

HIGHLANDS STATE BANK

310 Route 94
Vernon, NJ 07462

NOTICE OF ANNUAL MEETING OF STOCKHOLDERS

To Be Held on April 30, 2010

NOTICE IS HEREBY GIVEN that the Annual Meeting (the "Annual Meeting") of the holders of shares of Common Stock (the "Common Stock") of Highlands State Bank (the "Bank") will be held at the main offices of the Bank, 310 Route 94, Vernon, New Jersey 07462, on April 30, 2010 at 4:00 p.m. for the purpose of considering and voting upon the following matters, all of which are more completely set forth in the accompanying Proxy Statement:

1. The election of thirteen (13) Directors of the Bank to serve for the terms described in the proxy statement and until their successors are elected and shall qualify;
2. An Amendment to the Bank's Certificate of Incorporation to clarify certain terms and conditions of the Bank's Series A Preferred Stock previously issued to the United States Treasury, as described more fully in the accompanying Proxy Statement;
3. Approval of the of the Plan of Acquisition, whereby the holding company, Highlands Bancorp, Inc., will acquire 100% of the outstanding stock of the Bank, as more fully described in the accompanying Proxy Statement;
4. To consider and approve the following advisory (non-binding) proposal:

"Resolved, that the shareholders approve the executive compensation of the Bank, as described in the tabular disclosure regarding named executive officer compensation (together with the accompanying narrative disclosure) contained in this Proxy Statement"; and

5. Such other business as shall properly come before the Annual Meeting.

Holders of shares of Common Stock of record at the close of business on March 12, 2010 will be entitled to vote at the Annual Meeting or any postponement or adjournment.

You are requested to fill in, sign, date and return the enclosed proxy promptly, regardless of whether you expect to attend the Annual Meeting. A postage-paid return envelope is enclosed for your convenience.

If you are present at the Annual Meeting, you may vote in person even if you have already returned your proxy.

BY ORDER OF THE BOARD OF DIRECTORS

/s/ George E. Irwin

George E. Irwin
President & CEO

Vernon, New Jersey
April 7, 2010

IMPORTANT-PLEASE MAIL YOUR PROXY PROMPTLY

You are urged to sign and return the enclosed Proxy promptly in the envelope provided so that there may be sufficient representation at the Annual Meeting.

Important Notice Regarding the Availability of Proxy Materials for the Shareholder Meeting to be Held on April 30, 2010. Our Proxy Statement and Annual Report to Shareholders are also available on line at <http://www.highlandsstatebank.com>.

**HIGHLANDS STATE BANK
PROXY STATEMENT FOR
ANNUAL MEETING OF STOCKHOLDERS
TO BE HELD ON APRIL 30, 2010**

This Proxy Statement is being furnished to shareholders of Highlands State Bank in connection with the solicitation by the Board of Directors of proxies to be used at the Annual Meeting of stockholders to be held on April 30, 2010 at 4:00 p.m., at the main offices of the Bank, 310 Route 94, Vernon, New Jersey 07462.

About the Annual Meeting

Why have I received these materials?

The accompanying proxy, being mailed to shareholders on or about April 7, 2010, is solicited by the Board of Directors of Highlands State Bank (referred to throughout this Proxy Statement as the "Bank" or "we") in connection with our Annual Meeting of Shareholders that will take place on Friday, April 30, 2010. You are cordially invited to attend the Annual Meeting and are requested to vote on the proposals described in this Proxy Statement.

Who is entitled to vote at the Annual Meeting?

Holders of Common Stock of the Bank (the "Common Stock") as of the close of business on March 12, 2010 will be entitled to vote at the Annual Meeting. On March 12, 2010, there were outstanding and entitled to vote 1,788,262 shares of Common Stock, each of which is entitled to one vote with respect to each matter to be voted on at the Annual Meeting.

How do I vote my shares at the Annual Meeting?

If you are a "record" shareholder of Common Stock (that is, if you hold Common Stock in your own name in the Bank's stock records maintained by our transfer agent, Registrar and Transfer Company), you may complete and sign the accompanying proxy card and return it to the Bank or deliver it in person.

"Street name" shareholders of Common Stock (that is, shareholders who hold Common Stock through a broker or other nominee) who wish to vote at the Annual Meeting will need to obtain a proxy form from the institution that holds their shares and to follow the voting instructions on such form.

Can I change my vote after I return my proxy card?

Yes. After you have submitted a proxy, you may change your vote at any time before the proxy is exercised by submitting a notice of revocation or a proxy bearing a later date. You may change your vote either by submitting a proxy card prior to the date of the Annual Meeting or if you are a "record" holder of the Common Stock by voting in person at the Annual Meeting.

What constitutes a quorum for purposes of the Annual Meeting?

The presence at the Annual Meeting in person or by proxy of the holders of a majority of the voting power of all outstanding shares of Common Stock entitled to vote shall constitute a quorum for the transaction of business. Proxies marked as abstaining (including proxies containing broker non-votes) on any matter to be acted upon by shareholders will be treated as present at the meeting for purposes of determining a quorum but will not be counted as votes cast on such matters.

What vote is required to approve each item?

The election of directors at the Annual Meeting requires the affirmative vote of a plurality of the votes cast at the Annual Meeting. The affirmative vote of two-thirds (2/3) of the Bank's outstanding common stock is required to adopt the amendment to the Bank's certificate of incorporation and to approve the plan of acquisition. Approval of the advisory proposal on executive compensation requires the vote of a majority of those shares voting at the Annual Meeting.

Summary of the Proposals

How does the Board recommend that I vote my shares?

Unless you give other instructions on your proxy card, the persons named as proxies on the card will vote in accordance with the recommendations of the Board of Directors. The Board's recommendation is set forth together with the description of each item in this Proxy Statement. In summary, the Board recommends a vote:

- FOR** the directors' nominees to the Board of Directors;
- FOR** approval of the Plan of Acquisition;
- FOR** approval of the amendment to the Certificate of Incorporation; and
- FOR** approval of the advisory proposal on executive compensation.

With respect to any other matters that properly come before the Annual Meeting, the proxy holders will vote as recommended by the Board of Directors or, if no recommendation is given, in their own discretion in the best interests of the Bank. At the date this Proxy Statement went to press, the Board of Directors had no knowledge of any business other than that described in this proxy statement that would be presented for consideration at the Annual Meeting.

Who will bear the expense of soliciting proxies?

The Bank will bear the cost of soliciting proxies. In addition to the solicitation by mail, proxies may be solicited personally or by telephone, facsimile or electronic transmission by our employees. We may reimburse brokers holding Common Stock in their names or in the names of their nominees for their expenses in sending proxy materials to the beneficial owners of such Common Stock.

**PROPOSAL 1 -
ELECTION OF DIRECTORS**

The By-Laws of the Bank provide that the number of Directors shall not be less than five or more than twenty five and permit the exact number to be determined from time to time by the Board of Directors. We currently have fourteen members of our Board.

Since our last annual meeting, both Peter J. Confranceso and Terrence A. Duddy, DDS resigned from the Board of Directors. In addition, Mr. Paul F. Castellano has informed the Board that he would not stand for reelection at the 2010 Annual Meeting of Shareholders. Each of Mr. Confranceso, Dr. Duddy, and Mr. Castellano determined to leave the Board of Directors so as to devote more time to their personal business ventures. The size of the Board will therefore be reduced to thirteen members.

The Board of Directors of the Bank has nominated for election to the Board of Directors the persons named below, each of whom is currently serving as a member of the Board. The following table sets forth the names, ages, principal occupations, and business experience and qualifications for all nominees, as well as their prior service on the Board. Each nominee is currently a member of the Board of Directors of the Bank. Unless otherwise indicated, principal occupations shown for each Director have extended for five or more years.

NOMINEES FOR ELECTION

Name and Position with the Bank	Age	Principal Occupation for Past Five Years	Term of Office Commenced:
John V. Bosma Director	43	President and manager/estimator of Boz Electrical Contractors, Inc. (electrical contractor), Vernon, NJ.	2005
E. Jane Brown Director	62	Chief Financial Officer, Pope John XXIII High School, Sparta, NJ.	2008
George E. Irwin Director, President, CEO	66	President and Chief Executive Officer of the Bank since 2005; Director, American Bankers Professional Insurance Company (mutual insurance company) from 1999-2004.	2005
Andrew J. Mulvihill Director	47	President, Mountain Resort Properties (real estate brokerage), Vernon, NJ; Executive, Crystal Springs Builders LLC, Crystal Springs Development LLC, Crystal Springs Resort Development LLC and affiliates (real estate developer/builders), Vernon, NJ	2005
Steven V. Oroho Director	51	New Jersey State Senator, District 24; also Certified Financial Planner, Stonebridge Capital Management, West Caldwell, NJ.	2008
Jeffrey M. Parrott Vice-Chairman	54	President/CEO of Parr Homes, Inc., t/a Neil Parrott Real Estate (real estate brokerage), Wantage, NJ.	2008
Dov Perlysky Director	47	Managing Member, Neshor, LLC (private investment firm) since 2000; Director, Engex, Inc. (closed-end mutual fund); Director, Pharma-Bio Serv, Inc. (pharmaceutical services); Director, Florham Consulting Corp.; Vice President of Private Client Group, Laidlaw Global Securities (registered broker-dealer) from 1998-2002.	2006
Edward H. Rolando Director	67	General Manager, Earth-Tec Associates (site and utility contractor), Vernon, NJ.	2005

Charles H. Shotmeyer Director	46	President, Shotmeyer Bros Petroleum Corp.; previously Chief Financial Officer, Van Dyk Health Care, Inc. (assisted living services), Hawthorne, NJ.	2006
Martin Theobald Director	58	Owner, Heaven Hill Farm (retail garden center and farm market), in Vernon, NJ.	2005
Douglas Verduin Director	54	Certified Public Accountant and member, Berry, Verduin & Koch, LLC (certified public accountants), Ridgewood, NJ.	2005
Harold J. Wirths Director	44	Investor (self-employed); Owner, The Oak Shoppe (retail furniture store) from 1986 until 2004.	2008
Bruce D. Zaretsky Chairman of the Board	65	President and Chief Executive Officer, Glenwood Homes, Inc. (real estate construction), Vernon, NJ.	2005

To the Bank's knowledge, except as discussed below, no Director of the Bank is also a director, or was a director during the previous 5 years, of a company having a class of securities registered under Section 12 of the Securities Exchange Act of 1934, as amended, or subject to the requirements of Section 15(d) of such Act or any company registered as an investment company under the Investment Bank Act of 1940. Mr. Dov Perlysky serves as a Director of three companies having a class of equity securities registered under Section 12 of the Securities Exchange Act of 1934, as amended: Florham Consulting Corp. Engex, Inc. and Pharma-Bio Serv, Inc. The Bank encourages all Directors to attend the Bank's annual meeting. All of the Bank's Directors attended the 2009 annual meeting with the exception of Directors Bosma, Duddy, Mulvihill and Perlysky.

Director Qualifications

John V. Bosma – Mr. Bosma is the President of Boz Electrical Contractors, Inc., an electrical contracting company doing business primarily in Northern New Jersey and headquartered in Vernon, NJ. As president of a small business in Bank's market, Mr. Bosma's business experience has provided him with insight and understanding of many of the same issues our small business customers deal with today.

E. Jane Brown – Ms. Brown is the Chief Financial Officer of Pope John XXIII High School in Sparta, NJ. She is also an assistant treasurer and a director of Newton Memorial Hospital in Newton, NJ. Ms. Brown's accounting background and financial experience provides the Board with an awareness of accounting and reporting issues facing the Bank.

George E. Irwin – Mr. Irwin is the President and Chief Executive Officer of the Bank. He has been in the business of banking and finance for over forty five years. Prior to the incorporation of the Bank, Mr. Irwin held the same position at Greater Community Bancorp from 1987 to 2003. Mr. Irwin's experience in all areas of community banking equips him to lead the Bank both in the present environment and toward future growth.

Andrew J. Mulvihill – Mr. Mulvihill is President of Mountain Resort Properties, Vernon, NJ. He is also an Executive of Crystal Springs Builders LLC, Crystal Springs Development LLC, Crystal Springs Resort Development LLC and affiliates (real estate developer/builders), Vernon, NJ. Mr. Mulvihill, through his related business enterprises, is one on the largest employers in the Bank's Sussex County market. His experience in marketing, development and finance provides the board with an awareness of business conditions being encountered in the market.

Steven V. Oroho – Mr. Oroho is a New Jersey State Senator representing New Jersey district 24. He is a member of both the Senate Budget and Appropriations Committee and the Senate Economic Growth Committee. Prior to being elected State Senator Mr. Oroho was elected to the Sussex County Board of Chosen Freeholders. Mr. Oroho is also presently a certified financial planner with Stonebridge Capital Management. Mr. Oroho's knowledge of the Bank's market and his finance and accounting background provide him with insight into many of the matters facing the Bank.

Jeffrey M. Parrott – Mr. Parrott is Vice-Chairman of the Board of Directors of the Bank. He is also President and Chief Executive Officer of Parr Home, Inc., t/a Neil Parrott Real Estate, Wantage, NJ. Mr. Parrott was elected to the Sussex County Board of Chosen Freeholders in November, 2007. His knowledge of the real estate market is particularly valuable to the board both in the present environment and toward the future growth of the Bank in its market.

Dov Perlysky – Mr. Perlysky is Managing Member, Neshor, LLC (private investment firm) since 2000; Director, Engex, Inc. (closed-end mutual fund); Director, Pharma-Bio Serv, Inc. (pharmaceutical services); Director Florham Consulting Corp.; Vice President of Private Client Group, Laidlaw Global Securities (registered broker-dealer) from 1998-2002 Mr. Perlysky brings a background in sales, marketing and management as well as experience dealing with public company responsibility. His insight into public company matters, including various corporate governance structures, as well as management experience is of value to the Bank's board.

Edward H. Rolando – Mr. Rolando is the general manager of Earth-Tec Associates, a site and utility contractor in New Jersey and New York. Earth-Tec Associates is headquartered in Vernon, NJ. Mr. Rolando has been involved in the Bank's market for many years. The board benefits from his knowledge of the construction and development business as well as his knowledge of the Bank's market.

Charles H. Shotmeyer – Mr. Shotmeyer is President of Shotmeyer Bros, Inc. a seller of heating oil, kerosene and diesel fuel in Northern New Jersey. Prior to his current position Mr. Shotmeyer was the chief financial officer of Van Dyk Health Care, Inc., an assisted living facility. He is a former banker, having been a lending officer at a New Jersey Community Bank. Mr. Shotmeyer's background in finance and banking contributes to the board's understanding of issues facing the Bank.

Martin Theobald – Mr. Theobald is the owner of Heaven Hill Farm, a retail garden center and farm market in Vernon, NJ. He has been involved with the local business community and a civic volunteer for many years. Mr. Theobald's position in and knowledge of the Bank's market provides valuable insight to the board.

Douglas Verduin – Mr. Verduin is Certified Public Accountant and member of Berry, Verduin & Koch, LLC (certified public accountants), Ridgewood, NJ. Mr. Verduin is also a licensed investment advisor, holding Series 7 and 66 licenses. His financial, accounting and auditing background provides the board with understanding of many of the issues facing the Bank.

Harold J. Wirths – Mr. Wirths is an investor and was formerly the owner of a retail furniture store in Sussex County. He was elected to the Board of Chosen Freeholders in November, 2000. Mr. Wirths is a very active contributor to non-profit organizations in the Bank's market. He brings a unique perspective to the Bank's board.

Bruce D. Zaretsky – Mr. Zaretsky is the Chairman of the Board of Directors of the Bank. He is the President and Chief Executive Officer of Glenwood Homes, Inc., a builder and developer in Vernon, New Jersey and surrounding communities. Mr. Zaretsky has been active in the Bank's market area for many years. As such he brings knowledge of the community and insight of the local economy to the board.

Diversity

Although the Bank does not have a formal policy on diversity, our Nominating and Corporate Governance Committee considers all aspects of a candidate's background when selecting candidates for board service. When the Board determines a need to fill a director position, the Committee begins to identify qualified individuals for consideration. The Committee seeks individuals that possess skill sets that a prospective director will be required to draw upon in order to contribute to the Board, including professional experience, education, and local knowledge. While education and skills are important factors, the Committee also considers how candidates will contribute to the overall balance of the Board, so that the Bank will benefit from directors with different perspectives, varying view points and wide-ranging backgrounds and experiences.

Board Leadership

The Bank has determined to separate the positions of CEO and Board Chairman, with Mr. George E. Irwin serving as President and CEO, and Bruce D. Zaretsky serving as Chairman. The Board believes that this structure is currently the most appropriate for the Bank because it provides the Board with additional diversity of views on managing the Bank and provides the Board with greater independence.

Risk Oversight

Risk is an inherent part of the business of banking. Risks faced by the Bank include credit risk relating to its loans and interest rate risk related to its entire balance sheet. The Board of Directors oversees these risks through the adoption of policies and by delegating oversight to certain Board committees, including the loan and ALCO committees. These committees exercise oversight reviewing and updating the Board approved policies and overseeing management's compliance with the policies. The Committee's receive reports from management and asses the continuing effectiveness of the Bank's policies.

Required Vote

DIRECTORS WILL BE ELECTED BY A PLURALITY OF THE VOTES CAST AT THE ANNUAL MEETING WHETHER IN PERSON OR BY PROXY.

Recommendation

THE BOARD OF DIRECTORS RECOMMENDS THAT THE STOCKHOLDERS VOTE "FOR" THE NOMINEES SET FORTH ABOVE.

INFORMATION ABOUT THE BOARD OF DIRECTORS AND MANAGEMENT

Security Ownership of Management

The following table sets forth information concerning the beneficial ownership of shares of Common Stock as of March 12, 2010, by (i) each person who is known by the Bank to own beneficially more than five percent (5%) of the issued and outstanding Common Stock, (ii) each director and nominee for director of the Bank, (iii) each executive officer of the Bank described in the section heading "Executive Compensation" and (iv) all directors and executive officers of the Bank as a group.

Name	Common Stock Beneficially Owned (1)	Percentage of Class (2)
John V. Bosma	9,249 (3)	0.52%
E. Jane Brown	12,305 (3)	0.69%
Paul F. Castellano	15,500 (3)	0.87%
George E. Irwin	81,900 (4)	4.46%
Andrew J. Mulvihill	17,488 (5)	0.98%
Steven V. Oroho	18,985 (3)	1.06%
Jeffrey M. Parrott	16,515 (6)	0.92%
Dov Perlysky	37,367 (7)	2.09%
Edward H. Rolando	15,500 (3)	0.87%
Charles H. Shotmeyer	16,000 (3)	0.89%
Martin Theobald	15,500 (3)	0.87%
Douglas Verduin	15,500 (3)	0.87%
Harold J. Wirths	14,929 (3)	0.83%
Bruce D. Zaretsky	23,750 (8)	1.33%
All Executive Officers and Directors as a Group (15 persons)	310,488 (9)	16.47%

- (1) The address for all persons listed is c/o Highlands State Bank, 310 Route 94, PO Box 160, Vernon, NJ 07462.
- (2) Based on 1,788,262 shares actually outstanding. Pursuant to SEC Regulation 13d, the percentage owned by each of the named individuals assumes the exercise of options held by that individual but the nonexercise of options held by any other stockholder, and the percentage owned by all executive officers and Directors as a group assumes the exercise of options held by all members of the group but the nonexercise of options held by any other stockholder.
- (3) Includes 3,000 shares purchasable upon the exercise of immediately exercisable options.
- (4) Includes 50,000 shares subject to stock options.
- (5) Includes 1,988 shares held jointly with wife.
- (6) Includes 397 shares held jointly with wife and 197 shares held by wife. Also includes 594 shares held as custodian for Carson, Carley & Connor Parrott, of which Mr. Parrott disclaims beneficial ownership and 397 shares owned by Parr Homes, Inc.
- (7) Includes 32,367 shares owned through limited liability companies over which Mr. Perlysky has sole voting power.
- (8) Includes 5,000 shares subject to stock options.
- (9) Includes 97,000 shares subject to stock options.

None of the shares disclosed in the table above are pledged.

Other than as provided above, the following table sets forth information concerning the beneficial ownership of shares of Common Stock as of March 12, 2010 of all holders of common stock known to the Bank who beneficially own five (5%) percent or greater of our common stock.

