.

MASSBANK CORP. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS

<TABLE>
<CAPTION>

| (IN THOUSANDS) YEARS ENDED DECEMBER 31, | 1998 | 1997 | 1996 |
|---|---|---|---|
| <S> | <C> | <C> | <C> |
| CASH FLOWS FROM OPERATING ACTIVITIES: | | | |
| Net income | $ 10,914 | $ 10,167 | $ 9,427 |
| Adjustments to reconcile net income to net cash (used in) provided by operating activities: | | | |
| Depreciation and amortization | 928 | 853 | 735 |
| Loan interest capitalized | (88) | -- | -- |
| Amortization of ESOP shares committed to be released | 243 | 184 | 63 |
| Charitable contribution of appreciated securities | -- | 622 | 5 |
| Decrease in accrued interest receivable | 337 | 464 | 1,633 |
| (Decrease) increase in other liabilities | (734) | 56 | (388) |
| (Decrease) increase in current income taxes payable | (517) | 435 | (75) |
| Accretion of discounts on securities, net of amortization of premiums | (1,152) | (1,178) | (1,052) |
| Net trading securities activity | (8,671) | (16,480) | 2,065 |
| Gains on securities available for sale | (2,798) | (1,831) | (950) |
| (Gains) losses on trading securities | (95) | (108) | 82 |
| Increase in deferred mortgage loan origination fees, net of amortization | 231 | 168 | 114 |
| Deferred income tax (benefit) expense | 146 | (372) | 238 |
| Decrease (increase) in other assets | 85 | 553 | (74) |
| Loans originated for sale | (129) | (770) | (215) |
| Loans sold | 129 | 770 | 378 |
| Provision for loan losses | 193 | 260 | 160 |
| Provisions for losses and writedowns on real estate acquired through foreclosure | -- | (21) | 32 |
| Gains on sales of real estate acquired through foreclosure | (5) | (34) | (26) |
| Gains on sales of premises and equipment | -- | (1) | (2) |
| (Decrease) increase in escrow deposits of borrowers | (64) | 231 | 279 |
| Net cash (used in) provided by operating activities | (1,047) | (6,032) | 12,429 |
| CASH FLOWS FROM INVESTING ACTIVITIES: | | | |
| Cash and cash equivalents for acquisitions | -- | (2,874) | -- |
| Purchases of term federal funds | (35,000) | (30,000) | |
| Proceeds from maturities of term federal funds | 30,000 | 20,000 | 5,000 |
| Increase in interest-bearing bank deposits | (766) | (1,649) | (810) |
| Proceeds from maturities of interest-bearing bank deposits | 816 | 1,240 | -- |
| Proceeds from sales of investment securities available for sale | 26,580 | 42,741 | 49,940 |
| Proceeds from maturities of investment securities held to maturity and available for sale | 43,650 | 59,000 | 86,225 |
| Purchases of investment securities available for sale | (59,291) | (63,696) | (56,196) |
| Purchases of investment securities held to maturity | -- | (230) | -- |
| Purchases of mortgage-backed securities | (10,043) | (63,661) | (135,854) |
| Principal repayments of mortgage-backed securities | 70,203 | 42,246 | 36,858 |
| Principal repayments of securities held to maturity | 18 | 18 | 17 |
| Principal repayments of securities available for sale | 4 | 85 | -- |
| Loans originated | (105,103) | (57,787) | (51,152) |
| Loan principal payments received | 71,687 | 48,560 | 49,118 |
| Loans purchased | -- | (201) | -- |
| Purchases of premises and equipment | (508) | (491) | (310) |
| Proceeds from sale of premises and equipment | -- | 9 | 2 |
| Proceeds from sale of real estate acquired through foreclosure | 316 | 964 | 511 |
| Net advances on real estate acquired through foreclosure | (20) | (30) | -- |
| Net cash provided by (used in) investing activities | 32,543 | (5,756) | (26,651) |

(Continued)

</TABLE>



MASSBANK CORP. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
(Continued)

<TABLE>
<CAPTION>

| (IN THOUSANDS) YEARS ENDED DECEMBER 31, | 1998 | 1997 | 1996 |
|---|---|---|---|
| <S> | <C> | <C> | <C> |
| CASH FLOWS FROM FINANCING ACTIVITIES: | | | |
| Net increase (decrease) in deposits | 13,978 | (8,523) | 34,463 |
| Payments to acquire treasury stock | (4,703) | (1,665) | (3,534) |
| Issuance of common stock under stock option plan | 741 | 466 | 738 |
| Tax benefit resulting from stock options exercised | 329 | 260 | 266 |
| Cash dividends paid on common stock | (3,605) | (3,124) | (2,459) |
| Tax benefit resulting from dividends paid on unallocated shares held by the ESOP | 15 | 15 | 15 |
| Net cash provided by (used in) financing activities | 6,755 | (12,571) | 29,489 |
| Net increase (decrease) in cash and cash equivalents | 38,251 | (24,359) | 15,267 |
| Cash and cash equivalents at beginning of year | 116,563 | 140,922 | 125,655 |
| Cash and cash equivalents at end of year | $ 154,814 | $ 116,563 | $ 140,922 |
| SUPPLEMENTAL CASH FLOW DISCLOSURES: | | | |
| CASH TRANSACTIONS: | | | |
| Cash paid during the year for interest | $ 34,319 | $ 34,671 | $ 33,026 |
| Cash paid during the year for taxes | 6,185 | 5,237 | 5,557 |
| NON-CASH TRANSACTIONS: | | | |
| SFAS 115: | | | |
| Increase (decrease) in stockholders' equity | 2,620 | 5,070 | (3,239) |
| Increase (decrease) in deferred tax liabilities | 1,688 | 3,510 | (2,329) |
| Securities reclassified from available for sale to trading | 1,111 | -- | -- |
| Transfers from loans to real estate acquired through foreclosure | 377 | 376 | 765 |
| Transfers from loans to other assets | 56 | -- | -- |
| Transfers from premises and equipment to other assets | 9 | -- | -- |
| Purchases of securities incomplete (not settled) at beginning of year which settled during the year | 32 | -- | -- |
| Purchase of securities incomplete (not settled) as of year-end | 129 | 32 | -- |
| Sales of securities incomplete (not settled) as of year-end | 583 | -- | 30 |
| Cost of donated securities | -- | 2 | -- |
| In connection with the acquisition of Glendale Co-operative Bank in July, 1997, assets acquired and liabilities assumed were as follows: | | | |
| Assets acquired | -- | $ 31,561 | -- |
| Goodwill | -- | 1,530 | -- |
| Liabilities assumed | -- | 30,217 | -- |

</TABLE>
See accompanying notes to consolidated financial statements.





MASSBANK CORP. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY

<TABLE>
<CAPTION>

(IN THOUSANDS EXCEPT SHARE DATA) YEARS ENDED DECEMBER 31, 1998, 1997 AND 1996

| | COMMON STOCK | ADDITIONAL PAID-IN CAPITAL | RETAINED EARNINGS | TREASURY STOCK | ACCUMULATED OTHER COMPREHENSIVE INCOME | COMMON STOCK ACQUIRED BY ESOP | TOTAL |
|---|---|---|---|---|---|---|---|
| <S> | <C> | <C> | <C> | <C> | <C> | <C> | <C> |
| Balance at December 31, 1995 | $5,425 | $56,842 | $ 58,773 | $(36,370) | $ 7,240 | $(1,093) | $ 90,817 |
| Net Income | -- | -- | 9,427 | -- | -- | -- | 9,427 |
| Other comprehensive income, net of tax: | | | | | | | |
| Unrealized gains on securities, net of reclassification adjustment | -- | -- | -- | -- | (3,239) | -- | (3,239) |
| Comprehensive income | -- | -- | -- | -- | -- | -- | 6,188 |
| Cash dividends declared ($0.69 per share) | -- | -- | (2,459) | -- | -- | -- | (2,459) |
| Tax benefit resulting from dividends paid on unallocated shares held by the ESOP | -- | -- | 15 | -- | -- | -- | 15 |
| Net decrease in liability to ESOP | -- | -- | -- | -- | -- | 156 | 156 |
| Amortization of ESOP shares committed to be released | -- | 63 | -- | -- | -- | -- | 63 |
| Purchase of treasury stock | -- | -- | -- | (3,534) | -- | -- | (3,534) |
| Exercise of stock options and related tax benefits | 51 | 953 | -- | -- | -- | -- | 1,004 |
| Balance at December 31, 1996 | 5,476 | 57,858 | 65,756 | (39,904) | 4,001 | (937) | 92,250 |

| | | | | | | | |
|---|---|---|---|---|---|---|---|
| Net Income | -- | -- | 10,167 | -- | -- | -- | 10,167 |
| Other comprehensive income, net of tax: | | | | | | | |
| Unrealized gains on securities, net of reclassification adjustment (Note 1) | -- | -- | -- | -- | 5,070 | -- | 5,070 |
| Comprehensive income | -- | -- | -- | -- | -- | -- | 15,237 |
| Cash dividends declared ($0.885 per share) | -- | -- | (3,124) | -- | -- | -- | (3,124) |
| Tax benefit resulting from dividends paid on unallocated shares held by the ESOP | -- | -- | 15 | -- | -- | -- | 15 |
| Net decrease in liability to ESOP | -- | -- | -- | -- | -- | 156 | 156 |
| Amortization of ESOP shares committed to be released | -- | 184 | -- | -- | -- | -- | 184 |
| Purchase of treasury stock | -- | -- | -- | (1,665) | -- | -- | (1,665) |
| Exercise of stock options and related tax benefits | 31 | 695 | -- | -- | -- | -- | 726 |
| Transfer resulting from four-for-three stock split | 1,830 | -- | (1,830) | -- | -- | -- | -- |
| Balance at December 31, 1997 | 7,337 | 58,737 | 70,984 | (41,569) | 9,071 | (781) | 103,779 |
| Net Income | -- | -- | 10,914 | -- | -- | -- | 10,914 |
| Other comprehensive income, net of tax: | | | | | | | |
| Unrealized gains on securities, net of reclassification adjustment (Note 1) | -- | -- | -- | -- | 2,620 | -- | 2,620 |
| Comprehensive income | -- | -- | -- | -- | -- | -- | 13,534 |
| Cash dividends declared ($1.02 per share) | -- | -- | (3,605) | -- | -- | -- | (3,605) |
| Tax benefit resulting from dividends paid on unallocated shares held by the ESOP | -- | -- | 15 | -- | -- | -- | 15 |
| Net decrease in liability to ESOP | -- | -- | -- | -- | -- | 156 | 156 |
| Amortization of ESOP shares committed to be released | -- | 243 | -- | -- | -- | -- | 243 |
| Purchase of treasury stock | -- | -- | -- | (4,703) | -- | -- | (4,703) |
| Exercise of stock options and related tax benefits | 47 | 1,023 | -- | -- | -- | -- | 1,070 |
| Balance at December 31, 1998 | $7,384 | $60,003 | $ 78,308 | $(46,272) | $ 11,691 | $ (625) | $ 110,489 |

</TABLE>
See accompanying notes to consolidated financial statements.





MASSBANK CORP. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
YEARS ENDED DECEMBER 31, 1998, 1997 AND 1996

1. Summary of Significant Accounting Policies

MASSBANK Corp. (the "Company") is a Delaware chartered holding company whose principal subsidiary is MASSBANK (the "Bank"). The Bank operates fifteen full service banking offices in Reading, Melrose, Stoneham, Wilmington, Medford, Chelmsford, Tewksbury, Westford, Dracut, Lowell and Everett providing a variety of deposit, lending and trust services. As a Massachusetts chartered savings bank whose deposits are insured by the Federal Deposit Insurance Corporation ("FDIC") and the Depositors Insurance Fund ("DIF"), the activities of the Bank are subject to regulation, supervision and examination by federal and state regulatory authorities, including, but not limited to the FDIC, the Massachusetts Commissioner of Banks and the DIF. In addition, as a bank holding company, the Company is subject to supervision, examination and regulation by the Board of Governors of the Federal Reserve System.

