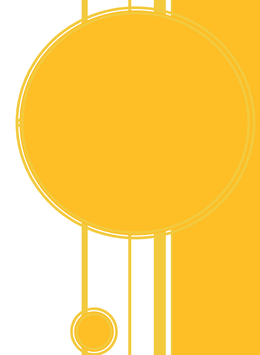
IBW FINANCIAL CORPORATION AND SUBSIDIARY

2017 FINANCIALS



IBW FINANCIAL CORPORATION
4812 GEORGIA AVE NW
WASHINGTON, DC 20011

CliftonLarsonAllen LLP
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INDEPENDENT AUDITORS' REPORT

Shareholders and Board of Directors
IBW Financial Corporation and Subsidiary
Washington, DC

Report on Financial Statements

We have audited the accompanying consolidated financial statement of IBW Financial Corporation and Subsidiary, which comprise the consolidated balance sheet as of December 31, 2017, and the related consolidated statements of income, comprehensive income, changes in shareholders' equity, and cash flows for the year then ended, and the related notes to the consolidated financial statements.

Management's Responsibility for the 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 financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' Responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audit. We conducted our audit 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 the auditors' 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 entity'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 entity'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.

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Shareholders and Board of Directors
IBW Financial Corporation and Subsidiary
Washington, DC

Opinion

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

Other Matter

The 2016 consolidated financial statements were audited by other auditors whose report, dated October 24, 2017, expressed an unmodified opinion on those statements.

CliftonLarsonAllen LLP

CliftonLarsonAllen LLP

Plymouth Meeting, Pennsylvania
August 3, 2018

CONSOLIDATED BALANCE SHEETS
December 31, 2017 and 2016

(dollars in thousands)	2017	2016
ASSETS		
Cash and due from banks	$ 5,636	$ 3,791
Interest-bearing deposits with banks	13,079	14,324
Total cash and cash equivalents	18,715	18,115
Short-term Investments	3,408	1,912
Investment securities available-for-sale, at fair value	66,814	57,266
Restricted stock, at cost	2,257	775
Loans held for sale	1,566	1,136
Loans receivable, net of unearned income and deferred fees	309,559	289,096
Less: Allowance for loan losses	(3,037)	(4,288)
Net loans	306,522	284,808
Premises and equipment, net	9,035	5,076
Real estate owned (REO)	-	155
Bank owned life insurance (BOLI)	9,136	8,957
Other assets	5,912	5,075
Total assets	**$ 423,365**	**$ 383,275**
LIABILITIES AND SHAREHOLDERS' EQUITY		
LIABILITIES		
Non-interest bearing deposits	$ 93,237	$ 92,130
Interest bearing deposits	241,678	238,698
Total deposits	334,915	330,828
Short-term borrowings	51,760	15,903
Accounts payable and accrued expenses	1,433	1,570
Total liabilities	388,108	348,301
SHAREHOLDERS' EQUITY		
Preferred stock $1 par value per share; (500,000 voting and 480,000 nonvoting) authorized; $25 par value, 20,000 Series A nonvoting issued and outstanding, stated liquidation value	500	500
Common stock, $1 par value; 1,000,000 shares authorized, 598,312 issued and outstanding for 2017 and 600,302 for 2016	598	600
Additional paid-in-capital	3,213	3,285
Retained earnings	30,645	30,062
Accumulated other comprehensive income	301	527
Total shareholders' equity	35,257	34,974
Total liabilities and shareholders' equity	**$ 423,365**	**$ 383,275**

See Notes to Consolidated Financial Statements.