Name of Beneficial Owner of More Than 5% of the Common Stock	Number of Shares Beneficially Owned (1)	Percentage of Class
Starboard Fund for New Bancs, L.P. 200 W. Adams Street, Suite 1015 Chicago, Illinois 60606	159,000	8.89%

- (1) Beneficially owned shares include shares over which the named person exercises either sole or shared voting power or sole or shared investment power. It also includes shares owned (i) by a spouse, minor children or by relatives sharing the same home, (ii) by entities owned or controlled by the named person, and (iii) by other persons if the named person has the right to acquire such shares within 60 days by the exercise of any right or option. Unless otherwise noted, all shares are owned of record and beneficially by the named person, either directly or through the dividend reinvestment plan.

Board of Directors and Committees

Meetings of the Board of Directors are held twelve (12) times annually and as needed. The Board of Directors held fourteen (14) meetings in the year ended December 31, 2009. The Bank's policy is that all Directors make every effort to attend each meeting. For the year ended December 31, 2009, each of the Bank's Directors attended at least 75% of the aggregate of the total number of meetings of the respective Board of Directors and the total number of meetings of committees on which the respective Directors served, except for Directors Cofrancesco, Duddy and Mulvihill.

A majority of the Board consists of individuals who are "independent" under the listing standards of the Nasdaq Stock Market (George E. Irwin is an officer and employee of the Bank and therefore not independent). Shareholders wishing to communicate directly with the independent members of the Board of Directors may send correspondence to: Bruce D. Zaretsky, Chairman, Highlands State Bank, P.O. Box 160, Vernon, New Jersey 07462. Any correspondence received will be forwarded to Mr. Zaretsky will not be screened by Bank management.

Code of Business Conduct and Ethics

The Board of Directors has adopted a Code of Business Conduct and Ethics governing the Bank's CEO and senior financial officer, as required by the Sarbanes-Oxley Act and SEC regulations, as well as the Board of Directors and other senior members of management. Our Code of Business Conduct governs such matters as conflicts of interest, use of corporate opportunity, confidentiality, compliance with law and the like. Our Code of Business Ethics is available on our website at www.highlandstatebank.com.

Committees

The Board of Directors has an Audit Committee, a Loan Committee, an ALCO/Investment Committee, a Compensation Committee, and a Nominating and Corporate Governance Committee.

Audit Committee

The Bank maintains an Audit Committee. The Audit Committee is responsible for the selection of the independent accounting firm for the annual audit and to establish, and oversee the adherence to a system of internal controls. The Audit Committee reviews and accepts the reports of the Bank's independent auditors and regulatory examiners. The Audit Committee arranges for the Bank's directors' examinations through its independent certified public accountants, evaluates and implements the recommendations of the directors' examinations and interim audits performed by the Bank's internal auditor, receives all reports of examination of the Bank by bank regulatory agencies, analyzes such regulatory reports, and reports to the Board the results of its analysis of the regulatory reports. The Audit Committee met four (4) times during 2009. The Board of Directors has adopted a written charter for the Audit Committee which is available on our website at www.highlandsstatebank.com. In 2009 the Audit Committee consisted of Douglas Verduin, Chairman, E. Jane Brown, Paul F. Castellano, Steven V. Oroho, Edward H. Rolando and Charles H. Shotmeyer, all of whom are "independent" under the Nasdaq listing standards and meet the independence standards of the Sarbanes-Oxley Act. In addition, Douglas Verduin has been determined by the Board to be the "Audit Committee financial expert", as such term is defined by SEC Rules.

Audit Committee Report

The Audit Committee meets periodically to consider the adequacy of the Bank's financial controls and the objectivity of its financial reporting. The Audit Committee meets with the Bank's independent auditors and the Bank's internal auditor, both of whom have unrestricted access to the Audit Committee.

In connection with this year's financial statements, the Audit Committee has reviewed and discussed the Bank's audited financial statements with the Bank's officers and ParenteBeard LLC, our independent auditors. We have discussed with ParenteBeard LLC, the matters required to be discussed by Statement on Auditing Standards No. 61, ("Communication with Audit Committees"). We also have received the written disclosures and letters from ParenteBeard LLC required by Independence Standards Board Standard No. 1 ("Independence Discussions with Audit Committees"), and have discussed with representatives of ParenteBeard LLC their independence.

Based on these reviews and discussions, the Audit Committee recommended to the Board of Directors that the audited financial statements be included in the Bank's Annual Report on form 10-K for the fiscal year 2009 for filing with the Federal Deposit Insurance Corporation.

Douglas Verduin, Chairman
E. Jane Brown
Paul F. Castellano
Steven V. Oroho
Edward H. Rolando
Charles H. Shotmeyer

Loan Committee

The Loan Committee consists of the following members: Harold J. Wirths, Chair, John V. Bosma, Andrew J. Mulvihill, Jeffrey M. Parrott, Edward H. Rolando and Martin Theobald.

The Loan committee is responsible for establishing or approving, in conjunction with management, all major policies and procedures pertaining to loan policy, including:

- establishing the loan approval system;
- approving all loan in excess of a predetermined amount;
- reviewing all past due reports, rated loan reports, non-accrual reports and other reports and indicators of overall loan portfolio quality;
- engaging, as appropriate, and reviewing the findings of, outsourced credit review consultants;
- reviewing and responding to all credit issues identified by way of regulatory examinations and outsourced credit review consultants;
- establishing measurements for adequacy of the loan loss reserve;
- reviewing any other matter pertaining to the loan portfolio such as yield and concentration.

ALCO Investment Committee

The Investment/ALCO Committee consist of the following members: Steven V. Oroho, Chair, Paul F. Castellano, Dov Perlysky, and Harold J. Wirths. The principal responsibilities of the Investment/ALCO committee include:

- overseeing the Bank's actions relating to interest rate risk and liquidity risks;
- reviewing management's strategies for investment securities activities, deposit programs, and lending initiatives;
- evaluating the Bank's liquidity position and considering the impact of anticipated changes in that position; and
- approving trading strategies and review positions in securities

The Investment/ALCO committee is also responsible for the Bank's overall investment strategy and asset/liability and investment policy. This includes liquidity management, risk management, net interest margin management, monitoring deposit level trends and pricing, monitoring asset level trends and pricing and portfolio decisions.

Compensation Committee

In 2009, the Compensation Committee consisted of Directors Steven V. Oroho, Chair, E. Jane Brown, Andrew J. Mulvihill, Dov Perlysky and Douglas Verduin. Each member of the Compensation Committee is independent, as such term is defined in the Nasdaq listing standards. The purpose of the Compensation Committee is to review senior management's performance and determine compensation, and review and set guidelines for compensation of all employees. The Compensation Committee does not delegate its authority regarding compensation. Mr. Irwin, our CEO, provides input to the Committee regarding the compensation of our executive officers. Currently, no consultants are engaged or used by the Compensation Committee for purposes of determining or recommending compensation. In 2009, the Compensation Committee met four (4) times. The Compensation Committee does not have a written charter.

Nominating and Corporate Governance Committee.

The Nominating and Corporate Governance Committee is comprised of Andrew J. Mulvihill, Chair, Bruce D. Zaretsky, Jeffrey M. Parrott, Dov Perlysky and Charles H. Shotmeyer. Each member of the Nominating and Corporate Governance Committee is independent as such term is defined in the Nasdaq listing standards. The purpose of the Committee is to assess Board composition, size, additional skills and talents needed, and then identify and evaluate candidates and make recommendations to the Board regarding those assessments and/or candidates. The Committee recommends to the Board the nominees for election as directors, and considers performance of incumbent directors to determine whether to nominate them for re-election. The Nominating and Corporate Governance Committee will consider qualified nominees for director recommended by shareholders. All shareholder recommendations are evaluated on the same basis as any recommendation from members of the Board or management of the Bank. Recommendations should be sent to Andrew J. Mulvihill, c/o Highlands State Bank, 310 Route 94, Vernon, New Jersey 07462. Any nomination for a director to be nominated at the 2011 annual meeting must have been received by December 1, 2010. Nominees should have a minimum of an undergraduate degree, have experience in a senior executive position in a corporate or equivalent organization, have experience in at least one facet of the Bank's business or its major functions, be active in the communities in which the Bank conducts business and be able to positively represent the Bank to its customers and potential customers. The Nominating and Corporate Governance Committee does not have a written charter.

EXECUTIVE COMPENSATION

The following table sets forth compensation paid to the CEO, and up to two other most highly compensated executive officers of the Bank earning in excess of \$100,000 (the “named executive officers”) as of the fiscal years ended December 31, 2009 and December 31, 2008.

Name and Principal Position	Year	Salary (\$)	Bonus (\$)	Stock Awards (\$)	Option Awards (\$)	Non-equity Incentive Plan Compensation (\$)	All Other Compensation (\$)	Total (\$)
George E. Irwin President and CEO	2009	184,226	0	0	0	0	12,000 (1)	196,276
	2008	164,500	0	0	0	0	12,000 (1)	176,500
Gerald R. Lake Executive Vice President & Senior Lending Officer	2009	136,504	0	0	0	0	0	136,504
	2008	128,500	0	0	0	0	0	128,500

(1) Consists of an automobile allowance.

In 2005 the Bank entered into an Employment Agreement employing George E. Irwin to serve as the Bank’s President and Chief Executive Officer and to serve on the Bank’s board of directors. On May 19, the agreement was extended until October 12, 2012. The term will be renewed automatically for one-year terms after 2012 unless either party provides notice of non-renewal to the other party at least 60 days before the employment anniversary date. Mr. Irwin’s base salary for 2010 is \$176,500 per annum and his current annual auto allowance is \$12,000. If the Bank terminates Mr. Irwin’s employment without “cause” (as defined in the Employment Agreement), as a severance benefit the Bank will continue Mr. Irwin’s salary for 12 months, plus accrued vacation and continuation of health benefits for one year. Had Mr. Irwin been terminated without cause at December 31, 2009, his severance payment would have been worth \$191,232. Notwithstanding these terms of Mr. Irwin’s employment Agreement, the Bank may be unable to pay any severance to Mr. Irwin due to the Bank’s participation in the U.S. Treasury’s Capital Purchase Program (“CPP”). See “Recent Legislation and Its Impact on Executive Compensation” below

During the twelve (12) months Mr. Irwin is entitled to severance pay following a termination of his employment by Bank without cause, Mr. Irwin may not, within Sussex County, New Jersey or Orange County, New York, accept employment with or render any services to any other entity whose primary business is banking or employ or offer to employ in a professional capacity any officer or employee of the Bank. Furthermore, for two years after a termination of his employment with the Bank, Mr. Irwin will not solicit any customer of the Bank.

No severance will be due to Mr. Irwin if he terminates the Employment Agreement.

If the Bank terminates Mr. Irwin’s employment for cause, he will not be entitled to a continuation of salary or other benefits after the termination date, but he will be entitled to a continuation of health benefits for himself and his covered dependents until his 65th birthday.

OUTSTANDING EQUITY AWARDS AT FISCAL YEAR-END

The Bank maintains three (3) stock option plans, the Highlands State Bank 2006 Nonstatutory Stock Option Plan, the Highlands State Bank 2006 Incentive Stock Option Plan, and the Highlands State Bank 2006 Nonemployee Directors Stock Option Plan (collectively, the “Plans”). Under the Plans, the Bank is authorized to issue options to purchase up to 150,000 shares of the Bank’s common stock, in the aggregate. Each of the Plans will terminate in April of 2016.

OUTSTANDING EQUITY AWARDS AT FISCAL YEAR-END									
OPTION AWARDS						STOCK AWARDS			
Name	Number of Securities Underlying Unexercised Options (#) Exercisable	Number of Securities Underlying Unexercised Options (#) Unexercisable	Equity Incentive Plan Awards: Number of Securities Underlying Unexercised Options (#)	Option Exercise Price (\$)	Option Expiration Date	Number of Shares or Units of Stock That Have Not Vested	Market Value of Shares or Units of Stock That Have Not Vested (\$)	Equity Incentive Plan Awards: Number of Shares, Units or Other Rights That Have Not Vested (#)	Equity Incentive Plan Awards: Market or Payout Value of Unearned Shares, Units or Other Rights That Have Not Vested (#)
George E. Irwin, President and CEO	25,000	0	0	\$10.00	4/2016	0	\$ -	0	\$
Gerald R. Lake, Executive Vice President & Senior Lending Officer	5,000	0	0	\$10.00	4/2016	0	\$ -	0	\$ -

Potential Payments upon Termination or Change-in-Control

In the event of a termination of Mr. Irwin’s employment as a result of a merger, acquisition of the Bank stock by another entity or a substantial change in ownership of the Bank during the term of his employment, Mr. Irwin will be entitled to severance pay of 2.99 times annual compensation unless he is requested to remain employed by the new entity at a position comparable in title, responsibility, authority and salary at a location within 10 miles of the Bank’s current headquarters. Had the Bank engaged in a change in control and had Mr. Irwin become entitled to severance under these provisions of his agreement, his severance would have been worth \$527,735.

Recent Legislation and Its Impact on Executive Compensation

On February 17, 2009, the American Recovery and Reinvestment Act of 2009 (the “ARRA”) became law. Under the ARRA, all institutions that have received government investment under the U.S. Treasury’s Troubled Asset Relief Program, which includes the Capital Purchase Program (the “CPP”), are required to comply with new executive compensation restrictions. Among other things, these restrictions prohibit the payment of severance to an institution’s senior executive officers upon their departure from the institution for any reason. In addition, the institution’s highest paid employee may not receive a cash bonus, but may receive a bonus in the form of restricted stock provided that (i) the restricted stock does not vest until the Treasury’s investment is redeemed, and (ii) the value of the restricted stock does not exceed one-third of the officer’s annual compensation. These restrictions remain in place for so long as the government’s investment in the institution is outstanding.

On May 8, 2009 and December 22, 2009, the Bank completed a financing transactions with the United States Treasury under the TARP. The Bank is therefore subject to these restrictions, and would be unable to make any of the severance payments to Mr. Irwin required under his employment agreement.

DIRECTOR COMPENSATION

Directors of the Bank do not currently receive cash compensation for their service on the Board of Directors. Directors do participate in the Bank’s stock option plans, however. The table below sets forth the options held by each director at year end.

	Fees Earned or Paid in Cash (\$)	Stock Awards (shares)	Option Awards (shares) (1)	Total
John V. Bosma	-	-	3,000	3,000
E. Jane Brown	-	-	3,000	3,000
Paul F. Castellano	-	-	3,000	3,000
Terrence A. Duddy, DDS	-	-	3,000	3,000
George E. Irwin	-	-	50,000	50,000
Andrew J. Mulvihill	-	-	3,000	3,000
Steven V. Oroho	-	-	3,000	3,000
Jeffrey M. Parrott	-	-	3,000	3,000
Dov Perlysky	-	-	3,000	3,000
Edward H. Rolando	-	-	3,000	3,000
Charles H. Shotmeyer	-	-	3,000	3,000
Martin Theobald	-	-	3,000	3,000
Douglas Verduin	-	-	3,000	3,000
Harold J. Wirths	-	-	3,000	3,000
Bruce D. Zaretsky	-	-	5,000	5,000

1 – Stock Options Issued pursuant to the 2006 Non-statutory Plan.

Interest of Management and Others in Certain Transactions; Review, Approval or Ratification of Transactions with Related Persons

The Bank has had, and expects to have in the future, banking transactions in the ordinary course of its business with Directors, officers, principal stockholders and their associates on substantially the same terms, including interest rates and collateral on loans, as those prevailing at the same time for comparable transactions with others. Those transactions do not involve more than the normal risk of collectability or present other unfavorable features.

The Bank is also a party to a lease agreement with Main Street Associates Inc., which is partially owned by Mr. Bosma, Mr. Castellano and Mr. Zaretsky, who serve as directors of the Bank. The Board of Directors believes that this lease agreement is an arms length transaction, as favorable to the Bank as the Bank would have received from an unrelated third party.

PROPOSAL 2 AMENDMENT TO THE BANKS CERTIFICATE OF INCORPORATION

The Bank participated in the United States Department of the Treasury's (the "Treasury") Capital Purchase Program (the "CPP"). Initially, on May 8, 2009, the Bank received an investment of \$3,091,000 from the Treasury in exchange for 3,091 shares of our Series A Preferred Stock and a warrant to purchase 155 shares of our Series B Preferred Stock, which was immediately exercised. In addition, on December 22, 2009, we received an additional investment of \$2,359,000 in exchange for 2,359 additional shares of Series A Preferred Stock.

The Treasury has requested that we make certain administrative revisions to the terms and conditions of the Series A Preferred Stock, which was originally approved by the shareholders on December 7, 2009. These revisions will not change the economic substance of the Series A Preferred Stock, nor change the relative rights of the Series A Preferred Stock in relation to our common stock. In particular, the Treasury has asked that we clarify that the dividend for the 2,359 shares of Series A Preferred Stock issued in connection with the December 2009 transaction did not begin to accrue dividends until their issuance on December 22, 2009, while the initial 3,091 shares of Series A Preferred Stock began to accrue dividends on May 8, 2009. A copy of the proposed amendment is annexed hereto as Exhibit A.

Required Vote

THE AFFIRMATIVE VOTE OF TWO-THIRDS (2/3) OF THE BANK'S OUTSTANDING COMMON STOCK IS REQUIRED TO ADOPT THE AMENDMENT TO THE BANK'S CERTIFICATE OF INCORPORATION.

Recommendation

THE BOARD OF DIRECTORS RECOMMENDS THAT THE STOCKHOLDERS VOTE "FOR" THE AMENDMENT TO THE BANK'S CERTIFICATE OF INCORPORATION

**PROPOSAL 3 -
APPROVAL OF THE PLAN OF ACQUISITION
OF HIGHLANDS STATE BANK**

The Board of Directors of the Bank has incorporated Highlands Bancorp, Inc. (the "Holding Company") under the laws of the State of New Jersey and has entered into the Plan of Acquisition of all the Outstanding Stock of Highlands State Bank by Highlands Bancorp, Inc. (the "Plan"), dated as of February 2, 2010. The Certificate of Incorporation of the Holding Company, is set forth as Exhibit B to this Proxy. The Plan is set forth as Exhibit C to this Proxy. Under the Plan, the Holding Company will become the holding company of the Bank and, except as to those stockholders exercising their dissenters' rights (See "RIGHTS OF DISSENTING STOCKHOLDERS"), each outstanding share of Bank common stock, \$5.00 per share par value, will be transferred and contributed to the Holding Company in exchange for one share of the common stock of the Holding Company in a transaction qualifying under Section 351 of the Internal Revenue Code of 1986, as amended (the "Code") (the "Capitalization").

Reason for Forming the Holding Company

The Board of Directors of the Bank believes that a bank holding company offers greater flexibility in undertaking the Bank's current and future activities, and in raising capital to support those activities. In addition, the Board believes that the holding company structure may provide the Board with additional means of protecting the rights of stockholders in the face of an unsolicited takeover bid. Although the Holding Company's Certificate of Incorporation does not currently contain any defensive provisions, stockholders may be asked to approve such provisions in the future. See "REASONS FOR PROPOSING THE PLAN" and "COMPARISON OF BANK SECURITIES WITH THE SECURITIES OF THE HOLDING COMPANY."

Appraisal Rights

Stockholders of the Bank may have dissenters' rights of appraisal pursuant to Sections 360-369 of the New Jersey Banking Act of 1948, as amended (the "Banking Act"), a copy of which is attached as Exhibit D hereto. Stockholders must file a written notice of dissent before the vote of stockholders is taken on the Plan. The notice of dissent should be delivered to George E. Irwin, President and Chief Executive Officer, Highlands State Bank, 310 Route 94 Vernon, NJ 07462. Stockholders who exercise their dissenters' rights will, if the transactions contemplated by the Plan are consummated, be entitled to be paid in cash the appraised value of their shares of stock of the Bank if they comply with the procedures summarized in this Proxy Statement and prescribed by Sections 360-369 of the Banking Act. See "RIGHTS OF DISSENTING STOCKHOLDERS."

A vote in favor of the Plan constitutes a waiver of dissenter's rights. A vote against the Plan does not constitute the exercise of dissenter's rights. Other additional steps are necessary for a stockholder to exercise his, her or its dissenter's rights.