BASIS OF PRESENTATION

The consolidated financial statements include the accounts of the Company and its wholly-owned subsidiary MASSBANK and its subsidiaries: Readibank Properties, Inc., Readibank Investment Corporation and Melbank Investment Corporation. The accounts of MASSBANK'S subsidiary, Readibank Equipment Corporation, which was sold in October, 1997 are also included through the sale date.

The Company has one reportable operating segment. All significant intercompany balances and transactions have been eliminated in consolidation. The accounting and reporting policies of the Company conform to generally accepted accounting principles and to general practices within the banking industry. In preparing the consolidated financial statements, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities at the balance sheet date and income and expenses for the period. Material estimates that are particularly susceptible to change in the near term relate to the determination of the allowance for loan losses.

Certain amounts in the prior years' consolidated financial statements were reclassified to permit comparison with the current fiscal year. The Company's reported per share amounts and average common and common equivalent shares outstanding for 1997 and prior years have been restated to reflect the Company's four-for-three stock split of September 15, 1997.

INVESTMENTS IN DEBT AND EQUITY SECURITIES

Under its investment policy, management determines the appropriate classification of securities at the time of purchase. Those debt securities that the Company has the intent and the ability to hold to maturity are classified as securities held to maturity and are carried at amortized historical cost. Those securities held for indefinite periods of time and not intended to be held to maturity are classified as available for sale. Securities held for indefinite periods of time include securities that management intends to use as part of its asset/liability management strategy and that may be sold in response to changes in interest rates, changes in prepayment risk, the need to increase regulatory capital and other similar factors. The Company records investment securities available for sale at aggregate market value with the net unrealized holding gains or losses reported, net of tax effect, as a separate component of stockholders' equity until realized. As of December 31, 1998, stockholders' equity included approximately $11.7 million, representing the net unrealized gains on securities available for sale, less applicable income taxes. Investments classified as trading securities are stated at market value with unrealized gains and losses included in earnings.

Income on debt securities is accrued and included in interest and dividend income. The specific identification method is used to determine realized gains and losses on sales of securities available for sale which are also reported in non-interest income under the caption "gains on securities." When a security suffers a loss in value which is considered other than temporary, such loss is recognized by a charge to earnings.

LOANS

Loans are reported at the principal amount outstanding, net of unearned fees. Loan origination fees and related direct incremental loan origination costs are offset and the resulting net amount is deferred and amortized over the life of the loan using the level-yield method.

The Bank generally does not accrue interest on loans which are 90 days or more past due. When a loan is placed on nonaccrual status, all interest previously accrued but not collected is reversed from income and all amortization of deferred loan fees is discontinued. Interest received on nonaccrual loans is either applied against principal or reported as income according to management's judgment as to the collectibility of principal. Interest accruals are resumed on such loans only when they are brought current with respect to interest and principal and when, in the judgment of management, the loans are estimated to be fully collectible as to both principal and interest.

Impairment on loans for which it is probable that the creditor will be unable to collect all amounts due according to the contractual terms of the loan agreement are measured on a discounted cash flow method, or at the loan's observable market price, or at the fair value of the collateral if the loan is collateral dependent. However, impairment must be measured based on the fair value of the collateral if it is determined that foreclosure is probable. Impaired loans consist of all nonaccrual commercial loans.





1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

ALLOWANCE FOR LOAN LOSSES

The Company maintains an allowance for probable losses that are inherent in the Company's loan portfolio. The allowance for loan losses is increased by provisions charged to operations based on management's assessment of many factors including the risk characteristics of the portfolio, underlying collateral, current and anticipated economic conditions that may affect the borrower's ability to pay, and trends in loan delinquencies and charge-offs. Realized losses, net of recoveries, are charged directly to the allowance. While management uses the information available in establishing the allowance for loan losses, future adjustments to the allowance may be necessary if economic conditions differ substantially from the assumptions used in making the evaluation. 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.

PREMISES AND EQUIPMENT

Land is carried at cost. Premises, equipment and leasehold improvements are stated at cost, less accumulated depreciation and amortization computed primarily by use of the straight-line method over the estimated useful lives of the related assets or terms of the related leases.

REAL ESTATE ACQUIRED THROUGH FORECLOSURE

Real estate acquired through foreclosure is comprised of foreclosed properties where the Bank has actually received title and loans determined to be substantially repossessed. Real estate loans that are substantially repossessed include only those loans for which the Bank has taken possession of the collateral but has not completed legal foreclosure proceedings. Loan losses arising from the acquisition of such properties are charged against the allowance for loan losses. Real estate acquired through foreclosure is recorded at the lower of the carrying value of the loan or the fair value of the property constructively or actually received, less estimated costs to sell the property following foreclosure. Operating expenses and any subsequent provisions to reduce the carrying value to fair value are charged to current period earnings. Gains and losses upon disposition are reflected in earnings as realized.

GOODWILL

The excess of purchase price over the fair value of net assets of acquired companies is classified and reported as goodwill. Goodwill is being amortized using the straight-line method, over 15 years.

DEPOSIT ACQUISITION PREMIUM

The deposit acquisition premium arising from acquisitions is reported net of accumulated amortization. Such premium is being amortized on a straight-line basis over 10 years.

PENSION PLAN

The Bank accounts for pension benefits on the net periodic pension cost method for financial reporting purposes. This method recognizes the compensation cost of an employee's pension benefit over that employee's approximate service period. Pension costs are funded in the year of accrual using the aggregate cost method.

EMPLOYEES' STOCK OWNERSHIP PLAN ("ESOP")

The Company recognizes compensation cost equal to the fair value of the ESOP shares committed to be released. Dividends on unallocated ESOP shares are reported as a reduction of accrued interest on the ESOP loan. The Company reports loans from outside lenders to its ESOP as a liability on its balance sheet and reports interest cost on the debt. For earnings per share (EPS) computations, ESOP shares that have been committed to be released are considered outstanding. ESOP shares that have not been committed to be released are not considered outstanding.

STOCK-BASED COMPENSATION

On January 1, 1996, the Company adopted Statement of Financial Accounting Standards ("SFAS") No. 123, "Accounting for Stock-Based Compensation." The Statement establishes financial accounting and reporting standards for stock-based compensation plans. SFAS No. 123 encourages, but does not require, a fair value based method of accounting for stock-based compensation plans. The Statement allows an entity to continue to measure compensation cost for those plans using the intrinsic value based method prescribed by Accounting Principles Board ("APB") Opinion No. 25. For those entities electing to use the intrinsic value based method, SFAS No. 123 requires pro forma disclosures of net income and earnings per share computed as if the fair value based method had been applied. The Company continues to account for stock-based compensation costs under APB Opinion No. 25.





1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

EARNINGS PER COMMON SHARE

In February 1997, the Financial Accounting Standards Board ("FASB") issued SFAS No. 128, "Earnings Per Share." This Statement supersedes APB Opinion No. 15 regarding the presentation of earnings per share ("EPS") on the face of the income statement. SFAS No. 128 replaces the presentation of Primary EPS with a Basic EPS calculation that excludes the dilutive effect of common stock equivalents. The Statement requires a dual presentation of Basic and Diluted EPS, which is computed similarly to Fully Diluted EPS pursuant to APB Opinion No. 15 for all entities with complex capital structures.

For earnings per share computations, ESOP shares that have been committed to be released are considered outstanding. ESOP shares that have not been committed to be released are not considered outstanding.

All share information set forth herein has been adjusted to reflect the 4-for-3 split of the Company's common stock effective September 15, 1997.

CASH AND CASH EQUIVALENTS

For purposes of reporting cash flows, cash and cash equivalents consist of cash and due from banks,and short-term investments with original maturities of less than 90 days.

As a nonmember of the Federal Reserve System, the Bank is required to maintain certain reserve requirements of vault cash and/or deposits with the Federal Reserve Bank of Boston. The amount of this reserve requirement, included in "Cash and Due from Banks," was $2.7 million and $3.6 million at December 31, 1998 and 1997, respectively.

INCOME TAXES

The Bank recognizes income taxes under the asset and liability method. Under this method, deferred tax assets and liabilities are established for the temporary differences between the accounting basis and the tax basis of the Bank's assets and liabilities at enacted tax rates expected to be in effect when the amounts related to such temporary differences are realized or settled. The Bank's deferred tax asset is reviewed and adjustments to such asset are recognized as deferred income tax expense or benefit based upon management's judgment relating to the realizability of such asset. Based on the Bank's historical and current pretax earnings, management believes it is more likely than not that the Bank will realize its existing gross deferred tax asset.

REPORTING COMPREHENSIVE INCOME

The Company has adopted SFAS No. 130, "Reporting Comprehensive Income." This Statement establishes standards for the reporting and displaying of comprehensive income. Comprehensive income is defined as "the change in equity of a business enterprise during a period from transactions and other events and circumstances from non-owner sources." It includes all changes in equity during a period except those resulting from investments by and distributions to shareholders.

The term "comprehensive income" is used in the Statement to describe the total of all components of comprehensive income including net income.

Comparative financial statements provided for earlier periods have been reclassified to reflect application of the provisions of the Statement. The adoption of this Statement did not have a material impact on the Company's financial presentation.

The Company's other comprehensive income and related tax effect for the year ended December 31, 1998 and the year ended December 31, 1997 is as follows:

<TABLE>
<CAPTION>

| (IN THOUSANDS) YEARS ENDED DECEMBER 31, | 1998 | | | 1997 | | |
|---|---|---|---|---|---|---|
| | BEFORE-TAX AMOUNT | TAX (EXPENSE) OR BENEFIT | NET-OF-TAX AMOUNT | BEFORE-TAX AMOUNT | TAX (EXPENSE) OR BENEFIT | NET-OF-TAX AMOUNT |
| <S> | <C> | <C> | <C> | <C> | <C> | <C> |
| Unrealized gains on securities: | | | | | | |
| Unrealized holding gains arising during period | $ 7,106 | $(2,864) | $ 4,242 | $ 10,411 | $(4,290) | $ 6,121 |
| Less: reclassification adjustment for gains realized in net income | (2,798) | 1,176 | (1,622) | (1,831) | 780 | (1,051) |
| Net unrealized gains | 4,308 | (1,688) | 2,620 | 8,580 | (3,510) | 5,070 |
| Other comprehensive income | $ 4,308 | $(1,688) | $ 2,620 | $ 8,580 | $(3,510) | $ 5.070 |

</TABLE>

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

EMPLOYERS' DISCLOSURES ABOUT PENSIONS AND OTHER POSTRETIREMENT BENEFITS

Effective January 1, 1998, the Company adopted SFAS No. 132, "Employers' Disclosures about Pensions and Other Postretirement Benefits, an amendment of SFAS Nos. 87, 88 and 106." SFAS No. 132 standardizes the disclosure requirements for pensions and other postretirement benefits to the extent practicable, requires additional information on changes in the benefit obligations and fair values of plan assets that will facilitate financial analysis, and eliminates certain disclosures required by SFAS Nos. 87, 88 and 106. The adoption of this pronouncement also requires restatement of disclosures for earlier periods. The adoption of this pronouncement did not have a material impact on the Company's financial presentation.

2. SHORT-TERM INVESTMENTS

Short-term investments consist of the following:

| (In thousands) At December 31, | 1998 | 1997 |
|---|---|---|
| Federal funds sold (overnight) | $123,207 | $ 85,241 |
| Money market funds | 24,569 | 24,514 |
| Total short-term investments | $147,776 | $109,755 |

The investments above are stated at cost which approximates market value.