CONSOLIDATED STATEMENTS OF INCOME
Years Ended December 31, 2017 and 2016

(dollars in thousands)	2017	2016
Interest income:		
Interest and fees on loans	$ 15,524	$ 15,317
Interest on investment securities	1,634	1,902
Interest on interest-bearing deposits and short-term investments	176	130
Total interest income	17,334	17,349
Interest expense:		
Interest on deposits	739	815
Interest on short-term borrowings	203	93
Total interest expense	942	908
Net interest income	16,392	16,441
Provision for loan losses	500	500
Net interest income after provision for loan losses	15,892	15,941
Noninterest income:		
Gain on sale of investment securities	-	541
Gain on sale of loans	286	304
Loss on sale of REO	(7)	(7)
Service charges and other fees on deposits	1,690	1,470
Other fee income	389	457
Other income	2,072	1,281
Total non-interest income	4,430	4,046
Noninterest expense:		
Salaries and benefits	10,014	9,636
Occupancy	1,475	1,581
Furniture and equipment	946	901
Data processing	1,332	1,287
Office expense	747	692
Professional fees	1,380	1,293
Security	381	402
FDIC insurance assessment	372	336
Lending expense	186	267
Other	1,907	1,194
Total non-interest expense	18,740	17,589
Income before income taxes	1,582	2,398
Income tax expense	915	485
Net income	**667**	**1,913**
Preferred stock dividends	(24)	(160)
Discount on preferred stock redemption	-	361
Net income available to common shareholders	**$ 643**	**$ 2,114**
Basic and diluted net income per common share	$ 1.07	$ 3.52
Dividend per common share	$ 0.10	$ 0.10
Weighted average number of common shares outstanding	600,027	600,405

See Notes to Consolidated Financial Statements.

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
Years Ended December 31, 2017 and 2016

(dollars in thousands)	2017	2016
Net income	667	1,913
Other comprehensive income before tax:		
Unrealized holding losses on available-for-sale investment securities	(365)	(440)
Reclassification adjustment for realized gains	-	(541)
Other comprehensive income before tax	(365)	(981)
Income tax benefit (expense) effect	139	46
Other comprehensive income, net of tax	(226)	(935)
Comprehensive income	$ 441	$ 978

CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY
Years Ended December 31, 2017 and 2016

(dollars in thousands)	Preferred Stock	Common Stock	Additional Paid-in-Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total
Balance January 1, 2016	$ 6,471	$ 600	$ 2,977	$ 28,370	$ 1,462	$ 39,880
Net income	—	—	—	1,913	—	1,913
Retirement of common stock	—	(3)	(104)	—	—	(107)
Net proceeds from issuance of shares of common stock	—	3	51	—	—	54
Redemption of 1,000 shares of preferred stock - Series D - pursuant to CDCI/TARP	(5,971)	—	361	—	—	(5,610)
Cash dividends paid:						
Preferred stock -						
Series A - $1.25 per share	—	—	—	(25)	—	(25)
Series D - $.20 per share	—	—	—	(135)	—	(135)
Cash dividends declared:						
Common stock - $.10 per share	—	—	—	(61)	—	(61)
Change in other comprehensive income	—	—	—	—	(935)	(935)
Balance December 31, 2016	$ 500	$ 600	$ 3,285	$ 30,062	$ 527	$ 34,974
Net income	—	—	—	667	—	667
Retirement of common stock	—	(2)	(72)	—	—	(74)
Cash dividends paid:						
Preferred stock -						
Series A - $1.25 per share	—	—	—	(24)	—	(24)
Common stock - $.10 per share	—	—	—	(60)	—	(60)
Change in other comprehensive income	—	—	—	—	(226)	(226)
Balance December 31, 2017	$ 500	$ 598	$ 3,213	$ 30,645	$ 301	$ 35,257

See Notes to Consolidated Financial Statements.