Conditions of the Plan

To be consummated, the Plan must be approved by the holders of at least two-thirds of the outstanding common stock of the Bank. In addition to stockholder approval, consummation of the Plan requires the non-objection of the Board of Governors of the Federal Reserve System (the "Federal Reserve Board") and the approval of the New Jersey Commissioner of Banking and Insurance (the "Commissioner"). The Commissioner approved the Plan on April 6, 2010. The Holding Company will file the necessary notification with the Federal Reserve Bank of New York after stockholder approval of the Plan. The Plan may be terminated at any time before it is consummated by the Bank's Board of Directors if the Board believes consummation of the Plan would be inadvisable. See "DESCRIPTION OF THE PLAN—CONDITIONS."

Tax Consequences

Consummation of the Capitalization and establishment of the holding company structure called for in the Plan will, subject to the accuracy of the assumptions described in the section entitled "FEDERAL INCOME TAX CONSEQUENCES OF THE CAPITALIZATION," be tax-free under the Code and generally no gain or loss will be recognized for Federal income tax purposes by the Bank, by the Holding Company or by any stockholder of the Bank unless a stockholder elects to receive cash for his, her or its Bank shares through the exercise of his, her or its dissenter's rights and unless, as a consequence of the exchange of Holding Company shares for Bank shares, a stockholder is relieved of liabilities in excess of such stockholder's basis in his, her or its Bank shares. Stockholders should consult their tax advisors as to the Federal, state and local tax consequences of the Capitalization given their individual tax circumstances. See "FEDERAL INCOME TAX CONSEQUENCES OF THE CAPITALIZATION."

Comparison of the Bank's Securities and the Securities of the Holding Company

The rights of the holders of the common stock of the Bank differ in certain respects from the rights of the holders of the common stock of the Holding Company. The differences result primarily from the fact that the Holding Company is incorporated under and subject to the New Jersey Business Corporation Act while the Bank is incorporated under and governed by the Banking Act.

In addition, the rights of the holders of the Bank's Series A Preferred Stock (the "Series A Preferred") and the Bank's Series B Preferred Stock (the "Series B Preferred") (jointly, the "Preferred Stock") differ in certain respects from the rights of the holders of the Preferred Stock of the Holding Company. The differences result primarily from certain provisions agreed to by the Bank in connection with the Bank's participation in the United States Department of the Treasury's (the "Treasury") Capital Purchase Program (the "CPP"), and contained in the terms of the Certificate of Designation of each series of Preferred Stock. The most material of these changes is related to the dividend rights associated with the Preferred Stock. These dividends are currently non-cumulative. However, upon completion of the Holding Company reorganization, the Preferred Stock dividends will become cumulative, which means that any required dividend which is not paid by the holding Company will remain as a liability of the Holding Company, and must ultimately be repaid to the holder of the Preferred Stock.

See "COMPARISON OF BANK SECURITIES WITH THE SECURITIES OF HOLDING COMPANY," and "CERTAIN REGULATORY MATTERS."

THE PLAN OF ACQUISITION DESCRIPTION OF THE PLAN

General

The Bank's Board of Directors believes that it is in the best interests of the Bank and its stockholders that the Bank reorganizes into a holding company which will own 100% of the outstanding stock of the Bank. To achieve this objective, the Bank, through its Directors, has proposed the Plan and incorporated the Holding Company. The Holding Company has not and will not engage in any operations or issue any of its shares prior to consummation of the Capitalization. The following is a summary of the terms of the Plan, and is qualified in its entirety by reference to the Plan, a copy of which is attached as Exhibit C hereto.

The Plan of Acquisition

On January 19, 2010, the Bank's Board of Directors unanimously adopted the Plan. The Plan provides for the transfer and contribution of all of the Bank's stock by the stockholders to the Holding Company solely in exchange for the stock of the Holding Company pursuant to the terms of the New Jersey Banking Act of 1948. The Holding Company will then be the sole stockholder of the Bank. Each outstanding share of the Common Stock,

Series A Preferred, and the Series B Preferred of the Bank will be exchanged for one share of Common Stock, Series A Preferred, or Series B Preferred, respectively, of the Holding Company. After consummation of the Capitalization, all of the stockholders of the Bank will become stockholders of the Holding Company, except for those stockholders who elect to exercise their dissenters' rights. See "RIGHTS OF DISSENTING STOCKHOLDERS."

Stockholders will be entitled to exchange their present Bank share certificates for new certificates evidencing shares of stock of the Holding Company. Further instructions on accomplishing this exchange will be provided by the Bank or its transfer agent after the Plan is approved and the Capitalization is consummated. Until so exchanged, each certificate evidencing Bank shares will represent shares of the Holding Company stock, and the holders of Bank stock certificates will have all the rights of holders of Holding Company shares.

The Holding Company has been incorporated at the direction of the Board of Directors of the Bank. The Holding Company is incorporated under the New Jersey Business Corporation Act and a copy of its Certificate of Incorporation is attached as Exhibit B to this Proxy Statement. After consummation of the Capitalization, the members of the present Board of Directors of the Bank will constitute the Board of Directors of the Holding Company.

Expenses and Financing the Plan

The expenses of carrying out the Plan are estimated at approximately \$50,000 which represents legal fees, accounting fees and printing costs incurred or expected to be incurred in connection with the formation of the Holding Company, the preparation, filing and printing of this Proxy Statement and the preparation and filing fees for applications for bank regulatory approvals. All such expenses will be borne solely by the Bank.

Conditions

Consummation of the transactions contemplated by the Plan is subject to several conditions, including the non-objection of the Federal Reserve Board and the approval of the Commissioner. In addition, consummation of the Capitalization is conditioned upon approval of the Plan by the Bank's stockholders.

The Capitalization may only be consummated if the Federal Reserve Board fails to object to a notice filed by the Holding Company of its intention to undertake the Capitalization. The Holding Company will file the necessary notice with the Federal Reserve Bank of New York under the Bank Holding Company Act of 1956, as amended, (the "BHCA") after the Plan has been approved by the stockholders of the Bank. Although it is anticipated that the Federal Reserve Board will not object to the Holding Company's notice, there can be no assurance that the Federal Reserve Board will not object or that the Federal Reserve Board will not impose conditions which the Bank finds objectionable.

The Commissioner approved the Plan on April 6, 2010.

In addition, consummation of the Capitalization requires the affirmative vote of the holders of two-thirds of the outstanding shares of common stock of the Bank. The Directors and Executive Officers of the Bank beneficially own, as of March 12, 2010 approximately 18% of the Bank's issued and outstanding stock.

Notwithstanding the receipt of stockholder and regulatory approvals, the Bank's Board of Directors may terminate the Plan at any time prior to consummation if it believes that consummation of the Capitalization would not be in the best interests of the Bank and its stockholders. If the Bank's Board of Directors terminates the Plan and elects not to consummate the Capitalization after obtaining stockholder approval, the Bank will notify its stockholders of such action in writing.

One of the factors which the Board of Directors will weigh heavily in determining whether to proceed with the Plan is the number of stockholders who elect to exercise their dissenters' rights. The Board of Directors will consider it unwise to proceed with the Plan if the number of stockholders who dissent from the transaction would require the Bank to pay an excessive amount in cash to satisfy obligations to dissenting stockholders.

REASONS FOR PROPOSING THE PLAN

The Bank's Board of Directors has proposed the formation of the Holding Company because the holding company structure will maximize the Bank's flexibility in undertaking its current and future operations and provide greater flexibility in raising capital to support those activities. In addition, the holding company structure makes available to the Board of Directors a variety of means to assist the Holding Company Board in acting in the best interests of stockholders in the face of an unsolicited takeover bid which are not available to the Bank. Although the Holding Company's Certificate of Incorporation does not currently contain any defensive provisions, stockholders may be asked to approve such provisions in the future.

The holding company structure provides greater flexibility in managing the current and future operations of the Bank. For example, the holding company structure provides more flexibility in raising capital for the Holding Company or for subsidiary banks. This flexibility is available because the capital structure of a holding company is subject to general corporate laws and Federal Reserve Board Regulation Y and not the more restrictive Federal and New Jersey laws and regulations pertaining to banks. In addition, because the New Jersey Business Corporation Act is a more modern statute than the Banking Act, a holding company structure provides greater flexibility in issues of corporate governance.

The Board of Directors of the Bank also believes that the creation of the Holding Company will maximize the Bank's ability to accomplish future expansion through the acquisition of other financial institutions. The holding company structure will permit the Bank to acquire other banks and financial institutions while operating them as wholly owned subsidiaries. The Bank's management believes that the operation of such institutions as wholly owned subsidiaries may better permit the deposit base and customer relations of the acquired institution to be maintained while the operations of the acquired institution are integrated with those of the Bank.

The bank holding company structure may also be utilized in the future to engage in certain non-banking activities which are closely related to banking, either directly, through newly formed subsidiaries or by acquiring companies already established in such activities. Although recent legislation has expanded the powers of banks, certain activities may still only be conducted through a holding company and some activities may be conducted more efficiently through a holding company. See "CERTAIN REGULATORY MATTERS - Bank Holding Company Regulation."

Finally, because the Holding Company is governed by the New Jersey Business Corporation Act, it has greater flexibility than does the Bank in adopting alternative provisions for its Certificate of Incorporation which are not permitted to the Bank, which is governed by the Banking Act. Among the provisions which are available to the Holding Company and not the Bank are super majority vote requirements for certain types of corporate transactions such as mergers and asset sales which have not been previously approved by the Holding Company's Board of Directors. The Bank is not permitted to have these provisions in its Certificate of Incorporation under the Banking Act. In addition, shareholders of the Holding Company may pre-approve the issuance of preferred stock, but delegate to the Board the authority to set the terms and conditions of such stock at the time of issuance. Under New Jersey law, banks are not permitted to have this so called "blank check" preferred stock. Although the Holding Company's Certificate of Incorporation does not currently contain these provisions, stockholders may be asked to adopt them in the future.

Adoption of a holding company structure may subject the Holding Company to certain additional regulation to which the Bank is not currently subject. For example, the Holding Company will become subject to oversight and regulation by the Federal Reserve Board. The Bank is not currently subject to such oversight and regulation. In addition, issuances of securities by the Holding Company will be subject to regulation by the Securities and Exchange Commission under the Securities Act of 1933, as amended (the "Securities Act"). The issuance of securities by the Bank is currently exempt from the Securities Act. This additional regulation could involve increased expense for the Holding Company. However, due to the benefits of a holding company structure discussed above, the Board believes that adoption of the Plan and the creation of a holding company structure is in the best interests of the stockholders of the Bank.

MANAGEMENT OF THE HOLDING COMPANY

The Board and management of the Holding Company will be the same as the Board and management of the Bank.

SUMMARY OF FEDERAL INCOME TAX CONSEQUENCES OF THE CAPITALIZATION

General. The following is a general summary of certain material potential Federal income tax consequences of the Capitalization to the Bank, the Holding Company and the participating stockholders. This summary does not consider all of the tax consequences of the Capitalization that may be relevant or materially affect participating stockholders. This summary is based on certain provisions of the Code, final, temporary and proposed Treasury Regulations promulgated thereunder (the "Regulations") and administrative and judicial interpretations thereof, all in effect as of the date hereof and all subject to change (possibly on a retroactive basis) at any time. Any such changes in legislative, judicial or administrative actions or interpretations could alter or significantly modify the tax summary set forth below. The summary does not address the foreign, state or local income tax consequences of the Capitalization. Stockholders are advised to consult with their own tax advisors for a comprehensive explanation of the Capitalization as it affects any stockholders' particular circumstances.

The Bank has sought neither a private letter ruling from the Internal Revenue Service nor an opinion of counsel with respect to the Federal income tax consequences of the Capitalization due to the cost involved in obtaining such a ruling or opinion and management's view that such a ruling or opinion would not materially benefit the stockholders. The following summary reflects the understanding of the Bank regarding certain Federal tax consequences of the Capitalization. There can be no assurance that the Internal Revenue Service would agree with the Bank's understanding of the Federal tax consequences of the Capitalization. Assuming that (i) no Holding Company stock will be issued for services rendered to or for the benefit of the participating stockholders in the Capitalization, (ii) the Holding Company will be a bank holding company within the meaning of Section 2(a) of the Bank Holding Company Act of 1956, (iii) there is no debt being transferred to or being assumed by the Holding Company in connection with the exchange of the Bank stock for the Holding Company stock by the participating stockholders, (iv) the adjusted basis and the fair market value of the stock being transferred by the participating stockholders will, in each instance, be equal to or exceed the sum of the liabilities to be assumed by the Holding Company plus any liabilities to which the stock being transferred are subject, (v) there is no indebtedness between the participating stockholders and the Holding Company and there will be no indebtedness created in favor of the participating stockholders as a result of the Capitalization, (vi) the transfer and exchange of the Bank stock and the Holding Company stock will occur under a plan in which the rights of the parties are defined and which was agreed to before the Capitalization, (vii) there is no current plan or intention on the part of the Holding Company to redeem or otherwise reacquire any stock issued in the Capitalization, (viii) taking into account any issuance of additional shares of the Holding Company stock; any issuance of Holding Company stock for services; the exercise of any Holding Company transferee stock rights, warrants or subscriptions; a public offering of Holding Company stock; and the sale, exchange, transfer by gift, or other disposition of any of the stock of Holding Company to be received in the Capitalization, the participating stockholders will be in "control" of the Holding Company within the meaning of Code Section 368(c), (ix) each participating shareholder will receive such amount of Holding Company stock which will be approximately equal to the fair market value of the Bank stock transferred by such participating shareholder to the Holding Company, and (x) there is no plan or intention of the Holding Company to dispose of the Bank stock received in the Capitalization, the Bank believes that the Capitalization will constitute a tax-free contribution by the participating stockholders of the Bank stock to the Holding Company under Code Section 351. Consequently, the material federal income tax consequence of the Capitalization will be as follows:

No gain or loss will be recognized by the participating stockholders with respect to their transfer of Bank stock to the Holding Company in exchange solely for Holding Company stock. Code Section 351.

No gain or loss will be recognized by the Holding Company on the receipt of the Bank stock in exchange for Holding Company stock. Code Section 1032.

The tax basis of the Holding Company common stock received by the participating stockholders pursuant to the Capitalization will equal the tax basis of the Bank common stock surrendered in exchange therefor. Code Section 358.

The holding period of the Holding Company stock received by the participating stockholders will include, in each instance, the holding period of the Bank stock surrendered in exchange therefor, provided that the Bank stock was a capital asset in the hands of the stockholders on the effective date of the Capitalization. Code Section 1223(a).

Stockholders who dissent and receive cash for their shares of Bank stock will recognize gain or loss measured by the difference between the tax basis of their Bank shares on the Effective Date and the amount of cash or the fair market value of other property received in exchange therefor. The character of the gain or loss recognized will be capital gain or ordinary income depending upon the particular circumstances of each dissenting stockholder. Stockholders who exercise their dissenter's rights of appraisal are urged to consult with their own tax advisors with respect to the tax character of gain or loss recognized due to the Plan.

THE FOREGOING IS A SUMMARY OF MANAGEMENT'S UNDERSTANDING OF CERTAIN MATERIAL FEDERAL INCOME TAX CONSEQUENCES OF THE CAPITALIZATION. STOCKHOLDERS SHOULD CONSULT WITH THEIR OWN TAX ADVISORS REGARDING THE TAX CONSEQUENCES OF THE CAPITALIZATION WITH RESPECT TO THEIR OWN PARTICULAR CIRCUMSTANCES, INCLUDING THE APPLICABILITY OF VARIOUS FOREIGN, STATE AND LOCAL LAWS.

BANK HOLDING COMPANY REGULATION

The Holding Company will be a bank holding company within the meaning of the BHCA. As a bank holding company, the Holding Company will be required to file with the Federal Reserve Board an annual report and such additional information as the Board may require pursuant to the BHCA. The Federal Reserve Board may also make examinations of the Holding Company and its subsidiaries. In addition, the Holding Company will be subject to capital standards similar to, but separate from, those applicable to the Bank.

The BHCA requires, among other things, the prior approval of the Federal Reserve in any case where a bank holding company proposes to (i) acquire all or substantially all of the assets of any other bank, (ii) acquire direct or indirect ownership or control of more than 5% of the outstanding voting stock of any bank (unless it owns a majority of such company's voting shares) or (iii) merge or consolidate with any other bank holding company. The Federal Reserve will not approve any acquisition, merger, or consolidation that would have a substantially anti-competitive effect, unless the anti-competitive impact of the proposed transaction is clearly outweighed by a greater public interest in meeting the convenience and needs of the community to be served. The Federal Reserve also considers capital adequacy and other financial and managerial resources and future prospects of the companies and the banks concerned, together with the convenience and needs of the community to be served, when reviewing acquisitions or mergers.

The BHCA generally prohibits a bank holding company, with certain limited exceptions, from (i) acquiring or retaining direct or indirect ownership or control of more than 5% of the outstanding voting stock of any company which is not a bank or bank holding company, or (ii) engaging directly or indirectly in activities other than those of banking, managing or controlling banks, or performing services for its subsidiaries, unless such non-banking business is determined by the Federal Reserve to be so closely related to banking or managing or controlling banks as to be properly incident thereto.

The BHCA was substantially amended through the Gramm-Leach-Bliley Financial Modernization Act of 1999 (the "Modernization Act"). The Modernization Act permits bank holding companies and banks which meet certain capital, management and Community Reinvestment Act standards to engage in a broader range of non-banking activities through electing to become "financial holding companies". In addition, bank holding companies which elect to become financial holding companies may engage in certain banking and non-banking activities without prior Federal Reserve approval. Finally, the Modernization Act imposes certain new privacy requirements on all financial institutions and their treatment of consumer information. Upon consummation of the Capitalization, the Holding Company will not be a financial holding company.

There are a number of obligations and restrictions imposed on bank holding companies and their depository institution subsidiaries by law and regulatory policy that are designed to minimize potential loss to the depositors of such depository institutions and the FDIC insurance funds in the event the depository institution becomes in danger of default. Under a policy of the Federal Reserve with respect to bank holding company operations, a bank holding company is required to serve as a source of financial strength to its subsidiary depository institutions and to commit resources to support such institutions in circumstances where it might not do so absent such policy. The Federal Reserve also has the authority under the Bank Holding Company Act to require a bank holding company to terminate any activity or to relinquish control of a non-bank subsidiary upon the Federal Reserve's determination that such activity or control constitutes a serious risk to the financial soundness and stability of any bank subsidiary of the bank holding company.

Resale Considerations with Respect to the Holding Company Common Stock

The shares of the Holding Company common stock to be issued upon consummation of the Capitalization are exempt from registration under the Securities Act, and will be freely transferable.

COMPARISON OF BANK SECURITIES WITH THE SECURITIES OF HOLDING COMPANY

General

The rights of the holders of the securities of the Holding Company will differ in certain respects from the rights of the holders of securities of the Bank. The following discussion describes certain rights of the holders of common stock, the Series A Preferred and the Series B Preferred of the Bank and the Holding Company and notes the material differences that arise, with respect to the common stock, primarily because New Jersey corporate law provides security holders with different rights than the rights provided for under the Banking Act, and, with respect to the Preferred Stock, as a result of certain provisions of the standard terms of the CPP. The rights of security holders may also be affected because the Holding Company will be subject to supervision and regulation by governmental agencies which are different than those for the Bank. See "CERTAIN REGULATORY MATTERS." While the following discussion summarizes certain provisions of the Holding Company's Certificate of Incorporation, any statements concerning the Certificate of Incorporation are qualified in their entirety by reference to that document, which is included in this Proxy Statement as Exhibit A.

Capital Structure

The Bank's Certificate of Incorporation currently provides for an authorized capitalization consisting of 5,000,000 shares of common stock, par value \$5.00 per share, 6,091 shares of Series A Preferred, and 155 shares of Series B Preferred. Each series of Preferred Stock was issued pursuant to the terms of and in connection with the Bank's participation in the CPP.

