Consolidated Financial Statements
Years Ended December 31, 2018 and 2017

Fentura Financial, Inc.

Table of Contents

Independent Auditors' Report 1

Consolidated Financial Statements for the Years Ended December 31, 2018 and 2017

Consolidated Balance Sheets 2

Consolidated Statements of Income 3

Consolidated Statements of Comprehensive Income 4

Consolidated Statements of Shareholders' Equity 5

Consolidated Statements of Cash Flows 6

Notes to Consolidated Financial Statements 8

Rehmann

Rehmann Robson
1500 W. Big Beaver Road
2nd Floor
Troy, MI 48084
Ph: 248.952.5000
Fx: 248.952.5750
rehmann.com

INDEPENDENT AUDITORS' REPORT

March 12, 2019

Shareholders and Board of Directors
Fentura Financial, Inc.
Fenton, Michigan

We have audited the accompanying consolidated financial statements of ***Fentura Financial, Inc.*** (the "Corporation"), which comprise the consolidated balance sheets as of December 31, 2018 and 2017, and the related consolidated statements of income, comprehensive income, shareholders' equity, and cash flows for the years then ended, and the related notes to the consolidated financial statements.

Management's Responsibility for the Consolidated Financial Statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

Independent Auditors' Responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on auditor judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the Company's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of ***Fentura Financial, Inc.*** as of December 31, 2018 and 2017, and the consolidated results of their operations and their cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Rehmann is an independent member of Nexia International.

CPAs & Consultants Wealth Advisors Corporate Investigators

A member of Nexia International

Consolidated Balance Sheets
(Dollars in thousands except per share amounts)

	December 31	
	2018	2017
ASSETS		
Cash and due from banks	$ 19,412	$ 15,928
Federal funds sold	4,000	—
Cash and cash equivalents	**23,412**	**15,928**
Securities, available-for-sale (AFS)	89,854	49,791
Securities, held-to-maturity (HTM)	2,971	3,603
Equity securities	1,896	1,929
Total investment securities	**94,721**	**55,323**
Loans held for sale	**903**	**2,067**
Loans	772,227	672,530
Less allowance for loan losses	4,488	3,603
Net loans	**767,739**	**668,927**
Premises and equipment, net	14,761	14,448
Bank owned life insurance	10,007	9,763
Mortgage servicing rights	3,406	3,043
Goodwill	3,219	3,219
Federal Home Loan Bank (FHLB) stock	3,150	2,925
Accrued interest receivable	3,020	2,393
Core deposit intangibles	1,353	1,895
Other real estate owned	32	92
Other assets	727	1,420
Total assets	**$ 926,450**	**$ 781,443**
LIABILITIES AND SHAREHOLDERS' EQUITY		
Noninterest-bearing deposits	$ 233,954	$ 216,607
Interest-bearing deposits	529,170	456,898
Total deposits	**763,124**	**673,505**
FHLB advances	55,000	30,000
Subordinated debentures	14,000	14,000
Federal funds purchased	—	2,000
Accrued interest and other liabilities	4,810	2,491
Total liabilities	**836,934**	**721,996**
Shareholders' equity		
Common stock, no par value; 5,000,000 shares authorized, 4,636,455 issued and outstanding (3,631,933 in 2017)	79,863	58,961
Retained earnings	9,988	156
Accumulated other comprehensive income (loss)	(335)	330
Total shareholders' equity	**89,516**	**59,447**
Total liabilities and shareholders' equity	**$ 926,450**	**$ 781,443**

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

Consolidated Statements of Income
(Dollars in thousands except per share amounts)

	Year Ended December 31	
	2018	2017
Interest and dividend income		
Loans, including fees	$ 34,371	$ 28,765
Investments		
Taxable	1,243	939
Tax-exempt	242	238
Cash and cash equivalents	334	88
Federal Home Loan Bank Stock	160	81
Total interest and dividend income	**36,350**	**30,111**
Interest expense		
Deposits	4,037	1,890
Borrowings	1,790	1,230
Total interest expense	**5,827**	**3,120**
Net interest income	**30,523**	**26,991**
Provision for loan losses	1,057	609
Net interest income, after provision for loan losses	**29,466**	**26,382**
Noninterest income		
Trust and investment services	1,591	1,424
ATM and debit card income	1,525	1,474
Service charges on deposit accounts	1,044	1,217
Net gain on sales of mortgage loans	841	1,231
Mortgage servicing fees	785	614
Net gain on sales of commercial loans	518	—
Other	1,973	3,028
Total noninterest income	**8,277**	**8,988**
Noninterest expenses		
Compensation	13,421	12,437
Professional services	2,755	2,533
Furniture and equipment	1,898	1,706
Occupancy	1,639	1,569
Advertising and promotional	718	598
Loan and collection	537	548
Telephone and communication	413	433
Acquisition related	—	646
Other	3,929	3,348
Total noninterest expenses	**25,310**	**23,818**
Income before federal income taxes	12,433	11,552
Federal income taxes	2,319	2,876
Net income	**$ 10,114**	**$ 8,676**
Earnings per share	**$ 2.65**	**$ 2.39**

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

Consolidated Statements of Comprehensive Income
(Dollars in thousands)

	Year Ended December 31	
	2018	**2017**
Net income	**$ 10,114**	**$ 8,676**
Other comprehensive income (loss)		
Unrealized gains (losses) on investment securities available for sale	**(247)**	**527**
Unrealized gains (losses) on cash flow hedge:		
Net unrealized cash flow hedge gains (losses) arising during the year	81	65
Reclassification of interest expense included in net income	136	33
Total unrealized gains (losses) on cash flow hedge	**217**	**98**
Other comprehensive income (loss) before income taxes	(30)	625
Income tax (provision) benefit related to other comprehensive income (loss)	6	(16)
Other comprehensive income (loss)	**(24)**	**609**
Comprehensive income	**$ 10,090**	**$ 9,285**

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

Consolidated Statements of Shareholders' Equity
(Dollars in thousands except per share amounts)

	Common Stock				
	Common Shares Outstanding	Amount	Retained Earnings (Accumulated Deficit)	Accumulated Other Comprehensive Income (Loss)	Total
Balances, January 1, 2017	**3,619,282**	**$ 58,734**	**$ (7,847)**	**$ (227)**	**$ 50,660**
Issuance of common shares under stock purchase and dividend reinvestment plans	12,651	227	—	—	227
Reclassification from AOCI resulting from the enactment of the Tax Act. [1]	—	—	52	(52)	—
Cash dividends paid	—	—	(725)	—	(725)
Comprehensive income	—	—	8,676	609	9,285
Balances, December 31, 2017	**3,631,933**	**58,961**	**156**	**330**	**59,447**
Issuance of common shares under stock purchase and dividend reinvestment plans	18,749	402	—	—	402
Issuance of common shares under stock grant plan	4,945	—	—	—	—
Issuance of common shares in private placement offerings, net of issuance costs	980,828	20,500	—	—	20,500
Reclassification from AOCI resulting from adoption of ASU 2016-01 [2]	—	—	641	(641)	—
Cumulative effect adjustment of change in accounting policy, net of tax impact [3]	—	—	5	—	5
Cash dividends paid	—	—	(928)	—	(928)
Comprehensive income	—	—	10,114	(24)	10,090
Balances, December 31, 2018	**4,636,455**	**$ 79,863**	**$ 9,988**	**$ (335)**	**$ 89,516**

[1] The reclassification from accumulated comprehensive income (loss) to retained earnings (accumulated deficit) is due to the early adoption of ASU 2018-02; refer to Note 15 for further details on the adoption.
[2] The reclassification from accumulated comprehensive income (loss) to retained earnings (accumulated deficit) is due to the adoption of ASU 2016-01; refer to Notes 1 and 15 for further details on the adoption.
[3] Refer to Note 1 for further details on the change in accounting policy.

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

Consolidated Statements of Cash Flows
(Dollars in thousands)

	Year Ended December 31	
	2018	2017
Cash flows from operating activities		
Net income	$ 10,114	$ 8,676
Adjustments to reconcile net income to net cash provided by operating activities		
Depreciation	1,437	910
Net amortization (accretion) on securities	161	417
Net unrealized (gains) losses on equity securities, at fair value	33	—
Amortization of mortgage servicing rights	605	538
Additions to mortgage servicing rights	(968)	(1,191)
Amortization of core deposit intangibles	542	631
Provision for loan losses	1,057	609
Mortgage loans originated for sale	(74,951)	(77,540)
Proceeds from sales of mortgage loans	76,956	80,573
Net (gains) on sales of mortgage loans	(841)	(1,231)
Net (gains) on sales of foreclosed assets	(97)	(11)
Write-down of foreclosed assets	50	46
Net (gains) losses on sales of premises and equipment	(39)	150
Net (gains) on redemptions of bank owned life insurance	(932)	(1,155)
Increase in cash surrender value of bank owned life insurance	(267)	(217)
Deferred income tax (benefit) expense	38	2,468
Net (increase) decrease in interest receivable and other assets	250	(2,334)
Net increase (decrease) in accrued interest payable and other liabilities	2,325	(1,832)
Net cash provided by (used in) operating activities	**15,473**	**9,507**
Cash flows from investing activities		
Activity in AFS securities		
Sales	—	—
Calls, maturities, and principal paydowns	15,856	22,291
Purchases	(56,297)	(5,293)
Activity in HTM securities		
Calls, maturities, and principal paydowns	602	247
Purchases	—	—
Net loan principal (originations) collections	(100,000)	(156,681)
Proceeds from sales of foreclosed assets	238	192
Purchases of FHLB stock	(225)	(1,151)
Net purchases of premises and equipment	(1,711)	(3,395)
Proceeds from redemption of bank owned life insurance	955	1,258
Net cash provided by (used in) investing activities	**(140,582)**	**(142,532)**

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

Consolidated Statements of Cash Flows (Continued)
(Dollars in thousands)

	Year Ended December 31	
	2018	**2017**
Cash flows from financing activities		
Net increase (decrease) in deposits	$ 89,619	$ 70,138
Dividends paid	(928)	(725)
Net advances (repayments) on line of credit	—	(1,000)
Net increase (decrease) in borrowed funds	23,000	2,000
Net proceeds from common stock issuance	20,902	227
Net cash provided by (used in) financing activities	**132,593**	**70,640**
Net change in cash and cash equivalents	**7,484**	**(62,385)**
Cash and cash equivalents, beginning of year	15,928	78,313
Cash and cash equivalents, end of year	**$ 23,412**	**$ 15,928**
Supplemental cash flows information:		
Interest paid	$ 5,594	$ 3,014
Income taxes paid	$ 500	$ 2,275
Transfers of loans to other real estate owned	$ 131	$ 69

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

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Dollars in thousands except per share amounts)

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

Nature of Operations and Principles of Consolidation

The consolidated financial statements include Fentura Financial, Inc. (the "Parent") and its wholly owned subsidiaries Fentura Holdings LLC ("FHLLC") and The State Bank ("the Bank"), (collectively the "Corporation"). Intercompany transactions and balances are eliminated in consolidation.

The Corporation provides banking and trust services principally to individuals, small businesses and governmental entities through its fifteen community banking and loan processing offices in Genesee, Livingston, Oakland, Saginaw, and Shiawassee Counties in central and southeastern Michigan. Its primary deposit products are checking, savings, and term certificate accounts, and its primary lending products are residential mortgage, commercial real estate, commercial, home equity, and installment loans. Substantially all loans are secured by specific items of collateral including business assets, consumer assets and real estate. Commercial loans are expected to be repaid from cash flow from operations of businesses. Real estate loans are secured by both residential and commercial real estate. The Corporation's exposure to credit risk is substantially affected by the economy in the Corporation's market area and by changes in commercial real estate values. While the loan portfolio is substantially commercial based, the Corporation is not dependent on any single borrower.

Use of Estimates

The preparation of consolidated financial statements in conformity with accounting principles generally accepted in the United States of America (GAAP) requires management to make estimates and assumptions based on available information. These estimates and assumptions affect the amounts reported in the consolidated financial statements and the disclosures provided, and future results could differ. The allowance for loan losses, the fair value amounts related to business combinations, the fair values of securities, and other financial instruments, other-than-temporary impairment of securities, goodwill and other intangible asset impairment and the carrying value of deferred income taxes are particularly subject to change.

Business Combinations

Pursuant to the guidance of Accounting Standards Codification ("ASC") Topic 805, "Business Combinations", the Corporation recognizes assets acquired, including identified intangible assets, and the liabilities assumed in acquisitions at their fair values as of the acquisition date, with the acquisition-related transaction costs expensed in the period incurred.

Cash and Cash Equivalents

Cash and cash equivalents, includes cash, deposits with other financial institutions that have an initial maturity of less than 90 days, and federal funds sold. The Corporation maintains deposits with other financial institutions that exceed federal deposit insurance coverage. Furthermore, federal funds sold are essentially uncollateralized loans to other financial institutions. Management regularly evaluates the credit risk associated with the counterparties to these transactions and believes that the Corporation is not exposed to any significant credit risks on cash and cash equivalents.

As of December 31, 2018 and 2017, the Corporation had $250 and $0, respectively, in cash collateral on deposit with counterparties to interest rate swap transactions. Further information on the Corporation's derivative instruments is included in Note 7.