3. INVESTMENT SECURITIES

The amortized cost and market value of investment securities follows:

| (IN THOUSANDS) AT DECEMBER 31, 1998 | AMORTIZED COST | GROSS UNREALIZED GAINS | GROSS UNREALIZED LOSSES | MARKET VALUE |
|---|---|---|---|---|
| Securities held to maturity: | | | | |
| Other bonds and obligations | $ 354 | $ -- | $ -- | $ 354 |
| Total securities held to maturity | 354 | -- | -- | 354 |
| Securities available for sale: | | | | |
| Debt securities: | | | | |
| U.S. Treasury obligations | 112,627 | 2,354 | -- | 114,981 |
| U.S. Government agency obligations | 8,966 | 26 | -- | 8,992 |
| Total | 121,593 | 2,380 | -- | 123,973 |
| Mortgage-backed securities: | | | | |
| Government National Mortgage Association | 48,347 | 1,517 | -- | 49,864 |
| Federal Home Loan Mortgage Corporation | 205,949 | 5,116 | (6) | 211,059 |
| Federal National Mortgage Association | 4,984 | 181 | -- | 5,165 |
| Collateralized mortgage obligations | 6,193 | 60 | (3) | 6,250 |
| Other | 223 | 12 | -- | 235 |
| Total mortgage-backed securities | 265,696 | 6,886 | (9) | 272,573 |
| Total debt securities | 387,289 | 9,266 | (9) | 396,546 |
| Equity securities | 11,054 | 10,579 | (53) | 21,580 |
| Total securities available for sale | 398,343 | $19,845 | $ (62) | $418,126 |
| Net unrealized gains on securities: available for sale | 19,783 | | | |
| Total securities available for sale, net | 418,126 | | | |
| Total investment securities, net | $418,480 | | | |

3. INVESTMENT SECURITIES (CONTINUED)

The amortized cost and market value of investment securities follows:

<TABLE>
<CAPTION>

| (IN THOUSANDS) AT DECEMBER 31, 1997 | AMORTIZED COST | GROSS UNREALIZED GAINS | GROSS UNREALIZED LOSSES | MARKET VALUE |
|---|---|---|---|---|
| <S> | <C> | <C> | <C> | <C> |
| Securities held to maturity: | | | | |
| Other bonds and obligations | $ 372 | $ -- | $ -- | $ 372 |
| Total securities held to maturity | 372 | -- | -- | 372 |
| Securities available for sale: | | | | |
| Debt securities: | | | | |
| U.S. Treasury obligations | 121,399 | 1,622 | -- | 123,021 |
| U.S. Government agency obligations | 9,800 | 24 | (11) | 9,813 |
| Total | 131,199 | 1,646 | (11) | 132,834 |
| Mortgage-backed securities: | | | | |
| Government National Mortgage Association | 60,493 | 1,247 | (31) | 61,709 |
| Federal Home Loan Mortgage Corporation | 248,744 | 4,257 | (180) | 252,821 |
| Federal National Mortgage Association | 7,733 | 258 | -- | 7,991 |
| Collateralized mortgage obligations | 7,836 | 62 | -- | 7,898 |
| Other | 298 | 14 | -- | 312 |
| Total mortgage-backed securities | 325,104 | 5,838 | (211) | 330,731 |
| Total debt securities | 456,303 | 7,484 | (222) | 463,565 |
| Investments in mutual funds | 1,110 | 4 | -- | 1,114 |
| Equity securities | 9,336 | 8,227 | (18) | 17,545 |
| Total securities available for sale | 466,749 | $15,715 | $(240) | $482,224 |
| Net unrealized gains on securities available for sale | 15,475 | | | |
| Total securities available for sale, net | 482,224 | | | |
| Total investment securities, net | $482,596 | | | |

</TABLE>

During the years ended December 31, 1998, 1997 and 1996, the Company realized gains and losses on sales of securities available for sale as follows:

<TABLE>
<CAPTION>

| (IN THOUSANDS) AT DECEMBER 31, | 1998 | | 1997 | | 1996 | |
|---|---|---|---|---|---|---|
| | REALIZED | | Realized | | Realized | |
| | GAINS | LOSSES | Gains | Losses | Gains | Losses |
| <S> | <C> | <C> | <C> | <C> | <C> | <C> |
| U.S. Treasury obligations | $ 180 | $-- | $ 38 | $ (35) | $ 118 | $(103) |
| Mortgage-backed securities | -- | -- | -- | (301) | -- | (166) |
| Marketable equity securities | 3,577 | (959) | 2,201 | (96) | 1,146 | (45) |
| Other equity securities | -- | -- | 25 | -- | -- | -- |
| Total realized gains (losses) | $3,757 | $(959) | $2,264 | $(432) | $1,264 | $(314) |

</TABLE>

Proceeds from sales of debt securities available for sale during 1998, 1997 and 1996 were $13.1 million, $34.1 million and $40.8 million, respectively. Proceeds from sales of equity securities available for sale during 1998, 1997 and 1996, were $13.7 million, $8.6 million and $9.1 million, respectively.

There were no sales of investment securities held-to-maturity during 1998, 1997 and 1996.

3. INVESTMENT SECURITIES (CONTINUED)

The amortized cost and market value of debt securities held to maturity and debt securities available for sale by contractual maturity are as follows:

| (IN THOUSANDS) AT DECEMBER 31, | 1998 | | 1997 | |
|---|---|---|---|---|
| | AMORTIZED COST | MARKET VALUE | AMORTIZED COST | MARKET VALUE |
| Investment securities held to maturity: | | | | |
| Other bonds and obligations: | | | | |
| Maturing after 1 year but within 5 years | $ 230 | $ 230 | $ 230 | $ 230 |
| Maturing after 5 years but within 10 years | 82 | 82 | 97 | 97 |
| Maturing after 10 years but within 15 years | 42 | 42 | 45 | 45 |
| Total debt securities held to maturity | 354 | 354 | 372 | 372 |
| Investment securities available for sale: | | | | |
| U.S. Treasury obligations: | | | | |
| Maturing within 1 year | 50,876 | 51,260 | 35,869 | 36,001 |
| Maturing after 1 year but within 5 years | 58,790 | 60,557 | 85,530 | 87,020 |
| Maturing after 5 years but within 10 years | 2,961 | 3,164 | -- | -- |
| Total | 112,627 | 114,981 | 121,399 | 123,021 |
| U.S. Government agency obligations: | | | | |
| Maturing within 1 year | 2,000 | 2,006 | 2,000 | 2,006 |
| Maturing after 1 year but within 5 years | 6,771 | 6,788 | 6,600 | 6,614 |
| Maturing after 5 years but within 10 years | -- | -- | 1,000 | 994 |
| Maturing after 15 years | 195 | 198 | 200 | 199 |
| Total | 8,966 | 8,992 | 9,800 | 9,813 |
| Mortgage-backed securities: | | | | |
| Maturing within 1 year | 371 | 367 | 312 | 311 |
| Maturing after 1 year but within 5 years | 6,014 | 6,155 | 8,826 | 8,984 |
| Maturing after 5 years but within 10 years | 35,087 | 36,073 | 30,677 | 31,617 |
| Maturing after 10 years but within 15 years | 219,579 | 225,298 | 279,147 | 283,631 |
| Maturing after 15 years | 4,645 | 4,680 | 6,142 | 6,188 |
| Total | 265,696 | 272,573 | 325,104 | 330,731 |
| Total debt securities available for sale | 387,289 | 396,546 | 456,303 | 463,565 |
| Net unrealized gains on debt securities available for sale | 9,257 | -- | 7,262 | -- |
| Total debt securities available for sale, net carrying value | $396,546 | $396,546 | $463,565 | $463,565 |

Mortgage-backed securities are shown at their contractual maturity but are expected to have shorter average lives due to normal principal amortization and prepayments.





4. TRADING SECURITIES

The amortized cost and market values of trading securities are as follows:

| (In thousands) AT DECEMBER 31, | 1998 | | 1997 | |
|---|---|---|---|---|
| | AMORTIZED COST | MARKET VALUE | AMORTIZED COST | MARKET VALUE |
| U.S. Treasury obligations | $29,690 | $29,707 | $18,548 | $18,542 |
| Investments in mutual funds | 1,112 | 1,086 | 2,757 | 2,718 |

| | | | | |
|---|---|---|---|---|
| Total trading securities | $30,802 | $30,793 | $21,305 | $21,260 |

</TABLE>

During the years ended December 31, 1998, 1997 and 1996, the Company realized gains and losses on sales of trading securities as follows:

<TABLE>
<CAPTION>

| (In thousands) YEARS ENDED DECEMBER 31, | 1998 | | 1997 | | 1996 | |
|---|---|---|---|---|---|---|
| | REALIZED | | REALIZED | | REALIZED | |
| | GAINS | LOSSES | GAINS | LOSSES | GAINS | LOSSES |
| <S> | <C> | <C> | <C> | <C> | <C> | <C> |
| U.S. Treasury obligations | $ 48 | $ -- | $22 | $ -- | $-- | $ -- |
| Investments in mutual funds | 11 | (35) | -- | (33) | -- | (44) |
| Marketable equity securities | 55 | (20) | 46 | -- | 65 | -- |
| Total realized gains (losses) | $114 | $(55) | $68 | $(33) | $65 | $(44) |

</TABLE>

Proceeds from sales of trading securities during 1998, 1997 and 1996 were $50.2 million, $16.3 million and $3.1 million, respectively. Unrealized gains or (losses) included in income in 1998, 1997 and 1996 were $36 thousand, $73 thousand and $(103) thousand, respectively.

5. LOANS

The Bank's lending activities are conducted principally in the local communities in which it operates banking offices, and to a lesser extent, in selected areas of Massachusetts and southern New Hampshire.

The Bank offers single family and multi-family residential mortgage loans, mortgage loans secured by commercial or investment property such as apartment buildings and commercial or corporate facilities, and a variety of consumer loans. The Bank also offers loans for the construction of residential homes, multi-family properties and for land development. Most loans granted by the Bank are either collateralized by real estate or guaranteed by federal or local governmental authorities. The ability of single family residential and consumer borrowers to honor their repayment commitments is generally dependent on the level of overall economic activity within the borrowers' geographic areas. The ability of commercial real estate and construction loan borrowers to honor their repayment commitments is generally dependent on the economic health of the real estate sector in the borrowers' geographic areas and the overall economy.





5. LOANS (continued)

The composition of the Bank's loan portfolio is summarized as follows:

<TABLE>
<CAPTION>

| (In thousands) AT DECEMBER 31, | 1998 | 1997 |
|---|---|---|
| <S> | <C> | <C> |
| Mortgage loans: | | |
| Residential: | | |
| Conventional: | | |
| Fixed rate | $237,979 | $193,319 |
| Variable rate | 42,702 | 50,163 |
| FHA and VA | 1,181 | 1,843 |
| Commercial | 2,257 | 3,861 |
| Construction | 730 | 492 |
| Total mortgage loans | 284,849 | 249,678 |
| Add: premium on loans | 259 | 343 |
| Less: deferred mortgage loan origination fees | (1,454) | (1,223) |
| Mortgage loans, net | 283,654 | 248,798 |
| Other loans: | | |
| Consumer: | | |

| | | |
|---|---|---|
| Installment | 1,547 | 2,199 |
| Guaranteed education | 7,967 | 8,934 |
| Other secured | 1,366 | 1,600 |
| Home equity lines of credit | 10,159 | 10,470 |
| Unsecured | 235 | 266 |
| Total consumer loans | 21,274 | 23,469 |
| Commercial | 61 | 36 |
| Total other loans | 21,335 | 23,505 |
| Total loans | $304,989 | $272,303 |

</TABLE>

In the ordinary course of business, the Bank makes loans to its directors, officers and their associates and affiliated companies ("related parties") at substantially the same terms as those prevailing at the time of origination for comparable transactions with unrelated borrowers. An analysis of total related party loans for the year ended December 31, 1998 follows:

<TABLE>
<CAPTION>

| (In thousands) | |
|---|---|
| <S> | <C> |
| Balance at December 31, 1997 | $340 |
| Additions | 342 |
| Repayments | (120) |
| Balance at December 31, 1998 | $562 |

</TABLE>





6. ALLOWANCE FOR LOAN LOSSES

An analysis of the activity in the allowance for loan losses is as follows:

<TABLE>
<CAPTION>

| (In thousands) YEARS ENDED DECEMBER 31, | 1998 | 1997 | 1996 |
|---|---|---|---|
| <S> | <C> | <C> | <C> |
| Balance at beginning of year | $2,334 | $2,237 | $2,529 |
| Glendale Co-operative Bank acquisition | -- | 105 | -- |
| Provision for loan losses | 193 | 260 | 160 |
| Recoveries of loans previously charged-off | 26 | 59 | 90 |
| Total | 2,553 | 2,661 | 2,779 |
| Less charge-offs: | | | |
| Mortgage loans | (81) | (221) | (480) |
| Other loans | (22) | (106) | (62) |
| Balance at end of year | $2,450 | $2,334 | $2,237 |

</TABLE>

The following table shows the allocation of the allowance for loan losses by category of loans at December 31, 1998, 1997 and 1996.