The Holding Company's Certificate of Incorporation provides for an authorized capitalization consisting of 10,000,000 shares of common stock, without par value. Upon consummation of the Capitalization, the Holding Company will have approximately 1,788,262 shares of common stock outstanding (fewer shares to the extent any stockholder exercises their dissenters' rights). The Holding Company's Certificate of Incorporation also provides for 6,091 shares of Series A Preferred Stock and 155 shares of Series B Preferred Stock, which have terms and conditions identical to those of the Bank's preferred shares, other than a requirement under the terms of the CPP that dividends payable by the Holding Company are cumulative, while the Bank's Preferred Stock bore a non-cumulative dividend. As a result, in the event that the Holding Company is unable make its periodic dividend payments, the obligation to pay previously accrued and unpaid dividends may substantially increase the obligations of the Holding Company under the Preferred Stock.

Liquidation Rights

The rights of the holders of the Series A Preferred, Series B Preferred and the Common Stock of the Bank and the Holding Company upon liquidation are substantially similar. In the event of liquidation, dissolution or winding up of either the Bank or the Holding Company, holders of Series A Preferred Stock and the Series B Preferred Stock are entitled to receive a liquidation preference of \$1,000 per share, after the payment of debts and liabilities. Thereafter, any remaining capital shall be paid to the Holding Company's holders of common stock, on a pro rata per share basis.

Dividend Rights

In general, the holders of the Bank's common stock are entitled to dividends when, as, and if declared by the Bank's Board of Directors, and subject to the restrictions imposed by the Banking Act. Under the Banking Act, dividends may be paid only if, after the payment of the dividend, the capital stock of the Bank will be unimpaired and either the Bank will have a surplus of not less than 50% of its capital stock or the payment of the dividend will not reduce the Bank's surplus. The payment of dividends is also dependent upon the Bank's ability to maintain adequate capital ratios pursuant to applicable regulatory requirements.

In addition, the Bank's participation in the CPP resulted in additional dividend obligations on the Preferred Stock, as well as certain limitations on the payment of dividends on the common stock. Pursuant to the terms of the CPP, the Series A Preferred Stock bears a non-cumulative 5% dividend for the first five years it is outstanding, and at non-cumulative rate of 9% thereafter, while the Series B Preferred Stock bears a non-cumulative 9% dividend commencing upon issuance. In addition, for so long as United States Treasury, the original purchaser of all issued and outstanding shares of the Preferred Stock, remains the holder of the Preferred Stock, the following dividend restrictions apply:

- Until May 8, 2012, the third anniversary of Treasury's investment, the Bank may not increase its cash dividends paid on its common stock without Treasury's prior approval,
- Between the May 9, 2012 and May 7, 2019, the Bank may increase its cash dividends paid on its common stock, but any increase of more than 3% per year per share must be approved by Treasury;
- After May 7, 2019, the Bank may not pay cash dividends unless and until it has repurchased all of the preferred stock.

In general the holders of the Holding Company's common stock will be entitled to dividends, when, as, and if declared by the Holding Company's Board of Directors, subject to the restrictions imposed by New Jersey law. The only statutory limitation applicable to the Holding Company is that dividends may not be paid if the Holding Company is insolvent. The Holding Company will become subject to the dividend limitations imposed under the CPP, however, as it will assume the entire Bank's rights and obligations under the Preferred Stock and will issue Holding Company Preferred Stock in substitution for the outstanding Bank preferred Stock. In addition, as a practical matter, unless the Holding Company expands its activities, its only source of income will be the Bank. Therefore, the dividend restrictions applicable to the Bank described in the two preceding paragraphs will continue to impact the Holding Company's ability to pay dividends.

It is anticipated that the Holding Company's dividend policy will be similar to the dividend policy of the Bank through the time of the Capitalization. The amount and form of dividends that may be declared by the Holding Company in the future will depend upon many factors, including future earnings, capital requirements and business conditions.

Voting Rights

Under the Banking Act and the Bank's Certificate of Incorporation, each share of the Bank's common stock is entitled to one vote per share. Under New Jersey law and the Holding Company's Certificate of Incorporation, each share of the Holding Company's common stock also will be entitled to one vote per share. Cumulative voting is not permitted with respect to either the Bank or the Holding Company.

While generally the voting rights of the stockholders are the same in the Holding Company as they are in the Bank, there are several material differences. Among other things, the Banking Act requires the affirmative vote

of two-thirds of the outstanding shares to approve a merger or consolidation. Under New Jersey corporate law, the affirmative vote of a majority of the votes cast is required to approve any merger, consolidation or disposition of substantially all of the Holding Company's assets.

The Series A and Series B preferred stock are each non-voting.

Preemptive Rights

Under the Banking Act and New Jersey law, stockholders may have preemptive rights if these rights are provided in the certificate of incorporation. Neither the Certificate of Incorporation of the Bank nor the Certificate of Incorporation of the Holding Company provide for preemptive rights.

Appraisal Rights

Under the Banking Act, stockholders of the Bank have appraisal rights upon a merger or certain other reorganizations. See "RIGHTS OF DISSENTING STOCKHOLDERS."

Under New Jersey law, dissenting stockholders of the Holding Company will have appraisal rights (subject to the broad exception set forth in the next sentence) upon certain mergers or consolidations. Unlike under the Banking Act, however, appraisal rights for stockholders of the Holding Company are not available in any such transaction if shares of the corporation are listed for trading on a national securities exchange or held of record by more than 1,000 holders. In addition, appraisal rights are not available to stockholders of an acquired corporation if, as a result of the transaction, shares of the acquired corporation are exchanged for any of the following: (i) cash; (ii) any securities listed on a national securities exchange or held of record by more than 1,000 holders; or (iii) any combination of the above. New Jersey law also provides that a corporation may grant appraisal rights in other types of transactions or regardless of the consideration received by providing for such rights in its Certificate of Incorporation. The Holding Company Certificate of Incorporation does not provide appraisal rights beyond those called for under New Jersey law.

Directors

Under the Banking Act, the Bank is authorized to have a minimum of five and a maximum of 25 Directors. Within the limits prescribed by the Banking Act, the Bank's Certificate of Incorporation authorizes the Board of Directors to fix the exact number of Directors. The Bank currently has fourteen (14) Directors.

Under New Jersey law and the Holding Company's Certificate of Incorporation, the Holding Company is to have a minimum of one Director, with the number of Directors at any given time to be fixed by the Board of Directors. The members of the Board of Directors of the Bank will initially constitute the Board of Directors of the Holding Company.

Indemnification

The Certificate of Incorporation of the Holding Company provides that the Holding Company shall indemnify its officers, directors, employees and agents and former officers, directors, employees and agents, and any other persons serving at the request of the Holding Company as an officer, director, employee or agent of another corporation, association, partnership, joint venture, trust, or other enterprise, against expenses (including attorneys' fees, judgments, fines and amounts paid in settlement) incurred in connection with any pending or threatened action, suit, or proceeding, whether civil, criminal, administrative or investigative, with respect to which such officer, director, employee, agent or other person is a party, or is threatened to be made a party, to the fullest extent permitted by the New Jersey Business Corporation Act. The indemnification provided herein (i) shall not be deemed exclusive of any other right to which any person seeking indemnification may be entitled under any by-law, agreement, or vote of shareholders or disinterested directors or otherwise, both as to action in his or her official capacity and as to action in any other capacity, and (ii) shall inure to the benefit of the heirs, executors, and the administrators of any such person. The Holding Company shall have the power, but shall not be obligated, to purchase and maintain insurance on behalf of any person or persons enumerated above against any liability asserted against or incurred by them or any of them arising out of their status as corporate directors, officers, employees, or agents whether or not the Corporation would have the power to indemnify them against such liability.

The Holding Company shall, from time to time, reimburse or advance to any person referred to in the indemnification section the funds necessary for payment of expenses, including attorneys' fees, incurred in connection with any action, suit or proceeding referred to in this article, upon receipt of a written undertaking by or on behalf of such person to repay such amount(s) if a judgment or other final adjudication adverse to the director or officer establishes that the director's or officer's acts or omissions (i) constitute a breach of the director's or officer's duty of loyalty to the corporation or its shareholders, (ii) were not in good faith, (iii) involved a knowing violation of law, (iv) resulted in the director or officer receiving an improper personal benefit, or (v) were otherwise of such a character that New Jersey law would require that such amount(s) be repaid.

The By-laws of the Bank provide that the Bank shall indemnify its officers, Directors and employees to the fullest extent permitted under New Jersey law. The Banking Act provides indemnification provisions substantially similar to those found in the Certificate of Incorporation of the Holding Company.

Limitation of Liability

The Certificate of Incorporation of the Holding Company provides that a director or officer of the Holding Company shall not be personally liable to the Holding Company or its shareholders for damages for breach of any duty owed to the Holding Company or its shareholders. The preceding sentence shall not relieve a director or officer from liability for any breach of duty based upon an act or omission (i) in breach of such person's duty of loyalty to the Holding Company or its shareholders, (ii) not in good faith or involving a knowing violation of law, or (iii) resulting in receipt by such person of an improper personal benefit. If the New Jersey Business Corporation Act is amended to authorize corporate action further eliminating or limiting the personal liability of directors or officers, then the liability of a director or officer or both of the Holding Company shall be eliminated or limited to the fullest extent permitted by the New Jersey Business Corporation Act as so amended. Any amendment to the Holding Company's Certificate of Incorporation, or change in law which authorizes this paragraph of the Holding Company's Certificate of Incorporation, shall not adversely affect any then existing right or protection of a director or officer of the Holding Company.

The Certificate of Incorporation of the Bank contains a provision which is substantially similar to that included in the Holding Company's Certificate of Incorporation, limiting the liability of an officer or director of the Bank to the Bank and its stockholders. The provision in the Bank's Certificate of Incorporation contains substantially the same limitations as those contained in the Holding Company's Certificate of Incorporation.

RIGHTS OF DISSENTING STOCKHOLDERS

Under the Banking Act, stockholders may dissent from the Plan and be paid the fair value of their shares if they comply with the applicable provisions of the Banking Act. A stockholder may not dissent as to less than all of the shares owned beneficially by him or her. Stockholders contemplating the exercise of their dissenters' rights should review the procedures set forth in Sections 360 through 369 of the Banking Act, a copy of which is attached to this Proxy Statement as Exhibit D. The following is a summary of the steps which must be taken for the exercise of dissenters' rights and is qualified in its entirety by reference to the attached sections of the Banking Act.

Notice of Dissent

To be eligible to exercise his or her right of dissent, a stockholder must file with the Bank a written notice of dissent, stating that he or she intends to demand payment for his or her shares if the Plan becomes effective. The notice of dissent must be filed before the vote of the stockholders on the Plan is taken. A vote against the Plan by a stockholder does not constitute the exercise of the dissenter's rights of such stockholder. A stockholder who votes in favor of the Plan waives his right to dissent. The notice of dissent should be delivered to George E. Irwin, President and Chief Executive Officer, Highlands State Bank, 310 Route 94, Vernon, New Jersey 07462.

Written Demand

If the Plan is approved by the necessary vote of stockholders, the Bank within 10 days of the approval will notify by certified mail stockholders who have filed a notice of dissent that the Plan was approved. Within 20 days after the Bank's notice is mailed, a stockholder who wishes to dissent must file with the Bank a written demand for the payment of the fair value of his or her shares. Such written demand should be delivered to the address set forth above.

Delivery of Shares for Notation

Within 20 days after making his or her written demand for payment, the stockholder must submit his or her share certificates to the Bank. The Bank will make a notation thereon that the stockholder has made a demand to be paid the fair value of his or her shares and thereafter the certificate will merely represent the rights of a dissenting stockholder, and will not represent shares of the Bank or the Holding Company.

Demand that Bank Institute Lawsuit

Within 10 days of the later of (i) the expiration of the period within which stockholders may make a written demand or (ii) the effective date of the Plan, the Bank will mail to each dissenting stockholder the latest available 12 month profit-and-loss statement and a balance sheet as of the close of the 12 month period. The close of the profit-and-loss statement and the balance sheet will be as of a date within 12 months prior to the mailing. The Bank may accompany these financial statements with a written offer to pay a specified price but the Bank is not obligated to do so. Each stockholder will have a 30-day period following the Bank's mailing of the financial statements to agree upon a price with the Bank. If the stockholder and the Bank are unable to agree upon a price within the 30-day period, the stockholder must serve a written demand on the Bank to commence an action in the Superior Court of New Jersey for the determination of the fair value of his or her shares. The stockholder's demand to commence an action must be served not later than 30 days after the expiration of the 30-day period stockholders have in which to agree upon a price with the Bank.

Commencement of Lawsuit by Stockholder

The Bank has 30 days after receipt of the stockholder's demand to commence a proceeding in the Superior Court. If the Bank fails to institute the proceeding, the stockholder may institute the proceeding in the name of the Bank for a period of 60 days after expiration of the Bank's 30 day period.

Determination and Payment of Fair Value

In the New Jersey Superior Court proceeding, the court has jurisdiction over all dissenting stockholders who have not agreed upon a price with the Bank and may proceed in a summary fashion to determine the fair value of the shares. The court's judgment must include interest from the date of the stockholder meeting approving the Plan to the date of payment unless the court finds that the refusal of any dissenting stockholder to accept the Bank's offered price was arbitrary, vexatious or otherwise not in good faith. The costs of the action (excluding the fees and expenses of each party's attorneys and experts) and of any court-appointed appraiser will be apportioned equitably by the court. The court may in its discretion award a dissenting stockholder the reasonable fees and expenses of his or her counsel and of any experts employed by the dissenting stockholder if the court finds that the price offered by the Bank was not offered in good faith or if no such offer was made.

RECOMMENDATION AND VOTE REQUIRED FOR ADOPTION

The affirmative vote of the holders of two-thirds of the issued and outstanding stock is required to approve the Plan. Therefore, brokers' non-votes and abstentions will count as votes against the Plan. **THE BOARD OF DIRECTORS UNANIMOUSLY RECOMMENDS A VOTE "FOR" THE PLAN.**

PROPOSAL 4 - ADVISORY VOTE ON EXECUTIVE PAY

Under the ARRA, entities that participate in any assistance programs administered by the United States Department of the Treasury including the CPP are required to provide shareholders the opportunity to vote on a non-binding advisory proposal to approve the compensation of executives. The Bank closed investments with the U.S. Treasury under the CPP on May 8, 2009 and December 22, 2009. Accordingly, the Bank's shareholders are entitled to cast a non-binding advisory vote on the Bank's executive compensation.

The Bank has determined to implement this requirement by providing shareholders a simple vote that indicates their position (by a yes or no vote) with respect to the Bank's executive compensation.

Our Board of Directors, primarily through our Compensation Committee, annually reviews and approves corporate and/or individual goals and objectives relevant to the compensation of our executive officers, evaluates performance in light of those goals and objectives, and makes recommendations to the Board for compensation levels based on this evaluation. In determining any long-term incentive component of compensation, the Committee will consider all such factors as it deems relevant, such as the Bank's performance and relative shareholder return, the value of similar incentive awards at comparable companies and the awards granted in previous years. We also believe that both the Bank and shareholders benefit from these compensation policies.

The Board recommends that shareholders approve, in an advisory vote, the following resolution:

“Resolved, that the shareholders approve the executive compensation of the Bank, as described in this proxy statement, including the tabular disclosure regarding the Bank's executive officers in this Proxy Statement.”

Because your vote is advisory, it will not be binding upon the Board. However, the Compensation Committee will take into account the outcome of the vote when considering future executive compensation arrangements.

Recommendation

**THE BOARD OF DIRECTORS RECOMMENDS THAT THE STOCKHOLDERS VOTE “FOR” THE
ADVISORY PROPOSAL SET FORTH ABOVE.**

INDEPENDENT AUDITORS

The Bank's independent auditors for the fiscal year ended December 31, 2009 were ParenteBeard LLC. ParenteBeard LLC has advised the Bank that one or more of its representatives will be present at the Annual Meeting to make a statement if they so desire and to respond to appropriate questions.

Principal Accounting Firm Fees

Aggregate fees billed to the bank for the fiscal years ended December 31, 2009 and 2008 by the Bank's principal accounting firm are shown in the following table.

(In Dollars)	Fiscal Year Ended December 31,	
	2009	2008
Audit fees (1)	\$ 74,139	\$ 65,621
Audit-related fees (2)	4,812	14,922
Tax fees (3)	9,000	13,000
All other fees		
Total Fees	<u>\$ 87,951</u>	<u>\$ 93,543</u>

- (1) Includes professional services rendered for the audit of the Bank's annual financial statements and review of financial statements included in Forms 10-Q, or services normally provided in connection with statutory and regulatory filings, including review of Form 10 filed in 2009 and out-of pocket expenses.
- (2) Assurance and related services reasonably related to performance of the audit or review of financial statements including the following; assistance with accounting for business combination, preferred stock issuance, new accounting standards disclosures, deferred taxes and review of proxy statement drafts.
- (3) Tax fees include the following: preparation of state and federal taxes.

These fees were approved in accordance with the Audit Committee's policy.

**COMPLIANCE WITH SECTION 16(a)
OF THE SECURITIES EXCHANGE ACT OF 1934**

Section 16(a) of the Securities Exchange Act of 1934 requires the Bank's officers and directors, and persons who own more than ten percent of a registered class of the Bank's equity securities, to file reports of ownership and changes in ownership with the Securities and Exchange Commission. Officers, directors and greater than ten percent stockholders are required by regulation of the Securities and Exchange Commission to furnish the Bank with copies of all Section 16(a) forms they file.

The Bank believes that all persons associated with the Bank and subject to Section 16(a) have made all required Form 4 filings for the fiscal year ended December 31, 2009. However, the initial filing of beneficial ownership for each of the Bank's officers and directors was filed after the time the filing was due. The initial filings of beneficial ownership are required to be filed with the FDIC by the effective date of a bank's registration statement under the Securities Exchange Act of 1934, as amended. The Bank's Registration Statement on Form 10 was deemed effective by the FDIC upon its filing date. However, the initial statements of beneficial ownership for the Bank's officers and directors had not yet been by the effective date, and so were deemed late.

SHAREHOLDER PROPOSALS

Proposals of shareholders to be included in the Bank's 2011 proxy material must be received by the secretary of the Bank no later than December 1, 2010.

OTHER MATTERS

The Board of Directors is not aware of any other matters which may come before the Annual Meeting. However, in the event such other matters come before the meeting, it is the intention of the persons named in the proxy to vote on any such matters in accordance with the recommendation of the Board of Directors.

Shareholders are urged to sign the enclosed proxy, which is solicited on behalf of the Board of Directors, and return it in the enclosed envelope.

By Order of the Board of Directors

/s/ George E. Irwin

George E. Irwin
President, Chief Executive Officer

**AMENDMENT TO THE
CERTIFICATE OF INCORPORATION OF
HIGHLANDS STATE BANK**

By the vote of the stockholders of Highlands State Bank, it was

RESOLVED FIRST, that it is deemed advisable that Highlands State Bank (the “Bank”) be authorized to make certain administrative revisions to the terms of the Bank’s Class A Preferred Stock pursuant to the request of the holder of such stock, the United States Department of the Treasury; and

RESOLVED SECOND, that to provide for such change, the Amendment Certificate of Incorporation filed with the New Jersey Department of Banking and Insurance be amended to read as follows

Section 2 of Schedule A of Annex A:

Section 2(j) is hereby amended to provide the definition of the “Dividend Period”, with respect to the shares of Class A Preferred Stock issued on December 28, 2009, dividends will only be paid beginning on the December 28, 2009, rather than on the Original Issue Date.

The foregoing resolution was adopted by the holders of more than two-thirds of the capital stock of the institution entitled to vote on the ___th day of _____, 2010, pursuant to a resolution passed by the Board of Directors on the th day of September, 2010 (certified copy attached) deeming it advisable to adopt the amendment set forth in the said resolution.

The following is a state of the vote of the stockholders of the foregoing resolutions and also a summary of the total number of shares voted in favor thereof and the total number of shares voted against the same:

Total number of shares issued of issued capital outstanding

Total number of shares of issued capital stock voted in favor of the resolution and amendment

Total number of shares of issued capital stock voted in against

the resolution and amendment

Total number of shares of issued capital stock abstaining from
voting with respect to resolution and amendment

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It is hereby certified that this is a true and correct report of the vote and the resolutions adopted by the stockholders of this institution on the date mentioned is on file in the institution.

We further certify that the said amendment to the certificate of incorporation was made in the manner required by Article 19 of Chapter 67, Laws of 1948, as amended.