Investment Securities

Debt securities are classified as HTM and carried at amortized cost when management has the positive intent and ability to hold them to maturity. Debt securities are classified as AFS when they might be sold before maturity. Debt securities AFS are carried at fair value, with unrealized holding gains and losses reported in other comprehensive income. Unrealized gains or losses on equity securities were recorded as part of AOCI in shareholders' equity through December 31, 2017. Effective January 1, 2018, the amendments within FASB Accounting Standard Update ("ASU") 2016-01, "Recognition and Measurement of Financial Assets and Financial Liabilities", require that equity investments be measured at fair value with changes in fair value recognized in net income. Equity securities with readily determinable fair values are carried on on the balance sheet at those determinable fair values. Equity securities without readily determinable fair values, are carried at cost, less any impairment, plus or minus changes resulting from observable price changes in orderly transactions for the identical or similar investment of the same issuer (measurement alternative). The adoption of this update resulted in an insignificant increase to retained earnings which was reclassified from AOCI.

Interest income includes amortization or accretion of purchase premiums or discounts. Premiums and discounts on securities are amortized or accreted on the level-yield method without anticipating prepayments, except for mortgage-backed securities, where prepayments are anticipated. Premiums and discounts are are amortized and accreted to maturity. Gains and losses on sales are based on the amortized cost of the security sold.

Management evaluates securities for other-than-temporary impairment ("OTTI") at least on an annual basis, and more frequently when economic or market conditions warrant such an evaluation.

The Corporation assesses debt securities that have fair values below amortized cost basis to determine whether declines (impairment) are other-than-temporary. If the Corporation intends to sell an impaired security or it is more-likely-than-not that the Corporation will be required to sell an impaired security prior to the recovery of its amortized cost, an OTTI write-down is recognized in earnings equal to the entire difference between the investment security's amortized cost basis and its fair value. In assessing whether OTTI exists, management considers, among other things: (1) the length of time and the extent to which the fair value has been less than cost, (2) the financial condition and near-term prospects of the issuer, (3) whether the market decline was affected by macroeconomic conditions, and (4) whether the Corporation has the intent to sell the debt security or it is more likely than not it will be required to sell the debt security before its anticipated recovery. For the years ended December 31, 2018 and 2017 the Corporation did not recognize any OTTI.

Loans Held for Sale

Mortgage loans originated and intended for sale in the secondary market are carried at the lower of cost or fair value, as determined by outstanding commitments from investors. Net unrealized losses, if any, are recorded as a valuation allowance and charged to earnings.

Mortgage loans held for sale ("HFS") are generally sold with servicing rights retained. The carrying value of mortgage loans sold is reduced by the amount allocated to the servicing right. Gains and losses on sales of mortgage loans are based on the difference between the selling price and the carrying value of the related loan sold.

Originated Loans

Loans that management has the intent and ability to hold for the foreseeable future, or until maturity or payoff, are reported at the principal balance outstanding, net of unearned interest, deferred loan fees and costs, and an allowance for loan losses. Loan origination fees are deferred and recognized in interest income using the level-yield method without anticipating prepayments.

Interest income on mortgage and commercial loans is discontinued and such loans are placed on non-accrual status at the time the loan is 90 days delinquent unless the loan is well-secured and in the process of collection. Mortgage loans are charged off at 180 days past due and commercial loans are charged off to the extent principal or interest is deemed uncollectible. Consumer and credit card loans continue to accrue interest until they are charged-off (no later than 120 days past due unless the loan is in the process of collection). Past-due status is based on the contractual terms of the loan. In all cases, loans are placed on non-accrual or charged-off at an earlier date if collection of principal or interest is considered doubtful. Non-accrual loans and loans past due 90 days still on accrual include both smaller balance homogeneous loans that are collectively evaluated for impairment and individually classified impaired loans.

All interest accrued but not received for loans placed on nonaccrual in the current year is reversed against interest income while interest accrued but not collected in prior years is reversed against the allowance for loan losses. Interest received on such loans is accounted for on the cash-basis or cost-recovery method, until qualifying for return to accrual. Under the cost-recovery method, interest income is not recognized until the loan balance is reduced to zero. Under the cash-basis method, interest income is recorded when the payment is received in cash. Loans are returned to accrual status when all the principal and interest amounts contractually due are brought current and future payments are reasonably assured.

Acquired Loans

Purchased loans are recorded at fair value at the date of acquisition based on a discounted cash flow methodology that considered various factors including the type of loan and related collateral, classification status, fixed or variable interest rate, term of loan and whether or not the loan was amortizing, and a discount rate reflecting the Corporation's assessment of risk inherent in the cash flow estimates. These cash flow evaluations are inherently subjective as they require material estimates, all of which may be susceptible to significant change.

Purchased credit impaired loans are accounted for in accordance with the provisions of Financial Accounting Standards Board ("FASB") ASC Subtopic 310-30, "Receivables—Loans and Debt Securities Acquired with Deteriorated Credit Quality" ("ASC 310-30"). The cash flows expected to be collected on purchased loans are estimated based upon the expected remaining life of the underlying loans, which includes the effects of estimated prepayments. Purchased loans are considered credit impaired if there is

evidence of credit deterioration at the date of purchase and if it is probable that not all contractually required payments will be collected. Purchased credit impaired loans are not classified as nonperforming assets as the loans are considered performing under ASC 310-30. Interest income, through accretion of the difference between the carrying value of the loans and the expected cash flows is recognized on all purchased loans accounted for under ASC 310-30. Expected cash flows are re-estimated at least annually for all loans accounted for under ASC 310-30. A decline in the present value of current expected cash flows compared to the previously estimated expected cash flows, due in any part to change in credit, is referred to as credit impairment and recorded as provision for loan losses during the period. Declines in the present value of expected cash flows only from the expected timing of such cash flows is referred to as timing impairment and recognized prospectively as a decrease in yield on the loan. Improvement in expected cash flows is recognized prospectively as an adjustment to the yield on the loan once any previously recorded impairment is recaptured. Accelerated discounts on acquired loans result from the accelerated recognition of a portion of the loan discount that would have been recognized over the expected life of the loan and occur when a loan is paid in full or otherwise settled.

Allowance for Loan Losses (ALLL)

The ALLL is a valuation allowance for probable incurred credit losses, increased by the provision for loan losses and decreased by charge-offs less recoveries. Management estimates the ALLL required using past loan loss experience, the nature and volume of the portfolio, information about specific borrower situations and estimated collateral values, economic conditions, and other factors. Allocations of the ALLL may be made for specific loans, but the entire ALLL is available for any loan that, in management's judgment, should be charged-off. Loan losses are charged against the allowance when management believes the uncollectability of a loan balance is confirmed.

The allowance consists of specific, general, and unallocated components. The specific component relates to loans that are individually classified as impaired or loans otherwise classified as substandard or doubtful. The general component covers non-classified loans and is based on historical loss experience adjusted for current factors. The historical loss experience is determined by portfolio segments and is based on the average loss history experienced by the Corporation over a range of the most recent 4 quarters to the most recent 20 quarters. This actual loss experience is supplemented with other economic factors based on the risks present for each portfolio segment. These economic factors include consideration of the following: levels of and trends in delinquencies and impaired loans; levels of and trends in charge-offs and recoveries; trends in volume and terms of loans; effects of any changes in risk selection and underwriting standards; other changes in lending policies, procedures, and practices; experience, ability and depth of lending management and other relevant staff; national and local economic trends and conditions; industry conditions; and effects of changes in credit concentrations. The following portfolio segments have been identified: commercial, commercial real estate, residential real estate, installment loans, and home equity loans.

A loan is impaired when full payment under the loan terms is not expected. Loans may be classified as impaired if they meet one of the following criteria: (i) there has been a charge-off of its principal balance (in whole or in part), (ii) the loan has been classified as a troubled debt restructuring (TDR), or (iii) the loan is in nonaccrual status. Commercial and commercial real estate loans are individually evaluated for impairment. If a loan is impaired, a portion of the allowance is allocated so that the loan is reported at the present value of estimated future cash flows using the loan's existing rate or at the fair value of collateral if repayment is expected solely from the collateral. Large groups of smaller balance homogeneous loans, such as consumer and residential real estate loans, are collectively evaluated for impairment, and accordingly, they are not separately identified for impairment disclosures.

Troubled Debt Restructurings

Under certain circumstances, the Corporation will provide borrowers relief through loan restructurings and modifications. A loan restructuring constitutes a TDR if for economic or legal reasons related to the borrower's financial difficulties the Corporation grants a concession to the borrower that it would not otherwise consider. TDRs typically present an elevated level of credit risk, as the borrowers are not able to perform according to the original contractual terms. Loans that are reported as TDRs are considered impaired and are individually analyzed for impairment.

Transfers of Financial Assets

Transfers of financial assets, including mortgage loans HFS, as described above, are accounted for as sales when control over the assets has been surrendered. Control over transferred assets is deemed to be surrendered when 1) the assets have been legally isolated from the Bank, 2) the transferee obtains the right (free of conditions that constrain it from taking advantage of that right) to pledge or exchange the transferred assets and 3) the Bank does not maintain effective control over the transferred assets through an agreement to repurchase them before their maturity. Other than servicing, the Bank has no substantive continuing involvement related to these loans.

Derivative Instruments and Hedging Activities

ASC 815 provides the disclosure requirements for derivatives and hedging activities with the intent to provide users of financial statements with an enhanced understanding of: (a) how and why an entity uses derivative instruments, (b) how the entity accounts for derivative instruments and related hedged items, and (c) how derivative instruments and related hedged items affect an entity's financial position, financial performance, and cash flows. Further, qualitative disclosures are required that explain the Corporation's objectives and strategies for using derivatives, as well as quantitative disclosures about the fair value of and gains and losses on derivative instruments, and disclosures about credit-risk-related contingent features in derivative instruments.

As required by ASC 815, the Corporation records all derivatives on the balance sheet at fair value. The accounting for changes in the fair value of derivatives depends on the intended use of the derivative, whether the Corporation has elected to designate a derivative in a hedging relationship and apply hedge accounting and whether the hedging relationship has satisfied the criteria necessary to apply hedge accounting. Derivatives designated and qualifying as a hedge of the exposure to changes in the fair value of an asset, liability, or firm commitment attributable to a particular risk, such as interest rate risk, are considered fair value hedges. Derivatives designated and qualifying as a hedge of the exposure to variability in expected future cash flows, or other types of forecasted transactions, are considered cash flow hedges. Hedge accounting generally provides for the matching of the timing of gain or loss recognition on the hedging instrument with the recognition of the changes in the fair value of the hedged asset or liability that are attributable to the hedged risk in a fair value hedge or the earnings effect of the hedged forecasted transactions in a cash flow hedge. The Corporation may enter into derivative contracts that are intended to economically hedge certain of its risk, even though hedge accounting does not apply or the Corporation elects not to apply hedge accounting.

In August 2017, the Financial Accounting Standards Board issued ASU 2017-12, "Derivatives and Hedging: Targeted Improvements to Accounting for Hedging Activities". The purpose of this updated guidance was to better align a company's financial reporting for hedging activities with the economic objectives of those activities. The Corporation early adopted ASU 2017-12 in 2018. The early adoption resulted in a cumulative adjustment to opening retained earnings of $5, which represented the adjustment to re-measure the hedged item in the Corporation's fair value hedge to the benchmark rate component of the contractual coupon cash flows.

The Alternative Reference Rates Committee ("ARRC") has proposed that the Secured Overnight Funding Rate ("SOFR") replace USD-LIBOR. ARRC has proposed that the transition to SOFR from USD-LIBOR will take place by the end of 2021. The Corporation has material contracts that are indexed to USD-LIBOR. Industry organizations are currently working on the transition plan. The Corporation is currently monitoring this activity and evaluating the risks involved.

Further information on the Corporation's derivative instrument and hedging activities is included in Note 7.

Servicing

Servicing assets are recognized as separate assets when rights are acquired through the purchase or sale of financial assets. For sales of mortgage loans, a portion of the cost of originating the loan is allocated to the servicing right based on relative fair value. Fair value is based on market prices for comparable mortgage servicing contracts when available, or alternatively, is based on a valuation model that calculates the present value of estimated future net servicing income. The valuation model incorporates assumptions that market participants would use in estimating future net servicing income, such as the cost to service, the discount rate, the custodial earnings rate, an inflation rate, ancillary income, prepayment speeds and default rates and losses.

Servicing assets or liabilities are amortized in proportion to and over the period of net servicing income or net servicing loss and are assessed for impairment or increased obligation based on the fair value of rights compared to amortized cost at each reporting date. Impairment is determined by reviewing the vintage of the loans and comparing the prospective interest rate market to the rate on the current portfolio. Given the recent vintage of the portfolio and the stable to rising rate environment, no impairment has been recorded. Should this situation change, impairment may be evaluated by stratifying rights into tranches based on predominant risk characteristics, such as interest rate, loan category, and investor type. Impairment is recognized through a valuation allowance for an individual tranche, to the extent that fair value is less than the capitalized amount for the tranche. If the Bank later determines that all or a portion of the impairment no longer exists for a particular tranche, a reduction of the allowance may be recorded as an increase to income. An analysis to test for impairment was performed on the portfolio as of December 31, 2018, and the portfolio was deemed to have no impairment.