<TABLE>
<CAPTION>

| (In thousands) AT DECEMBER 31, | 1998 | | 1997 | | 1996 | |
|---|---|---|---|---|---|---|
| | AMOUNT | PERCENTAGE OF LOANS TO TOTAL | AMOUNT | PERCENTAGE OF LOANS TO TOTAL | AMOUNT | PERCENTAGE OF LOANS TO TOTAL |
| <S> | <C> | <C> | <C> | <C> | <C> | <C> |
| Mortgage loans: | | | | | | |
| Residential | $1,786 | 92% | $1,544 | 90% | $1,915 | 88% |
| Commercial | 2 | 1 | 12 | 1 | 3 | 2 |
| Consumer loans | 153 | 7 | 160 | 9 | 119 | 10 |

| | | | | | | |
|---|---|---|---|---|---|---|
| Other loans | 25 | -- | -- | -- | 57 | -- |
| Unallocated | 484 | -- | 618 | -- | 143 | -- |
| Total | $2,450 | 100% | $2,334 | 100% | $2,237 | 100% |

</TABLE>

7. NON-PERFORMING ASSETS

The following schedule summarizes non-performing assets at the dates shown:

<TABLE>
<CAPTION>

| (In thousands) AT DECEMBER 31, | 1998 | 1997 | 1996 |
|---|---|---|---|
| <S> | <C> | <C> | <C> |
| Total nonaccrual loans | $1,004 | $1,771 | $1,601 |
| Total real estate acquired through foreclosure | 86 | -- | 503 |
| Total non-performing assets | $1,090 | $1,771 | $2,104 |
| Percent of non-performing loans to total loans | 0.33% | 0.65% | 0.64% |
| Percent of non-performing assets to total assets | 0.12% | 0.19% | 0.24% |

</TABLE>

The reduction in interest income associated with nonaccrual loans is as follows:

<TABLE>
<CAPTION>

| (In thousands) YEARS ENDED DECEMBER 31, | 1998 | 1997 | 1996 |
|---|---|---|---|
| <S> | <C> | <C> | <C> |
| Interest income that would have been recorded under original terms | $84 | $163 | $149 |
| Interest income actually recorded | 61 | 97 | 78 |
| Reduction in interest income | $23 | $ 66 | $ 71 |

</TABLE>

During 1998, 1997 and 1996 the Company had no impaired loans.





8. FINANCIAL INSTRUMENTS WITH OFF-BALANCE SHEET RISK

The Bank is party to financial instruments with off-balance sheet risk in the normal course of business to meet the financing needs of its customers and to reduce its own exposure to fluctuations in interest rates. These financial instruments include commitments to extend credit and involve, to varying degrees, elements of credit risk in excess of the amount recognized in the consolidated balance sheet. The contract or notional amounts reflect the extent of involvement the Bank has in particular classes of these instruments. The Bank's exposure to credit loss in the event of nonperformance by the other party to the financial instrument is represented by the contractual or notional amount of those instruments. The Bank uses the same credit policies in making commitments and conditional obligations as it does for on-balance sheet instruments.

<TABLE>
<CAPTION>

| | CONTRACT OR NOTIONAL AMOUNT | |
|---|---|---|
| (In thousands) AT DECEMBER 31, | 1998 | 1997 |
| <S> | <C> | <C> |
| Financial instruments whose contract amounts represent credit risk: | | |
| Commitments to originate residential mortgage loans | $ 7,941 | $ 4,090 |
| Unadvanced portions of construction loans | 281 | 496 |
| Unused credit lines, including unused portions of equity lines of credit | 29,163 | 19,445 |

</TABLE>

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

9. PREMISES AND EQUIPMENT

A summary of premises and equipment and their estimated useful lives used for depreciation purposes is as follows:

<TABLE>
<CAPTION>

| (IN THOUSANDS) AT DECEMBER 31, | 1998 | 1997 | ESTIMATED USEFUL LIFE (IN YEARS) |
|---|---|---|---|
| <S> | <C> | <C> | <C> |
| Premises: | | | |
| Land | $1,227 | $1,227 | -- |
| Buildings | 3,637 | 3,642 | 25-45 |
| Building and leasehold improvements | 1,937 | 1,635 | 1-20 |
| Equipment | 3,606 | 3,405 | 1-30 |
| | 10,407 | 9,909 | |
| Less: accumulated depreciation and amortization | 6,087 | 5,540 | |
| Total premises and equipment, net | $4,320 | $4,369 | |

</TABLE>

The Bank is obligated under a number of noncancelable operating leases for various banking offices. These operating leases expire at various dates through 2006 with options for renewal. Rental expenses for the years ended December 31, 1998, 1997 and 1996 amounted to $518 thousand, $522 thousand and $508 thousand, respectively.

The minimum rental commitments, with initial or remaining terms of one year or more exclusive of operating costs and real estate taxes to be paid by the Bank under these leases, as of December 31, 1998, are as follows:

<TABLE>
<CAPTION>

| (In thousands) YEARS ENDING DECEMBER 31, | PAYMENTS |
|---|---|
| <C> | <C> |
| 1999 | $ 465 |
| 2000 | 252 |
| 2001 | 252 |
| 2002 | 165 |
| 2003 | 110 |
| Later years | 98 |
| Total | $1,342 |

</TABLE>





10. DEPOSITS

Deposits are summarized as follows:

<TABLE>
<CAPTION>

| (In thousands) AT DECEMBER 31, | 1998 | | 1997 | |
|---|---|---|---|---|
| | AMOUNT | RATE | AMOUNT | RATE |
| <S> | <C> | <C> | <C> | <C> |
| Demand and NOW: | | | | |
| NOW accounts | $ 52,324 | 1.16% | $ 47,944 | 1.14% |
| Demand accounts | 23,849 | -- | 18,915 | -- |
| Total demand and NOW | 76,173 | 0.80 | 66,859 | 0.82 |
| Savings: | | | | |
| Regular savings and special notice accounts | 326,192 | 3.46 | 329,348 | 3.47 |

| | | | | |
|---|---|---|---|---|
| Money market accounts | 21,857 | 2.99 | 23,527 | 3.09 |
| Total savings | 348,049 | 3.43 | 352,875 | 3.44 |
| Time certificates: | | | | |
| Fixed rate certificates | 318,491 | 5.23 | 316,368 | 5.53 |
| Variable rate certificates | 82,033 | 5.88 | 74,666 | 6.48 |
| Total time certificates | 400,524 | 5.36 | 391,034 | 5.71 |
| Deposit acquisition premium, net of amortization | (715) | -- | (918) | -- |
| Total deposits | $824,031 | 4.13% | $809,850 | 4.32% |

</TABLE>

The maturity distribution and related rate structure of the Bank's time certificates at December 31, 1998 follows:

<TABLE>
<CAPTION>

| (In thousands) AT DECEMBER 31, | 1998 | |
|---|---|---|
| | AMOUNT | AVERAGE INTEREST RATE |
| <S> | <C> | <C> |
| Due within 3 months | $103,985 | 5.34% |
| Due within 3-6 months | 87,696 | 5.10 |
| Due within 6-12 months | 93,181 | 5.41 |
| Due within 1-2 years | 84,874 | 5.48 |
| Due within 2-3 years | 28,843 | 5.77 |
| Due within 3-5 years | 1,789 | 5.38 |
| Thereafter | 156 | 4.92 |
| Total | $400,524 | 5.36% |

</TABLE>

At December 31, the Bank had individual time certificates of deposit of $100 thousand or more maturing as follows:

<TABLE>
<CAPTION>

| (In thousands) AT DECEMBER 31, | 1998 | 1997 |
|---|---|---|
| <S> | <C> | <C> |
| Due within 3 months | $24,283 | $22,757 |
| Due within 3-6 months | 13,338 | 9,298 |
| Due within 6-12 months | 15,511 | 17,969 |
| Due within 1-2 years | 16,997 | 12,293 |
| Due within 2-3 years | 6,759 | 8,602 |
| Due within 3-5 years | 100 | 114 |
| Total | $76,988 | $71,033 |

</TABLE>





11. FAIR VALUE OF FINANCIAL INSTRUMENTS

SFAS No. 107, "Disclosures about Fair Value of Financial Instruments," requires that the Bank disclose estimated fair values for its financial instruments. Fair value estimates, methods, and assumptions are set forth below for the Bank's financial instruments.

CASH AND DUE FROM BANKS, SHORT-TERM INVESTMENTS AND ACCRUED INTEREST RECEIVABLE

The carrying amounts for these financial instruments approximate fair value because they mature in 90 days or less.

INTEREST-BEARING DEPOSITS IN BANKS AND TERM FEDERAL FUNDS SOLD

The carrying amounts of the interest-bearing deposits in banks and term federal funds sold reported in the balance sheet at December 31, 1998 and 1997 approximate fair value.

SECURITIES

The fair value of investment securities is estimated based on bid prices published in financial newspapers or bid quotations received from securities dealers.

Statement 107 specifies that fair values should be calculated based on the value of one unit without regard to any premium or discount that may result from concentrations of ownership of a financial instrument, possible tax ramifications, or estimated transaction costs.

The carrying amount and estimated fair values of the Company's investment securities are as follows:

| (In thousands) AT DECEMBER 31, | 1998 | | 1997 | |
|---|---|---|---|---|
| | CARRYING AMOUNT | CALCULATED FAIR VALUE | CARRYING AMOUNT | CALCULATED FAIR VALUE |
| Securities held to maturity | $ 354 | $ 354 | $ 372 | $ 372 |
| Securities available for sale | 418,126 | 418,126 | 482,224 | 482,224 |
| Trading securities | 30,793 | 30,793 | 21,260 | 21,260 |
| Total securities | $449,273 | $449,273 | $503,856 | $503,856 |

LOANS

Fair values are estimated for portfolios of loans with similar financial characteristics. Loans are segregated by type such as residential mortgage, commercial real estate, consumer and other.

The fair values of residential, commercial, and certain consumer and other loans are calculated by discounting scheduled cash flows through the estimated maturity using estimated market discount rates that reflect the credit and interest rate risk inherent in the loan. The estimate of maturity is based on the Bank's historical experience with repayments for each loan classification, modified, as required, by an estimate of the effect of current economic and lending conditions. For certain variable rate consumer loans, including home equity lines of credit, carrying value approximates fair value. Assumptions regarding credit risk, cash flows, and discount rates are judgmentally determined using available market information.

The following table presents information for loans:

| (In thousands) AT DECEMBER 31, | 1998 | | 1997 | |
|---|---|---|---|---|
| | CARRYING AMOUNT | CALCULATED FAIR VALUE | CARRYING AMOUNT | CALCULATED FAIR VALUE |
| Real estate: | | | | |
| Residential: | | | | |
| Variable | $ 42,617 | $ 43,142 | $ 50,068 | $ 50,709 |
| Fixed | 238,787 | 245,858 | 194,881 | 199,220 |
| Commercial: | | | | |
| Variable | 2,243 | 2,267 | 3,833 | 3,867 |
| Fixed | 7 | 7 | 16 | 16 |
| Consumer and other | 21,335 | 21,564 | 23,505 | 23,438 |
| Total loans | 304,989 | 312,838 | 272,303 | 277,250 |
| Less: allowance for loan losses | (2,450) | -- | (2,334) | -- |
| Net loans | $302,539 | $312,838 | $269,969 | $277,250 |





11. FAIR VALUE OF FINANCIAL INSTRUMENTS (continued)

DEPOSITS

Under Statement 107, the fair value of deposits with no stated maturity, such as demand deposits, NOW accounts, regular savings and special notice accounts, and money market accounts, is equal to the amount payable on demand as of December 31, 1998 and 1997. The fair value of certificates of deposit is based on the discounted value of contractual cash flows. The discount rate is estimated using the rates currently offered for deposits of similar remaining maturities.