IN WITNESS WHEREOF, the president and chief executive officer and corporate secretary have hereunto set our hands and the corporate seal of said institution this ___th day of _____, 2010.

(SEAL OF INSTITUTION)

George E. Irwin
President and Chief Executive Officer

Carol J. Hults
Corporate Secretary

STATE OF NEW JERSEY)
COUNTY OF SUSSEX) SS:

On this ___th day of _____, 2010, before me personally appeared George E. Irwin and Carol J. Hults who, I am satisfied, are the President and Chief Executive Officer, and Corporate Secretary, respectively, of Highlands State Bank, the persons who executed the foregoing certificate as such officers of the corporation and I having first made known to George E. Irwin, President and Chief Executive Officer and Carol J. Hults, Corporate Secretary, the contents thereof, they acknowledged that they signed, sealed and delivered the foregoing instruments as the free and voluntary act and deed of said corporation, made by virtue of authority of its Board of Directors.

**CERTIFICATE OF INCORPORATION
OF
HIGHLANDS BANCORP, INC.**

THIS IS TO CERTIFY THAT, there is hereby organized a corporation under and by virtue of N.J.S.A. 14A:1-1 et seq., the "New Jersey Business Corporation Act."

**ARTICLE I
Corporate Name**

The name of the Corporation shall be Highlands Bancorp, Inc.

**ARTICLE II
Registered Office and Registered Agent**

The address of the Corporation's registered office is:

Highlands Bancorp, Inc.
C/O Highlands State Bank
310 Route 94
Vernon, NJ 07462

The name of the registered agent at that address is:

George E. Irwin
President and Chief Executive Officer

**ARTICLE III
Initial Board of Directors and Number of Directors**

The number of directors shall be governed by the By-laws of the Corporation. The number of directors constituting the initial Board of Directors shall be 13. The names and addresses of the initial Board of Directors are as follows:

NAME	ADDRESS
John V. Bosma	Highlands State Bank 310 Route 94 Vernon, NJ 07462
E. Jane Brown	Highlands State Bank 310 Route 94 Vernon, NJ 07462
George E. Irwin President, CEO	Highlands State Bank 310 Route 94 Vernon, NJ 07462

Andrew J. Mulvihill	Highlands State Bank 310 Route 94 Vernon, NJ 07462
Steven V. Oroho	Highlands State Bank 310 Route 94 Vernon, NJ 07462
Jeffrey M. Parrott Vice-Chairman	Highlands State Bank 310 Route 94 Vernon, NJ 07462
Dov Perlysky	Highlands State Bank 310 Route 94 Vernon, NJ 07462
Edward H. Rolando	Highlands State Bank 310 Route 94 Vernon, NJ 07462
Charles H. Shotmeyer	Highlands State Bank 310 Route 94 Vernon, NJ 07462
Martin Theobald	Highlands State Bank 310 Route 94 Vernon, NJ 07462
Douglas Verduin	Highlands State Bank 310 Route 94 Vernon, NJ 07462
Harold J. Wirths	Highlands State Bank 310 Route 94 Vernon, NJ 07462
Bruce D. Zaretsky Chairman of the Board	Highlands State Bank 310 Route 94 Vernon, NJ 07462

ARTICLE IV Corporate Purpose

The purpose for which the Corporation is organized is to engage in any activities for which corporations may be organized under the New Jersey Business Corporation Act.

ARTICLE V Capital Stock

The Corporation is authorized to issue (i) 10,000,000 shares of common stock, without par value (ii) 6,091 shares of Class A Preferred Stock, par value \$2.00, having the rights, obligations and preferences set forth below under paragraph (A) of this Article V of this Certificate of Incorporation, and (iii) 155 shares of Class B Preferred Shares, par value \$2.00 per share, with the rights, obligations and preferences set forth below under paragraph (B).

(A)

Part 1. Designation and Number of Shares. There is hereby created out of the authorized and unissued shares of preferred stock of the Issuer a series of preferred stock designated as the “Fixed Rate Cumulative Perpetual Preferred Stock, Class A” (the “Designated Preferred Stock”). The authorized number of shares of Designated Preferred Stock shall be 6,091.

Part 2. Standard Provisions. The Standard Provisions contained in Schedule A attached hereto are incorporated herein by reference in their entirety and shall be deemed to be a part of this Article V(A) of this Certificate of Incorporation to the same extent as if such provisions had been set forth in full herein.

Part 3. Definitions. The following terms are used in this Article V(A) of this Certificate of Incorporation (including the Standard Provisions in Schedule A hereto) as defined below:

- (a) “Common Stock” means the common stock, no par value per share, of the Issuer.
- (b) “Dividend Payment Date” means February 15, May 15, August 15 and November 15 of each year.
- (c) “Junior Stock” means the Common Stock, and any other class or series of stock of the Issuer the terms of which expressly provide that it ranks junior to Designated Preferred Stock as to dividend rights and/or as to rights on liquidation, dissolution or winding up of the Issuer.
- (d) “Liquidation Amount” means \$1,000 per share of Designated Preferred Stock.
- (e) “Minimum Amount” means \$ 1,362,500.
- (f) “Parity Stock” means any class or series of stock of the Issuer (other than Designated Preferred Stock) the terms of which do not expressly provide that such class or series will rank senior or junior to Designated Preferred Stock as to dividend rights and/or as to rights on liquidation, dissolution or winding up of the Issuer (in each case without regard to whether dividends accrue cumulatively or non-cumulatively).
- (e) “Signing Date” means May 8, 2009

Part 4. Certain Voting Matters. Holders of shares of Designated Preferred Stock will be entitled to one vote for each such share on any matter on which holders of Designated Preferred Stock are entitled to vote, including any action by written consent.

(B)

Part 1. Designation and Number of Shares. There is hereby created out of the authorized and unissued shares of preferred stock of the Issuer a series of preferred stock designated as the “Fixed Rate Cumulative Perpetual Preferred Stock, Class B” (the “Designated Preferred Stock”). The authorized number of shares of Designated Preferred Stock shall be 155.

Part 2. Standard Provisions. The Standard Provisions contained in Schedule B attached hereto are incorporated herein by reference in their entirety and shall be deemed to be a part of this Article V(B) of this Certificate of Incorporation to the same extent as if such provisions had been set forth in full herein.

Part. 3. Definitions. The following terms are used in this Article V(B) of this Certificate of Incorporation (including the Standard Provisions in Schedule B hereto) as defined below:

- (a) “Common Stock” means the common stock, no par value per share of the Issuer.
- (b) “Dividend Payment Date” means February 15, May 15, August 15 and November 15 of each year.
- (c) “Junior Stock” means the Common Stock and any other class or series of stock of the Issuer the terms of which expressly provide that it ranks junior to Designated Preferred Stock as to dividend rights and/or as to rights on liquidation, dissolution or winding up of the Issuer.
- (d) “Liquidation Amount” means \$1,000 per share of Designated Preferred Stock.
- (e) “Minimum Amount” means \$38,750.
- (f) “Parity Stock” means any class or series of stock of the Issuer (other than Designated Preferred Stock) the terms of which do not expressly provide that such class or series will rank senior or junior to Designated Preferred Stock as to dividend rights and/or as to rights on liquidation, dissolution or winding up of the Issuer (in each case without regard to whether dividends accrue cumulatively or non-cumulatively). Without limiting the foregoing, Parity Stock shall include the Issuer’s UST Preferred Stock.
- (g) “Signing Date” means May 8, 2009
- (h) “UST Preferred Stock” means the Issuer’s Fixed Rate Cumulative Perpetual Preferred Stock, Class A.

Part. 4. Certain Voting Matters. Holders of shares of Designated Preferred Stock will be entitled to one vote for each such share on any matter on which holders of Designated Preferred Stock are entitled to vote, including any action by written consent.

ARTICLE VI

Limitation of Liability

Subject to the following, a director or officer of the Corporation shall not be personally liable to the Corporation or its shareholders for damages for breach of any duty owed to the Corporation or its shareholders. The preceding sentence shall not relieve a director or officer from liability for any breach of duty based upon an act or omission (i) in breach of such person's duty of loyalty to the Corporation or its shareholders, (ii) not in good faith or involving a knowing violation of law, or (iii) resulting in receipt by such person of an improper personal benefit. If the New Jersey Business Corporation Act is amended to authorize corporate action further eliminating or limiting the personal liability of directors or officers, then the liability of a director or officer or both of the Corporation shall be eliminated or limited to the fullest extent permitted by the New Jersey Business Corporation Act as so amended. Any amendment to this Certificate of Incorporation, or change in law which authorizes this paragraph, shall not adversely affect any then existing right or protection of a director or officer of the Corporation.

ARTICLE VII
Indemnification

The Corporation shall indemnify its officers, directors, employees and agents and former officers, directors, employees and agents, and any other persons serving at the request of the Corporation as an officer, director, employee or agent of another corporation, association, partnership, joint venture, trust, or other enterprise, against expenses (including attorneys' fees, judgments, fines and amounts paid in settlement) incurred in connection with any pending or threatened action, suit, or proceeding, whether civil, criminal, administrative or investigative, with respect to which such officer, director, employee, agent or other person is a party, or is threatened to be made a party, to the fullest extent permitted by the New Jersey Business Corporation Act. The indemnification provided herein (i) shall not be deemed exclusive of any other right to which any person seeking indemnification may be entitled under any by-law, agreement, or vote of shareholders or disinterested directors or otherwise, both as to action in his or her official capacity and as to action in any other capacity, and (ii) shall inure to the benefit of the heirs, executors, and the administrators of any such person. The Corporation shall have the power, but shall not be obligated, to purchase and maintain insurance on behalf of any person or persons enumerated above against any liability asserted against or incurred by them or any of them arising out of their status as corporate directors, officers, employees, or agents whether or not the Corporation would have the power to indemnify them against such liability under the provisions of this article.

The Corporation shall, from time to time, reimburse or advance to any person referred to in this article the funds necessary for payment of expenses, including attorneys' fees, incurred in connection with any action, suit or proceeding referred to in this article, upon receipt of a written undertaking by or on behalf of such person to repay such amount(s) if a judgment or other final adjudication adverse to the director or officer establishes that the director's or officer's acts or omissions (i) constitute a breach of the director's or officer's duty of loyalty to the corporation or its shareholders, (ii) were not in good faith, (iii) involved a knowing violation of law, (iv) resulted in the director or officer receiving an improper personal benefit, or (v) were otherwise of such a character that New Jersey law would require that such amount(s) be repaid.

ARTICLE VIII
Name and Address of Incorporator

The name and address of the incorporator is:

Gregory T. Krauss, Esq.
120 Albany Street Plaza, FL 6
New Brunswick, New Jersey 08901

IN WITNESS WHEREOF, I, the incorporator of the above named Corporation, being over eighteen years of age, have signed this Certificate of Incorporation on the 2nd day of February, 2010.

/s/ Gregory T. Krauss

Gregory T. Krauss
Incorporator

STANDARD PROVISIONSSection 1. General Matters

Each share of Designated Preferred Stock shall be identical in all respects to every other share of Designated Preferred Stock. The Designated Preferred Stock shall be perpetual, subject to the provisions of Section 5 of these Standard Provisions that form a part of the Certificate of Designations. The Designated Preferred Stock shall rank equally with Parity Stock and shall rank senior to Junior Stock with respect to the payment of dividends and the distribution of assets in the event of any dissolution, liquidation or winding up of the Issuer.

Section 2. Standard Definitions

As used herein with respect to Designated Preferred Stock:

(a) “Applicable Dividend Rate” means (i) during the period from the Exchange Date to, but excluding, the first day of the first Dividend Period commencing on or after the fifth anniversary of the Original Issue Date, 5% per annum and (ii) from and after the first day of the first Dividend Period commencing on or after the fifth anniversary of the Original Issue Date, 9% per annum.

(b) “Appropriate Federal Banking Agency” means the “appropriate Federal banking agency” with respect to the Issuer as defined in Section 3(q) of the Federal Deposit Insurance Act (12 U.S.C. Section 1813(q)), or any successor provision.

(c) “Bank” means *Highlands State Bank*

(d) “Business Combination” means a merger, consolidation, statutory share exchange or similar transaction that requires the approval of the Issuer’s stockholders.

(e) “Business Day” means any day except Saturday, Sunday and any day on which banking institutions in the State of New York generally are authorized or required by law or other governmental actions to close.

(f) “Bylaws” means the bylaws of the Issuer, as they may be amended from time to time.

(g) “Certificate of Designations” means the Certificate of Designations or comparable instrument relating to the Designated Preferred Stock, of which these Standard Provisions form a part, as it may be amended from time to time.

(h) “Charter” means the Issuer’s certificate or articles of incorporation, articles of association, or similar organizational document.

(i) “Dividend Period” has the meaning set forth in Section 3(a).

(j) “Dividend Record Date” has the meaning set forth in Section 3(a).

(k) “Exchange Date” means the date on which the shares of preferred stock of the Bank were exchanged for shares of Designated Preferred Stock.

(l) “Liquidation Preference” has the meaning set forth in Section 4(a).

- (m) “Original Issue Date” means *May 8, 2009*
- (n) “Preferred Director” has the meaning set forth in Section 7(b).
- (o) “Preferred Stock” means any and all series of preferred stock of the Issuer, including the Designated Preferred Stock.
- (p) “Qualified Equity Offering” means the sale and issuance for cash by the Issuer to persons other than the Issuer or any of its subsidiaries after the Original Issue Date of shares of perpetual Preferred Stock, Common Stock or any combination of such stock, that, in each case, qualify as and may be included in Tier 1 capital of the Issuer at the time of issuance under the applicable risk-based capital guidelines of the Issuer’s Appropriate Federal Banking Agency (other than any such sales and issuances made pursuant to agreements or arrangements entered into, or pursuant to financing plans which were publicly announced, on or prior to November 17, 2008).
- (q) “Standard Provisions” mean these Standard Provisions that form a part of the Certificate of Designations relating to the Designated Preferred Stock.
- (r) “Successor Preferred Stock” has the meaning set forth in Section 5(a).
- (s) “Voting Parity Stock” means, with regard to any matter as to which the holders of Designated Preferred Stock are entitled to vote as specified in Sections 7(a) and 7(b) of these Standard Provisions that form a part of the Certificate of Designations, any and all series of Parity Stock upon which like voting rights have been conferred and are exercisable with respect to such matter.

Section 3. Dividends

(a) Rate. Holders of Designated Preferred Stock shall be entitled to receive, on each share of Designated Preferred Stock if, as and when declared by the Board of Directors or any duly authorized committee of the Board of Directors, but only out of assets legally available therefor, cumulative cash dividends with respect to each Dividend Period (as defined below) at a rate per annum equal to the Applicable Dividend Rate on (i) the Liquidation Amount per share of Designated Preferred Stock and (ii) the amount of accrued and unpaid dividends for any prior Dividend Period on such share of Designated Preferred Stock, if any. Such dividends shall begin to accrue and be cumulative from the Exchange Date, shall compound on each subsequent Dividend Payment Date (*i.e.*, no dividends shall accrue on other dividends unless and until the first Dividend Payment Date for such other dividends has passed without such other dividends having been paid on such date) and shall be payable quarterly in arrears on each Dividend Payment Date, commencing with the first such Dividend Payment Date to occur at least 20 calendar days after the Original Issue Date. In the event that any Dividend Payment Date would otherwise fall on a day that is not a Business Day, the dividend payment due on that date will be postponed to the next day that is a Business Day and no additional dividends will accrue as a result of that postponement. The period from and including any Dividend Payment Date to, but excluding, the next Dividend Payment Date is a “Dividend Period”, provided that the initial Dividend Period shall be the period from and including the Original Issue Date to, but excluding, the next Dividend Payment Date.

Dividends that are payable on Designated Preferred Stock in respect of any Dividend Period shall be computed on the basis of a 360-day year consisting of twelve 30-day months. The amount of dividends payable on Designated Preferred Stock on any date prior to the end of a Dividend Period, and for the initial Dividend Period, shall be computed on the basis of a 360-day year consisting of twelve 30-day months, and actual days elapsed over a 30-day month.

Dividends that are payable on Designated Preferred Stock on any Dividend Payment Date will be payable to holders of record of Designated Preferred Stock as they appear on the stock register of the Issuer on the applicable record date, which shall be the 15th calendar day immediately preceding such Dividend Payment Date or such other record date fixed by the Board of Directors or any duly authorized committee of the Board of Directors that is not more than 60 nor less than 10 days prior to such Dividend Payment Date (each, a “Dividend Record Date”). Any such day that is a Dividend Record Date shall be a Dividend Record Date whether or not such day is a Business Day.

Holders of Designated Preferred Stock shall not be entitled to any dividends, whether payable in cash, securities or other property, other than dividends (if any) declared and payable on Designated Preferred Stock as specified in this Section 3 (subject to the other provisions of the Certificate of Designations).

(b) Priority of Dividends. So long as any share of Designated Preferred Stock remains outstanding, no dividend or distribution shall be declared or paid on the Common Stock or any other shares of Junior Stock (other than dividends payable solely in shares of Common Stock) or Parity Stock, subject to the immediately following paragraph in the case of Parity Stock, and no Common Stock, Junior Stock or Parity Stock shall be, directly or indirectly, purchased, redeemed or otherwise acquired for consideration by the Issuer or any of its subsidiaries unless all accrued and unpaid dividends for all past Dividend Periods, including the latest completed Dividend Period (including, if applicable as provided in Section 3(a) above, dividends on such amount), on all outstanding shares of Designated Preferred Stock have been or are contemporaneously declared and paid in full (or have been declared and a sum sufficient for the payment thereof has been set aside for the benefit of the holders of shares of Designated Preferred Stock on the applicable record date). The foregoing limitation shall not apply to (i) redemptions, purchases or other acquisitions of shares of Common Stock or other Junior Stock in connection with the administration of any employee benefit plan in the ordinary course of business and consistent with past practice; (ii) the acquisition by the Issuer or any of its subsidiaries of record ownership in Junior Stock or Parity Stock for the beneficial ownership of any other persons (other than the Issuer or any of its subsidiaries), including as trustees or custodians; and (iii) the exchange or conversion of Junior Stock for or into other Junior Stock or of Parity Stock for or into other Parity Stock (with the same or lesser aggregate liquidation amount) or Junior Stock, in each case, solely to the extent required pursuant to binding contractual agreements entered into prior to the Signing Date or any subsequent agreement for the accelerated exercise, settlement or exchange thereof for Common Stock.

When dividends are not paid (or declared and a sum sufficient for payment thereof set aside for the benefit of the holders thereof on the applicable record date) on any Dividend Payment Date (or, in the case of Parity Stock having dividend payment dates different from the Dividend Payment Dates, on a dividend payment date falling within a Dividend Period related to such Dividend Payment Date) in full upon Designated Preferred Stock and any shares of Parity Stock, all dividends declared on Designated Preferred Stock and all such Parity Stock and payable on such Dividend Payment Date (or, in the case of Parity Stock having dividend payment dates different from the Dividend Payment Dates, on a dividend payment date falling within the Dividend Period related to such Dividend Payment Date) shall be declared *pro rata* so that the respective amounts of such dividends declared shall bear the same ratio to each other as all accrued and unpaid dividends per share on the shares of Designated Preferred Stock (including, if applicable as provided in Section 3(a) above, dividends on such amount) and all Parity Stock payable on such Dividend Payment Date (or, in the case of Parity Stock having dividend payment

dates different from the Dividend Payment Dates, on a dividend payment date falling within the Dividend Period related to such Dividend Payment Date) (subject to their having been declared by the Board of Directors or a duly authorized committee of the Board of Directors out of legally available funds and including, in the case of Parity Stock that bears cumulative dividends, all accrued but unpaid dividends) bear to each other. If the Board of Directors or a duly authorized committee of the Board of Directors determines not to pay any dividend or a full dividend on a Dividend Payment Date, the Issuer will provide written notice to the holders of Designated Preferred Stock prior to such Dividend Payment Date.

Subject to the foregoing, and not otherwise, such dividends (payable in cash, securities or other property) as may be determined by the Board of Directors or any duly authorized committee of the Board of Directors may be declared and paid on any securities, including Common Stock and other Junior Stock, from time to time out of any funds legally available for such payment, and holders of Designated Preferred Stock shall not be entitled to participate in any such dividends.