The following table outlines the key economic assumptions and the resulting estimated fair value of mortgage servicing rights as of:

	December 31	
	2018	2017
Annual constant prepayment speed	8.55%	9.48%
Weighted average life (in months)	283	281
Discount rate	9.91%	9.21%
Estimated fair value	$ 4,000	$ 3,120

The following table outlines activity recorded within and year end balances for mortgage servicing rights and the year end balances of mortgage loans serviced for others as of and for the years ended:

	December 31	
	2018	2017
Beginning of year	$ 3,043	$ 2,390
Additions	968	1,191
Amortized to expense	(605)	(538)
End of year	**$ 3,406**	**$ 3,043**
Gross mortgage servicing rights	$ 4,817	$ 3,849
Accumulated amortization	(1,411)	(806)
End of year	**$ 3,406**	**$ 3,043**
Mortgage loans serviced for others	**$ 333,049**	**$ 288,357**

Servicing fee income is recorded for fees earned for servicing loans for others. The fees are based on a contractual percentage of the outstanding principal, or a fixed amount per loan and are recognized as income when earned. These fees were $785 and $614 in 2018 and 2017, respectively. The amortization of mortgage servicing rights is netted against loan servicing fee income, and reported as a component of mortgage servicing fees.

Other Real Estate Owned and Foreclosed Assets

Assets acquired through or instead of loan foreclosure are initially recorded at fair value less estimated selling costs when acquired, establishing a new cost basis. Physical possession of residential real estate property collateralizing a consumer mortgage loan occurs when legal title is obtained upon completion of foreclosure or when the borrower conveys all interest in the property to satisfy the loan through completion of a deed in lieu of foreclosure or through a similar legal agreement. If fair value declines, a valuation allowance is recorded through expense. Costs after acquisition are expensed as incurred.

Premises and Equipment

Land is carried at cost. Premises and equipment are stated at cost less accumulated depreciation. Buildings and related components are depreciated using the straight-line method with useful lives ranging from 15 to 40 years. Furniture, fixtures and equipment are depreciated using the straight-line method with useful lives ranging from 3 to 7 years. Premises and equipment and other assets are reviewed for impairment when events indicate their carrying amount may not be recoverable from future undiscounted cash flows. If impaired, the assets are recorded at fair value, if lower than the carrying amount.

Bank Owned Life Insurance

The Corporation holds life insurance policies purchased on the lives of key members of management. In the event of death of one of these individuals, the Corporation, as beneficiary of the policies, would receive a specified cash payment equal to the face value of the policy. Such policies are recorded at their cash surrender value, or the amount that can be currently realized as of the balance sheet date. The change in cash surrender value is an adjustment of premiums paid in determining the net expense or income recognized under the contracts for the year and is included in noninterest income.

Federal Home Loan Bank (FHLB) Stock

The Bank is a member of the FHLB system. Members are required to own a certain amount of stock based on the level of borrowings and other factors, and may invest additional amounts. FHLB stock is carried at cost, classified as a restricted security, and periodically evaluated for impairment based on ultimate recovery of par value. Both cash and stock dividends are reported in interest and dividend income in the Consolidated Statements of Income.

Stock Based Compensation

Compensation cost is recognized for stock options, restricted stock awards issued to employees, and stock appreciation rights based on the fair value of these awards at the date of grant. A valuation model is utilized to estimate the fair value of stock options and stock appreciation rights. Compensation cost is recognized over the required service period, generally defined as the vesting period. For awards with graded vesting, compensation cost is recognized on a straight-line basis over the requisite service period for the entire award.

Income Taxes

Income tax expense is the total of the current year income tax due or refundable and the change in deferred tax assets and liabilities. Deferred tax assets and liabilities are the expected future tax amounts for the temporary differences between carrying amounts and tax bases of assets and liabilities, computed using enacted tax rates. If determined necessary, a valuation allowance reduces deferred tax assets to the amount expected to be realized.

A tax position is recognized as a benefit only if it is “more likely than not” that the tax position would be sustained in a tax examination, with a tax examination being presumed to occur. The amount recognized is the largest amount of tax benefit that has a greater than 50% likelihood of being realized on examination including the appeals process. For tax positions not meeting the “more likely than not” test, no tax benefit is recorded.

The Corporation recognizes interest and/or penalties related to income tax matters in income tax expense. Such interest or penalties recorded in 2018 and 2017 were not significant.

See Note 11 for a discussion of the impact of the Tax Cuts and Jobs Act, which was enacted on December 22, 2017.

Goodwill and Other Intangible Assets

Goodwill resulting from business combinations is generally determined as the excess of the fair value of the consideration transferred over the fair value of the net assets acquired and liabilities assumed as of the acquisition date. Goodwill and intangible assets acquired in a purchase business combination and determined to have an indefinite useful life are not amortized but tested for impairment at least annually or more frequently if events and circumstances exist that indicate that a goodwill impairment test should be performed. Intangible assets with definite useful lives are amortized over their estimated useful lives to their estimated residual values. Goodwill is the only intangible asset with an indefinite life on the consolidated balance sheet. Core deposit intangible assets arising from whole bank and branch acquisitions are amortized using an accelerated method (sum of the years' digits) over their estimated useful lives of 7 years.

Loan Commitments and Financial Instruments

Financial instruments include off-balance sheet credit instruments, such as commitments to make loans and standby letters of credit, issued to meet customer financing needs. The face amount for these items represents the exposure to loss, before considering customer collateral or ability to repay. Such financial instruments are recorded when they are funded.

Earnings Per Common Share

Basic earnings per common share is calculated as net income divided by the weighted average number of common shares outstanding during the year. Stock grants that have a grant date prior to the date of earnings per common share calculation, and Employee Stock Ownership Plan (ESOP) shares, are considered outstanding for this calculation.

Comprehensive Income

Comprehensive income consists of net income and other comprehensive income (loss). Other comprehensive income (loss) includes unrealized gains and losses on securities available for sale and cash flow hedges, net of income taxes, which are also recognized in accumulated comprehensive income (loss).

Loss Contingencies

Loss contingencies, including claims and legal actions arising in the ordinary course of business, are recorded as liabilities when the likelihood of loss is probable and an amount or range of loss can be reasonably estimated.

Fair Value of Financial Instruments

Fair values of financial instruments are estimated using relevant market information and other assumptions, as more fully disclosed in Note 14. Fair value estimates involve uncertainties and matters of significant judgment regarding interest rates, credit risk, prepayments, and other factors, especially in the absence of broad markets for particular items. Changes in assumptions or in market conditions could significantly affect the estimates.

Reclassifications

Certain items in the prior year consolidated financial statements were reclassified to conform to the current year presentation.

Subsequent Events

In preparing these consolidated financial statements, the Corporation has evaluated, for potential recognition or disclosure, significant events or transactions that occurred during the period subsequent to December 31, 2018, the most recent balance sheet presented herein, through March 12, 2019, the date these consolidated financial statements were available to be issued. No significant such events or transactions were identified.

Recently Adopted Accounting Pronouncements

ASU 2014-09, "Revenue from Contracts with Customers (Topic 606)", implements a common revenue standard that clarifies the principles for recognizing revenue. Revenue is to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. To achieve that core principle, an entity should apply the following steps: (i) identify the contract(s) with a customer, (ii) identify the performance obligations in the contract, (iii) determine the transaction price, (iv) allocate the transaction price to the performance obligations in the contract and (v) recognize revenue when (or as) the entity satisfies a performance obligation. The new authoritative guidance, as amended, was effective on January 1, 2018. The Corporation's contracts related to trust and investment services, and those related to other noninterest income, were reviewed to determine if changes in income recognition were required as a result of this guidance. Implementation of this guidance did not have any impact on the Corporation's operating results for the 12 month period ended December 31, 2018. Refer to Note 3 - Revenue Recognition for further discussion.

ASU 2016-01, "Financial Instruments - Overall (Subtopic 825-10) - Recognition and Measurement of Financial Assets and Liabilities" amended current guidance by: (i) requiring equity investments with readily determinable fair values to be measured at fair value with changes in fair value recognized in net income, (ii) allowing an entity to measure equity investments that do not have readily determinable fair values at either fair value or cost minus impairment, changes in measurement are recognized in net income, (iii) simplifying impairment assessment of equity investments without readily determinable fair values by requiring a qualitative assessment to identify impairment, (iv) eliminating the requirement to disclose the methods and assumptions used to estimate the fair value of financial instruments measured at amortized cost; (v) requiring the use of exit price notion when measuring the fair value of financial instruments; (vi) requiring recognition of changes in the fair value related to instrument-specific credit risk in other comprehensive income if financial liabilities are measured at fair value, (vii) requiring separate presentation in financial statements by measurement category, and (viii) clarifying that an entity should evaluate the need for a valuation allowance on deferred tax assets related to available-for-sale securities in combination with the entity's other deferred tax assets. The Corporation identified available-for-sale investment securities qualifying as equity investments in the securities portfolio at January 1, 2018. The adoption resulted in recognizing the unrealized fair value adjustment related to the identified equity investments as a cumulative effect to retained earnings of $641. In addition, the Corporation updated disclosures related to the fair value of financial instruments to the use of the exit price notion. Refer to Note 5 – Investment Securities and Note 14 – Fair Value Measurements, for further discussion.

ASU 2017-12, "Derivatives and Hedging (Topic 815) - Targeted Improvements to Accounting for Hedging Activities" amends the hedge accounting recognition and presentation requirements in ASC 815 to improve the transparency and understandability of information conveyed to financial statement users about an entity's risk management activities to better align the entity's financial reporting for hedging relationships with those risk management activities and to reduce the complexity of and simplify the application of hedge accounting. ASU 2017-12 eliminates the separate measurement of hedge ineffectiveness as well as the benchmark interest rate concept when applying hedge risk to variable-rate instruments. It also allows a company to elect to perform subsequent effectiveness assessments qualitatively if the initial quantitative hedge effectiveness assessment is found to be highly effective.

The Corporation early adopted ASU 2017-12 in 2018. The early adoption resulted in a cumulative adjustment to opening retained earnings of $5, which represented the adjustment to re-measure the hedged item in the Corporation's fair value hedge to the benchmark rate component of the contractual coupon cash flows.

Pending Accounting Pronouncements

ASU 2016-02, "Leases (Topic 842)", requires lessees to recognize leases on-balance sheet, lessors to classify leases as sales-type, direct financing, or operating, and disclose key information about leasing arrangements. Leases will be classified as either finance or operating, with the classification affecting the pattern of expense recognition in the statement of operations. The ASU also requires additional disclosure of the amount, timing, and uncertainty of cash flows arising from leases, including qualitative and quantitative requirements. The guidance becomes effective for the Corporation on January 1, 2019 and will be applied using a modified retrospective transition method to all leases existing at the date of initial application. Early adoption will be permitted. In July 2018, the FASB issued ASU 2018-11 "Leases (Topic 842): Targeted Improvements" to provide entities with relief from the costs of implementing certain aspects of the new leasing standard. Specifically, under the amendments in ASU 2018-11 (1) entities may elect not to recast the comparative periods presented when transitioning to ASC 842 and (2) lessors may elect not to separate lease and nonlease components when certain conditions are met. The new standard is not expected to have a significant impact on the Corporation's consolidated financial statements.

ASU 2016-13, "Financial Instruments - Credit Losses (Topic 326)", requires the measurement of all expected credit losses for financial assets held at the reporting date based on historical experience, current conditions, and reasonable and supportable forecasts and requires enhanced disclosures related to the significant estimates and judgments used in estimating credit losses, as well as the credit quality and underwriting standards of an organization's portfolio. In addition, ASU 2016-13 amends the accounting for credit losses on AFS debt securities and purchased financial assets with credit deterioration. The Corporation is currently developing an implementation plan to include an assessment of processes, portfolio segmentation, model development, system requirements and the identification of data and resource needs, among other things. Upon adoption, a cumulative-effect adjustment to retained earnings will be recorded as of the beginning of the first reporting period in which the guidance is effective. Management is currently evaluating the potential impact that adoption of ASU 2016-13 will have on the Corporation's consolidated financial statements and disclosures. While the Corporation is currently unable to reasonably estimate the impact of adopting ASU 2016-13, management expects that the impact of adoption could be significantly influenced by the composition, characteristics and quality of our loan portfolio as well as the prevailing economic conditions and forecasts as of the adoption date. ASU 2016-13 will be effective on January 1, 2020. The guidance of ASU 2016-13 was recently amended by ASU 2018-19, "Codification Improvements to Topic 326, Financial Instruments - Credit Losses", which clarified that operating lease receivables are not within the scope of the standard.

ASU 2017-04, "Intangibles - Goodwill and Other (Topic 350) - Simplifying the Test for Goodwill Impairment" eliminates Step 2 from the goodwill impairment test which required entities to compute the implied fair value of goodwill. Under ASU 2017-04, an entity should perform its annual, or interim, goodwill impairment test by comparing the fair value of a reporting unit with its carrying amount. An entity should recognize an impairment charge for the amount by which the carrying amount exceeds the reporting unit's fair value; however, the loss recognized should not exceed the total amount of goodwill allocated to that reporting unit. ASU 2017-04 will be effective January 1, 2020, with earlier adoption permitted. The Corporation does not expect ASU 2017-04 to have a significant impact on the consolidated financial statements.