CONSOLIDATED STATEMENTS OF CASH FLOWS
Years Ended December 31, 2017 and 2016

(dollars in thousands)	2017	2016
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income	**$ 667**	**$ 1,913**
Adjustments to reconcile net income		
to net cash provided by operating activities:		
Depreciation and amortization	495	514
Provision for loan losses	500	500
Deferred income taxes	766	(386)
Net amortization of investment securities	533	708
Increase in value of BOLI	(179)	(253)
Gain on sale of loans	(286)	(304)
Originations of loans held for sale	(13,688)	(14,969)
Proceeds from sales of loans held for sale	13,544	14,540
Gain on sale of investment securities	-	(541)
Loss on sale of REO	7	7
Decrease in accrued interest receivable	30	316
(Increase) in other assets	(1,633)	(1,110)
(Decrease) increase in other liabilities	(137)	271
Net cash provided by operating activities	**619**	**1,206**
CASH FLOWS FROM INVESTING ACTIVITIES:		
Increase in loans receivable, net	(22,214)	(5,385)
Purchase of short-term investments	(1,496)	-
Purchases of investment securities available-for-sale	(20,017)	(11,595)
Purchase of restricted stock	(1,482)	(832)
Proceeds received from maturity and sales of available-for-sale investment securities	9,711	27,629
Purchases of premises and equipment	(4,454)	(1,491)
Capitalized cost in REO	(10)	-
Proceeds from sale of REO	158	174
Net cash provided by (used in) investing activities	**(39,804)**	**8,500**
CASH FLOWS FROM FINANCING ACTIVITIES:		
Net increase in total deposits	4,087	20,322
Net increase (decrease) in short-term borrowing	35,857	(21,460)
Cash dividends paid	(85)	(160)
Discount from redemption of preferred stock	-	361
Redemption of preferred stock, net	-	(5,971)
Proceeds from sale of common stock	-	54
Retirement of common stock	(74)	(107)
Net cash (used in) provided by financing activities	**39,785**	**(6,961)**
Net increase (decrease) in cash and cash equivalents	600	2,745
Cash and cash equivalents at beginning of year	18,115	15,370
Cash and cash equivalents at end of year	**$ 18,715**	**$ 18,115**
SUPPLEMENTAL DISCLOSURES OF CASH FLOW AND NONCASH INFORMATION:		
Cash paid during the year for:		
Interest on deposits and other borrowings	$ 949	$ 899
Income taxes	1,259	329
Noncash transactions:		
Transfer of loans to REO	$ -	$ 336
Dividend declared	-	61

See Notes to Consolidated Financial Statements.

1. Summary Of Significant Accounting Policies

IBW Financial Corporation (the "Company") is a one bank holding company for its wholly owned subsidiary, Industrial Bank, (the "Bank"). The Bank wholly owns 96 HST LLC which holds property to be used for Bank facilities. The accounting and reporting policies of IBW Financial Corporation and subsidiary (the "Company") conform to accounting principles generally accepted in the United States of America and prevailing practices within the banking industry. The following summarizes the significant accounting policies. We have evaluated subsequent events for possible disclosure through the date of the audit report date.

Consolidation – The consolidated financial statements include the accounts of the Company and the Bank. All significant inter-company transactions and balances have been eliminated.

Nature of Business – The principal business of the Company is to make loans and other investments and to accept time and demand deposits. The Company's primary market areas are in the District of Columbia and surrounding areas, although the Company's business development efforts generate business outside of these areas. The Company offers a broad range of banking products, including a full line of business and personal savings and certificates of deposit, and other banking services. The Company funds a variety of loan types including commercial term loans and residential real estate loans, and lines of credit, consumer loans, and letters of credit. The Company's customers are primarily individuals and small businesses.

Use of Estimates – The preparation of consolidated financial statements in accordance with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the amounts reported in the consolidated financial statements and accompanying notes. Actual results could differ from those estimates. In addition, there are inherent risks and uncertainties related to the operation of a financial institution, such as credit and interest rate risk. The possibility exists that because of changing economic conditions; unforeseen changes could occur and have an adverse effect on the Company's financial position.

Material estimates that are particularly susceptible to significant change in the near-term relate to the determination of the allowance for loan losses. Management believes that the allowance for loan losses is sufficient to address the risks in the current loan portfolio. While management uses available information to recognize losses on loans, future additions to the allowance may be necessary based on changes in economic conditions. In addition, various regulatory agencies, as an integral part of their examination processes, periodically review the Bank's allowance for loan losses. Such agencies may require the Bank to recognize additions to the allowance based on their judgments about information available to them at the time of their examinations.

Other material estimates that are particularly susceptible to significant change in the near-term relate to the determination of the valuation of foreclosed real estate, deferred income taxes and other than temporary impairment of investment securities.