<TABLE>
<CAPTION>

| (In thousands) AT DECEMBER 31, | 1998 CARRYING AMOUNT | 1998 CALCULATED FAIR VALUE | 1997 CARRYING AMOUNT | 1997 CALCULATED FAIR VALUE |
|---|---|---|---|---|
| <S> | <C> | <C> | <C> | <C> |
| Demand accounts | $ 23,849 | $ 23,849 | $ 18,915 | $ 18,915 |
| NOW accounts | 52,324 | 52,324 | 47,944 | 47,944 |
| Regular savings and special notice accounts | 326,192 | 326,192 | 329,348 | 329,348 |
| Money market accounts | 21,857 | 21,857 | 23,527 | 23,527 |
| Time certificates | 400,524 | 402,040 | 391,034 | 391,926 |
| Deposit acquisition premium, net of amortization | (715) | -- | (918) | -- |
| Total deposits | 824,031 | 826,262 | 809,850 | 811,660 |
| Escrow deposits of borrowers | 1,438 | 1,438 | 1,502 | 1,502 |
| Total | $825,469 | $827,700 | $811,352 | $813,162 |

</TABLE>

The fair value estimates and the carrying amounts above do not include the benefit that results from the low-cost funding provided by the deposit liabilities compared to the cost of borrowing funds in the market.

COMMITMENTS TO EXTEND CREDIT

The fair value of commitments to extend credit is estimated using the fees currently charged to enter into similar agreements, taking into account the remaining terms of the agreements and the present creditworthiness of the counterparties. For fixed rate loan commitments, fair value also considers the difference between current levels of interest rates and the committed rates.

The Bank estimates the fair value of the cost to terminate commitments to advance funds on construction loans and for residential mortgage loans in the pipeline at December 31, 1998 and 1997 to be immaterial. Unused credit lines, including unused portions of equity lines of credit, are at floating interest rates and therefore there is no fair value adjustment.

LIMITATIONS

Fair value estimates are made at a specific point in time, based on relevant market information and information about the financial instrument. These estimates do not reflect any premium or discount that could result from offering for sale at one time the Bank's entire holdings of a particular financial instrument. Because no active market exists for a significant portion of the Bank's financial instruments, fair value estimates are based on judgments regarding future expected loss experience, current economic conditions, risk characteristics of various financial instruments and other factors. These estimates are subjective in nature and involve uncertainties and matters of significant judgment and therefore cannot be determined with precision. Changes in assumptions could significantly affect the estimates.

Fair value estimates are based on existing on and off-balance sheet financial instruments without attempting to estimate the value of anticipated future business and the value of assets and liabilities that are not considered financial instruments. For example, the Bank has a trust department that contributes net fee income annually. The trust department is not considered a financial instrument, and its value has not been incorporated into the fair value estimates. Other significant assets and liabilities that are not considered financial assets or liabilities include deferred tax liabilities, premises and equipment and goodwill. In addition, the tax ramifications related to the realization of the unrealized gains and losses can have a significant effect on fair value estimates and have not been considered in many of the estimates.





12. INCOME TAXES

Income tax payable was allocated as follows:

<TABLE>
<CAPTION>

| (In thousands) AT DECEMBER 31, | 1998 | 1997 |
|---|---|---|

| | | |
|---|---|---|
| <S> | <C> | <C> |
| Current income tax payable (receivable): | | |
| Federal | $1,010 | $1,192 |
| State | (287) | 48 |
| Total current income tax payable | 723 | 1,240 |
| Deferred income tax payable: | | |
| Federal | 5,298 | 3,735 |
| State | 1,463 | 1,192 |
| Total deferred income tax payable | 6,761 | 4,927 |
| Total income tax payable | $7,484 | $6,167 |

</TABLE>

Income tax expense (benefit) was allocated as follows:

<TABLE>
<CAPTION>

| (In thousands) YEARS ENDED DECEMBER 31, | 1998 | 1997 | 1996 |
|---|---|---|---|
| <S> | <C> | <C> | <C> |
| Current income tax expense: | | | |
| Federal | $5,565 | $5,096 | $4,641 |
| State | 771 | 1,034 | 1,122 |
| Total current tax expense | 6,336 | 6,130 | 5,763 |
| Deferred income tax expense (benefit): | | | |
| Federal | 110 | (102) | 194 |
| State | 40 | (26) | 53 |
| Change in valuation reserve | (4) | (4) | (9) |
| Total deferred tax expense (benefit) | 146 | (132) | 238 |
| Total income tax expense | $6,482 | $5,998 | $6,001 |

</TABLE>

Income tax expense attributable to income from operations for the years ended December 31, differed from the amounts computed by applying the federal income tax rate of 35 percent as a result of the following:

<TABLE>
<CAPTION>

| (In thousands) YEARS ENDED DECEMBER 31, | 1998 | 1997 | 1996 |
|---|---|---|---|
| <S> | <C> | <C> | <C> |
| Computed "expected" income tax expense at statutory rate | $6,089 | $5,658 | $5,400 |
| Increase (reduction) in income taxes resulting from: | | | |
| State and local income taxes, net of federal benefit | 527 | 656 | 764 |
| Dividends received deduction | (87) | (95) | (94) |
| Other | (43) | (217) | (60) |
| Change in valuation reserve | (4) | (4) | (9) |
| Income tax expense | $6,482 | $5,998 | $6,001 |
| Effective income tax rate | 37.26% | 37.10% | 38.90% |

</TABLE>





12. INCOME TAXES (continued)

At December 31, 1998 and 1997, the Bank had gross deferred tax assets and gross deferred tax liabilities as follows:

<TABLE>
<CAPTION>

| (In thousands) YEARS ENDED DECEMBER 31, | 1998 | 1997 |
|---|---|---|
| <S> | <C> | <C> |
| Deferred tax assets: | | |

| | | |
|---|---|---|
| Loan losses | $ 431 | $ 257 |
| Deferred loan fees, net | 100 | 195 |
| Deferred compensation and pension cost | 463 | 546 |
| Depreciation | 33 | 83 |
| Purchase accounting | 419 | 468 |
| Other | 6 | 26 |
| Gross deferred tax asset | 1,452 | 1,575 |
| Deferred tax liabilities: | | |
| Valuation of securities | 8,092 | 6,404 |
| Other unrealized securities gains | 102 | 86 |
| Other | 19 | 12 |
| Gross deferred tax liability | 8,213 | 6,502 |
| Net deferred tax liability | $6,761 | $4,927 |

</TABLE>

Based on the Company's historical and current pretax earnings, management believes it is more likely than not that the Company will realize the gross deferred tax asset existing at December 31, 1998. The primary sources of recovery of the gross federal deferred tax asset are federal income taxes paid in 1998, 1997 and 1996 that are available for carryback and the expectation that the existing net deductible temporary differences will reverse during periods in which the Company generates net taxable income. Since there is no carryback provision for state income tax purposes, management believes the existing net deductible temporary differences which give rise to the gross deferred state income tax asset will reverse during periods in which the Company generates net taxable income. There can be no assurance, however, that the Company will generate any earnings or any specific level of continuing earnings.

As a result of the Tax Reform Act of 1996, the special tax bad debt provisions were amended to eliminate the reserve method. However, the tax effect of the pre-1988 bad debt reserve amount of approximately $7.3 million remains subject to recapture in the event that the Bank pays dividends in excess of its reserves and profits.

13. EARNINGS PER SHARE

The following is a calculation of earnings per share for the years indicated:

<TABLE>
<CAPTION>

| Years Ended December 31, | 1998 | | 1997 | | 1996 | |
|---|---|---|---|---|---|---|
| (In thousands except share data) | Basic | Diluted | Basic | Diluted | Basic | Diluted |
| <S> | <C> | <C> | <C> | <C> | <C> | <C> |
| Net income | $ 10,914 | $ 10,914 | $ 10,167 | $ 10,167 | $ 9,427 | $ 9,427 |
| Average shares outstanding | 3,571,298 | 3,571,298 | 3,575,962 | 3,575,962 | 3,616,769 | 3,616,769 |
| Dilutive stock options | -- | 147,825 | -- | 138,653 | -- | 101,845 |
| Unallocated Employee Stock Ownership Plan ("ESOP") shares not committed to be released | (42,481) | (42,481) | (51,305) | (51,305) | (60,109) | (60,109) |
| Weighted average shares outstanding | 3,528,817 | 3,676,642 | 3,524,657 | 3,663,310 | 3,556,660 | 3,658,505 |
| Earnings per share (in dollars) | $ 3.09 | $ 2.97 | $ 2.88 | $ 2.77 | $ 2.65 | $ 2.58 |

</TABLE>





14. STOCKHOLDERS' EQUITY

The Company may not declare or pay cash dividends on its shares of common stock if the effect thereof would cause its stockholders' equity to be reduced below or to otherwise violate legal or regulatory requirements. Substantially all of the Company's retained earnings are unrestricted at December 31, 1998.

The Bank is a Federal Deposit Insurance Corporation insured institution subject to the FDIC regulatory capital requirements. The FDIC regulations require all FDIC insured institutions to maintain minimum levels of Tier I capital. Highly rated banks (i.e., those with a composite rating of 1 under the CAMELS rating system) are required to maintain a minimum leverage ratio of Tier I capital to total average assets of at least 3.00%. An additional 100 to 200 basis points are required for all but these most highly rated institutions. The Bank is also required to maintain a minimum level of risk-based capital. Under the new risk-based capital standards, FDIC insured institutions must maintain a Tier I capital to risk-weighted assets ratio of 4.00% and are generally expected to meet a minimum total qualifying capital to risk-weighted assets ratio of 8.00%. The new risk-based capital guidelines take into consideration risk factors, as defined by the regulators, associated with various categories of assets, both on and off the balance sheet. Under the guidelines, capital strength is measured in two tiers which are used in conjunction with risk adjusted assets to determine the risk-based capital ratios. Tier II capital components include supplemental capital components such as qualifying allowance for loan losses, qualifying subordinated debt and up to 45 percent of the pretax net unrealized holding gains on certain available for sale equity securities. Tier I capital plus the Tier II capital components are referred to as total qualifying capital.

The capital ratios of the Company and its principal subsidiary "Massbank" set forth below currently exceed the minimum ratios for "well capitalized" banks as defined by federal regulators.

| (IN THOUSANDS) AT DECEMBER 31, 1998 | ACTUAL | | FOR CAPITAL ADEQUACY PURPOSES | | TO BE WELL CAPITALIZED(1) | |
|---|---|---|---|---|---|---|
| | AMOUNT | RATIO | AMOUNT | RATIO | AMOUNT | RATIO |
| TIER I CAPITAL (TO AVERAGE ASSETS): | | | | | | |
| Massbank Corp. (consolidated) | $ 96,696 | 10.61% | $27,349 | 3.00 | N/A | -- |
| Massbank (the "Bank") | 94,305 | 10.34 | 27,349 | 3.00 | $45,583 | 5.00% |
| TIER I CAPITAL (TO RISK-WEIGHTED ASSETS): | | | | | | |
| Massbank Corp. (consolidated) | 96,696 | 32.40 | 11,936 | 4.00 | N/A | -- |
| Massbank (the "Bank") | 94,305 | 31.59 | 11,939 | 4.00 | 17,909 | 6.00 |
| TOTAL CAPITAL (TO RISK-WEIGHTED ASSETS): | | | | | | |
| Massbank Corp. (consolidated) | 103,883 | 34.81 | 23,872 | 8.00 | N/A | -- |
| Massbank (the "Bank") | 101,492 | 34.00 | 23,878 | 8.00 | 29,848 | 10.00 |

(1) This column presents the minimum amounts and ratios that a financial institution must have to be categorized as adequately capitalized.

| (IN THOUSANDS) AT DECEMBER 31, 1997 | ACTUAL | | FOR CAPITAL ADEQUACY PURPOSES | | TO BE WELL CAPITALIZED(1) | |
|---|---|---|---|---|---|---|
| | AMOUNT | RATIO | AMOUNT | RATIO | AMOUNT | RATIO |
| TIER I CAPITAL (TO AVERAGE ASSETS): | | | | | | |
| Massbank Corp. (consolidated) | $92,303 | 10.23% | $27,071 | 3.00% | N/A | -- |
| Massbank (the "Bank") | 88,852 | 9.85 | 27,071 | 3.00 | $45,118 | 5.00% |
| TIER I CAPITAL (TO RISK-WEIGHTED ASSETS): | | | | | | |
| Massbank Corp. (consolidated) | 92,303 | 34.14 | 10,814 | 4.00 | N/A | -- |
| Massbank (the "Bank") | 88,852 | 32.87 | 10,814 | 4.00 | 16,221 | 6.00 |
| TOTAL CAPITAL (TO RISK-WEIGHTED ASSETS): | | | | | | |
| Massbank Corp. (consolidated) | 94,637 | 35.01 | 21,628 | 8.00 | N/A | -- |
| Massbank (the "Bank") | 91,186 | 33.73 | 21,628 | 8.00 | 27,035 | 10.00 |

(1) This column presents the minimum amounts and ratios that a financial institution must have to be categorized as adequately capitalized.