ASU 2017-08,"Receivables - Nonrefundable Fees and Other Costs (Subtopic 310-20) - Premium Amortization on Purchased Callable Debt Securities" shortens the amortization period for certain callable debt securities held at a premium to require such premiums to be amortized to the earliest call date unless applicable guidance related to certain pools of securities is applied to consider estimated prepayments. Under prior guidance, entities were generally required to amortize premiums on individual, non-pooled callable debt securities as a yield adjustment over the contractual life of the security. ASU 2017-08 does not change the accounting for callable debt securities held at a discount. ASU 2017-08 will be effective on January 1, 2019, and is not expected to have a significant impact on the consolidated financial statements of the Corporation.

ASU 2018-13, "Fair Value Measurement (Topic 820) - Disclosure Framework - Changes to the Disclosure Requirements for Fair Value Measurement" removed the requirement to disclose the amount of and reasons for transfers between Level 1 and Level 2 of the fair value hierarchy. ASU 2018-13 also removed the requirement to disclose the valuation process for Level 3 fair value measurements. The amendment includes additional disclosure requirements which include disclosing the change in unrealized gains (losses) for recurring Level 3 fair value measurements held at the end of the reporting period and the range and weighted average of significant unobservable inputs used to develop Level 3 fair value measurements or other quantitative information. ASU 2018-13 will be effective on January 1, 2020, with early adoption permitted for any removed or modified disclosures. The adoption of this ASU is not expected to have a significant impact on the Corporation's consolidated financial statements.

ASU 2018-15, “Intangibles - Goodwill and Other - Internal-Use Software (Subtopic 350-40) - Customer’s Accounting for Implementation Costs Incurred in a Cloud Computing Arrangement That Is a Service Contract” clarifies certain aspects of ASU 2015-05, “Customer’s Accounting for Fees Paid in a Cloud Computing Arrangement,” which was issued in April 2015. Specifically, ASU 2018-15 aligns the requirements for capitalizing implementation costs incurred in a hosting arrangement that is a service contract with the requirements for capitalizing implementation costs incurred to develop or obtain internal-use software (and hosting arrangements that include an internal-use software license). ASU 2018-15 does not affect the accounting for the service element of a hosting arrangement that is a service contract. ASU 2018-15 will be effective on January 1, 2020, with early adoption permitted, and is not expected to have a significant impact on the Corporation's consolidated financial statements.

ASU 2018-16, “Derivatives and Hedging (Topic 815) - Inclusion of the Secured Overnight Financing Rate (SOFR) Overnight Index Swap (OIS) Rate as a Benchmark Interest Rate for Hedge Accounting Purposes” amends the use of the OIS rate based on SOFR as a U.S. benchmark interest rate for hedge accounting purposes under Topic 815 in addition to the interest rates on direct U.S. Treasury obligations, the LIBOR swap rate, the OIS rate based on the Fed Funds Effective Rate and the Securities Industry and Financial Markets Association Municipal Swap Rate. ASU 2018-16 will be effective on January 1, 2019 and is not expected to have a significant impact on the Corporation's consolidated financial statements.

Note 2 – Goodwill and Intangible Assets

The Corporation has goodwill and core deposit intangible assets which arose from the acquisition of Community Bancorp, Inc. ("Community") effective on December 31, 2016. The carrying value of goodwill was $3,219 as of December 31, 2018 and 2017.

	December 31, 2018		
	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount
Core deposit premium resulting from acquisitions	$ 2,526	$ 1,173	$ 1,353

	December 31, 2017		
	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount
Core deposit premium resulting from acquisitions	$ 2,526	$ 631	$ 1,895

The estimated future amortization expense on the core deposit intangible asset for years ending December 31 are as follows:

2019	$ 451
2020	361
2021	271
2022	180
2023	90
Total	**$ 1,353**

Note 3 – Revenue Recognition

All of the Corporation's revenue from contracts with customers in the scope of ASC 606 is recognized within Noninterest income. The following table presents the Corporation's sources of Noninterest income for the twelve months ended December 31, 2018 and 2017. Items outside the scope of ASC 606 are noted as such.

	Year Ended December 31	
	2018	2017 [c]
Noninterest income		
Trust related income	$ 894	$ 827
Investment services income [a]	697	597
ATM card income	267	259
Debit card income [a]	1,258	1,215
Service charges on deposit accounts	1,044	1,217
Net gain on sales of loans [a]	1,359	1,231
Mortgage servicing fees [a]	785	614
Other [b]	1,973	3,028
Total noninterest income	**$ 8,277**	**$ 8,988**

[a] Not within the scope of ASC 606.
[b] The Other category includes items that are outside the scope of ASC 606.
[c] The Corporation elected the modified retrospective approach of adoption; therefore, prior period balances are presented under legacy GAAP and may not be comparable to current year presentation.

A description of the Corporation's revenue streams accounted for under ASC 606 follows:

Trust related income

The Corporation earns trust related income from its contracts with customers to manage assets for investment, and/or to transact on their accounts. These fees are primarily earned over time as the Corporation provides the contracted monthly or quarterly services that are generally assessed based on a tiered scale of the market value of assets under management at month-end. Fees that are transaction based are recognized at the point in time that the transaction is executed.

Service charges on deposit accounts and ATM card income

The Corporation earns fees from its deposit customers for transaction-based, account maintenance and overdraft services. Transaction-based fees, which include stop payment charges, statement rendering, ACH and ATM fees, are recognized at the time the transaction is executed as that is the point in time the Corporation fulfills the customer's request. Account maintenance fees, which relate primarily to monthly maintenance, are earned over the course of a month, representing the period over which the Corporation satisfies the performance obligation. Similarly, overdraft fees are recognized at the point in time that the overdraft occurs as this corresponds with the Corporation's performance obligation. Service charges and ATM fees on deposit accounts are withdrawn from the customer's account balance.

Note 4 – Earnings Per Share

The components in the earnings per share computation follow for the years ended:

	December 31	
	2018	2017
Net income	$ 10,114	$ 8,676
Weighted average common shares - issued	3,812,433	3,625,568
Average unvested stock grants	(756)	—
Weighted average common shares - basic	3,811,677	3,625,568
Basic earnings per common share	**$ 2.65**	**$ 2.39**

There were no common stock options or other common stock equivalents outstanding at December 31, 2018 or 2017.

Note 5 – Investment Securities

The following is a summary of the amortized cost and fair value of investment securities as of:

	December 31, 2018			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Available-for-sale				
U.S. Government and federal agency	$ 57,029	$ 26	$ (192)	$ 56,863
State and municipal	10,558	73	(31)	10,600
Mortgage backed residential	4,276	27	(109)	4,194
Certificates of deposit	8,393	—	(70)	8,323
Collateralized mortgage obligations - agencies	9,833	67	(26)	9,874
Total available-for-sale	**$ 90,089**	**$ 193**	**$ (428)**	**$ 89,854**
Held-to-maturity State and municipal	**$ 2,971**	**$ 1**	**$ (48)**	**$ 2,924**

	December 31, 2017			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Available-for-sale				
U.S. Government and federal agency	$ 23,146	$ 3	$ (83)	$ 23,066
State and municipal	14,972	121	(25)	15,068
Mortgage backed residential	5,193	59	(47)	5,205
Certificates of deposit	4,449	2	(11)	4,440
Collateralized mortgage obligations - agencies	2,019	1	(8)	2,012
Total available-for-sale	**$ 49,779**	**$ 186**	**$ (174)**	**$ 49,791**
Held-to-maturity State and municipal	**$ 3,603**	**$ —**	**$ (36)**	**$ 3,567**
Equity securities	**$ 1,288**	**$ 646**	**$ (5)**	**$ 1,929**

As of January 1, 2018, the Corporation adopted ASU 2016-01 which requires that changes in the fair value of equity securities flow through earnings, thus eliminating the recording of unrealized gains and losses in AOCI. ASU 2016-01 also allows for equity securities without readily determinable fair values to be reported at the measurement alternative (refer to Note 1 for further discussion). At December 31, 2018, the values of equity securities were as follows:

Securities with readily determinable fair values	$ 966
Securities without readily determinable fair values	930
Total equity securities	**$ 1,896**

Contractual maturities of securities at December 31, 2018, were as follows. Securities not due at a single maturity date, such as mortgage backed residential and collateralized mortgage obligations, are shown separately.

	December 31, 2018			
	Available for Sale		Held to Maturity	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
U.S. Government and federal agency				
Due from one year or less	$ 6,996	$ 6,955	—	—
Due from one to five years	40,786	40,661	—	—
Due from five to ten years	9,247	9,247	—	—
Due after ten years	—	—	—	—
State and Municipal				
Due from one year or less	2,865	2,862	822	822
Due from one to five years	5,287	5,300	1,248	1,229
Due from five to ten years	2,406	2,438	671	653
Due after ten years	—	—	230	220
Certificates of Deposit				
Due from one year or less	1,735	1,728	—	—
Due from one to five years	6,658	6,595	—	—
Due from five to ten years	—	—	—	—
Due after ten years	—	—	—	—
Mortgage backed residential	4,276	4,194	—	—
Collateralized mortgage obligations - agencies	9,833	9,874	—	—
Total	**$ 90,089**	**$ 89,854**	**$ 2,971**	**$ 2,924**

Securities pledged at December 31, 2018 and 2017 had a carrying amount of $17,226 and $13,403, respectively, and were pledged to secure public deposits and borrowings.

Securities with unrealized losses at December 31, 2018 and 2017, including both AFS and HTM securities, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position are as follows:

	December 31, 2018					
	Less Than 12 Months		Over 12 Months			
	Amortized Cost	Gross Unrealized Losses	Amortized Cost	Gross Unrealized Losses	Fair Value	Total Gross Unrealized Losses
U.S. Government and federal agency	$ 19,217	$ (28)	$ 16,954	$ (164)	$ 35,979	$ (192)
State and municipal	2,012	(13)	5,625	(66)	7,558	(79)
Mortgage backed residential	1,382	(26)	1,791	(83)	3,064	(109)
Certificates of deposit	5,183	(43)	2,966	(27)	8,079	(70)
Collateralized mortgage obligations - agencies	—	—	1,455	(26)	1,429	(26)
Total	**$ 27,794**	**$ (110)**	**$ 28,791**	**$ (366)**	**$ 56,109**	**$ (476)**

Securities with unrealized losses at December 31, 2017, including AFS, HTM, and equity securities, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position are as follows:

	December 31, 2017					
	Less Than 12 Months		Over 12 Months			
	Amortized Cost	Gross Unrealized Losses	Amortized Cost	Gross Unrealized Losses	Fair Value	Total Gross Unrealized Losses
U.S. Government and federal agency	$ 1,039	$ (7)	$ 19,898	$ (76)	$ 20,854	$ (83)
State and municipal	5,780	(26)	5,083	(35)	10,802	(61)
Mortgage backed residential	2,016	(47)	—	—	1,969	(47)
Certificates of deposit	—	—	3,954	(11)	3,943	(11)
Collateralized mortgage obligations - agencies	1,737	(8)	—	—	1,729	(8)
Equity securities	1,000	(5)	—	—	995	(5)
Total	**$ 11,572**	**$ (93)**	**$ 28,935**	**$ (122)**	**$ 40,292**	**$ (215)**

As of December 31, 2018, the Corporation's security portfolio consisted of 181 securities, 118 of which were in an unrealized loss position.

Management evaluates securities for OTTI at least on an annual basis, and more frequently when economic or market conditions warrant such an evaluation. In evaluating OTTI, management additionally considers the factors presented in Note 1. No OTTI was indicated following analysis in 2018 and 2017.

Note 6 – Loans and Allowance for Loan Losses

The Bank originates primarily residential and commercial real estate loans, commercial, and installment loans. The majority of the Bank's loan portfolio is based in Genesee, Oakland, Saginaw, Shiawassee and Livingston counties within central and southeast Michigan. The ability of the Corporation's debtors to honor their contracts is dependent upon the real estate values and general economic conditions in these areas.