Section 4. Liquidation Rights.

(a) Voluntary or Involuntary Liquidation. In the event of any liquidation, dissolution or winding up of the affairs of the Issuer, whether voluntary or involuntary, holders of Designated Preferred Stock shall be entitled to receive for each share of Designated Preferred Stock, out of the assets of the Issuer or proceeds thereof (whether capital or surplus) available for distribution to stockholders of the Issuer, subject to the rights of any creditors of the Issuer, before any distribution of such assets or proceeds is made to or set aside for the holders of Common Stock and any other stock of the Issuer ranking junior to Designated Preferred Stock as to such distribution, payment in full in an amount equal to the sum of (i) the Liquidation Amount per share and (ii) the amount of any accrued and unpaid dividends (including, if applicable as provided in Section 3(a) above, dividends on such amount), whether or not declared, to the date of payment (such amounts collectively, the “Liquidation Preference”).

(b) Partial Payment. If in any distribution described in Section 4(a) above the assets of the Issuer or proceeds thereof are not sufficient to pay in full the amounts payable with respect to all outstanding shares of Designated Preferred Stock and the corresponding amounts payable with respect of any other stock of the Issuer ranking equally with Designated Preferred Stock as to such distribution, holders of Designated Preferred Stock and the holders of such other stock shall share ratably in any such distribution in proportion to the full respective distributions to which they are entitled.

(c) Residual Distributions. If the Liquidation Preference has been paid in full to all holders of Designated Preferred Stock and the corresponding amounts payable with respect of any other stock of the Issuer ranking equally with Designated Preferred Stock as to such distribution has been paid in full, the holders of other stock of the Issuer shall be entitled to receive all remaining assets of the Issuer (or proceeds thereof) according to their respective rights and preferences.

(d) Merger, Consolidation and Sale of Assets Not Liquidation. For purposes of this Section 4, the merger or consolidation of the Issuer with any other corporation or other entity, including a merger or consolidation in which the holders of Designated Preferred Stock receive cash, securities or other property for their shares, or the sale, lease or exchange (for cash, securities or other property) of all or substantially all of the assets of the Issuer, shall not constitute a liquidation, dissolution or winding up of the Issuer.

Section 5. Redemption.

(a) Optional Redemption. Except as provided below, the Designated Preferred Stock may not be redeemed prior to the first Dividend Payment Date falling on or after the third anniversary of the Original Issue Date. On or after the first Dividend Payment Date falling on or after the third anniversary of the Original Issue Date, the Issuer, at its option, subject to the approval of the Appropriate Federal Banking Agency, may redeem, in whole or in part, at any time and from time to time, out of funds legally available therefor, the shares of Designated Preferred Stock at the time outstanding, upon notice given as provided in Section 5(c) below, at a redemption price equal to the sum of (i) the Liquidation Amount per share and (ii) except as otherwise provided below, any accrued and unpaid dividends (including, if applicable as provided in Section 3(a) above, dividends on such amount) (regardless of whether any dividends are actually declared) to, but excluding, the date fixed for redemption.

Notwithstanding the foregoing, prior to the first Dividend Payment Date falling on or after the third anniversary of the Original Issue Date, the Issuer, at its option, subject to the approval of the Appropriate Federal Banking Agency, may redeem, in whole or in part, at any time and from time to time, the shares of Designated Preferred Stock at the time outstanding, upon notice given as provided in Section 5(c) below, at a redemption price equal to the sum of (i) the Liquidation Amount per share and (ii) except as otherwise provided below, any accrued and unpaid dividends (including, if applicable as provided in Section 3(a) above, dividends on such amount) (regardless of whether any dividends are actually declared) to, but excluding, the date fixed for redemption; *provided* that (x) the Issuer (or any successor by Business Combination) has received aggregate gross proceeds of not less than the Minimum Amount (plus the “Minimum Amount” as defined in the relevant certificate of designations for each other outstanding series of preferred stock of such successor that was originally issued to the United States Department of the Treasury (the “Successor Preferred Stock”) in connection with the Troubled Asset Relief Program Capital Purchase Program) from one or more Qualified Equity Offerings (including Qualified Equity Offerings of such successor), and (y) the aggregate redemption price of the Designated Preferred Stock (and any Successor Preferred Stock) redeemed pursuant to this paragraph may not exceed the aggregate net cash proceeds received by the Issuer (or any successor by Business Combination) from such Qualified Equity Offerings (including Qualified Equity Offerings of such successor).

The redemption price for any shares of Designated Preferred Stock shall be payable on the redemption date to the holder of such shares against surrender of the certificate(s) evidencing such shares to the Issuer or its agent. Any declared but unpaid dividends payable on a redemption date that occurs subsequent to the Dividend Record Date for a Dividend Period shall not be paid to the holder entitled to receive the redemption price on the redemption date, but rather shall be paid to the holder of record of the redeemed shares on such Dividend Record Date relating to the Dividend Payment Date as provided in Section 3 above.

(b) No Sinking Fund. The Designated Preferred Stock will not be subject to any mandatory redemption, sinking fund or other similar provisions. Holders of Designated Preferred Stock will have no right to require redemption or repurchase of any shares of Designated Preferred Stock.

(c) Notice of Redemption. Notice of every redemption of shares of Designated Preferred Stock shall be given by first class mail, postage prepaid, addressed to the holders of record of the shares to be redeemed at their respective last addresses appearing on the books of the Issuer. Such mailing shall be at least 30 days and not more than 60 days before the date fixed for redemption. Any notice mailed as provided in this Subsection shall be conclusively presumed to have been duly given, whether or not the holder receives such notice, but failure duly to give such notice by mail, or any defect in such notice or in the mailing thereof, to any holder of shares of Designated Preferred Stock designated for redemption shall

not affect the validity of the proceedings for the redemption of any other shares of Designated Preferred Stock. Notwithstanding the foregoing, if shares of Designated Preferred Stock are issued in book-entry form through The Depository Trust Company or any other similar facility, notice of redemption may be given to the holders of Designated Preferred Stock at such time and in any manner permitted by such facility. Each notice of redemption given to a holder shall state: (1) the redemption date; (2) the number of shares of Designated Preferred Stock to be redeemed and, if less than all the shares held by such holder are to be redeemed, the number of such shares to be redeemed from such holder; (3) the redemption price; and (4) the place or places where certificates for such shares are to be surrendered for payment of the redemption price.

(d) Partial Redemption. In case of any redemption of part of the shares of Designated Preferred Stock at the time outstanding, the shares to be redeemed shall be selected either *pro rata* or in such other manner as the Board of Directors or a duly authorized committee thereof may determine to be fair and equitable. Subject to the provisions hereof, the Board of Directors or a duly authorized committee thereof shall have full power and authority to prescribe the terms and conditions upon which shares of Designated Preferred Stock shall be redeemed from time to time. If fewer than all the shares represented by any certificate are redeemed, a new certificate shall be issued representing the unredeemed shares without charge to the holder thereof.

(e) Effectiveness of Redemption. If notice of redemption has been duly given and if on or before the redemption date specified in the notice all funds necessary for the redemption have been deposited by the Issuer, in trust for the *pro rata* benefit of the holders of the shares called for redemption, with a bank or trust company doing business in the Borough of Manhattan, The City of New York, and having a capital and surplus of at least \$500 million and selected by the Board of Directors, so as to be and continue to be available solely therefor, then, notwithstanding that any certificate for any share so called for redemption has not been surrendered for cancellation, on and after the redemption date dividends shall cease to accrue on all shares so called for redemption, all shares so called for redemption shall no longer be deemed outstanding and all rights with respect to such shares shall forthwith on such redemption date cease and terminate, except only the right of the holders thereof to receive the amount payable on such redemption from such bank or trust company, without interest. Any funds unclaimed at the end of three years from the redemption date shall, to the extent permitted by law, be released to the Issuer, after which time the holders of the shares so called for redemption shall look only to the Issuer for payment of the redemption price of such shares.

(f) Status of Redeemed Shares. Shares of Designated Preferred Stock that are redeemed, repurchased or otherwise acquired by the Issuer shall revert to authorized but unissued shares of Preferred Stock (*provided* that any such cancelled shares of Designated Preferred Stock may be reissued only as shares of any series of Preferred Stock other than Designated Preferred Stock).

Section 6. Conversion. Holders of Designated Preferred Stock shares shall have no right to exchange or convert such shares into any other securities.

Section 7. Voting Rights.

(a) General. The holders of Designated Preferred Stock shall not have any voting rights except as set forth below or as otherwise from time to time required by law.

(b) Preferred Stock Directors. Whenever, at any time or times, dividends payable on the shares of Designated Preferred Stock have not been paid for an aggregate of six quarterly Dividend Periods or more, whether or not consecutive, the authorized number of directors of the Issuer shall automatically be increased by two and the holders of the Designated Preferred Stock shall have the right, with holders of shares of any one or more other classes or series of Voting Parity Stock outstanding at the time, voting together as a class, to elect two directors (hereinafter the "Preferred Directors") and each a

“Preferred Director”) to fill such newly created directorships at the Issuer’s next annual meeting of stockholders (or at a special meeting called for that purpose prior to such next annual meeting) and at each subsequent annual meeting of stockholders until all accrued and unpaid dividends for all past Dividend Periods, including the latest completed Dividend Period (including, if applicable as provided in Section 3(a) above, dividends on such amount), on all outstanding shares of Designated Preferred Stock have been declared and paid in full at which time such right shall terminate with respect to the Designated Preferred Stock, except as herein or by law expressly provided, subject to reversion in the event of each and every subsequent default of the character above mentioned; *provided* that it shall be a qualification for election for any Preferred Director that the election of such Preferred Director shall not cause the Issuer to violate any corporate governance requirements of any securities exchange or other trading facility on which securities of the Issuer may then be listed or traded that listed or traded companies must have a majority of independent directors. Upon any termination of the right of the holders of shares of Designated Preferred Stock and Voting Parity Stock as a class to vote for directors as provided above, the Preferred Directors shall cease to be qualified as directors, the term of office of all Preferred Directors then in office shall terminate immediately and the authorized number of directors shall be reduced by the number of Preferred Directors elected pursuant hereto. Any Preferred Director may be removed at any time, with or without cause, and any vacancy created thereby may be filled, only by the affirmative vote of the holders a majority of the shares of Designated Preferred Stock at the time outstanding voting separately as a class together with the holders of shares of Voting Parity Stock, to the extent the voting rights of such holders described above are then exercisable. If the office of any Preferred Director becomes vacant for any reason other than removal from office as aforesaid, the remaining Preferred Director may choose a successor who shall hold office for the unexpired term in respect of which such vacancy occurred.

(c) Class Voting Rights as to Particular Matters. So long as any shares of Designated Preferred Stock are outstanding, in addition to any other vote or consent of stockholders required by law or by the Charter, the vote or consent of the holders of at least 66 2/3% of the shares of Designated Preferred Stock at the time outstanding, voting as a separate class, given in person or by proxy, either in writing without a meeting or by vote at any meeting called for the purpose, shall be necessary for effecting or validating:

(i) Authorization of Senior Stock. Any amendment or alteration of the Certificate of Designations for the Designated Preferred Stock or the Charter to authorize or create or increase the authorized amount of, or any issuance of, any shares of, or any securities convertible into or exchangeable or exercisable for shares of, any class or series of capital stock of the Issuer ranking senior to Designated Preferred Stock with respect to either or both the payment of dividends and/or the distribution of assets on any liquidation, dissolution or winding up of the Issuer;

(ii) Amendment of Designated Preferred Stock. Any amendment, alteration or repeal of any provision of the Certificate of Designations for the Designated Preferred Stock or the Charter (including, unless no vote on such merger or consolidation is required by Section 7(c)(iii) below, any amendment, alteration or repeal by means of a merger, consolidation or otherwise) so as to adversely affect the rights, preferences, privileges or voting powers of the Designated Preferred Stock; or

(iii) Share Exchanges, Reclassifications, Mergers and Consolidations. Any consummation of a binding share exchange or reclassification involving the Designated Preferred Stock, or of a merger or consolidation of the Issuer with another corporation or other entity, unless in each case (x) the shares of Designated Preferred Stock remain outstanding or, in the case of any such merger or consolidation with respect to which the Issuer is not the surviving or

provided, however, that for all purposes of this Section 7(c), any increase in the amount of the authorized Preferred Stock, including any increase in the authorized amount of Designated Preferred Stock necessary to satisfy preemptive or similar rights granted by the Issuer to other persons prior to the Signing Date, or the creation and issuance, or an increase in the authorized or issued amount, whether pursuant to preemptive or similar rights or otherwise, of any other series of Preferred Stock, or any securities convertible into or exchangeable or exercisable for any other series of Preferred Stock, ranking equally with and/or junior to Designated Preferred Stock with respect to the payment of dividends (whether such dividends are cumulative or non-cumulative) and the distribution of assets upon liquidation, dissolution or winding up of the Issuer will not be deemed to adversely affect the rights, preferences, privileges or voting powers, and shall not require the affirmative vote or consent of, the holders of outstanding shares of the Designated Preferred Stock.

(d) Changes after Provision for Redemption. No vote or consent of the holders of Designated Preferred Stock shall be required pursuant to Section 7(c) above if, at or prior to the time when any such vote or consent would otherwise be required pursuant to such Section, all outstanding shares of the Designated Preferred Stock shall have been redeemed, or shall have been called for redemption upon proper notice and sufficient funds shall have been deposited in trust for such redemption, in each case pursuant to Section 5 above.

(e) Procedures for Voting and Consents. The rules and procedures for calling and conducting any meeting of the holders of Designated Preferred Stock (including, without limitation, the fixing of a record date in connection therewith), the solicitation and use of proxies at such a meeting, the obtaining of written consents and any other aspect or matter with regard to such a meeting or such consents shall be governed by any rules of the Board of Directors or any duly authorized committee of the Board of Directors, in its discretion, may adopt from time to time, which rules and procedures shall conform to the requirements of the Charter, the Bylaws, and applicable law and the rules of any national securities exchange or other trading facility on which Designated Preferred Stock is listed or traded at the time.

Section 8. Record Holders. To the fullest extent permitted by applicable law, the Issuer and the transfer agent for Designated Preferred Stock may deem and treat the record holder of any share of Designated Preferred Stock as the true and lawful owner thereof for all purposes, and neither the Issuer nor such transfer agent shall be affected by any notice to the contrary.

Section 9. Notices. All notices or communications in respect of Designated Preferred Stock shall be sufficiently given if given in writing and delivered in person or by first class mail, postage prepaid, or if given in such other manner as may be permitted in this Certificate of Designations, in the Charter or Bylaws or by applicable law. Notwithstanding the foregoing, if shares of Designated Preferred Stock are issued in book-entry form through The Depository Trust Company or any similar facility, such notices may be given to the holders of Designated Preferred Stock in any manner permitted by such facility.

Section 10. No Preemptive Rights. No share of Designated Preferred Stock shall have any rights of preemption whatsoever as to any securities of the Issuer, or any warrants, rights or options issued or granted with respect thereto, regardless of how such securities, or such warrants, rights or options, may be designated, issued or granted.

Section 11. Replacement Certificates. The Issuer shall replace any mutilated certificate at the holder's expense upon surrender of that certificate to the Issuer. The Issuer shall replace certificates that become destroyed, stolen or lost at the holder's expense upon delivery to the Issuer of reasonably satisfactory evidence that the certificate has been destroyed, stolen or lost, together with any indemnity that may be reasonably required by the Issuer.

Section 12. Other Rights. The shares of Designated Preferred Stock shall not have any rights, preferences, privileges or voting powers or relative, participating, optional or other special rights, or qualifications, limitations or restrictions thereof, other than as set forth herein or in the Charter or as provided by applicable law.

STANDARD PROVISIONS

Section 1. General Matters. Each share of Designated Preferred Stock shall be identical in all respects to every other share of Designated Preferred Stock. The Designated Preferred Stock shall be perpetual, subject to the provisions of Section 5 of these Standard Provisions that form a part of the Certificate of Designations. The Designated Preferred Stock shall rank equally with Parity Stock and shall rank senior to Junior Stock with respect to the payment of dividends and the distribution of assets in the event of any dissolution, liquidation or winding up of the Issuer. Standard Definitions. As used herein with respect to Designated Preferred Stock:

(a) “Appropriate Federal Banking Agency” means the “appropriate Federal banking agency” with respect to the Issuer as defined in Section 3(q) of the Federal Deposit Insurance Act (12 U.S.C. Section 1813(q)), or any successor provision.

(b) “Bank” means *Highlands State Bank*

(c) “Business Combination” means a merger, consolidation, statutory share exchange or similar transaction that requires the approval of the Issuer’s stockholders.

(d) “Business Day” means any day except Saturday, Sunday and any day on which banking institutions in the State of New York generally are authorized or required by law or other governmental actions to close.

(e) “Bylaws” means the bylaws of the Issuer, as they may be amended from time to time.

(f) “Certificate of Designations” means the Certificate of Designations or comparable instrument relating to the Designated Preferred Stock, of which these Standard Provisions form a part, as it may be amended from time to time.

(g) “Charter” means the Issuer’s certificate or articles of incorporation, articles of association, or similar organizational document.

(h) “Dividend Period” has the meaning set forth in Section 3(a).

(i) “Dividend Record Date” has the meaning set forth in Section 3(a).

(j) “Exchange Date” means the date on which the shares of preferred stock of the Bank were exchanged for shares of Designated Preferred Stock.

(k) “Liquidation Preference” has the meaning set forth in Section 4(a).

(l) “Original Issue Date” May 8, 2009

(m) “Preferred Director” has the meaning set forth in Section 7(b).

(n) “Preferred Stock” means any and all series of preferred stock of the Issuer, including the Designated Preferred Stock.

(o) “Qualified Equity Offering” means the sale and issuance for cash by the Issuer to persons other than the Issuer or any of its subsidiaries after the Original Issue Date of shares of perpetual Preferred Stock, Common Stock or any combination of such stock, that, in each case, qualify as and may be included in Tier 1 capital of the Issuer at the time of issuance under the applicable risk-based capital guidelines of the Issuer’s Appropriate Federal Banking Agency (other than any such sales and issuances made pursuant to agreements or arrangements entered into, or pursuant to financing plans which were publicly announced, on or prior to November 17, 2008).

(p) “Standard Provisions” mean these Standard Provisions that form a part of the Certificate of Designations relating to the Designated Preferred Stock.

(q) “Successor Preferred Stock” has the meaning set forth in Section 5(a).

(r) “Voting Parity Stock” means, with regard to any matter as to which the holders of Designated Preferred Stock are entitled to vote as specified in Sections 7(a) and 7(b) of these Standard Provisions that form a part of the Certificate of Designations, any and all series of Parity Stock upon which like voting rights have been conferred and are exercisable with respect to such matter.

Section 3. Dividends.

(a) Rate. Holders of Designated Preferred Stock shall be entitled to receive, on each share of Designated Preferred Stock if, as and when declared by the Board of Directors or any duly authorized committee of the Board of Directors, but only out of assets legally available therefor, cumulative cash dividends with respect to each Dividend Period (as defined below) at a per annum rate of 9.0% on (i) the Liquidation Amount per share of Designated Preferred Stock and (ii) the amount of accrued and unpaid dividends for any prior Dividend Period on such share of Designated Preferred Stock, if any. Such dividends shall begin to accrue and be cumulative from the Exchange Date, shall compound on each subsequent Dividend Payment Date (*i.e.*, no dividends shall accrue on other dividends unless and until the first Dividend Payment Date for such other dividends has passed without such other dividends having been paid on such date) and shall be payable quarterly in arrears on each Dividend Payment Date, commencing with the first such Dividend Payment Date to occur at least 20 calendar days after the Original Issue Date. In the event that any Dividend Payment Date would otherwise fall on a day that is not a Business Day, the dividend payment due on that date will be postponed to the next day that is a Business Day and no additional dividends will accrue as a result of that postponement. The period from and including any Dividend Payment Date to, but excluding, the next Dividend Payment Date is a “Dividend Period”, provided that the initial Dividend Period shall be the period from and including the Original Issue Date to, but excluding, the next Dividend Payment Date.