Investment Securities – The Company may segregate its investments securities into the following three categories: trading, held-to-maturity, and available-for-sale. Trading securities are purchased and held principally for the purpose of reselling them within a short period of time. Their unrealized gains and losses are included in earnings. Securities classified as held-to-maturity are accounted for at amortized cost, and require the Company to have both positive intent and ability to hold these securities to maturity. Securities not classified as either trading or held-to-maturity are considered to be available-for-sale. Unrealized gains and losses on available-for-sale securities are excluded from earnings and reported, net of deferred taxes, as accumulated other comprehensive income, a separate component of shareholders' equity. Premiums are amortized and discounts accreted using the level yield method.

Purchases and sales of securities are recorded on a trade date basis. Realized gains or losses on the sale of investment securities are reported in earnings and determined using the adjusted cost of the specific security sold. Investment in Federal Reserve Bank and Federal Home Loan Bank stock are considered restricted as to marketability. Because no ready market exists for these stocks, the Bank's investment is carried at cost. Declines in the fair value of individual securities below their cost that are other than temporary result in write-downs of the individual securities to their fair value. Factors affecting the determination of whether other-than-temporary impairment has occurred include a downgrading of the security by a rating agency, a significant deterioration in the financial condition of the issuer or that management would not have the intent and ability to hold a security for a period of time sufficient to allow for any anticipated recovery in fair value.

Non-Marketable Equity Investments -
The Company invested $800 in a bank holding company in 2015 resulting in an approximate 3% stake at the time the investment was made. The bank holding company's stock is not publically traded and there is no readily determinable fair value. The Company carries this investment using the cost method of accounting and it is included in Other Assets in the consolidated balance sheets. As conditions warrant, we review our investment for impairment and will adjust the carrying value of the investment if it is deemed to be impaired. During 2017, the bank holding company improved its financial condition as it continued to implement changes to its business model. In discussions with management of the bank holding company and review of strategic objectives and actions of the bank holding company, we determined that the value of the investment was not impaired as of December 31, 2017.

Loans – Loans are reported at the principal amount outstanding net of deferred fees and costs and the allowance for loan losses. Interest on loans is accrued at the contractual rate based upon the principal amount outstanding. Loans fees and related direct loan origination costs are deferred and recognized as a part of interest income over the life of the loan as an adjustment to the loan yield. Loans are placed on non-accrual status when management deems the collectability of interest is doubtful. Interest ultimately collected is recorded in the period received as a reduction of the principal loan balance. Accruals are resumed on loans only when they are brought fully current with respect to interest and principal and when, in the judgment of management, the loan is estimated to be fully collectible as to both principal and interest.

Loans are considered impaired when, based on current information, it is probable that the Company will not collect all principal and interest payments according to contractual terms. Generally, loans are considered impaired once principal and interest payments are past due more than 90 days and they are placed on non-accrual. Management also considers the financial condition of the borrower, cash flows of the loan and the value of the related collateral. Impaired loans do not include large groups of smaller balance homogenous credits such as residential real estate, consumer installment loans, and commercial leases, which are evaluated collectively for impairment. Loans specifically reviewed for impairment are not considered impaired during periods of "minimal delay" in payment (usually ninety days or less) provided eventual collection of all amounts due is expected. The impairment of a loan is measured based upon the present value of future cash flows discounted at the loan's effective interest rate, except that as a practical alternative, the Company may measure impairment based on a loan's observable market price or the fair value of the collateral, if the loan is collateral dependent. The Company recognizes interest income on impaired loans on a cash basis if the borrower demonstrates the ability to meet the contractual obligation and collateral is sufficient. If there is doubt regarding the borrower's ability to make payments or the collateral is not sufficient, payments received are accounted for as reduction in principal.

Trouble Debt Restructuring (TDR) - Under certain circumstances, the Company will provide borrowers relief through loan restructurings. A restructuring of

debt constitutes a TDR if the Company for economic or legal reasons related to the borrower's financial difficulties grants a concession to the borrower that it would not otherwise consider. Restructured loans 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 measured for impairment as described above in the calendar year of the restructuring. In subsequent years, a restructured loan may cease being classified as impaired if the loan was modified at a market rate and is performing according to the modified terms. TDR concessions can include reduction of interest rates, extension of maturity dates, forgiveness of principal or interest due, or acceptance of other assets in full or partial satisfaction of the debt. Restructured loans can involve loans remaining on nonaccrual, moving to nonaccrual, or continuing on accrual status, depending on the individual facts and circumstances of the borrower. Nonaccrual restructured loans are included and treated with other nonaccrual loans.