Loans are summarized as follows at December 31:

	2018	2017
Commercial	$ 56,583	$ 51,278
Commercial real estate	369,043	330,309
Residential real estate	293,271	234,047
Home equity	43,597	44,602
Installment	9,733	12,294
Total loans	772,227	672,530
Allowance for loan losses	(4,488)	(3,603)
Loans, net	**$ 767,739**	**$ 668,927**

Included in total loans above were unamortized premiums (discounts) on purchased loans and net deferred loan fees as of December 31:

	2018	2017
Unamortized premium (discount) on purchased loans	$ (2,317)	$ (3,318)
Net deferred loan fees	$ 1,465	$ 1,254

Activity in the allowance for loan losses, by loan portfolio segment, for the years ended December 31, 2018 and 2017, is as follows:

	Commercial	Commercial Real Estate	Residential Real Estate	Home Equity	Installment	Unallocated	Total
January 1, 2018	$ 230	$ 1,748	$ 1,359	$ 202	$ 64	$ —	$ 3,603
Provision for loan losses	227	215	514	14	86	1	1,057
Loans charged-off	(214)	—	(76)	(12)	(81)	—	(383)
Loan recoveries	1	190	—	—	20	—	211
December 31, 2018	**$ 244**	**$ 2,153**	**$ 1,797**	**$ 204**	**$ 89**	**$ 1**	**$ 4,488**

	Commercial	Commercial Real Estate	Residential Real Estate	Home Equity	Installment	Unallocated	Total
January 1, 2017	$ 236	$ 1,504	$ 922	$ 174	$ 28	$ (13)	$ 2,851
Provision for loan losses	(11)	35	460	33	79	13	609
Loans charged-off	—	—	(23)	(8)	(46)	—	(77)
Loan recoveries	5	209	—	3	3	—	220
December 31, 2017	**$ 230**	**$ 1,748**	**$ 1,359**	**$ 202**	**$ 64**	**$ —**	**$ 3,603**

The following table presents the balance in the allowance for loan losses and the recorded investment in loans by loan portfolio segment, and impairment evaluation method at December 31, 2018:

	Commercial	Commercial Real Estate	Residential Real Estate	Home Equity	Installment	Unallocated	Total
Individually evaluated for impairment	$ —	$ —	$ 40	$ —	$ —	$ —	$ 40
Collectively evaluated for impairment	242	2,102	1,688	200	89	1	4,322
Acquired with deteriorated credit quality	2	51	69	4	—	—	126
Total ALLL	**$ 244**	**$ 2,153**	**$ 1,797**	**$ 204**	**$ 89**	**$ 1**	**$ 4,488**

	Commercial	Commercial Real Estate	Residential Real Estate	Home Equity	Installment	Unallocated	Total
Individually evaluated for impairment	$ —	$ 2,085	$ 756	$ —	$ —		$ 2,841
Collectively evaluated for impairment	56,496	365,816	291,263	43,566	9,711		766,852
Acquired with deteriorated credit quality	87	1,142	1,252	31	22		2,534
Total loans	**56,583**	**369,043**	**293,271**	**43,597**	**9,733**		**772,227**
Accrued interest receivable	139	899	555	226	13		1,832
Total recorded investment in loans	**$ 56,722**	**$ 369,942**	**$ 293,826**	**$ 43,823**	**$ 9,746**		**$ 774,059**

The following table presents the balance in the allowance for loan losses and the recorded investment in loans by loan portfolio segment, and impairment evaluation method at December 31, 2017:

	Commercial	Commercial Real Estate	Residential Real Estate	Home Equity	Installment	Unallocated	Total
Individually evaluated for impairment	$ —	$ —	$ 43	$ —	$ —	$ —	$ 43
Collectively evaluated for impairment	205	1,748	1,316	202	64	—	3,535
Acquired with deteriorated credit quality	25	—	—	—	—	—	25
Total ALLL	**$ 230**	**$ 1,748**	**$ 1,359**	**$ 202**	**$ 64**	**$ —**	**$ 3,603**

	Commercial	Commercial Real Estate	Residential Real Estate	Home Equity	Installment	Unallocated	Total
Individually evaluated for impairment	$ —	$ 1,736	$ 241	$ —	$ —		$ 1,977
Collectively evaluated for impairment	51,119	327,071	232,158	44,562	12,272		667,182
Acquired with deteriorated credit quality	159	1,502	1,648	40	22		3,371
Total loans	**51,278**	**330,309**	**234,047**	**44,602**	**12,294**		**672,530**
Accrued interest receivable	159	919	585	224	18		1,905
Total recorded investment in loans	**$ 51,437**	**$ 331,228**	**$ 234,632**	**$ 44,826**	**$ 12,312**		**$ 674,435**

Acquired loans were recorded at fair value as of the acquisition date. At the acquisition date, where a loan exhibited evidence of credit deterioration since origination and it was probable at the date of acquisition that the Corporation would not collect all principal and interest payments in accordance with the terms of the loan agreement, the Corporation accounted for the loan under ASC 310-30 and recognized the expected shortfall of expected future cash flows, as compared to the contractual amount due, as a nonaccretable discount. Any excess of the net present value of expected future cash flows over the acquisition date fair value was recognized as the accretable discount, or accretable yield. The Corporation recognizes accretion of the accretable discount as interest income over the expected remaining life of the purchased loan. Fair value discounts/premiums created on acquired loans accounted for outside the scope of ASC 310-30 are accounted for under ASC 310-20 and are accreted/amortized into interest income over the remaining term of the loan as an adjustment to the related loan's yield.

Changes in the carrying amount of accretable discount for purchased loans accounted for under ASC 310-30 were as follows for the years ended December 31:

	2018	2017
Balance at January 1,	$ 1,868	$ 1,441
Discount accretion recognized in interest income	(537)	(1,108)
Net reclassifications (to) from nonaccretable difference [1]	(10)	1,535
Balance at December 31,	**$ 1,321**	**$ 1,868**

[1] The reclassification from nonaccretable discount and other additions to accretable discount may include increases in the amount of contractual principal and interest expected to be collected due to improvement in credit quality, increases in balances outstanding from advances, renewals, extensions and interest rates; as well as reductions in contractual principal and interest expected to be collected due to credit deterioration, payoffs, and decreases in interest rates.

For loans accounted for under ASC 310-30, the Corporation remeasures expected cash flows on at least an annual basis. For loans where the remeasurement process results in a decline in expected cash flows, impairment is recorded. Alternatively, when a loan's remeasurement results in an increase in expected cash flows, the effective yield of the related loan is increased through an addition to the accretable discount.

The total identified (improvement)/decline in the cash flow expectations resulting in yield adjustments on a prospective basis during the years ended December 31, 2018 and 2017 for purchased credit impaired loans was $(10) and $1,535, respectively. The Corporation also identified declines in the cash flow expectations of certain loans. A decline in the present value of current expected cash flows compared to the previously estimated expected cash flows, due in any part to change in credit, is referred to as credit impairment and recorded as provision for loan losses during the year. Declines in the present value of expected cash flows only from the expected timing of such cash flows is referred to as timing impairment and recognized prospectively as a decrease in yield on the loan. Prepayment assumptions are based on one or more of the following estimates or observations: historical observed prepayments, industry trends, or anticipated fluctuations in interest rates. The Corporation recorded a provision for loan losses on purchase credit impaired loans of $126 and $25 in 2018 and 2017, respectively.

Below is the composition of the recorded investment for purchased credit impaired loans accounted for under ASC 310-30 at December 31:

	2018	2017
Contractual cash flows	$ 5,659	$ 7,880
Contractual cash flows not expected to be collected (nonaccretable difference)	1,929	2,641
Expected cash flows	3,730	5,239
Interest component of expected cash flows (accretable yield)	1,196	1,868
Recorded investment	**$ 2,534**	**$ 3,371**

Below is the composition of the outstanding contractual principal balance and carrying amount of acquired loans as of December 31:

	2018	2017
Contractual principal balance	$ 39,404	$ 59,663
Carrying amount	$ 37,087	$ 56,345

For loans not accounted for under ASC 310-30, the Corporation individually assesses all nonaccrual loans and TDRs for impairment.

The following table presents originated loans individually evaluated for impairment by portfolio segment of loans as of December 31, 2018:

	Contractual Principal Balance	Recorded Investment	Allowance for Loan Losses Allocated	Average Recorded Investment	Interest Income Recognized
With no related allowance recorded					
Commercial	$ —	$ —	$ —	$ —	$ —
Commercial real estate	2,085	2,093	—	2,115	132
Residential real estate	527	527	—	544	18
Consumer					
Installment loans	—	—	—	—	—
Home equity	—	—	—	—	—
With an allowance recorded					
Commercial	—	—	—	3	—
Commercial real estate	—	—	—	—	—
Residential real estate	229	230	40	235	11
Consumer					
Installment loans	—	—	—	—	—
Home equity	—	—	—	—	—
Total	**$ 2,841**	**$ 2,850**	**$ 40**	**$ 2,897**	**$ 161**

The following table presents originated loans individually evaluated for impairment by portfolio segment of loans as of December 31, 2017:

	Contractual Principal Balance	Recorded Investment	Allowance for Loan Losses Allocated	Average Recorded Investment	Interest Income Recognized
With no related allowance recorded					
Commercial	$ —	$ —	$ —	$ —	—
Commercial real estate	1,736	1,741	—	2,998	146
Residential real estate	—	—	—	—	—
Home equity	—	—	—	—	—
Installment	—	—	—	3	—
With an allowance recorded					
Commercial	—	—	—	22	4
Commercial real estate	—	—	—	—	—
Residential real estate	241	242	43	247	11
Home equity	—	—	—	—	—
Installment	—	—	—	—	—
Total	**$ 1,977**	**$ 1,983**	**$ 43**	**$ 3,270**	**$ 161**

Non-accrual loans and loans past due 90 days still accruing include both smaller balance homogeneous loans that are collectively evaluated for impairment and individually classified impaired loans.

Modifications

A modification of a loan constitutes a TDR if for economic or legal reasons related to the borrower's financial difficulties, a concession is granted to the borrower that would not otherwise be considered. The Corporation offers various types of concessions when modifying a loan or lease, however, forgiveness of principal is rarely granted. Commercial loans modified in a TDR often involve temporary interest-only payments, term extensions, and converting revolving credit lines to term loans. Additional collateral, a co-borrower, or a guarantor is often requested. Commercial real estate loans modified in a TDR often involve reducing the interest rate for the remaining term of the loan, extending the maturity date at an interest rate lower than the current market rate for new debt with similar risk, or substituting or adding a new borrower or guarantor. Residential real estate loans modified in a TDR are primarily comprised of loans where monthly payments are lowered to accommodate the borrowers' financial needs through a reduction of interest rate and/or extension of the maturity date. Installment loans modified in a TDR are primarily comprised of loans where the Corporation has lowered monthly payments by extending the term.

Loans modified in a TDR are typically already on nonaccrual status and partial charge-offs have in some cases been taken against the outstanding loan balance. As a result, loans modified in a TDR for the Corporation may have the financial effect of increasing the specific allowance associated with the loan.

The following schedule presents the Corporation's TDRs as of:

	December 31, 2018		
	Accruing TDRs	Nonaccrual TDRs	Total
Commercial real estate	$ 1,700	$ —	$ 1,700
Residential real estate	229	—	229
Total	**$ 1,929**	**$ —**	**$ 1,929**

	December 31, 2017		
	Accruing TDRs	Nonaccrual TDRs	Total
Commercial real estate	$ 1,736	$ —	$ 1,736
Residential real estate	241	—	241
Total	**$ 1,977**	**$ —**	**$ 1,977**

The Corporation allocated $40 and $43 of specific reserves to customers whose loan terms have been modified in TDRs as of December 31, 2018 and 2017, respectively. The Corporation does not have material commitments to lend additional funds to borrowers with loans whose terms have been modified in troubled debt restructurings or whose loans are on nonaccrual as of December 31, 2018.

There were no loans modified in a TDR during 2018 or 2017. There were no TDRs that defaulted in 2018 or 2017.

Based on the Corporation's historical loss experience, losses associated with TDRs are not significantly different than other impaired loans within the same loan segment. As such, TDRs are analyzed in the same manner as other impaired loans within their respective loan segment.

Credit Quality Indicators

Loan delinquency, excluding acquired loans accounted for under ASC 310-30, was as follows as of:

	December 31, 2018					
	Accruing					
	Current	30-89 Days Past Due	90+ Days Past Due	Nonaccrual	Total Loans	Total Past Due and Nonaccrual
Commercial	$ 56,432	$ 64	$ —	$ —	$ 56,496	$ 64
Commercial real estate	367,518	—	—	383	367,901	383
Residential real estate	290,771	721	—	527	292,019	1,248
Home equity	43,512	25	29	—	43,566	54
Installment	9,706	5	—	—	9,711	5
Total	**$ 767,939**	**$ 815**	**$ 29**	**$ 910**	**$ 769,693**	**$ 1,754**

	December 31, 2017					
	Accruing					
	Current	30-89 Days Past Due	90+ Days Past Due	Nonaccrual	Total Loans	Total Past Due and Nonaccrual
Commercial	$ 51,119	$ —	$ —	$ —	$ 51,119	$ —
Commercial real estate	328,807	—	—	—	328,807	—
Residential real estate	231,277	1,097	—	26	232,399	1,123
Home equity	44,562	—	—	—	44,562	—
Installment	12,267	5	—	—	12,272	5
Total	**$ 668,032**	**$ 1,102**	**$ —**	**$ 26**	**$ 669,159**	**$ 1,128**

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

Pass - Loans have a moderate to average risk to established borrowers that display sound financial condition and operating results. The capacity to service debt is stable and demonstrated at a level consistent with or above the industry norms. Borrower and industry trends and outlook are considered good.

Special Mention **-** Loans have a potential weakness that deserves management's close attention. If left uncorrected, these potential weaknesses may result in deterioration of the repayment prospects for the loan or of the Corporation's credit position at some future date.

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

Doubtful - Loans have all the weaknesses inherent in those classified as substandard, with the added characteristic that the weaknesses make collection or liquidation in full, on the basis of currently existing facts, conditions, and values, highly questionable and improbable. The Corporation does not typically classify loans as doubtful. Loans that approach this status are charged-off.