Dividends that are payable on Designated Preferred Stock in respect of any Dividend Period shall be computed on the basis of a 360-day year consisting of twelve 30-day months. The amount of dividends payable on Designated Preferred Stock on any date prior to the end of a Dividend Period, and for the initial Dividend Period, shall be computed on the basis of a 360-day year consisting of twelve 30-day months, and actual days elapsed over a 30-day month.

Dividends that are payable on Designated Preferred Stock on any Dividend Payment Date will be payable to holders of record of Designated Preferred Stock as they appear on the stock register of the Issuer on the applicable record date, which shall be the 15th calendar day immediately preceding such Dividend Payment Date or such other record date fixed by the Board of Directors or any duly authorized committee of the Board of Directors that is not more than 60 nor less than 10 days prior to such Dividend Payment Date (each, a “Dividend Record Date”). Any such day that is a Dividend Record Date shall be a Dividend Record Date whether or not such day is a Business Day.

Holders of Designated Preferred Stock shall not be entitled to any dividends, whether payable in cash, securities or other property, other than dividends (if any) declared and payable on Designated Preferred Stock as specified in this Section 3 (subject to the other provisions of the Certificate of Designations).

(b) Priority of Dividends. So long as any share of Designated Preferred Stock remains outstanding, no dividend or distribution shall be declared or paid on the Common Stock or any other shares of Junior Stock (other than dividends payable solely in shares of Common Stock) or Parity Stock, subject to the immediately following paragraph in the case of Parity Stock, and no Common Stock, Junior Stock or Parity Stock shall be, directly or indirectly, purchased, redeemed or otherwise acquired for consideration by the Issuer or any of its subsidiaries unless all accrued and unpaid dividends for all past Dividend Periods, including the latest completed Dividend Period (including, if applicable as provided in Section 3(a) above, dividends on such amount), on all outstanding shares of Designated Preferred Stock have been or are contemporaneously declared and paid in full (or have been declared and a sum sufficient for the payment thereof has been set aside for the benefit of the holders of shares of Designated Preferred Stock on the applicable record date). The foregoing limitation shall not apply to (i) redemptions, purchases or other acquisitions of shares of Common Stock or other Junior Stock in connection with the administration of any employee benefit plan in the ordinary course of business and consistent with past practice; (ii) the acquisition by the Issuer or any of its subsidiaries of record ownership in Junior Stock or Parity Stock for the beneficial ownership of any other persons (other than the Issuer or any of its subsidiaries), including as trustees or custodians; and (iii) the exchange or conversion of Junior Stock for or into other Junior Stock or of Parity Stock for or into other Parity Stock (with the same or lesser aggregate liquidation amount) or Junior Stock, in each case, solely to the extent required pursuant to binding contractual agreements entered into prior to the Signing Date or any subsequent agreement for the accelerated exercise, settlement or exchange thereof for Common Stock.

When dividends are not paid (or declared and a sum sufficient for payment thereof set aside for the benefit of the holders thereof on the applicable record date) on any Dividend Payment Date (or, in the case of Parity Stock having dividend payment dates different from the Dividend Payment Dates, on a dividend payment date falling within a Dividend Period related to such Dividend Payment Date) in full upon Designated Preferred Stock and any shares of Parity Stock, all dividends declared on Designated Preferred Stock and all such Parity Stock and payable on such Dividend Payment Date (or, in the case of Parity Stock having dividend payment dates different from the Dividend Payment Dates, on a dividend payment date falling within the Dividend Period related to such Dividend Payment Date) shall be declared *pro rata* so that the respective amounts of such dividends declared shall bear the same ratio to each other as all accrued and unpaid dividends per share on the shares of Designated Preferred Stock (including, if applicable as provided in Section 3(a) above, dividends on such amount) and all Parity Stock payable on such Dividend Payment Date (or, in the case of Parity Stock having dividend payment dates different from the Dividend Payment Dates, on a dividend payment date falling within the Dividend Period related to such Dividend Payment Date) (subject to their having been declared by the Board of Directors or a duly authorized committee of the Board of Directors out of legally available funds and including, in the case of Parity Stock that bears cumulative dividends, all accrued but unpaid dividends) bear to each other. If the Board of Directors or a duly authorized committee of the Board of Directors determines not to pay any dividend or a full dividend on a Dividend Payment Date, the Issuer will provide written notice to the holders of Designated Preferred Stock prior to such Dividend Payment Date.

Subject to the foregoing, and not otherwise, such dividends (payable in cash, securities or other property) as may be determined by the Board of Directors or any duly authorized committee of the Board of Directors may be declared and paid on any securities, including Common Stock and other Junior Stock, from time to time out of any funds legally available for such payment, and holders of Designated Preferred Stock shall not be entitled to participate in any such dividends.

Section 4. Liquidation Rights Voluntary or Involuntary Liquidation. In the event of any liquidation, dissolution or winding up of the affairs of the Issuer, whether voluntary or involuntary, holders of Designated Preferred Stock shall be entitled to receive for each share of Designated Preferred Stock, out of the assets of the Issuer or proceeds thereof (whether capital or surplus) available for distribution to stockholders of the Issuer, subject to the rights of any creditors of the Issuer, before any distribution of such assets or proceeds is made to or set aside for the holders of Common Stock and any other stock of the Issuer ranking junior to Designated Preferred Stock as to such distribution, payment in full in an amount equal to the sum of (i) the Liquidation Amount per share and (ii) the amount of any accrued and unpaid dividends (including, if applicable as provided in Section 3(a) above, dividends on such amount), whether or not declared, to the date of payment (such amounts collectively, the “Liquidation Preference”).

(b) **Partial Payment.** If in any distribution described in Section 4(a) above the assets of the Issuer or proceeds thereof are not sufficient to pay in full the amounts payable with respect to all outstanding shares of Designated Preferred Stock and the corresponding amounts payable with respect of any other stock of the Issuer ranking equally with Designated Preferred Stock as to such distribution, holders of Designated Preferred Stock and the holders of such other stock shall share ratably in any such distribution in proportion to the full respective distributions to which they are entitled.

(c) **Residual Distributions.** If the Liquidation Preference has been paid in full to all holders of Designated Preferred Stock and the corresponding amounts payable with respect of any other stock of the Issuer ranking equally with Designated Preferred Stock as to such distribution has been paid in full, the holders of other stock of the Issuer shall be entitled to receive all remaining assets of the Issuer (or proceeds thereof) according to their respective rights and preferences.

(d) **Merger, Consolidation and Sale of Assets Not Liquidation.** For purposes of this Section 4, the merger or consolidation of the Issuer with any other corporation or other entity, including a merger or consolidation in which the holders of Designated Preferred Stock receive cash, securities or other property for their shares, or the sale, lease or exchange (for cash, securities or other property) of all or substantially all of the assets of the Issuer, shall not constitute a liquidation, dissolution or winding up of the Issuer.

Section 5. Redemption.

(a) **Optional Redemption.** Except as provided below, the Designated Preferred Stock may not be redeemed prior to the later of (i) first Dividend Payment Date falling on or after the third anniversary of the Original Issue Date; and (ii) the date on which all outstanding shares of UST Preferred Stock have been redeemed, repurchased or otherwise acquired by the Issuer. On or after the first Dividend Payment Date falling on or after the third anniversary of the Original Issue Date, the Issuer, at its option, subject to the approval of the Appropriate Federal Banking Agency, may redeem, in whole or in part, at any time and from time to time, out of funds legally available therefor, the shares of Designated Preferred Stock at the time outstanding, upon notice given as provided in Section 5(c) below, at a redemption price equal to the sum of (i) the Liquidation Amount per share and (ii) except as otherwise provided below, any accrued and unpaid dividends (including, if applicable as provided in Section 3(a) above, dividends on such amount) (regardless of whether any dividends are actually declared) to, but excluding, the date fixed for redemption.

Notwithstanding the foregoing, prior to the first Dividend Payment Date falling on or after the third anniversary of the Original Issue Date, the Issuer, at its option, subject to the approval of the Appropriate Federal Banking Agency and subject to the requirement that all outstanding shares of UST Preferred Stock shall previously have been redeemed, repurchased or otherwise acquired by the Issuer,

may redeem, in whole or in part, at any time and from time to time, the shares of Designated Preferred Stock at the time outstanding, upon notice given as provided in Section 5(c) below, at a redemption price equal to the sum of (i) the Liquidation Amount per share and (ii) except as otherwise provided below, any accrued and unpaid dividends (including, if applicable as provided in Section 3(a) above, dividends on such amount) (regardless of whether any dividends are actually declared) to, but excluding, the date fixed for redemption; *provided* that (x) the Issuer (or any successor by Business Combination) has received aggregate gross proceeds of not less than the Minimum Amount (plus the “Minimum Amount” as defined in the relevant certificate of designations for each other outstanding series of preferred stock of such successor that was originally issued to the United States Department of the Treasury (the “Successor Preferred Stock”) in connection with the Troubled Asset Relief Program Capital Purchase Program) from one or more Qualified Equity Offerings (including Qualified Equity Offerings of such successor), and (y) the aggregate redemption price of the Designated Preferred Stock (and any Successor Preferred Stock) redeemed pursuant to this paragraph may not exceed the aggregate net cash proceeds received by the Issuer (or any successor by Business Combination) from such Qualified Equity Offerings (including Qualified Equity Offerings of such successor).

The redemption price for any shares of Designated Preferred Stock shall be payable on the redemption date to the holder of such shares against surrender of the certificate(s) evidencing such shares to the Issuer or its agent. Any declared but unpaid dividends payable on a redemption date that occurs subsequent to the Dividend Record Date for a Dividend Period shall not be paid to the holder entitled to receive the redemption price on the redemption date, but rather shall be paid to the holder of record of the redeemed shares on such Dividend Record Date relating to the Dividend Payment Date as provided in Section 3 above.

(b) No Sinking Fund. The Designated Preferred Stock will not be subject to any mandatory redemption, sinking fund or other similar provisions. Holders of Designated Preferred Stock will have no right to require redemption or repurchase of any shares of Designated Preferred Stock.

(c) Notice of Redemption. Notice of every redemption of shares of Designated Preferred Stock shall be given by first class mail, postage prepaid, addressed to the holders of record of the shares to be redeemed at their respective last addresses appearing on the books of the Issuer. Such mailing shall be at least 30 days and not more than 60 days before the date fixed for redemption. Any notice mailed as provided in this Subsection shall be conclusively presumed to have been duly given, whether or not the holder receives such notice, but failure duly to give such notice by mail, or any defect in such notice or in the mailing thereof, to any holder of shares of Designated Preferred Stock designated for redemption shall not affect the validity of the proceedings for the redemption of any other shares of Designated Preferred Stock. Notwithstanding the foregoing, if shares of Designated Preferred Stock are issued in book-entry form through The Depository Trust Company or any other similar facility, notice of redemption may be given to the holders of Designated Preferred Stock at such time and in any manner permitted by such facility. Each notice of redemption given to a holder shall state: (1) the redemption date; (2) the number of shares of Designated Preferred Stock to be redeemed and, if less than all the shares held by such holder are to be redeemed, the number of such shares to be redeemed from such holder; (3) the redemption price; and (4) the place or places where certificates for such shares are to be surrendered for payment of the redemption price.

(d) Partial Redemption. In case of any redemption of part of the shares of Designated Preferred Stock at the time outstanding, the shares to be redeemed shall be selected either *pro rata* or in such other manner as the Board of Directors or a duly authorized committee thereof may determine to be fair and equitable. Subject to the provisions hereof, the Board of Directors or a duly authorized committee

(e) Effectiveness of Redemption. If notice of redemption has been duly given and if on or before the redemption date specified in the notice all funds necessary for the redemption have been deposited by the Issuer, in trust for the *pro rata* benefit of the holders of the shares called for redemption, with a bank or trust company doing business in the Borough of Manhattan, The City of New York, and having a capital and surplus of at least \$500 million and selected by the Board of Directors, so as to be and continue to be available solely therefor, then, notwithstanding that any certificate for any share so called for redemption has not been surrendered for cancellation, on and after the redemption date dividends shall cease to accrue on all shares so called for redemption, all shares so called for redemption shall no longer be deemed outstanding and all rights with respect to such shares shall forthwith on such redemption date cease and terminate, except only the right of the holders thereof to receive the amount payable on such redemption from such bank or trust company, without interest. Any funds unclaimed at the end of three years from the redemption date shall, to the extent permitted by law, be released to the Issuer, after which time the holders of the shares so called for redemption shall look only to the Issuer for payment of the redemption price of such shares.

(f) Status of Redeemed Shares. Shares of Designated Preferred Stock that are redeemed, repurchased or otherwise acquired by the Issuer shall revert to authorized but unissued shares of Preferred Stock (*provided* that any such cancelled shares of Designated Preferred Stock may be reissued only as shares of any series of Preferred Stock other than Designated Preferred Stock).

Section 6. Conversion. Holders of Designated Preferred Stock shares shall have no right to exchange or convert such shares into any other securities.

Section 7. Voting Rights.

(a) General. The holders of Designated Preferred Stock shall not have any voting rights except as set forth below or as otherwise from time to time required by law.

(b) Preferred Stock Directors. Whenever, at any time or times, dividends payable on the shares of Designated Preferred Stock have not been paid for an aggregate of six quarterly Dividend Periods or more, whether or not consecutive, the authorized number of directors of the Issuer shall automatically be increased by two and the holders of the Designated Preferred Stock shall have the right, with holders of shares of any one or more other classes or series of Voting Parity Stock outstanding at the time, voting together as a class, to elect two directors (hereinafter the "Preferred Directors" and each a "Preferred Director") to fill such newly created directorships at the Issuer's next annual meeting of stockholders (or at a special meeting called for that purpose prior to such next annual meeting) and at each subsequent annual meeting of stockholders until all accrued and unpaid dividends for all past Dividend Periods, including the latest completed Dividend Period (including, if applicable as provided in Section 3(a) above, dividends on such amount), on all outstanding shares of Designated Preferred Stock have been declared and paid in full at which time such right shall terminate with respect to the Designated Preferred Stock, except as herein or by law expressly provided, subject to reversion in the event of each and every subsequent default of the character above mentioned; *provided* that it shall be a qualification for election for any Preferred Director that the election of such Preferred Director shall not cause the Issuer to violate any corporate governance requirements of any securities exchange or other trading facility on which securities of the Issuer may then be listed or traded that listed or traded companies must have a majority of independent directors. Upon any termination of the right of the holders of shares of

(c) Class Voting Rights as to Particular Matters. So long as any shares of Designated Preferred Stock are outstanding, in addition to any other vote or consent of stockholders required by law or by the Charter, the vote or consent of the holders of at least 66 2/3% of the shares of Designated Preferred Stock at the time outstanding, voting as a separate class, given in person or by proxy, either in writing without a meeting or by vote at any meeting called for the purpose, shall be necessary for effecting or validating:

(i) Authorization of Senior Stock. Any amendment or alteration of the Certificate of Designations for the Designated Preferred Stock or the Charter to authorize or create or increase the authorized amount of, or any issuance of, any shares of, or any securities convertible into or exchangeable or exercisable for shares of, any class or series of capital stock of the Issuer ranking senior to Designated Preferred Stock with respect to either or both the payment of dividends and/or the distribution of assets on any liquidation, dissolution or winding up of the Issuer;

(ii) Amendment of Designated Preferred Stock. Any amendment, alteration or repeal of any provision of the Certificate of Designations for the Designated Preferred Stock or the Charter (including, unless no vote on such merger or consolidation is required by Section 7(c)(iii) below, any amendment, alteration or repeal by means of a merger, consolidation or otherwise) so as to adversely affect the rights, preferences, privileges or voting powers of the Designated Preferred Stock; or

(iii) Share Exchanges, Reclassifications, Mergers and Consolidations. Any consummation of a binding share exchange or reclassification involving the Designated Preferred Stock, or of a merger or consolidation of the Issuer with another corporation or other entity, unless in each case (x) the shares of Designated Preferred Stock remain outstanding or, in the case of any such merger or consolidation with respect to which the Issuer is not the surviving or resulting entity, are converted into or exchanged for preference securities of the surviving or resulting entity or its ultimate parent, and (y) such shares remaining outstanding or such preference securities, as the case may be, have such rights, preferences, privileges and voting powers, and limitations and restrictions thereof, taken as a whole, as are not materially less favorable to the holders thereof than the rights, preferences, privileges and voting powers, and limitations and restrictions thereof, of Designated Preferred Stock immediately prior to such consummation, taken as a whole;

provided, however, that for all purposes of this Section 7(c), any increase in the amount of the authorized Preferred Stock, including any increase in the authorized amount of Designated Preferred Stock necessary to satisfy preemptive or similar rights granted by the Issuer to other persons prior to the Signing Date, or the creation and issuance, or an increase in the authorized or issued amount, whether pursuant to preemptive or similar rights or otherwise, of any other series of Preferred Stock, or any securities

convertible into or exchangeable or exercisable for any other series of Preferred Stock, ranking equally with and/or junior to Designated Preferred Stock with respect to the payment of dividends (whether such dividends are cumulative or non-cumulative) and the distribution of assets upon liquidation, dissolution or winding up of the Issuer will not be deemed to adversely affect the rights, preferences, privileges or voting powers, and shall not require the affirmative vote or consent of, the holders of outstanding shares of the Designated Preferred Stock.

(d) Changes after Provision for Redemption. No vote or consent of the holders of Designated Preferred Stock shall be required pursuant to Section 7(c) above if, at or prior to the time when any such vote or consent would otherwise be required pursuant to such Section, all outstanding shares of the Designated Preferred Stock shall have been redeemed, or shall have been called for redemption upon proper notice and sufficient funds shall have been deposited in trust for such redemption, in each case pursuant to Section 5 above.

(e) Procedures for Voting and Consents. The rules and procedures for calling and conducting any meeting of the holders of Designated Preferred Stock (including, without limitation, the fixing of a record date in connection therewith), the solicitation and use of proxies at such a meeting, the obtaining of written consents and any other aspect or matter with regard to such a meeting or such consents shall be governed by any rules of the Board of Directors or any duly authorized committee of the Board of Directors, in its discretion, may adopt from time to time, which rules and procedures shall conform to the requirements of the Charter, the Bylaws, and applicable law and the rules of any national securities exchange or other trading facility on which Designated Preferred Stock is listed or traded at the time.

Section 8. Record Holders. To the fullest extent permitted by applicable law, the Issuer and the transfer agent for Designated Preferred Stock may deem and treat the record holder of any share of Designated Preferred Stock as the true and lawful owner thereof for all purposes, and neither the Issuer nor such transfer agent shall be affected by any notice to the contrary.

Section 9. Notices. All notices or communications in respect of Designated Preferred Stock shall be sufficiently given if given in writing and delivered in person or by first class mail, postage prepaid, or if given in such other manner as may be permitted in this Certificate of Designations, in the Charter or Bylaws or by applicable law. Notwithstanding the foregoing, if shares of Designated Preferred Stock are issued in book-entry form through The Depository Trust Company or any similar facility, such notices may be given to the holders of Designated Preferred Stock in any manner permitted by such facility.

Section 10. No Preemptive Rights. No share of Designated Preferred Stock shall have any rights of preemption whatsoever as to any securities of the Issuer, or any warrants, rights or options issued or granted with respect thereto, regardless of how such securities, or such warrants, rights or options, may be designated, issued or granted.

Section 11. Replacement Certificates. The Issuer shall replace any mutilated certificate at the holder's expense upon surrender of that certificate to the Issuer. The Issuer shall replace certificates that become destroyed, stolen or lost at the holder's expense upon delivery to the Issuer of reasonably satisfactory evidence that the certificate has been destroyed, stolen or lost, together with any indemnity that may be reasonably required by the Issuer.

Section 12. Other Rights. The shares of Designated Preferred Stock shall not have any rights, preferences, privileges or voting powers or relative, participating, optional or other special rights, or qualifications, limitations or restrictions thereof, other than as set forth herein or in the Charter or as provided by applicable law.

**PLAN OF ACQUISITION
OF ALL THE OUTSTANDING STOCK
OF HIGHLANDS STATE BANK
BY
HIGHLANDS BANCORP, INC.**

THIS PLAN OF ACQUISITION (the "Plan") is entered into as of this 2nd day of February, 2010, by HIGHLANDS STATE BANK, a commercial bank organized under the laws of the State of New Jersey, with its principal office at 310 Route 94 Vernon, NJ 07462 (the "Bank") and HIGHLANDS BANCORP, INC., a corporation organized under the laws of the state of New Jersey, with its principal office at 310 Route 94 Vernon, NJ 07462 (the "Corporation").