Loans Held for Sale – Loans originated for sale are carried at the lower of aggregate cost or market.

Market value is based on commitments from investors. Gains and losses on sales are determined using the specific identification method.

Allowance for Loan Losses – The allowance for loan losses is maintained at a level management believes to be adequate to absorb probable losses inherent in the loan portfolio. The calculation is based on the size and current risk characteristics of the loan portfolio, an assessment of individual problem loans and actual loss experience, current economic events in specific industries or geographical areas, these events would include unemployment levels, and other pertinent factors, including regulatory guidance and general economic conditions. Determination of the allowance is inherently subjective as it requires significant estimates, including the amounts and timing of expected future cash flows on impaired loans, estimated losses on pools of homogenous loans based on historical loss experience, and consideration of current economic trends, all of which may be susceptible to significant change. Loan losses are charged off against the allowance, while recoveries of amounts previously charged off are credited to the allowance. A provision for loan losses is charged to operations based on management's periodic evaluation of the factors previously mentioned, as well as other pertinent factors. Evaluations are conducted at least quarterly or more often if deemed necessary.

The allowance for loan losses consists of a specific component and a nonspecific component. The components of the allowance for loan losses represent an estimation done pursuant to Financial Accounting Standards Board ("FASB") Accounting Standards Codification ("ASC") Topic 450 *Contingencies* and ASC Topic 310 *Receivables*. The specific component of the allowance for loan losses reflects expected losses resulting from analysis developed through credit allocations for individual loans and historical loss experience for each loan category. The specific credit allocations are based on a regular analysis of all loans over a fixed-dollar amount where the internal credit rating is at or below a predetermined classification. The historical loan loss element is determined statistically using a loss migration analysis that examines loss experience and the related internal grading of loans charged-off. The loss migration analysis is performed quarterly and loss factors are updated regularly based on actual experience. The specific component of the allowance for loan losses also includes management's determination of the amounts necessary for concentrations and changes in portfolio mix and volume.

The nonspecific portion of the allowance reflects management's estimate of probable inherent but undetected losses within the portfolio due to uncertainties in economic conditions, delays in obtaining information, including unfavorable information about a borrower's financial condition, the difficulty in identifying triggering events that correlate perfectly to subsequent loss rates, and risk factors that have not yet manifested themselves in loss allocation factors. In addition, the nonspecific allowance includes a component that explicitly accounts for the inherent imprecision in loan loss

migration models. Historical loss experience data used to establish estimates may not precisely correspond to the current portfolio. The uncertainty surrounding the strength and timing of economic cycles, including management's concerns over the effects of the prolonged economic downturn and also losses used in the migration analysis may not be representative of actual losses inherent in the portfolio that have not yet been realized.

Bank Premises and Equipment – Properties and equipment are stated at cost less accumulated depreciation and amortization. Depreciation and amortization are calculated using the straight-line method over the estimated useful lives of the assets. Useful lives range from three to 10 years for furniture, fixtures, and equipment; three to five years for software, hardware, and data handling equipment; and 10 to 40 years for buildings and building improvements. Land is carried at cost and is not depreciated. Land improvements are amortized over a period of 15 years; and leasehold improvements amortized over the lesser of their estimated useful lives, or the stated duration of the lease plus the optional renewal period, if applicable. Maintenance and repairs are charged to expense as incurred, while improvements which extend the useful life are capitalized and depreciated over the estimated remaining life of the asset.

Long-lived depreciable assets are evaluated periodically for impairment when events or changes in the circumstances indicate the carrying amount may not be recoverable. Impairment exists when the expected undiscounted future cash flows of a long-lived asset are less than its carrying value. In that event, the Company recognizes a loss for the estimated fair value of the asset based on a quoted market price, if applicable, or a discounted cash flow analysis.