Based on the most recent analysis performed, the ending loan balance by risk category of loans by portfolio class is as follows at December 31:

	2018			
	Pass	Special Mention	Substandard	Total
Originated Loans				
Commercial	$ 53,034	$ —	$ —	$ 53,034
Commercial Real Estate	346,818	567	—	347,385
Total	$ 399,852	$ 567	$ —	$ 400,419
Acquired Loans				
Commercial	$ 3,348	$ 114	$ 87	$ 3,549
Commercial Real Estate	19,901	1,134	623	21,658
Total	$ 23,249	$ 1,248	$ 710	$ 25,207

	2017			
	Pass	Special Mention	Substandard	Total
Originated Loans				
Commercial	$ 45,316	$ —	$ —	$ 45,316
Commercial Real Estate	298,893	357	—	299,250
Total	$ 344,209	$ 357	$ —	$ 344,566
Acquired Loans				
Commercial	$ 5,667	$ 135	$ 160	$ 5,962
Commercial Real Estate	29,544	462	1,053	31,059
Total	$ 35,211	$ 597	$ 1,213	$ 37,021

The Corporation considers the performance of the loan portfolio and its impact on the allowance for loan losses. For residential and consumer loan classes, the Corporation also evaluates credit quality based on the aging status of the loan, which was previously presented, and by payment activity. The Corporation defines performing loans as those which are accruing interest, and nonperforming

loans as non-accrual loans. The following table presents the ending loan balance in residential and consumer loans based on payment activity as of December 31:

	2018			
	Home Equity	Installment	Residential Real Estate	Total
Originated loans				
Performing	$ 39,541	$ 9,014	$ 285,767	$ 334,322
Nonperforming	—	—	398	398
Total	$ 39,541	$ 9,014	$ 286,165	$ 334,720
Acquired loans				
Performing	$ 4,056	$ 719	$ 6,977	$ 11,752
Nonperforming	—	—	129	129
Total	$ 4,056	$ 719	$ 7,106	$ 11,881

	2017			
	Home Equity	Installment	Residential Real Estate	Total
Originated loans				
Performing	$ 39,487	$ 10,852	$ 221,280	$ 271,619
Nonperforming	—	—	—	—
Total	$ 39,487	$ 10,852	$ 221,280	$ 271,619
Acquired loans				
Performing	$ 5,115	$ 1,442	$ 12,539	$ 19,096
Nonperforming	—	—	228	228
Total	$ 5,115	$ 1,442	$ 12,767	$ 19,324

Loans to principal officers, directors, and affiliates at December 31, 2018 and 2017 were $6,166 and $5,415, respectively.

Note 7 – Derivatives

Risk Management Objective of Using Derivatives

The Corporation is exposed to certain risks arising from both its business operations and economic conditions. The Corporation principally manages its exposures to a wide variety of business and operational risks through management of its core business activities. The Corporation manages economic risks, including interest rate, liquidity, and credit risk primarily by managing the amount, sources, and duration of its assets and liabilities and through the use of derivative financial instruments. Specifically, the Corporation enters into derivative financial instruments to manage exposures that arise from business activities that result in the receipt or payment of future known and uncertain cash amounts, the value of which are determined by interest rates. The Corporation's derivative financial instruments are used to manage differences in the amount, timing, and duration of the Corporation's known or expected cash receipts and its known or expected cash payments principally related to the Corporation's loan portfolio and borrowings. The Corporation does not use derivatives for speculative purposes.

Cash Flow Hedges of Interest Rate Risk

The Corporation's objectives in using interest rate derivatives are to add stability to interest expense and to manage its exposure to interest rate movements. To accomplish this objective, the Corporation primarily uses interest rate caps as part of its interest rate risk management strategy. Interest rate caps designated as cash flow hedges involve the receipt of variable amounts from a counterparty if interest rates rise above the strike rate on the contract in exchange for an up-front premium. During 2018, such derivatives were used to hedge the variable cash flows associated with existing variable-rate debt.

For derivatives designated and that qualify as cash flow hedges of interest rate risk, the gain or loss on the derivative is recorded in Accumulated Other Comprehensive Income and subsequently reclassified into interest expense in the same period(s) during which the hedged transaction affects earnings. Amounts reported in accumulated other comprehensive income related to derivatives will

be reclassified to interest expense as interest payments are made on the Corporation's variable-rate debts. During the next twelve months, the Corporation estimates that an additional $205 will be reclassified as an increase to interest expense.

Fair Value Hedges of Interest Rate Risk

The Corporation is exposed to changes in the fair value of certain of its fixed-rate assets due to changes in benchmark interest rates. The Corporation uses interest rate swaps to manage its exposure to changes in fair value on these instruments attributable to changes in the designated benchmark interest rate, LIBOR. Interest rate swaps designated as fair value hedges involve the payments of fixed-rate amounts to a counterparty in exchange for the Corporation receiving variable-rate payments over the life of the agreements without the exchange of the underlying notional amount.

For derivatives designated and that qualify as fair value hedges, the gain or loss on the derivative as well as the offsetting loss or gain on the hedged item attributable to the hedged risk are recognized in interest income.

The following table presents the carrying amounts of the hedged items accounted for as fair value hedges for the years ended December 31:

Line Item in the Consolidated Balance Sheets in Which the Hedged Item is Included	Carrying Amount of the Hedged Assets		Cumulative Amount of Fair Value Hedging Adjustment Included in the Carrying Amount of the Hedged Assets	
	2018	2017	2018	2017
Loans	$ 20,004	$ 2,092	$ 316	$ (38)

The table below presents the fair value of the Corporation's derivative financial instruments as well as their classification on the Consolidated Balance Sheets as of December 31:

Derivatives Designed as Hedging Instruments	Location	2018 Notional Amount	2018 Fair Value	2017 Notional Amount	2017 Fair Value
Interest rate cap	Other Assets	$ 12,000	$ 122	$ 12,000	$ 69
Interest rate swaps	Other Assets	19,688	(316)	2,130	33
Total interest rate contracts		**$ 31,688**	**$ (194)**	**$ 14,130**	**$ 102**

The table below presents the effect of cash flow hedge accounting on Accumulated Other Comprehensive Income for the years ended December 31:

	Amount of Gain (Loss) Recognized in Other Comprehensive Income on Derivative		Location of Gain (Loss) Reclassified from AOCI into Earnings	Amount of Gain (Loss) Reclassified from AOCI into Earnings	
	2018	2017		2018	2017
Interest rate cap	$ 217	$ 98	Interest Expense	$ (136)	$ (33)

The table below presents the effect of the Corporation's derivative financial instruments on the Consolidated Income Statement for the years ended December 31:

	2018		2017	
	Interest Income	Interest Expense	Interest Income	Interest Expense
Total amount of income and expense line items presented in the Consolidated Statements of Income in which the effects of fair value or cash flow hedges are recorded	**$ (69)**	**$ (136)**	**$ (3)**	**$ (33)**
The effects of fair value and cash flow hedging:				
Gain (loss) on fair value hedging relationship				
Interest contracts				
Hedged items	354	—	(24)	—
Derivatives designated as hedging instruments [1]	(423)	—	21	—
Gain (loss) on cash flow hedging relationship				
Interest contracts				
Amount of gain (loss) reclassified from AOCI into earnings	—	(136)	—	(33)
Amount of gain (loss) reclassified from AOCI into earnings as a result that a forecasted transaction is no longer probable of occurring	—	—	—	—

[1] Amounts include changes in fair value as well as net settlement on the derivatives.

The tables below present a gross presentation, the effects of offsetting, and a net presentation of the Corporation's derivatives as of December 31, 2018 and 2017. The net amounts of derivative assets or liabilities can be reconciled to the tabular disclosure of fair value. The tabular disclosure of fair value, Note 14, provides the location that derivative assets and liabilities are presented on the Consolidated Balance Sheets.

Offsetting of Derivative Assets as of December 31, 2018

				Gross Amounts Not Offset in the Consolidated Balance Sheets		
	Gross Amounts of Recognized Assets	Gross Amounts Offset in the Consolidated Balance Sheets	Net Amounts of Assets presented in the Consolidated Balance Sheets	Financial Instruments	Cash Collateral Received (Posted)	Net Amount
Interest rate derivatives	$ 122	$ —	$ 122	$ —	$ —	$ 122

Offsetting of Derivative Liabilities as of December 31, 2018

				Gross Amounts Not Offset in the Consolidated Balance Sheets		
	Gross Amounts of Recognized Assets	Gross Amounts Offset in the Consolidated Balance Sheets	Net Amounts of Liabilities presented in the Consolidated Balance Sheets	Financial Instruments	Cash Collateral Received (Posted)	Net Amount
Interest rate derivatives	$ 380	$ 64	$ 316	$ —	$ (250)	$ 66

Offsetting of Derivative Assets as of December 31, 2017

	Gross Amounts of Recognized Assets	Gross Amounts Offset in the Consolidated Balance Sheets	Net Amounts of Assets presented in the Consolidated Balance Sheets	Gross Amounts Not Offset in the Consolidated Balance Sheets		
				Financial Instruments	Cash Collateral Received (Posted)	Net Amount
Interest rate derivatives	$ 102	$ —	$ 102	$ —	$ —	$ 102

There was no offsetting of derivative liabilities as of December 31, 2017.

Credit-risk-related Contingent Features

The Corporation has agreements with each of its derivative counterparties that contain a provision where if the Corporation either defaults, or is capable of being declared in default, on any of its indebtedness, then the Corporation could also be declared in default on its derivative obligations.

As of December 31, 2018, the fair value of derivatives, which includes accrued interest but excludes any adjustment for nonperformance risk, related to these agreements was $(316). As of December 31, 2018, and the 2017, Corporation had minimum collateral posting thresholds with certain of its derivative counterparties and had posted collateral of $250 and $0, respectively, in cash collateral on deposit with counterparties. If the Corporation had breached any of these provisions at December 31, 2018, it could have been required to settle its obligations under the agreements at their termination value of $(316).

Note 8 – Premises and Equipment, Net

Bank premises and equipment, net, is comprised of the following at:

	December 31	
	2018	2017
Land and land improvements	$ 2,978	$ 2,951
Building and building improvements	14,514	14,155
Furniture and equipment	8,658	8,251
Construction in progress	570	43
	26,720	25,400
Less accumulated depreciation	11,959	10,952
Total	**$ 14,761**	**$ 14,448**
Depreciation expense for the year	$ 1,437	$ 910

The Corporation leases property for certain branches and ATM locations. Rent expense was $86 and $85 for 2018 and 2017, respectively. Rent commitments under non-cancelable operating leases is as follows, before considering renewal options that generally are present, at December 31, 2018:

2019	$ 59
2020	58
2021	32
2022	4
2023	—
	$ 153

Note 9 – Deposits

The following is a summary of deposits at:

	December 31	
	2018	2017
Non-interest bearing		
Demand	$ 233,954	$ 216,607
Interest bearing		
Savings	223,728	224,558
Money market demand	61,369	67,387
NOW	10,234	2,253
Time, over $250,000	113,668	40,689
Time, $250,000 and under	120,171	122,011
Total interest bearing	529,170	456,898
Total deposits	**$ 763,124**	**$ 673,505**

Scheduled maturities of time deposits for years succeeding December 31, 2018, are as follows:

2019	$ 161,756
2020	56,064
2021	6,915
2022	6,645
2023	2,459
Thereafter	—
Total	$ 233,839

The Corporation held $37,298 and $37,932 in brokered deposits at December 31, 2018 and 2017, respectively.

Deposits from principal officers, directors, and affiliates at December 31, 2018 and 2017 were $6,153 and $5,746, respectively.

Note 10 – Borrowings

Federal Home Loan Bank Advances

Advances from the FHLB were as follows as of December 31,

	2018		2017	
	Rate	Amount	Rate	Amount
Fixed rate due 2018	—	$ —	1.66%	$ 10,000
Fixed rate due 2019	2.35%	22,500	1.82%	7,500
Fixed rate due 2020	1.93%	2,500	1.93%	2,500
Fixed rate due 2021	—	—	—	—
Fixed rate due 2022	—	—	—	—
Fixed rate due 2023	2.91%	10,000	—	—
One-time putable due 2025, putable in 2021	2.53%	10,000	—	—
One-time putable due 2026, putable in 2021	1.06%	10,000	1.06%	10,000
	2.23%	$ 55,000	1.52%	$ 30,000

The advances are payable at their maturity date; a prepayment penalty is assessed with early payoffs of advances. The advances are collateralized by securities totaling $3,759 and loans totaling $225,280 at December 31, 2018 and securities totaling $4,928 and loans totaling $165,940 at December 31, 2017.

Subordinated Debentures and Trust Preferred Securities

A trust formed by the Corporation issued $12,000 of trust preferred securities in 2003 as part of a pooled offering of such securities. The interest rate is a floating rate (3 month LIBOR plus 3.00%), and the current rate at December 31, 2018 is 5.80%. The Corporation issued subordinated debentures at the same terms as the trust preferred securities to the trust in exchange for the proceeds of the offering; the debentures and related debt issuance costs represent the sole assets of the trust. The Corporation may redeem the subordinated debentures, in whole but not in part, any time after 2008 at a price of 100% of face value. The subordinated debentures must be redeemed no later than 2033.