## 15. EMPLOYEE BENEFITS

### PENSION PLAN

The Bank sponsors a noncontributory defined benefit pension plan that covers all employees who meet specified age and length of service requirements, which is administered by the Savings Banks Employees Retirement Association ("SBERA").

The plan provides for benefits to be paid to eligible employees at retirement based primarily upon their years of service with the Bank and compensation levels near retirement. Contributions to the plan reflect benefits attributed to employees' service to date, as well as services expected to be earned in the future. Pension plan assets consist principally of government and agency securities, equity securities (primarily common stocks) and short-term investments.

The following table sets forth the plan's funded status and amounts recognized in the Company's consolidated financial statements for the plan years ended October 31, 1998 and 1997, the plan's latest valuation dates:

<TABLE>
<CAPTION>

| (In thousands) YEARS ENDED DECEMBER 31, | 1998 | 1997 | 1996 |
|---|---|---|---|
| <S> | <C> | <C> | <C> |
| Actuarial present value of vested benefits | $4,442 | $4,028 | $3,636 |
| Total accumulated benefit obligation | 4,481 | 4,063 | 3,661 |
| Change in benefit obligation | | | |
| Projected benefit obligation at beginning of year | $4,990 | $4,287 | $4,622 |
| Service cost | 443 | 367 | 309 |
| Interest cost | 362 | 321 | 308 |
| Actuarial loss (gain) | 283 | 221 | (742) |
| Benefits paid | (290) | (206) | (210) |
| Projected benefit obligation at end of year | $5,788 | $4,990 | $4,287 |
| Change in plan assets | | | |
| Fair value of plan assets at beginning of year | $5,810 | $5,090 | $4,181 |
| Actual return on plan assets | 469 | 926 | 667 |
| Employer contribution | 254 | -- | 452 |
| Benefits paid | (290) | (206) | (210) |
| Fair value of plan assets at end of year | $6,243 | $5,810 | $5,090 |
| Excess of plan assets over projected benefit obligation | $ 455 | $ 820 | $ 803 |

Certain changes in the items shown are not recognized as they occur, but are amortized systematically over subsequent periods. Unrecognized amounts to be amortized and the amounts included in the consolidated balance sheets are shown below:

<CAPTION>

| <S> | <C> | <C> | <C> |
|---|---|---|---|
| Unrecognized net actuarial gain | $ 487 | $ 886 | $ 670 |
| Transition asset | 190 | 211 | 232 |
| Accrued benefit cost | (222) | (277) | (99) |
| Excess of plan assets over projected benefit obligation | $ 455 | $ 820 | $ 803 |
| Assumptions used in determining the actuarial present value of the projected benefit obligation were as follows: | | | |
| Discount rate | 6.75% | 7.25% | 7.50% |
| Rate of compensation increase | 4.50% | 4.50% | 4.50% |
| Assumptions used to develop the net periodic benefit cost data were: | | | |
| Discount rate | 7.25% | 7.50% | 7.00% |
| Expected return on plan assets | 8.00% | 8.00% | 8.00% |
| Rate of compensation increase | 4.50% | 4.50% | 4.50% |
| Components of net periodic benefit cost | | | |
| Service cost | $ 443 | $ 367 | $ 309 |
| Interest cost | 362 | 322 | 308 |
| Expected return on plan assets | (465) | (407) | (335) |
| Transition obligation | (21) | (21) | (21) |
| Recognized net actuarial (gain) loss | (119) | (84) | 7 |
| Net periodic benefit cost | $ 200 | $ 177 | $ 268 |

</TABLE>





15. EMPLOYEE BENEFITS (CONTINUED)

PROFIT SHARING AND INCENTIVE COMPENSATION BONUS PLANS

The Bank's Profit Sharing and Incentive Compensation Bonus Plans provide for payments to employees under certain circumstances based upon a year-end measurement of the Company's net income and attainment of individual goals and objectives by certain key officers. Payments of $399 thousand, $417 thousand and $418 thousand were awarded under the plan in 1998, 1997 and 1996, respectively.

EMPLOYEE STOCK OWNERSHIP PLAN

The Bank has an Employees' Stock Ownership Plan ("ESOP") for the benefit of each employee who has completed at least 1,000 hours of service with the Company in the previous twelve months. Under the plan, the ESOP has borrowed funds from a third party bank to invest in the Company's common stock. As this obligation will be liquidated primarily through future contributions to the ESOP by the Bank, the obligation is reflected as a liability of the Company and a reduction of stockholders' equity on the consolidated balance sheet. As of December 31, 1998 and 1997, such outstanding liabilities totaled $625 thousand and $781 thousand, respectively.

Shares of the Company's common stock purchased with the loan proceeds are held in a suspense account. As the loan is repaid, a proportionate number of shares are released for allocation to plan participants. The shares are allocated to plan participants annually, on a pro rata basis, based on compensation.

The ESOP acquired unallocated shares in 1986 when the plan was first established and more recently in 1993. At December 31, 1998, the ESOP held 35,200 unallocated shares and 123,563 shares which have been allocated to participants. The fair value of the unallocated shares at December 31, 1998 was approximately $1.4 million.

Dividends on unallocated shares are used to offset a portion of the interest paid on the ESOP loan. Dividends on allocated shares held by the ESOP are allocated to plan participants proportionately based on the number of shares in the participant's allocated account.

Total compensation and interest expense applicable to the ESOP amounted to $462 thousand, $398 thousand and $314 thousand for the years ended December 31, 1998, 1997 and 1996, respectively.

EMPLOYEE AGREEMENTS

The Bank has entered into employment agreements with certain executive officers which provide that the officer will receive a minimum amount of annual compensation from the Bank for a specified period. The agreements also provide for the continued payment of compensation to the officer for a specified period after termination under certain circumstances, including if the officer's termination follows a "change of control," generally defined to mean a person or group attaining ownership of 25% or more of the shares of the Company.

EXECUTIVE SUPPLEMENTAL RETIREMENT AGREEMENTS

The Bank maintains executive supplemental retirement agreements for certain executive officers. These agreements provide retirement benefits designed to supplement benefits available through the Bank's retirement plan for employees. Total expenses for benefits payable under the agreements amounted to $105 thousand, $132 thousand and $99 thousand in 1998, 1997 and 1996, respectively.

STOCK OPTION PLAN

Effective May 28, 1986, the Board of Directors of the Bank adopted a stock option plan for the benefit of its officers and other employees. In January, 1991, the plan was amended to authorize the grant of options to non-employee Directors of the Company. All but 42/3 of the 690,000 shares reserved for issuance under the plan were issued. On April 19, 1994, shareholders approved and the Bank adopted the Company's 1994 Stock Incentive Plan. The total number of shares of common stock that can be issued under this plan is 360,000 shares. Both incentive stock options and non-qualified stock options may be granted under the plans. As of December 31, 1998, there were 141,010.7 non-qualified stock options and 206,906.6 incentive stock options granted and outstanding to purchase shares under the plans. The maximum option term is ten years. Further stock options may be granted pursuant to the 1994 Stock Incentive Plan and will generally have an exercise price equal to, or in excess of, the fair market value of a share of common stock of the Company on the date the option is granted.





15. EMPLOYEE BENEFITS (CONTINUED)

A summary of the status of the Company's fixed stock option plan as of December 31, 1998, 1997 and 1996, and changes during the years ended on those dates is presented below:(1)

<TABLE>
<CAPTION>

| YEARS ENDED DECEMBER 31, | 1998 | | 1997 | | 1996 | |
|---|---|---|---|---|---|---|
| FIXED OPTIONS | SHARES UNDER OPTION | WEIGHTED AVERAGE EXERCISE PRICE | SHARES UNDER OPTION | WEIGHTED AVERAGE EXERCISE PRICE | SHARES UNDER OPTION | WEIGHTED AVERAGE EXERCISE PRICE |
| <S> | <C> | <C> | <C> | <C> | <C> | <C> |
| Outstanding at beginning of year | 360,200 | $17.65 | 347,166.7 | $ 15.46 | 369,776 | $13.60 |
| Granted | 35,250 | 44.25 | 48,333.3 | 30.09 | 46,000 | 23.40 |
| Exercised | (47,532) | 15.59 | (35,300) | 13.19 | (68,605.3) | 10.74 |
| Forfeited | (0.7) | 30.09 | -- | -- | (4) | 8.63 |
| Outstanding at end of year | 347,917.3 | $20.62 | 360,200 | $17.65 | 347,166.7 | $15.46 |
| Options exercisable at year-end | 347,917.3 | | 360,200 | | 347,166.7 | -- |

</TABLE>

The following table summarizes information about fixed stock options outstanding and exercisable at December 31, 1998:
<TABLE>
<CAPTION>

| AT DECEMBER 31, 1998 | OPTIONS OUTSTANDING | | | OPTIONS EXERCISABLE | |
|---|---|---|---|---|---|
| RANGE OF EXERCISE PRICES | NUMBER OUTSTANDING | WEIGHTED AVG. REMAINING CONTRACTUAL LIFE | WEIGHTED AVG. EXERCISE PRICE | NUMBER EXERCISABLE | WEIGHTED AVG. EXERCISE PRICE |
| <C> <C> | <C> | <C> | <C> | <C> | <C> |
| $6.88 to $10.75 | 61,700 | 2.6 years | $ 8.66 | 61,700 | $ 8.66 |
| 16.00 to $17.34 | 159,884 | 4.8 years | 16.62 | 159,884 | 16.62 |
| 18.28 to $19.88 | 3,666.7 | 6.5 years | 19.44 | 3,666.7 | 19.44 |
| 23.25 to $44.25 | 122,666.6 | 8.0 years | 31.89 | 122,666.6 | 31.89 |
| $6.88 to $44.25 | 347,917.3 | 5.5 years | $20.62 | 347,917.3 | $20.62 |

</TABLE>

(1) All share information presented has been adjusted to reflect the 4-for-3 and 3-for-2 split of the Company's common stock effective September 15, 1997 and September 9, 1994, respectively.

As discussed in Note 1, the Company adopted SFAS No. 123 on January 1, 1996, but continues to account for its stock option plan using the intrinsic value based method prescribed by APB Opinion No. 25. Accordingly, no compensation cost for this plan has been recognized in the Consolidated Statements of Income for 1998.