Advertising Costs – Advertising costs are generally expensed as incurred. Advertising expenses totaled $176 and $159 for the years ended December 31, 2017 and 2016, respectively.

Real Estate Owned– Real estate owned (REO) represents properties acquired through foreclosures or other proceedings in satisfaction of indebtedness. At the date of acquisition such property is recorded at the fair value less estimated costs to sell. A write-down to fair value, less estimated costs to sell, at the date of acquisition is charged to the allowance for loan losses. Subsequent declines in fair value, operating expenses, and gains or losses on the disposition of real estate are reported in noninterest expense. The amounts the Company will ultimately realize on disposition of these properties could differ from management's current estimates.

Transfer of Financial Assets – Transfer of financial assets are accounted for as sales, when control over the assets has been surrendered. Control over transferred assets is deemed to be surrendered when (1) the assets have been isolated from the Company, (2) the transferee obtains the right (free of conditions that constrain it from taking advantage of that right) to pledge or exchange the transferred assets, and (3) the Company does not maintain effective control over the transferred assets through an agreement to repurchase them before their maturity.

Fair Value Measurements – The Company follows the guidance of ASC Topic 825, *Financial Instruments* and ASC Topic 820, *Fair Value Measurements*. ASC Topic 825 permits entities to measure many financial instruments and certain other items at fair value. The objective is to improve financial reporting by providing entities with the opportunity to mitigate volatility in reported earnings caused by measuring related assets and liabilities differently without having to apply complex hedge accounting provisions. ASC Topic 820 clarifies that fair value is an exit price, representing the amount that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants. Under ASC Topic 820, fair value measurements are not adjusted for transaction costs. ASC topic 820 establishes a fair value hierarchy that prioritizes unadjusted quoted prices in active markets for identical financial assets or liabilities (Level 1 measurements) and gives the lowest priority to unobservable inputs (Level 3 measurements).

Earnings Per Share ("EPS") – Net income (loss) available to common shareholders is adjusted to give effect to dividends on preferred stock. Net income available to common shareholders for basic and diluted EPS purposes is $643 and $2,114 for the years ended December 31, 2017 and 2016, respectively. EPS is computed based on the weighted average number of common shares outstanding during the year (600,027 for 2017 and 600,405 for 2016). Basic and diluted EPS are the same, as the Company had no dilutive common stock equivalents outstanding as of December 31, 2017 or 2016 and for the years then ended.

Income Taxes – The Company and its wholly owned subsidiary file a consolidated federal income tax return. Deferred income tax assets and liabilities are computed annually for differences between financial statement and tax basis of assets and liabilities that will result in taxable or deductible amounts in the future based on the enacted tax laws and rates applicable to periods in which the differences are expected to affect taxable income. Valuation allowances are established, when necessary, to reduce deferred tax assets to the amount expected to be realized. Income tax expense is based upon the results of operations, adjusted for permanent differences between items of income or expense reported in the financial statements and those reported for tax purposes. The Company does not have any uncertain tax positions and did not recognize any adjustments for unrecognized tax benefits. The Company remains subject to examination for income tax returns ending after December 31, 2013.

Cash and Cash Equivalents – For purposes of the consolidated statements of cash flows, cash equivalents include due from banks, federal funds sold, and interest-bearing deposits with banks with original maturities of three months or less. Included in cash and due from banks were required deposits at the Federal Reserve Bank of approximately $627 for 2017 and $457 for 2016.

Short-term Investments – Short-term investments consist of interest-bearing deposits due from banks with original maturities of more than three months.

Bank owned life insurance - The Bank purchased single-premium life insurance on certain employees of the Bank. Appreciation in value of the insurance policies is classified as noninterest income.

Comprehensive income - Accounting principles generally require that recognized revenue, expenses, gains, and losses be included in net income. Certain changes in assets and liabilities, such as unrealized gains and losses on available-for-sale securities, are reported as a separate component of the equity section of the balance sheet. Such items, along with net income, are components of comprehensive income.