A trust formed by the Corporation issued $2,000 of trust preferred securities in 2005 as part of a pooled offering of such securities. The interest rate is a floating rate (3 month LIBOR plus 1.60%), and the current rate at December 31, 2018 is 4.25%. The Corporation issued subordinated debentures at the same terms as the trust preferred securities to the trust in exchange for the proceeds of the offering; the debentures and related debt issuance costs represent the sole assets of the trust. The Corporation may redeem the subordinated debentures, in whole but not in part, any time after 2010 at a price of 100% of face value. The subordinated debentures must be redeemed no later than 2035.

The Corporation is not considered the primary beneficiary of these trusts, therefore the trusts are not consolidated in the Corporation's financial statements; rather, the subordinated debentures are presented as a liability.

The Parent has entered into an $8,000 line of credit secured by the Corporation's investment in the Bank. This instrument has the option to be at a fixed or variable rate at the time of each draw and matures annually with any individual draw having a maturity of no more than 3 years. The fixed rate option would be priced at the time of draw and the variable rate spreads are 2.75% over 1, 2, or 3 month LIBOR or 0.50% below National Prime if the respective LIBOR rate cannot be determined or offered. There were no outstanding advances against this line as of December 31, 2018 or 2017.

Note 11 – Income Taxes

The provision for income taxes reflected in the consolidated statements of income for the years ended December 31 consists of the following:

	2018	2017
Current expense	$ 2,281	$ 423
Deferred expense	38	2,453
Income tax expense	**$ 2,319**	**$ 2,876**

The Tax Cuts and Jobs Act (The "Act") was enacted on December 22, 2017. The Act reduced the U.S. federal corporate tax rate from 35% to 21%, among other provisions. The Corporation remeasured certain deferred tax assets and liabilities as of December 31, 2017 based on the rates at which they are expected to reverse in the future, which is generally 21%, resulting in an immediate tax reduction of $489 in 2017.

Income tax expense for continuing operations was less than the amount computed by applying the statutory federal income tax rate to income before income taxes. The reasons for the difference are as follows for the years ended December 31:

	2018	2017
Income tax at statutory rate	$ 2,611	$ 3,928
Tax-exempt interest income	(68)	(160)
Net indemnity proceeds on bank owned life insurance	(196)	(393)
Bank owned life insurance	(39)	(29)
Remeasurement of deferred taxes due to changes in federal tax law	—	(489)
Other, net	11	19
Income tax expense	**$ 2,319**	**$ 2,876**

The net deferred tax asset (liability) recorded includes the following amounts of deferred tax assets and liabilities as of December 31:

	2018	2017 (Remeasured at 21%)
Deferred tax assets		
Allowance for loan losses	$ 895	$ 674
Acquired loans	487	697
Alternative minimum tax credit	268	—
Compensation	163	156
Other comprehensive income tax adjustments	90	84
Other	98	91
Total deferred tax assets	$ 2,001	$ 1,702
Deferred tax liabilities		
Fixed assets	1,383	1,106
Mortgage servicing rights	718	649
Deferred loan fees (costs)	307	185
Core deposit intangible	284	398
Prepaid expenses	69	96
Other	57	53
Total deferred tax liabilities	2,818	2,487
Net deferred tax asset (liability)	**$ (817)**	**$ (785)**

The deferred tax assets will continue to be analyzed at each reporting period for changes affecting realizability and a valuation allowance may be recorded in future periods accordingly. The ultimate realization of these deferred tax assets is primarily dependent on the generation of future taxable income during the periods in which those temporary differences become deductible. Changes in existing tax laws could also affect actual tax results and the valuation of deferred tax assets over time. The accounting for deferred taxes is based on an estimate of future results. Differences between anticipated and actual outcomes of these future tax consequences could have an impact on the Corporation's consolidated statement of income and balance sheet.

The Corporation concluded that there are no significant uncertain tax positions requiring recognition in the Corporation's consolidated financial statements based on the evaluation performed for 2015 through 2018, the years which remain subject to examination by major tax jurisdictions as of December 31, 2018. The Corporation does not expect the total amount of unrecognized tax benefits to significantly change in the next 12 months.

Note 12 – Benefit Plans

The Corporation has a noncontributory discretionary ESOP covering substantially all of its employees. It is a requirement of the plan to invest principally in the Corporation's common stock. The Corporation contributed $50 and $25 to the Plan in 2018 and 2017, respectively. Contributions are allocated to participants based on relative compensation. Total allocated shares outstanding related to the employee stock ownership plan at December 31, 2018 and 2017 were 29,537 and 28,777, respectively. Such shares are included in the computation of dividends and earnings per share in each of the respective years. Expenses related to the ESOP were $35 and $9 in 2018 and 2017, respectively.

The Corporation has also established a 401(k) Plan in which 100% of the employees' contribution can be matched up to 3% of their gross pay and 50% can be matched on the next 2% of their gross pay with a discretionary contribution by the Corporation. Contributions to the plan were $314 and $294 in 2018 and 2017, respectively.

The Corporation entered into Supplemental Executive Retirement Agreements ("SERP Agreements") with certain executives. The SERP Agreements are designed to encourage executives to remain long term employees of the Corporation, and to provide specified benefits to certain key executives who contribute materially to the continued growth, development and future business success of the Corporation. The retirement benefits are an unsecured obligation of the Corporation. At year end 2018 and 2017, the accumulated liability for these plans totaled $681 and $628, respectively, and are included in accrued interest and other liabilities on the accompanying consolidated balance sheets. Expenses related to the SERP agreements were $106 and $107 in 2018 and 2017, respectively.

Note 13 - Common Stock Purchase and Option Plans

Director and Employee Stock Purchase Plan

The Director and Employee Stock Purchase Plan permits directors and employees of the Corporation to purchase shares of common stock made available for purchase under the plan at the average fair value of the shares over the most recent five days prior to the issuance date. Additionally, the plan allows directors to elect to receive shares of common stock in full or partial payment of the director's retainer fees and fees for attending meetings. The number of shares is determined by dividing the dollar amount of fees to be paid in shares by the fair value of the stock on the first business day prior to the payment date. There were 9,049 and 6,900 shares issued under the Director and employee stock option plan in 2018 and 2017, respectively.

Dividend Reinvestment Plan

The Automatic Dividend Reinvestment Plan ("DRIP") permits enrolled shareholders to automatically use dividends paid on common stock to purchase additional shares of the Corporation's common stock at its fair value on the investment date. Any shareholder who is the beneficial or record owner of not more than 9.9% of the issued and outstanding shares of the Corporation's common stock is eligible to participate in the plan. There were 9,700 and 5,751 shares issued under the DRIP in 2018 and 2017, respectively.

Stock Compensation Plan

The Corporation adopted a Stock Compensation Plan in 2017 to provide for discretionary grants of restricted stock, stock options, or stock appreciation rights to certain executives. The plan's purpose is to advance the interests of the Corporation and its stockholders by helping the Corporation and its Subsidiaries attract and retain the services of executives, upon whose judgment, initiative and efforts the Corporation is substantially dependent, and to provide those persons with further incentives to advance the interests of the Corporation. The plan is also established with the objective of encouraging stock ownership by such executives and aligning their interests with those of stockholders. In 2018, the plan issued grants of restricted stock. Under the plan, the shares partially vest at 20%

each year, until fully vested at the end of five years. During the five year vesting period, the employees receive dividends or dividend equivalent compensation on the shares.

A summary of changes in the Corporation's nonvested shares in 2018 follows:

	Shares	Weighted-Average Grant-Date Fair Value
Nonvested at January 1, 2018	—	$ —
Granted	4,945	19.76
Vested	—	—
Forfeited	—	—
Nonvested at December 31, 2018	**4,945**	**$ 19.76**

As of December 31, 2018 there was $98 of total unrecognized compensation cost related to nonvested shares under the plan. The cost is expected to be recognized over a weighted average period of 5 years from grant date.

Note 14 – Fair Value Measurements

Fair value is the exchange price that would be received for an asset or paid to transfer a liability (exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. There are three levels of inputs that may be used to measure fair values.

Level 1: Valuation is based upon quoted prices for identical instruments traded in active markets.

Level 2: Valuation is based upon quoted prices for similar instruments in active markets, quoted prices for identical or similar instruments in markets that are not active, and model-based valuation techniques for which all significant assumptions are observable in the market. Level 2 valuations for the Corporation include government and government-sponsored enterprise debt obligations, including securities issued by the FHLB, Federal Home Loan Mortgage Corporation, Federal National Mortgage Association, Federal Farm Credit Bank, securities issued by certain state and political subdivisions, residential mortgage-backed securities, and collateralized mortgage obligations. Valuations are obtained from a third-party pricing service for these investment securities. Additionally included in Level 2 valuations are loans held-for-sale and derivative assets.

Level 3: Valuation is generated from model-based techniques that use at least one significant assumption not observable in the market. These unobservable assumptions reflect estimates of assumptions that market participants would use in pricing the asset or liability. Valuation techniques include use of option pricing models, discounted cash flow models, yield curves and similar techniques. The determination of fair value requires management's judgment or estimation and generally is corroborated by external data, which includes third-party pricing services. Level 3 valuations for the Corporation include impaired loans, goodwill, core deposit intangible assets, non-compete intangible assets, mortgage servicing rights, and other real estate owned.

A description of the valuation methodologies used for instruments measured at fair value, as well as the general classification of such instruments pursuant to the valuation hierarchy, is set forth below. These valuation methodologies were applied to all of the Corporation's financial assets and financial liabilities carried at fair value and all financial instruments disclosed at fair value. Transfers of asset or liabilities between levels of the fair value hierarchy are recognized at the beginning of the reporting period, when applicable.

In general, fair value is based upon quoted market prices, where available. If quoted market prices are not available, fair value is based upon third-party pricing services when available. Fair value may also be based on internally developed models that primarily use, as inputs, observable market-based parameters. Valuation adjustments may be required to record financial instruments at fair value. Any such valuation adjustments are applied consistently over time. The Corporation's valuation methodologies may produce a fair value calculation that may not be indicative of net realizable value or reflective of future fair values.

While management believes the Corporation's valuation methodologies are appropriate and consistent with other market participants, the use of different methodologies or assumptions to determine the fair value of certain financial instruments could result in a different estimate of fair value at the reporting date. Furthermore, the fair value amounts may change significantly after the date of the Consolidated Balance Sheets.

Assets and Liabilities Recorded at Fair Value on a Recurring Basis

Available-for-Sale Securities: The fair values of available for sale debt securities are determined by obtaining quoted prices on nationally recognized securities exchanges (Level 1 inputs) or matrix pricing, which is a mathematical technique widely used in the industry to value debt securities without relying exclusively on quoted prices for the specific securities but rather by relying on the securities' relationship to other benchmark quoted securities (Level 2 inputs).

Equity Securities: The fair values of equity securities (Level 1 inputs) are determined by obtaining quoted prices on nationally recognized securities exchanges.

Derivatives: Derivatives (including interest rate caps and swaps) are reported at fair value utilizing Level 2 inputs. Substantially all of the derivative instruments held by the Corporation for risk management purposes are traded in over-the-counter markets where quoted market prices are not readily available. The Corporation measures fair value using models that use primarily market observable inputs, such as yield curves and option volatilities, and include the value associated with counterparty credit risk. In addition, the Corporation obtains third party validation sources. Derivatives are included in other assets or liabilities in the consolidated balance sheets.

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

	December 31, 2018			
	Total	Level 1	Level 2	Level 3
Available-for-sale securities				
U.S. Government and federal agency	$ 56,863	$ 5,857	$ 51,006	$ —
State and municipal	10,600	—	10,600	—
Mortgage backed residential	4,194	—	4,194	—
Certificates of deposit	8,323	—	8,323	—
Collateralized mortgage obligations - agencies	9,874	—	9,874	—
Total available-for-sale securities	**$ 89,854**	**$ 5,857**	**$ 83,997**	**$ —**
Equity securities	**$ 966**	**$ 966**	**$ —**	**$ —**
Interest rate cap	**$ 122**	**$ —**	**$ 122**	**$ —**
Interest rate swaps	**$ (316)**	**$ —**	**$ (316)**	**$ —**

	December 31, 2017			
	Total	Level 1	Level 2	Level 3
Available-for-sale securities				
U.S. Government and federal agency	$ 23,066	$ 3,981	$ 19,085	$ —
State and municipal	15,068	—	15,068	—
Mortgage backed residential	5,205	—	5,205	—
Certificates of deposit	4,440	—	4,440	—
Collateralized mortgage obligations - agencies	2,012	—	2,012	—
Total available-for-sale securities	**$ 49,791**	**$ 3,981**	**$ 45,810**	**$ —**
Equity securities	**$ 999**	**$ 999**	**$ —**	**$ —**
Interest rate cap	**$ 69**	**$ —**	**$ 69**	**$ —**
Interest rate swaps	**$ 33**	**$ —**	**$ 33**	**$ —**

There were no transfers between levels within the fair value hierarchy during the years ended December 31, 2018 or 2017.

Assets Measured at Fair Value on a Non-Recurring Basis

Held-to-Maturity Securities: Investment securities classified as held-to-maturity are recorded at fair value if the value is below amortized cost and the Corporation has determined that such unrealized loss is an other-than-temporary impairment. Fair value measurement is based upon quoted prices, if available. If quoted prices are not available, fair values are generally measured using

independent pricing models or other model-based valuation techniques that include market inputs, such as benchmark yields, reported trades, broker dealer quotes, issuer spreads, two-sided markets, benchmark securities, bids, offers, reference data and industry and economic events. There were no other-than-temporary impairments recognized on held-to-maturity securities during 2018 and 2017.