In determining the pro forma disclosures required by SFAS No. 123, the fair value of each option grant is estimated on the date of grant using the Black-Scholes option-pricing model. The following table presents pro forma net income and earnings per share assuming the stock option plan was accounted for using the fair value method prescribed by SFAS No. 123, the weighted average assumptions used and the grant date fair value of options granted in 1998, 1997 and 1996:

<TABLE>
<CAPTION>

| (In thousands except per share data) Years Ended December 31, | | 1998 | 1997 | 1996 |
|---|---|---|---|---|
| <S> | | <C> | <C> | <C> |
| Net income | As reported | $ 10,914 | $ 10,167 | $9,427 |
| | Pro forma | 0,743 | 9,916 | 9,230 |
| Basic earnings per share | As reported | $ 3.09 | $ 2.88 | $ 2.65 |
| | Pro forma | 3.04 | 2.81 | 2.60 |
| Diluted earnings per share | As reported | $ 2.97 | $ 2.77 | $ 2.58 |
| | Pro forma | 2.92 | 2.70 | 2.52 |
| Weighted average fair value | | $ 8.23 | $ 8.84 | $ 8.04 |
| Expected life | | 7.3 years | 7.4 years | 7.2 years |
| Risk-free interest rate | | 5.53% | 6.47% | 5.64% |
| Expected volatility | | 23.0% | 22.0% | 23.0% |
| Expected dividend yield | | 2.7% | 2.3% | 2.7% |

</TABLE>





16. SHAREHOLDER RIGHTS AGREEMENT

In January, 1990, the Board of Directors adopted a Shareholders Rights Plan. Under the Plan, the Rights automatically become part of and trade with the Company's shares of common stock. Although the Rights are not exercisable initially, they become exercisable upon the occurrence of one of three triggering events as specified in the Plan. In the event they become exercisable, each holder of a Right would then be entitled to buy a unit consisting of one one-hundredth of a share of the Company's preferred stock at an exercise price of $70. The provisions of the Rights Plan, including the time periods set forth therein, generally may be extended or amended by the Board of Directors. The Rights will expire January 16, 2000, but they may be redeemed at the option of the Board of Directors for $0.01 per Right until ten days after a person becomes a 15% shareholder of Massbank Corp. or until certain other triggering events have occurred.

17. PARENT COMPANY FINANCIAL STATEMENTS

The following are the condensed financial statements for MASSBANK Corp. (the "Parent Company") only:

Balance Sheets

<TABLE>
<CAPTION>

| (In thousands except share data) AT DECEMBER 31, | 1998 | 1997 |
|---|---|---|
| <S> | <C> | <C> |
| Assets: | | |
| Cash | $ 1 | $ 13 |
| Interest-bearing deposits in banks | 2,324 | 3,390 |
| Investment in subsidiaries | 108,724 | 101,109 |
| Due from subsidiaries | 45 | -- |
| Other assets | 53 | 77 |
| Total assets | $111,147 | $104,589 |
| Liabilities: | | |
| Employee stock ownership plan liability (Note 15) | $ 625 | $ 781 |
| Other liabilities | 33 | 29 |
| Total liabilities | 658 | 810 |
| Stockholders' equity (Notes 12, 14, 15 and 16): | | |
| Preferred stock, par value $1.00 per share; | -- | -- |
| 2,000,000 shares authorized, none issued | -- | -- |
| Common stock, par value $1.00 per share; 10,000,000 shares authorized, 7,384,332 and 7,336,800 shares issued, respectively | 7,384 | 7,337 |
| Additional paid-in capital | 60,003 | 58,737 |
| Retained earnings | 78,308 | 70,984 |
| | 145,695 | 137,058 |
| Treasury stock at cost, 3,885,222 and 3,766,022 shares, respectively | (46,272) | (41,569) |
| Accumulated other comprehensive income (Note 1) | 11,691 | 9,071 |
| Common stock acquired by ESOP (Note 15) | (625) | (781) |
| Total stockholders' equity | 110,489 | 103,779 |
| Total liabilities and stockholders' equity | $111,147 | $104,589 |

</TABLE>





17. PARENT COMPANY FINANCIAL STATEMENTS (CONTINUED)

STATEMENTS OF INCOME

<TABLE>
<CAPTION>

| (In thousands) YEARS ENDED DECEMBER 31, | 1998 | 1997 | 1996 |
|---|---|---|---|
| Income: | | | |
| Dividends received from subsidiaries | $ 6,400 | $ 6,400 | $5,750 |
| Interest and dividend income | 96 | 56 | 20 |
| Total interest and dividend income | 6,496 | 6,456 | 5,770 |
| Non-interest expense | 99 | 118 | 103 |
| Income before income taxes | 6,397 | 6,338 | 5,667 |
| Income tax benefit | 28 | 40 | 14 |
| Income before equity in undistributed earnings of subsidiaries | 6,425 | 6,378 | 5,681 |
| Equity in undistributed earnings of subsidiaries | 4,489 | 3,789 | 3,746 |
| Net income | $10,914 | $10,167 | $9,427 |

The Parent Company only Statements of Changes in Stockholders' Equity are identical to the consolidated statements and therefore are not presented here.

STATEMENTS OF CASH FLOWS

| (In thousands) YEARS ENDED DECEMBER 31, | 1998 | 1997 | 1996 |
|---|---|---|---|
| Cash flows from operating activities: | | | |
| Net income | $10,914 | $10,167 | $ 9,427 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | | |
| Equity in undistributed earnings of subsidiaries | (4,489) | (3,789) | (3,746) |
| Decrease in other assets | -- | -- | 25 |
| Increase (decrease) in accrued income taxes payable | 25 | (59) | (21) |
| Deferred income tax benefit | (1) | (4) | (2) |
| Increase in other liabilities | 4 | 13 | 6 |
| Increase in amount due from subsidiaries | (45) | -- | -- |
| Decrease in amount due to subsidiaries | -- | (3) | (121) |
| Net cash provided by operating activities | 6,408 | 6,325 | 5,568 |
| Cash flow from financing activities: | | | |
| Payments to acquire treasury stock | (4,703) | (1,665) | (3,534) |
| Issuance of common stock under stock option plan | 741 | 467 | 738 |
| Tax benefit resulting from stock options exercised | 66 | -- | 28 |
| Dividends paid on common stock | (3,605) | (3,124) | (2,459) |
| Tax benefit resulting from dividends paid on unallocated shares held by the ESOP | 15 | 15 | 15 |
| Net cash used in financing activities | (7,486) | (4,307) | (5,212) |
| Net change in cash and cash equivalents | (1,078) | 2,018 | 356 |
| Cash and cash equivalents at beginning of year | 3,403 | 1,385 | 1,029 |
| Cash and cash equivalents at end of year | $ 2,325 | $ 3,403 | $ 1,385 |

During the years ended December 31, 1998, 1997 and 1996, the Company made cash payments for income taxes of $24 thousand, $16 thousand and $23 thousand, respectively, and no payments for interest.

In addition, the Company made cash payments to the state of Delaware for franchise taxes in the amount of $29 thousand, $42 thousand and $41 thousand during the years ended December 31, 1998, 1997 and 1996, respectively.





18. TEN-YEAR STATISTICAL SUMMARY (UNAUDITED)

| (In thousands except per share data) YEARS ENDED DECEMBER 31, | 1998 | 1997 | 1996 | 1995 | 1994 | 1993 | 1992 | 1991 | 1990 | 1989 |
|---|---|---|---|---|---|---|---|---|---|---|

| | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| Net income | $10,914 | $10,167 | $9,427 | $ 8,759 | $8,185 | $6,695 | $ 4,677 | $ 2,250 | $ 725 | $2,668 |
| Basic earnings per share(2) | 3.09 | 2.88 | 2.65 | 2.43 | 2.19 | 1.71 | 1.22 | 0.59 | 0.16 | 0.50 |
| Cash dividends declared per share(2) | 1.02 | 0.88 1/2 | 0.69 | 0.54 3/4 | 0.45 | 0.34 | 0.26 1/2 | 0.22 1/4 | 0.22 | 0.21 |
| Book value per share, at year end(2) | 31.58 | 29.06 | 25.75 | 24.84 | 20.09 | 20.46 | 18.37 | 17.54 | 16.20 | 15.16 |
| Return on average assets | 1.17% | 1.12% | 1.08% | 1.04% | 0.96% | 0.79% | 0.61% | 0.60% | 0.23% | 0.86% |
| Return on average realized equity(1) | 11.08% | 11.11% | 11.01% | 10.81% | 10.62% | 8.98% | 6.79% | 3.39% | 1.03% | 3.38% |

</TABLE>

(1) Excludes average net unrealized gains or losses on securities available for sale.

(2) All share information presented has been adjusted to reflect the 4-for-3 and 3-for-2 split of the Company's common stock effective September 15, 1997 and September 9, 1994, respectively.

19. QUARTERLY DATA (UNAUDITED)

<TABLE>
<CAPTION>

| YEARS ENDED DECEMBER 31, | 1998 | | | | 1997 | | | |
|---|---|---|---|---|---|---|---|---|
| (In thousands except per share data) | 4th Quarter | 3rd Quarter | 2nd Quarter | 1st Quarter | 4th Quarter | 3rd Quarter | 2nd Quarter | 1st Quarter |
| <S> | <C> | <C> | <C> | <C> | <C> | <C> | <C> | <C> |
| Interest and dividend income | $14,721 | $14,995 | $15,025 | $15,093 | $15,496 | $15,460 | $15,017 | $14,760 |
| Interest expense | 8,534 | 8,703 | 8,562 | 8,521 | 8,840 | 8,937 | 8,555 | 8,349 |
| Net interest income | 6,187 | 6,292 | 6,463 | 6,572 | 6,656 | 6,523 | 6,462 | 6,411 |
| Provision for loan losses | 88 | 15 | 45 | 45 | 95 | 45 | 52 | 68 |
| Net interest income after provision for loan losses | 6,099 | 6,277 | 6,418 | 6,527 | 6,561 | 6,478 | 6,410 | 6,343 |
| Non-interest income | 1,447 | 796 | 1,101 | 1,246 | 882 | 886 | 1,136 | 894 |
| Non-interest expense | 3,269 | 2,871 | 3,119 | 3,256 | 3,115 | 3,191 | 3,924 | 3,195 |
| Income before income taxes | 4,277 | 4,202 | 4,400 | 4,517 | 4,328 | 4,173 | 3,622 | 4,042 |
| Income tax expense | 1,598 | 1,507 | 1,694 | 1,683 | 1,672 | 1,584 | 1,173 | 1,569 |
| Net income | $ 2,679 | $ 2,695 | $ 2,706 | $ 2,384 | $ 2,656 | $ 2,589 | $ 2,449 | $ 2,473 |
| Earnings per share (in dollars):(1) | | | | | | | | |
| Basic | $ 0.77 | $ 0.76 | $ 0.76 | $ 0.80 | $ 0.75 | $ 0.74 | $ 0.69 | $ 0.70 |
| Diluted | 0.74 | 0.73 | 0.73 | 0.77 | 0.72 | 0.70 | 0.67 | 0.68 |
| Weighted average common shares outstanding:(1) | | | | | | | | |
| Basic | 3,487 | 3,548 | 3,546 | 3,535 | 3,521 | 3,520 | 3,529 | 3,530 |
| Diluted | 3,610 | 3,692 | 3,709 | 3,697 | 3,683 | 3,671 | 3,653 | 3,647 |

</TABLE>

(1) Computation of earnings per share is further described in Note 1.





MASSBANK CORP. AND SUBSIDIARIES STOCKHOLDER DATA

YEARS ENDED DECEMBER 31, 1998 AND 1997

MASSBANK Corp.'s common stock is currently traded on the Nasdaq Stock Market under the symbol "MASB." At December 31, 1998 there were 3,499,110 shares outstanding and 925 shareholders of record. Shareholders of record do not reflect the number of persons or entities who hold their stock in nominee or "street" name.

The following table includes the quarterly ranges of high and low sales prices for the common stock, as reported by Nasdaq, and dividends declared per share for the periods indicated.