WHEREAS, the Bank is desirous of forming a bank holding company because it believes that the holding company will provide it with future flexibility in undertaking the Bank's current activities and future new activities and assist the Bank in remaining an independent institution, if the Board determines that remaining independent is in the best interests of the Bank and its shareholders; and

WHEREAS, the Bank's Board of Directors has determined that the formation of a holding company is in the best interest of the Bank's shareholders; and

WHEREAS, Corporation was formed under the New Jersey Business Corporation Act on behalf of the Bank at the direction of the Bank's Board of Directors; and

WHEREAS, N.J.S.A. 17:9A-355 et seq. authorizes a New Jersey corporation and a state-chartered bank to enter into a plan of acquisition to exchange shares in the bank for shares in the holding company, to submit the plan to the New Jersey Department of Banking and Insurance for

approval and implement the plan if it is approved by the bank's shareholders, subject to the right of the bank's shareholders to dissent and receive the fair value of their shares; and

WHEREAS, the Boards of Directors of the Bank and Corporation have adopted this Plan pursuant to the provisions of N.J.S.A. 17:9A-357.

NOW, THEREFORE, the parties hereto agree as follows:

1.0 PLAN OF ACQUISITION REQUIRED BY SECTION 17:9A-357.

1.1 Name of Acquiring Corporation. The name and the address of the acquiring corporation is: Highlands Bancorp, Inc., 310 Route 94 Vernon, NJ 07462.

1.2 Name of Participating Bank. The name and address of the participating bank is: Highlands State Bank, 310 Route 94 Vernon, NJ 07462.

1.3 Names and Address of Directors. The names and addresses of the members of the Board of Directors of Corporation are:

NAME	ADDRESS
John V. Bosma	Highlands State Bank 310 Route 94 Vernon, NJ 07462
E. Jane Brown	Highlands State Bank 310 Route 94 Vernon, NJ 07462
George E. Irwin President, CEO	Highlands State Bank 310 Route 94 Vernon, NJ 07462
Andrew J. Mulvihill	Highlands State Bank 310 Route 94 Vernon, NJ 07462
Steven V. Oroho	Highlands State Bank 310 Route 94 Vernon, NJ 07462
Jeffrey M. Parrott Vice-Chairman	Highlands State Bank 310 Route 94 Vernon, NJ 07462

Dov Perlysky	Highlands State Bank 310 Route 94 Vernon, NJ 07462
Edward H. Rolando	Highlands State Bank 310 Route 94 Vernon, NJ 07462
Charles H. Shotmeyer	Highlands State Bank 310 Route 94 Vernon, NJ 07462
Martin Theobald	Highlands State Bank 310 Route 94 Vernon, NJ 07462
Douglas Verduin	Highlands State Bank 310 Route 94 Vernon, NJ 07462
Harold J. Wirths	Highlands State Bank 310 Route 94 Vernon, NJ 07462
Bruce D. Zaretsky Chairman	Highlands State Bank 310 Route 94 Vernon, NJ 07462

1.4 Directors of the Bank. Upon the effective date of the acquisition, the

Board of Directors of the Bank shall consist of the following:

NAME	ADDRESS
John V. Bosma	Highlands State Bank 310 Route 94 Vernon, NJ 07462
E. Jane Brown	Highlands State Bank 310 Route 94 Vernon, NJ 07462
George E. Irwin President, CEO	Highlands State Bank 310 Route 94 Vernon, NJ 07462
Andrew J. Mulvihill	Highlands State Bank 310 Route 94 Vernon, NJ 07462
Steven V. Oroho	Highlands State Bank 310 Route 94 Vernon, NJ 07462
Jeffrey M. Parrott Vice-Chairman	Highlands State Bank 310 Route 94 Vernon, NJ 07462

Dov Perlysky	Highlands State Bank 310 Route 94 Vernon, NJ 07462
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Douglas Verduin	Highlands State Bank 310 Route 94 Vernon, NJ 07462
Harold J. Wirths	Highlands State Bank 310 Route 94 Vernon, NJ 07462
Bruce D. Zaretsky Chairman	Highlands State Bank 310 Route 94 Vernon, NJ 07462

1.5 Shares of Other Banks Owned by Corporation. Corporation does not own any shares of capital stock of any other bank.

1.6 Terms and Conditions of Acquisition. The terms and conditions of the acquisition are the terms set forth in Sections 2, 3, 5, and 6 hereof.

1.7 Effective Date. The effective date shall be the date determined under Section 7 hereof.

1.8 Other Provisions. There are no other provisions of the Plan except as set forth herein.

2.0 CAPITALIZATION; TERMS OF ACQUISITION.

2.1 Capitalization of Corporation. Corporation is authorized to issue 10,000,000 shares of capital stock without nominal or par value ("Common Stock), 6,091 shares of Fixed Rate Cumulative Perpetual Preferred, Series A Preferred Stock (the "Series A Preferred"), and 155 shares of Fixed Rate Cumulative Perpetual Preferred Series B Preferred

Stock (the "Series B Preferred"). Corporation shall not issue any of its shares of Common Stock, Series A Preferred or Series B Preferred prior to the Effective Date.

2.2 Capitalization of the Bank. The Bank is authorized to issue 5,000,000 shares of common stock, par value \$5.00 per share (the "Bank Common Stock"). As of February 2, 2010, 1,788,262 shares of common stock were issued and outstanding. In addition, as of February 2, 2010, options to purchase 114,000 shares of Bank's Common Stock were reserved for issuance under employee and director stock option plans. In addition, the Bank is authorized to issue 6,091 shares of its Series A Preferred Stock, par value \$2.00 per share (the "Bank Series A Preferred"). As of February 10, 2010, 5,450 shares of the Bank Series A preferred stock are issued and outstanding. The Bank is authorized to issue 155 shares of its Series B Preferred Stock, par value \$2.00 per share (the "Bank Series B Preferred"). As of June 1, 2009, 155 shares of the Bank Series B Preferred Stock are issued and outstanding.

2.3 Terms of Exchange. Upon the Effective Date, each share of the Bank Common Stock shall be converted into one share of Common Stock, and, to the extent applicable, each option to purchase a share of Bank Common Stock shall be converted into an option to purchase a share of Common Stock, each share of the Bank Series A Preferred shall be converted into one share of the Series A Preferred Stock, and each share of the Bank Series B Preferred Stock shall be converted into one share of the Corporation Series B Preferred Stock, subject to the rights of dissenting shareholders as provided in Section 4 hereof. In addition, the Corporation shall assume all of the Bank's obligations under any outstanding stock option or benefit plan.

3.0 MODE OF CARRYING INTO EFFECT THE PLAN OF EXCHANGE.

3.1 Exchange Effective Immediately. Upon the Effective Date, each certificate representing shares of the Bank Common Stock, the Bank Series A Preferred or the Bank Series B Preferred shall by virtue of the Plan, and without any action on the part of the holder thereof, be deemed to represent shares of Common Stock, Series A Preferred or Series B Preferred, as the case may be, and shall no longer represent the shares of the Bank. As set forth in Section 4 hereof, after the Effective Date any dissenting shareholder who complies with the requirements of N.J.S.A. 17:9A-360 et seq. shall have only the rights accorded dissenting shareholders and such stockholder certificates shall not be deemed to represent shares of Common Stock, the Series A Preferred, the Series B Preferred, Bank Common Stock, the Bank Series A Preferred, or the Bank Series B Preferred.

3.2 Issuance of Shares of Bank to Corporation. Upon the Effective Date, the Bank shall issue to Corporation 1,788,262 shares of its Common Stock, par value \$5.00 per share.

3.3 Means of Effecting Exchange of Certificates of Bank Stock for Certificates in Corporation. Upon or immediately after the Effective Date, the Bank shall notify each Bank stockholder of record on the Effective Date (except a holder who is a dissenting shareholder as provided in Section 4 hereof) of the procedure by which certificates representing the Bank Common Stock, the Bank Series A Preferred or the Bank Series B Preferred, may be exchanged for certificates of Common Stock, Series A Preferred, or Series B Preferred, as the case may be. The Bank's transfer agent shall act as exchange agent in effecting the exchange of certificates for the Common Stock. The Corporation shall act as its own exchange agent in effecting the exchange of the certificates for the Series A Preferred and the Series B Preferred. After receipt of such notification, each holder shall be obligated to surrender the certificates

representing the Bank Common Stock, the Bank Series A Preferred and the Bank Series B Preferred for exchange into certificates of Common Stock, Series A Preferred and Series B Preferred, as the case may be, as promptly as possible.

4.0 DISSENTING SHAREHOLDER.

Any shareholder of the Bank who desires to dissent from the transactions contemplated by the Plan shall have the right to dissent by complying with all of the requirements set forth in N.J.S.A. 17:9A-360 et seq., and, if the transactions contemplated by the Plan are consummated, shall be entitled to be paid the fair value of his shares in accordance with those provisions.

5.0 CONDITIONS FOR CONSUMMATION OF THE PLAN AND RIGHT OF THE BANK TO TERMINATE THE PLAN PRIOR TO CONSUMMATION.

5.1 Conditions for Consummation. Consummation of the Plan is conditioned upon the following:

(a) Approval of the Plan by the Commissioner of Banking and Insurance of the State of New Jersey;

(b) Approval of the Plan by the holders of two-thirds (2/3) or more of each outstanding classes of the Bank's Stock entitled to vote;

(c) The non-objection of the Board of Governors of the Federal Reserve System to a notification by Corporation of its acquisition of Bank;

(d) The receipt of consent from the United States Treasury, as the holder of the Bank Series A Preferred and the Bank Series B Preferred; and

(e) The Bank's Board of Directors not terminating the Plan prior to the Effective Date as permitted by Section 5.2 hereof.

5.2 Right of Bank to Terminate Plan Prior to the Effective Date. At any time prior to the Effective Date, the Board of Directors of the Bank may terminate the Plan if in the judgment of the Board of Directors the consummation of the Plan is inadvisable for any reason. To terminate the Plan the Bank's Board of Directors shall adopt a resolution terminating the Plan and in the event such termination occurs after the shareholders of the Bank have voted on the Plan, promptly give written notice that the Plan has been terminated to the shareholders of the Bank. Upon the adoption of the Board resolution, the Plan shall be of no further force or effect and the Bank and Corporation shall not be liable to each other, to any shareholder of the Bank or to any other person by reason of the Plan or the termination thereof. Without limiting the reasons for which the Bank's Board may terminate the Plan, the Board may terminate the Plan if:

(a) The number of shareholders dissenting from the Plan and demanding payment of the fair value of their shares would in the judgment of the Board render consummation of the Plan inadvisable; or

(b) The Bank or Corporation fails to receive, or fails to receive in form and substance satisfactory to the Bank or Corporation, any permit, license or qualification from any federal or state authority required in connection with the consummation of the Plan.

6.0 EXPENSES.

Bank will bear all of the expenses incurred by the Bank and by the Corporation in connection with the Plan, including, without limiting the foregoing, all attorneys, accountants, and printing fees and all licensing fees incurred in connection with the Plan and the formation of Corporation.

7.0 EFFECTIVE DATE.

The Plan shall become effective upon a date selected by the mutual agreement in writing of the parties hereto (the "Effective Date"). The date so selected shall be within a reasonable period after the conditions set forth in Section 5.1 have been complied with and the Bank has received any approvals or consents without which it might terminate the Plan under Section 5.2. At least one week prior to the agreed upon effective date, the Plan shall be filed with the Department of Banking and Insurance of the State of New Jersey together with the writing specifying the Effective Date and a certification by the president or a vice president of the Bank that the Bank's shareholders have approved the Plan.

IN WITNESS WHEREOF, the Boards of Directors of Highlands State Bank and Highlands Bancorp, Inc. have authorized the execution of the Plan and caused the Plan to be executed as of the date first written above.

ATTEST:

HIGHLANDS BANCORP, INC.

By:

Name: George E. Irwin

Title: President and Chief Executive Officer

ATTEST:

HIGHLANDS STATE BANK

By:

Name: George E. Irwin

Title: President and Chief Executive Officer

SECTIONS 360 – 369 OF NEW JERSEY BANKING ACT OF 1948

17:9A-360. Notice of dissent; “dissenting stockholder” defined

(1) Any stockholder of a participating bank electing to dissent from the plan of acquisition may do so by filing with the participating bank of which he is a stockholder, a written notice of such dissent, stating that he intends to demand payment for his shares if the plan of acquisition becomes effective. Such dissent shall be filed before the taking of the vote of the stockholders on the plan of acquisition pursuant to section 5.

(2) Within 10 days after the date on which the plan of acquisition is approved by stockholders of a participating bank as provide in section 5 hereof, such bank shall give notice of such approval by certified mail to each stockholder who has filed written notice of dissent pursuant to subsection (1) of this section, except any who voted for or consented in writing to such plan of acquisition.

(3) Within 20 days after the mailing of such notice, any stockholder to whom the participating bank was required to give such notice, may make written demand on the participating bank for the payment of the fair value of his shares. A stockholder who makes a demand pursuant to this subsection (3) is hereafter in this act referred to as a “dissenting stockholder.” Upon making such demand, the dissenting stockholder shall cease to have any rights of a stockholder except the right to be paid the fair value of his shares and any other rights of a dissenting stockholder under this act.

(4) Not later than 20 days after demanding payment for his shares pursuant to this section, the stockholder shall submit the certificate or certificates representing such shares to the participating bank of which he is a stockholder for notation thereon that such demand has been made, whereupon such certificate or certificates shall be returned to him. If shares represented by a certificate on which such notation has been made shall be transferred, each new certificate issued therefor shall bear similar notation, together with the name of the original dissenting holder of such shares, and a transferee of such shares shall acquire by such transfer no rights other than those which the original dissenting stockholder had after making a demand for payment of the fair value thereof.

(5) A stockholder may not dissent as to less than all of the shares owned beneficially by him. A nominee or fiduciary may not dissent on behalf of any beneficial owner as to less than all of the shares of such owner.

17:9A-361. Valuation date of fair value

For the purposes of this act, the fair value of the shares of a participating bank shall be determined as of the day before the day on which the vote of stockholders of such bank was taken as provided in section 5. In determining fair value, there shall be excluded any appreciation or depreciation in value resulting from the consummation of the plan of acquisition.

17:9A-362. Termination of right of stockholder to be paid the fair value of his shares

(1) The right of a dissenting stockholder to be paid the fair value of his shares shall cease if

(a) He has failed to present his certificate for notation as provided by subsection (4) of section 6, unless a court having jurisdiction, for good and sufficient cause shown, shall otherwise direct;

(b) His demand for payment is withdrawn with the written consent of the participating bank;

(c) The fair value of the shares is not agreed upon as provided in this act, and no action for the determination of fair value by the Superior Court is commenced within the time provided by this act;

(d) The Superior Court determines that the stockholder is not entitled to payment for his shares;

(e) The plan of acquisition of shares is abandoned, rescinded, or otherwise terminated in respect to the participating bank of which he is a stockholder; or

(f) A court having jurisdiction permanently enjoins or sets aside the acquisition of shares.

(2) In any case provided for in subsection (1) of this section the rights of the dissenting stockholder as a stockholder shall be reinstated as of the date of the making of a demand for payment pursuant to section 6 without prejudice to any corporate action which has taken place during the interim period. In such event, he shall be entitled to any intervening pre-emptive rights and the right to payment of any intervening dividend or other distribution, or if any such rights have expired or any such dividend or distribution other than in cash has been completed, in lieu thereof, at the election of the participating bank, the fair value thereof in cash as of the time of such expiration or completion.

17:9A-363. Rights of dissenting stockholder

(1) A dissenting stockholder may not withdraw his demand for payment of the fair value of his shares without the written consent of the participating bank.

(2) The enforcement by a dissenting stockholder of his right to receive payment for his shares shall exclude the enforcement by such dissenting stockholder of any other right to which he might otherwise be entitled by virtue of share ownership, except as provided in subsection (2) of section 8 and except that this subsection shall not exclude the right of such dissenting stockholder to bring or maintain an appropriate action to obtain relief on the ground that consummation of the plan of acquisition will be or is ultra vires, unlawful or fraudulent as to such dissenting stockholder.

17:9A-364. Determination of fair value by agreement

(1) Within 10 days after the expiration of the period within which stockholders may make written demand to be paid the fair value of their shares, or within 10 days after the plan of acquisition becomes effective, whichever is later, the participating bank shall mail to each dissenting stockholder the balance sheet and the surplus statement of the participating bank as of the latest available date, which shall not be earlier than 12 months prior to the making of the offer of payment hereinafter referred to in this subsection, and a profit and loss statement or statements for not less than a 12-month period ended on the date of such balance sheet or, if the participating bank was not in existence for such 12-month period, for the portion thereof during which it was in existence. The participating bank may accompany such mailing with a written offer to pay each dissenting stockholder for his shares at a specified price deemed by such bank to be the fair value thereof. Such offer shall be made at the same price per share to all dissenting stockholders of the same class, or, if divided into series, of the same series.

(2) If, not later than 30 days after the expiration of the 10-day period limited by subsection (1) of this section, the fair value of the shares is agreed upon between any dissenting stockholder and the participating bank, payment therefor shall be made upon surrender of the certificate or certificates representing such shares.

17:9A-365. Procedure on failure to agree upon fair value; commencement of action to determine fair value

(1) If the fair value of the shares is not agreed upon within the 30-day period limited by subsection (2) of section 10, the dissenting stockholder may serve upon the participating bank a written demand that it commence an action in the Superior Court for the determination of such fair value. Such demand shall be served not later than 30 days after the expiration of the 30-day period so limited and such action shall be commenced by the participating bank not later than 30 days after receipt by such bank of such demand, but nothing herein shall prevent such bank from commencing such action at any earlier time.

(2) If a participating bank fails to commence the action as provided in subsection (1) of this section a dissenting stockholder may do so in the name of such bank, not later than 60 days after the expiration of the time limited by subsection (1) of this section in which such bank may commence such an action.

17:9A-366. Action to determine fair value; jurisdiction of court; appointment of appraiser

In any action to determine the fair value of shares pursuant to this act:

(a) The Superior Court shall have jurisdiction and may proceed in the action in a summary manner or otherwise;

(b) All dissenting stockholders, wherever residing, except those who have agreed with the participating bank upon the price to be paid for their shares, shall be made parties thereto as an action against their shares quasi in rem;

(c) The court in its discretion may appoint an appraiser to receive evidence and report to the court on the question of fair value, who shall have such power and authority as shall be specified in the order of his appointment; and

(d) The court shall render judgment against the participating bank and in favor of each stockholder who is a party to the action for the amount of the fair value of his shares.

17:9A-367. Judgment in action to determine fair value

(1) A judgment for the payment of the fair value of shares shall be payable upon surrender to the participating bank of the certificate or certificates representing such shares.

(2) The judgment shall include an allowance for interest at such rate as the court finds to be equitable, from the day of the meeting of stockholders of the participating bank at which the plan of acquisition was approved to the day of payment. If the court finds that the refusal of any dissenting stockholder to accept any offer of payment made by the participating bank under section 10 was arbitrary, vexatious or otherwise not in good faith, no interest shall be allowed to him.

17:9A-368. Costs and expenses of action

The costs and expenses of bringing an action pursuant to section 11 shall be determined by the court and shall be apportioned and assessed as the court may find equitable upon the parties or any of them. Such expenses shall include reasonable compensation for and reasonable expenses of the appraiser, if any, but shall exclude the fees and expenses of counsel for and experts employed by any party; but if the court finds that the offer of payment made by the participating bank under section 10 was not made in good faith, or if no such offer was made, the court in its discretion may award to any dissenting stockholder who is a party to the action reasonable fees and expenses of his counsel and of any experts employed by the dissenting stockholder.

17:9A-369. Disposition of shares

Upon payment for shares pursuant to subsection (2) of section 10, or upon payment of a judgment pursuant to subsection (1) of section 13, the participating bank making such payment shall acquire all the right, title and interest in and to such shares notwithstanding any other provision of law. Shares so acquired by the participating bank shall be disposed of as a stock dividend as provided by section 212 of the Banking Act of 1948, P.L.1948, chapter 67.