Loans Held for Sale: Loans held for sale are carried at the lower of cost or fair value, which is evaluated on a pool-level basis. The fair value of loans held for sale is determined using quoted prices for similar assets, adjusted for specific attributes of that loan or other observable market data, such as outstanding commitments from third party investors (Level 2).

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

Goodwill: Goodwill is subject to impairment testing on an annual basis. The assessment of goodwill for impairment requires a significant degree of judgment. In the event the assessment indicates that it is more-likely-than-not that the fair value is less than the carrying value, the asset is considered impaired and recorded at fair value. Goodwill that is impaired and subject to nonrecurring fair value measurements is a Level 3 valuation. At December 31, 2018 and 2017, no goodwill was impaired.

Mortgage Servicing Rights (“MSRs”): MSRs originated by the Corporation and those acquired in acquisitions are accounted for under the amortization method. The fair value of these MSRs is initially estimated using a model that calculates the net present value of estimated future cash flows using various assumptions, including prepayment speeds, the discount rate and servicing costs. If the valuation model reflects a value less than the carrying value, MSRs are adjusted to fair value, as determined by the model, through a valuation allowance. The Corporation classifies the MSRs subject to nonrecurring fair value measurements as Level 3 valuations. At December 31, 2018 and 2017, there was no impairment identified for MSRs.

Core Deposit Intangible: The core deposit intangible is recorded at fair value when initially recorded. Subsequently, core deposit intangible assets are amortized primarily on an accelerated basis over a 7 year period and are subject to impairment testing whenever events or changes in circumstances indicate that the carrying amount exceeds the fair value of the asset. If core deposit intangible asset impairment is identified, the Corporation classifies impaired core deposit intangible assets subject to nonrecurring fair value measurements as Level 3 valuations. At December 31, 2018 and 2017, there was no impairment identified for core deposit intangible assets.

Other Real Estate Owned: Nonrecurring adjustments to certain commercial and residential real estate properties classified as other real estate owned are measured at the lower of carrying amount or fair value, less costs to sell. Fair values are generally based on third party appraisals of the property. Adjustments are routinely made in the appraisal process by the appraisers to adjust for differences between the comparable sales and income data available, which results in a Level 3 classification. In cases where the carrying amount exceeds the fair value, less costs to sell, an impairment loss is recognized.

Certain assets may be required to be measured at fair value on a nonrecurring basis. The carrying value of these assets represent end of period values, which approximate the fair value measurements that occurred on the various measurement dates during the period. For assets measured at fair value on a nonrecurring basis, quantitative disclosures about fair value measurements for each major category of assets follow:

	December 31, 2018			
	Total	Level 1	Level 2	Level 3
Impaired loans	$ 190	$ —	$ —	$ 190
Other real estate owned	32	—	—	32
Total	**$ 222**	**$ —**	**$ —**	**$ 222**

	December 31, 2017			
	Total	Level 1	Level 2	Level 3
Impaired loans	$ 198	$ —	$ —	$ 198
Other real estate owned	92	—	—	92
Total	**$ 290**	**$ —**	**$ —**	**$ 290**

Qualitative information about Level 3 fair value instruments is as follows as of:

	December 31, 2018			
	Fair Value	Valuation Technique	Unobservable Input	Weighted Average
Impaired loans	$ 190	Discounted Cash Flows	Discount Rate	7.13%
Other real estate owned	$ 32	Appraisal Value - Real Estate	Discount Applied to Appraisal	20.00%

	December 31, 2017			
	Fair Value	Valuation Technique	Unobservable Input	Weighted Average
Impaired loans	$ 198	Discounted Cash Flows	Discount Rate	7.10%
Other real estate owned	$ 92	Appraisal Value - Real Estate	Discount Applied to Appraisal	20.00%

There were no liabilities recorded at fair value on a nonrecurring basis at either December 31, 2018 or 2017.

Disclosures About Fair Value of Financial Instruments

GAAP requires disclosures about the estimated fair value of the Corporation's financial instruments, including those financial assets and liabilities that are not measured and reported at fair value on a recurring or nonrecurring basis. The Corporation utilized the fair value hierarchy in computing the fair values of its financial instruments. In cases where quoted market prices were not available, the Corporation employed the exit-price notion following the adoption of ASU 2016-01 on January 1, 2018 and used the present value method prior to the adoption of ASU 2016-01, using unobservable inputs requiring management's judgment to estimate the fair values of its financial instruments, which are considered Level 3 valuations. These Level 3 valuations are affected by the assumptions made and, accordingly, are not necessarily indicative of amounts that would be realized in a current market exchange. It is also the Corporation's general practice and intent to hold the majority of its financial instruments until maturity and, therefore, the Corporation does not expect to realize the estimated amounts disclosed.

A summary of carrying amounts and estimated fair values of the Corporation's financial instruments not recorded at fair value in their entirety on a recurring basis on the Consolidated Balance Sheets are disclosed in the table below:

		2018		2017	
	Level in Fair Value Measurement Hierarchy	Carrying Amount	Fair Value	Carrying Amount	Fair Value
Assets					
Held to maturity securities	Level 2	$ 2,971	$ 2,924	$ 3,603	$ 3,567
Loans held for sale	Level 2	$ 903	$ 912	$ 2,067	$ 2,087
Net loans (including impaired loans)	Level 3	$ 767,739	$ 756,831	$ 668,927	$ 670,450
MSRs	Level 3	$ 3,406	$ 4,000	$ 3,043	$ 3,120
Liabilities					
Time deposits	Level 2	$ 233,839	$ 232,687	$ 162,700	$ 162,421
FHLB advances	Level 2	$ 55,000	$ 54,145	$ 30,000	$ 29,039
Subordinated debentures	Level 2	$ 14,000	$ 14,000	$ 14,000	$ 14,000

The short-term nature of certain assets and liabilities result in their carrying value approximating fair value. These include cash and cash equivalents, FHLB stock, non-marketable equity securities, accrued interest receivable, bank owned life insurance, deposits without defined maturities, federal funds purchased, and accrued interest payable.

Note 15 – Accumulated Other Comprehensive Income (Loss)

The following table presents a reconciliation of the changes in the components of accumulated other comprehensive income and details the components of other comprehensive income, including the amount of income tax (benefit) expense allocated to each component of other comprehensive income:

	Unrealized Holding Gains (Losses) on AFS Securities	Unrealized Gains (Losses) on Cash Flow Hedge	Total
Balance, January 1, 2017	**$ 106**	**$ (333)**	**$ (227)**
Unrealized gains (losses) arising during the year	527	65	592
Reclassification adjustments for net (gains) losses included in net income	—	33	33
Net unrealized gains (losses)	527	98	625
Tax effect	16	(32)	(16)
OCI, net of tax	543	66	609
Reclassification resulting from enactment of the Tax Act [(1)]	1	(53)	(52)
Balance, December 31, 2017	**650**	**(320)**	**330**
Unrealized gains (losses) arising during the year	(247)	81	(166)
Reclassification adjustments for net (gains) losses included in net income	—	136	136
Net unrealized gains (losses)	(247)	217	(30)
Tax effect	52	(46)	6
OCI, net of tax	(195)	171	(24)
Reclassification resulting from adoption of ASU 2016-01 [(2)]	(641)	—	(641)
Balance, December 31, 2018	**$ (186)**	**$ (149)**	**$ (335)**

[(1)] In accordance with the Tax Act, the effect of income tax law changes on deferred taxes also applies to items recognized in other comprehensive income. In February 2018, the FASB issued ASU 2018-02 which allowed for the "stranded" tax effects in AOCI to be reclassified to retained earnings rather than charged to income tax expense. The Corporation early adopted this guidance and applied this accounting alternative in the consolidated statements of shareholders' equity as of December 31, 2017.

[(2)] On January 1, 2018 the Corporation adopted ASU 2016-01. Upon adoption AOCI related to equity securities was reclassified to retained earnings (accumulated deficit).

Note 16 – Regulatory Matters

The Corporation and the Bank are subject to various regulatory capital requirements administered by the federal banking agencies. Failure to meet minimum capital requirements can initiate certain mandatory - and possibly discretionary - actions by regulators that, if undertaken, could have a direct material effect on the Corporation and the Bank. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, the Corporation and the Bank must meet specific capital guidelines that involve quantitative measures of assets, liabilities, and certain off-balance-sheet items that are calculated under regulatory accounting practices. The capital amounts and classifications are also subject to qualitative judgments by the regulators about components, risk weightings, and other factors. Prompt corrective action provisions are not applicable to bank holding companies.

Failure to meet capital requirements can initiate regulatory action. The final rules related to the implementation of the Basel Committee on Banking Supervision's capital guidelines for U.S. banks (Basel III rules) became effective for the Corporation and the Bank on January 1, 2015, with full compliance of all of the requirements being phased in over a multi-year schedule, and fully phased in by January 1, 2019. The capital conservation buffer was 1.88% and 1.25% as of December 31, 2018 and 2017, respectively. The net unrealized gain or loss on available for sale securities is not included in computing regulatory capital.

Quantitative measures established by regulation to ensure capital adequacy require the Corporation and the Bank to maintain minimum amounts and ratios (set forth in the table below). As of December 31, 2018 and 2017, the most recent notifications from the Federal Deposit Insurance Corporation categorized the Bank as well capitalized under the regulatory framework for prompt corrective

action. Management believes, as of December 31, 2018 and 2017, that the Corporation and the Bank met all capital adequacy requirements to which they are subject. There are no conditions or events since the notifications that management believes have changed the Corporation and the Bank's category.

The Corporation's principal source of funds for dividend payments is dividends received from the Bank. Banking regulations limit the amount of dividends that may be paid without prior approval of regulatory agencies.

The tables below illustrate the regulatory capital amounts and ratios for the Corporation and the Bank as of:

	December 31, 2018					
	Actual		Minimum Capital Requirement		Minimum to be Well Capitalized Under Prompt Corrective Action Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
Total capital to risk weighted assets						
The Corporation	$ 104,265	14.00%	$ 73,522	9.88%	N/A	N/A
The State Bank	94,909	12.76%	73,472	9.88%	$ 74,402	10.00%
Tier 1 capital to risk weighted assets						
The Corporation	99,777	13.40%	58,631	7.88%	N/A	N/A
The State Bank	90,421	12.15%	58,592	7.88%	59,522	8.00%
Common Tier 1 capital to risk weighted assets						
The Corporation	85,777	11.52%	47,463	6.38%	N/A	N/A
The State Bank	90,421	12.15%	47,431	6.38%	48,361	6.50%
Tier 1 capital to average assets[(1)]						
The Corporation	99,777	10.92%	73,074	8.00%	N/A	N/A
The State Bank	90,421	9.91%	73,034	8.00%	73,034	8.00%

	December 31, 2017					
	Actual		Minimum Capital Requirement		Minimum to be Well Capitalized Under Prompt Corrective Action Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
Total capital to risk weighted assets						
The Corporation	$ 72,303	10.93%	$ 61,176	9.25%	N/A	N/A
The State Bank	69,124	10.46%	61,130	9.25%	$ 66,086	10.00%
Tier 1 capital to risk weighted assets						
The Corporation	68,700	10.39%	47,949	7.25%	N/A	N/A
The State Bank	65,521	9.91%	47,913	7.25%	52,869	8.00%
Common Tier 1 capital to risk weighted assets						
The Corporation	54,700	8.27%	38,028	5.75%	N/A	N/A
The State Bank	65,521	9.91%	38,000	5.75%	42,956	6.50%
Tier 1 capital to average assets[(1)]						
The Corporation	68,700	8.98%	61,197	8.00%	N/A	N/A
The State Bank	65,521	8.57%	61,157	8.00%	61,157	8.00%

(1) The minimum capital requirements and minimum to be well capitalized under prompt corrective action represent the minimum capital requirements set forth in the regulatory approval for the acquisition of Community in 2016.

Note 17 – Loan Commitments and Other Related Activities

Off-Balance-Sheet Risk

Some financial instruments, such as loan commitments, credit lines, letters of credit, and overdraft protection, are issued to meet customer financing needs. These are agreements to provide credit or to support the credit of others, as long as conditions established in the contract are met, and usually have expiration dates. Commitments may expire without being used. Off-balance-sheet risk to credit loss exists up to the face amount of these instruments, although material losses are not anticipated. The same credit policies are used to make such commitments as are used for loans, including obtaining collateral at exercise of the commitment.

The contractual amount of financial instruments with off-balance-sheet risk was as follows at:

	December 31	
	2018	2017
Commitments to make loans (at market rate)	$ 42,594	$ 39,693
Unused lines of credit and letters of credit	173,794	147,746

Commitments to make loans are generally made for periods of 90 days or less.

Note 18 – Contingencies

Litigation

The Corporation is party to litigation arising during the normal course of business. In the opinion of management, based on consultation with legal counsel, the resolution of such litigation is not expected to have a material effect on the consolidated financial statements.

Environmental Issues

As a result of acquiring real estate from foreclosure proceedings, the Corporation is subject to potential claims and possible legal proceedings involving environmental matters. No such claims have been asserted as of December 31, 2018.