<TABLE>
<CAPTION>

| | PRICE PER SHARE(1) | CASH DIVIDENDS |
|---|---|---|

| | HIGH | LOW | DECLARED |
|---|---|---|---|
| YEAR ENDED DECEMBER 31, | 1998 | | |
| <S> | <C> | <C> | <C> |
| Fourth Quarter | 40 1/2 | 29 1/2 | $ 0.27 |
| Third Quarter | 50 3/4 | 38 3/4 | 0.25 |
| Second Quarter | 54 1/4 | 47 1/2 | 0.25 |
| First Quarter | 51 1/4 | 43 3/4 | 0.25 |
| YEAR ENDED DECEMBER 31, | 1997 | | |
| Fourth Quarter | 48 1/4 | 41 | $ 0.24 |
| Third Quarter | 47 1/2 | 35 5/8 | 0.24 |
| Second Quarter | 35 13/16 | 29 29/32 | 0.2025 |
| First Quarter | 31 7/8 | 28 1/8 | 0.2025 |

</TABLE>

(1) Stock prices have been adjusted to reflect the 4-for-3 split of the Company's common stock effective September 15, 1997.





MASSBANK BRANCH OFFICES d/b/a

MASSBANK of Reading*

123 Haven Street
Reading, MA 01867
(781) 942-8188
(978) 446-9200

MASSBANK of Chelmsford

296 Chelmsford Street
Eastgate Plaza
Chelmsford, MA 01824
(978) 256-3751

17 North Road
Chelmsford, MA 01824
(978) 256-3733

MASSBANK of Dracut

45 Broadway Road
Dracut, MA 01826
(978) 441-0040

MASSBANK of Everett

738 Broadway
Everett, MA 02149
(617) 387-5115

MASSBANK of Lowell

50 Central Street
Lowell, MA 01852
(978) 446-9200

755 Lakeview Avenue
Lowell, MA 01850
(978) 446-9216

MASSBANK of Medford

4110 Mystic Valley Parkway
Wellington Circle Plaza
Medford, MA 02155
(781) 395-4899

MASSBANK of Melrose

476 Main Street
Melrose, MA 02176
(781) 662-0100

27 Melrose Street
Towers Plaza
Melrose, MA 02176
(781) 662-0165

MASSBANK of Stoneham

240 Main Street
Stoneham, MA 02180
(781) 662-0177

MASSBANK of Tewksbury

1800 Main Street
Tewksbury, MA 01876
(978) 851-0300

MASSBANK of Westford

203 Littleton Road
Westford, MA 01886
(978) 692-3467

MASSBANK of Wilmington

370 Main Street
Wilmington, MA 01887
(978) 658-4000

219 Lowell Street
Lucci's Plaza
Wilmington, MA 01887
(978) 658-5775

* Main Office

CORPORATE INFORMATION

<TABLE>

| <S> | <C> | <C> |
|---|---|---|
| MASSBANK CORP. | Form 10-K | Independent Auditors |
| 123 Haven Street<br>Reading, MA 01867<br>(781) 662-0100<br>(978) 446-9200<br>FAX (781) 942-1022 | Shareholders may obtain without charge a copy of the Company's 1998 Form 10-K. Written requests should be addressed to:<br>Shareholder Services<br>Massbank Corp.<br>159 Haven Street<br>Reading, MA 01867 | KPMG Peat Marwick LLP<br>99 High Street<br>Boston, MA 02110<br><br>Legal Counsel<br><br>Goodwin, Procter & Hoar<br>Exchange Place<br>Boston, MA 02109 |
| Savings and Mortgage<br>24-Hour-Rate Lines<br>(781) 662-0154<br>(978) 446-9285 | Dividend Reinvestment and Stock Purchase Plan | Reports on Effectiveness of Internal Control Structure Over Financial Reporting |
| Notice of Shareholders' Meeting<br><br>The Annual Meeting of the Shareholders of Massbank Corp. will be held at 10:00 A.M. on Tuesday, April 20, 1999 at the<br>Tara Ferncroft Conference Center<br>50 Ferncroft Road<br>Danvers, MA 01923 | Shareholders may obtain a brochure containing a detailed description of the plan by writing to:<br>Shareholder Services<br>Massbank Corp.<br>159 Haven Street<br>Reading, MA 01867 | Shareholders may obtain without charge a copy of Management's and the Independent Auditors' 1998 Reports on the Effectiveness of the Company's Internal Control Structure Over Financial Reporting. Written requests should be addressed to:<br>Shareholder Services<br>Massbank Corp.<br>159 Haven Street<br>Reading, MA 01867 |
| Trademark<br><br>MASSBANK and its logo are registered trademarks of the Company | Transfer Agent<br><br>EquiServe<br>Boston EquiServe Division<br>Shareholder Services<br>P.O. Box 644<br>Boston, MA 02102-0644 | |

</TABLE>





OFFICERS AND DIRECTORS
MASSBANK CORP.

<TABLE>

| <S> | <C> | <C> |
|---|---|---|
| OFFICERS | BOARD OF DIRECTORS | *Robert S. Cummings<br>Senior Partner, Peabody and Brown |
| Gerard H. Brandi<br>Chairman, President and Chief Executive Officer | Samuel Altschuler<br>Executive Vice President and Director,<br>Sanmina Corp. | Louise A. Hickey<br>Retired, Melrose-Wakefield Hospital |
| Reginald E. Cormier<br>Vice President, Treasurer and Chief Financial Officer | *Mathias B. Bedell<br>Retired, Bedell Brothers Insurance Agency, Inc. | Leonard Lapidus<br>United States Government Official |
| Robert S. Cummings<br>Secretary | *Gerard H. Brandi<br>Chairman, President and Chief Executive Officer,<br>MASSBANK Corp. | *Stephen E. Marshall<br>President, C.H. Cleaves Insurance Agency, Inc. |
| Donna H. West<br>Assistant Secretary | | +Arthur W. McPherson<br>Certified Financial Planner |
| | Allan S. Bufferd<br>Treasurer,<br>Massachusetts Institute of Technology | Nancy L. Pettinelli<br>Executive Director,<br>Visiting Nurse Association |
| | +Peter W. Carr<br>Retired, Guilford Transportation Industries | +*Herbert G. Schurian<br>Certified Public Accountant |
| | | *Dr. Donald B. Stackhouse<br>Dentist |
| | Alexander S. Costello<br>Editorial Page Editor,<br>Lowell Sun Publishing Co., Inc. | *Member, Executive Committee<br>+Member, Audit Committee |

OFFICERS AND DIRECTORS

MASSBANK

OFFICERS

Gerard H. Brandi
Chairman, President and
Chief Executive Officer

Donald R. Washburn
Senior Vice President, Lending

Donna H. West
Senior Vice President,
Community Banking

Reginald E. Cormier
Vice President, Treasurer
and Chief Financial Officer

David F. Carroll
Vice President, Operations

Thomas J. Queeney
Vice President and
Senior Trust Officer

Marilyn H. Abbott
Assistant Treasurer

Andrea S. Bradford
Assistant Vice President

Gregory W. Bowe
Assistant Vice President

Ernest G. Campbell, Jr.
Collections Officer

Marianne J. Carpenter
Assistant Treasurer

Charles F. Coupe
Information Officer

Janet L. Daniels
Assistant Vice President
Aunali Dohadwala
Auditor

Karen J. Downs
Assistant Treasurer

Karen L. Flammia
Assistant Vice President

Melissa J. Flanagan
Assistant Treasurer

Richard J. Flannigan
Vice President, Trust

Ana M. Foster
Compliance and
Security Officer

Gerard F. Frechette
Loan Officer

Rachael E. Garneau
Assistant Treasurer

Margo E. Higgins
Assistant Vice President
and Human Resources Officer

Brian W. Hurley
Assistant Vice President

Kenneth A. Masson
Assistant Vice President

Mindy S. Peloquin
Assistant Treasurer

Renald A. Robillard
Assistant Treasurer

Lisa A. Sawyer
Assistant Treasurer

Alice B. Sweeney
Assistant Comptroller

Richard A. Tatarczuk
Assistant Vice President
and Comptroller

Francis J. Walsh
Operations Officer

Margaret E. White
Assistant Treasurer

Patricia A. Witts
Assistant Treasurer

Michael J. Woods
Assistant Vice President

BOARD OF DIRECTORS AND
EXECUTIVE COMMITTEE

Mathias B. Bedell
Gerard H. Brandi, Chairman
Robert S. Cummings, Clerk
Stephen E. Marshall
Herbert G. Schurian
Dr. Donald B. Stackhouse
Donna H. West

</TABLE>

Exhibit 22

List of Subsidiaries of MASSBANK Corp.

MASSBANK Corp. is the parent company of:

MASSBANK (the "Bank")

MASSBANK has three wholly-owned subsidiaries:

Readibank Properties, Inc.
Readibank Investment Corporation
Melbank Investment Corporation

Exhibit 23

CONSENT OF INDEPENDENT AUDITORS

The Board of Directors
MASSBANK Corp.:

We consent to incorporation by reference in the Registration Statements (No. 33-11949 and No. 33-82110) on Form S-8 of MASSBANK Corp. of our report dated January 11, 1999, relating to the consolidated balance sheets of MASSBANK Corp. and subsidiaries as of December 31, 1998 and 1997, and the related consolidated statements of income, changes in stockholders' equity and cash flows for each of the years in the three-year period ended December 31, 1998, which report appears in the December 31, 1998, annual report on Form 10-K of MASSBANK Corp.

/s/ KPMG Peat Marwick LLP

Boston, Massachusetts
March 26, 1999

<TABLE> <S> <C>

<ARTICLE> 9
<CIK> 0000799166
<NAME> MASSBANK CORP.
<MULTIPLIER> 1,000

| <S> | <C> |
|---|---|
| <PERIOD-TYPE> | 12-MOS |
| <FISCAL-YEAR-END> | DEC-31-1998 |
| <PERIOD-START> | JAN-01-1998 |
| <PERIOD-END> | DEC-31-1998 |
| <CASH> | 7,038 |
| <INT-BEARING-DEPOSITS> | 2,033 |
| <FED-FUNDS-SOLD> | 148,207 |
| <TRADING-ASSETS> | 30,793 |
| <INVESTMENTS-HELD-FOR-SALE> | 418,126 |
| <INVESTMENTS-CARRYING> | 354 |
| <INVESTMENTS-MARKET> | 354 |
| <LOANS> | 304,989 |
| <ALLOWANCE> | (2,450) |
| <TOTAL-ASSETS> | 946,625 |
| <DEPOSITS> | 824,031 |
| <SHORT-TERM> | 1,438 |
| <LIABILITIES-OTHER> | 10,042 |
| <LONG-TERM> | 625 |
| <PREFERRED-MANDATORY> | 0 |
| <PREFERRED> | 0 |
| <COMMON> | 7,384 |
| <OTHER-SE> | 103,105 |
| <TOTAL-LIABILITIES-AND-EQUITY> | 946,625 |
| <INTEREST-LOAN> | 21,434 |
| <INTEREST-INVEST> | 29,625 |
| <INTEREST-OTHER> | 8,775 |
| <INTEREST-TOTAL> | 59,834 |
| <INTEREST-DEPOSIT> | 34,320 |
| <INTEREST-EXPENSE> | 34,320 |
| <INTEREST-INCOME-NET> | 25,514 |
| <LOAN-LOSSES> | 193 |
| <SECURITIES-GAINS> | 2,893 |
| <EXPENSE-OTHER> | 12,515 |
| <INCOME-PRETAX> | 17,396 |
| <INCOME-PRE-EXTRAORDINARY> | 17,396 |
| <EXTRAORDINARY> | 0 |
| <CHANGES> | 0 |
| <NET-INCOME> | 10,914 |
| <EPS-PRIMARY> | 3.09 |
| <EPS-DILUTED> | 2.97 |
| <YIELD-ACTUAL> | 2.81 |

| | |
|---|---|
| <LOANS-NON> | 1,004 |
| <LOANS-PAST> | 0 |
| <LOANS-TROUBLED> | 0 |
| <LOANS-PROBLEM> | 1,004 |
| <ALLOWANCE-OPEN> | 2,334 |
| <CHARGE-OFFS> | (103) |
| <RECOVERIES> | 26 |
| <ALLOWANCE-CLOSE> | 2,450 |
| <ALLOWANCE-DOMESTIC> | 1,966 |
| <ALLOWANCE-FOREIGN> | 0 |
| <ALLOWANCE-UNALLOCATED> | 484 |

</TABLE>