Valuation of long-lived assets - The Company accounts for the valuation of long-lived assets under ASC Topic 360 *Property, Plant and Equipment*. This guidance requires that long-lived assets and certain identifiable intangible assets be reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of the long-lived asset is measured by a comparison of the carrying amount of the asset to future undiscounted net cash flows expected to be generated by the asset. If such assets are considered to be impaired, the impairment to be recognized is measured by the amount by which the carrying amount of the assets exceeds the estimated fair value of the assets. Assets to be disposed of are reportable at the lower of the carrying amount or fair value, less costs to sell.

Compensating Balances - Compensating balance arrangements exist with various correspondent banks. These noninterest-bearing deposits are maintained in lieu of cash payments for standard bank services. The required balances amounted to $250 at December 31, 2017 and 2016, respectively.

<u>**New Accounting Pronouncements**</u> –

The FASB issued Update No. 2017-08, Receivables-Nonrefundable Fees and Other Costs (Subtopic 310-20): Premium Amortization on Purchased Callable Debt Securities, in March 2017. This guidance is intended to eliminate the current diversity in practice with respect to the amortization period for certain purchased callable debt securities held at a premium. Under current generally accepted accounting principles (GAAP), entities generally amortize the premium as an adjustment of yield over the contractual life. As a result, upon the exercise of a call on a callable debt security held at a premium, the unamortized premium is recorded as a loss in earnings. The amendments in this update shorten the amortization period for such callable debt securities held at a premium requiring the premium to be amortized to the earliest call date. This guidance is effective for public business entities as of fiscal years beginning after December 15, 2018, and interim periods within those fiscal years. The adoption of this standard is not expected to have a material impact on the Company's financial position, results of operations or cash flows.

The FASB issued Update No. 2016-15, Statement of Cash Flow (Topic 230): Classification of Certain Cash Receipts and Cash Payments, in August 2016. This guidance is intended to reduce the diversity in practice with respect to the presentation and classification of items in the consolidated statements of cash flows. This guidance is effective for public business entities for fiscal years beginning after December 15, 2017, and interim periods within those fiscal years. The standard's provisions will be applied using a retrospective transition method to each period presented. An entity may elect early adoption but must adopt all of the amendments in the same period. The adoption of this standard is not expected to have a material impact on the Company's consolidated financial position, results of operations or cash flows.

The FASB issued Update No. 2016-02, Leases, in February 2016. From the lessee's perspective, the new standard establishes a right-of-use (ROU) model that requires a lessee to record a ROU asset and a lease liability on the balance sheet for all leases with terms longer than 12 months. Leases will be classified as either finance or operating, with classification affecting the pattern of expense recognition in the income statement for lessees. With respect to lessors, the guidance modifies the classification criteria and the accounting for sales-type and direct financing leases. All entities will classify leases to determine how to recognize lease-related revenue and expense and determine whether an arrangement contains a lease or service agreement. Disclosures are required by lessees and lessors to meet the objective of enabling users of financials statements to assess the amount, timing, and uncertainty of cash flows arising from leases. For public business entities, this guidance is effective for fiscal years beginning after December 15, 2018, and interim periods within those fiscal years. Early adoption is permitted. The Company is assessing this guidance to determine its impact on the Company's consolidated financial position, results of operations and cash flows.

The FASB issued Update No. 2016-01, Financial Instruments - Overall, in January 2016. This guidance requires entities to measure equity investments at fair value and recognize changes on fair value in net income. The guidance also provides a new measurement alternative for equity investments that do not have readily determinable fair values and don't qualify for the net asset value practical expedient. Entities will have to record changes in instrument – specific credit risk for financial liabilities measured under the fair value option in other comprehensive income, except for certain financial liabilities of consolidated collateralized financing entities. Entities will also have to reassess the realizability of a deferred tax asset related to an available-for-sale debt security in combination with their other deferred tax assets. This simplifies the impairment assessment of equity investments without readily determinable fair values by requiring a qualitative assessment to identify impairment. For public business entities, the guidance in this update is effective for fiscal years beginning after December 15, 2017, and for interim periods within those fiscal years. The adoption of this standard is not expected to have a material

impact on the Company's consolidated financial position, results of operations or cash flows.

The FASB issued Update No. 2014-09, Revenue from Contracts with Customers (Topic 606), in May 2014, as amended by Update No. 2015-14, that provides accounting guidance for all revenue arising from contracts with customers and affects all entities that enter into contracts to provide goods or services to customers. The guidance also provides for a model for the measurement and recognition of gains and losses on the sale of certain nonfinancial assets, such as property and equipment, including real estate. The guidance is effective for annual reporting periods beginning after December 15, 2017. The guidance must be adopted using either a full retrospective approach for all periods presented in the period of adoption or a modified retrospective approach. The Company's revenue is majorly comprised of net interest & dividend income as well as fee income. Accordingly, the majority of the Company's revenues will not be affected. The Company has completed an assessment of the revenue contracts for the revenue streams identified to be in scope as well as worked with industry participants on matters of interpretation and application. The Company's accounting policies and revenue recognition principles will not change materially as the principles of ASC 606 are largely consistent with the current revenue recognition practices.

In June 2016, the FASB issued ASU No. 2016-13, Financial Instruments - Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments, (ASU 2016-13), which addresses concerns regarding the perceived delay in recognition of credit losses under the existing incurred loss model. The amendment introduces a new, single model for recognizing credit losses on all financial instruments presented on cost basis. Under the new model, entities must estimate current expected credit losses by considering all available relevant information, including historical and current information, as well as reasonable and supportable forecasts of future events. The update also requires additional qualitative and quantitative information to allow users to better understand the credit risk within the portfolio and the methodologies for determining allowance. ASU 2016-13 is effective for public business entities that are not U.S. Securities and Exchange Commission (SEC) filers for annual periods beginning after December 15, 2020, and interim periods within those annual periods and must be applied using the modified retrospective approach with limited exceptions. Early adoption is permitted. The Company and Bank is currently in the process of evaluating the impact of the amended guidance on its consolidated financial statements. It is reasonable to predict that the ALLL will increase upon adoption given that the allowance will be required to cover the full remaining expected life of the portfolio upon adoption, rather than the incurred loss model under current U.S. GAAP.

2. Investment Securities

At December 31, 2017 and 2016, the amortized cost and approximate fair value of investment securities available-for-sale, with gross unrealized gains and losses, are summarized as follows:

(dollars in thousands)	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
December 31, 2017:				
U.S. Government Agencies	$ 10,291	$ 437	$ (38)	$ 10,690
Mortgage-Backed Securities:				
Pass-through securities:				
Issued by FNMA, GNMA and FHLMC	11,049	105	(135)	11,019
Collateralized Mortgage Obligations:				
Collateralized by FNMA, FHLMC and GNMA mortgage-backed securities	34,444	246	(481)	34,209
Private label mortgage-backed securities	2,000	-	(11)	1,989
Municipal securities	8,445	450	-	8,895
Total debt securities	66,229	1,238	(665)	66,802
Marketable equity securities	128	-	(116)	12
Total equity securities	128	-	(116)	12
Total	$ 66,357	$ 1,238	$ (781)	$ 66,814
December 31, 2016:				
U.S. Government Agencies	$ 10,945	$ 438	$ (82)	$ 11,301
Mortgage-Backed Securities:				
Pass-through securities:				
Issued by FNMA, GNMA and FHLMC	13,805	161	(171)	13,795
Collateralized Mortgage Obligations:				
Collateralized by FNMA, FHLMC and GNMA mortgage-backed securities	21,133	376	(181)	21,328
Private label mortgage-backed securities	2,000	-	(232)	1,768
Municipal securities	8,455	548	-	9,003
Total debt securities	56,338	1,523	(666)	57,195
Marketable equity securities	128	-	(57)	71
Total equity securities	128	-	(57)	71
Total	$ 56,466	$ 1,523	$ (723)	$ 57,266

2. Investment Securities (continued)

Gross unrealized losses and fair value by length of time that the individual available-for-sale investment securities have been in a continuous unrealized loss position that are not deemed to be other-than-temporarily impaired at December 31, 2017 and 2016 are as follows:

(dollars in thousands)	Number of Securities	Fair Value	Less than 12 Months	12 months or More	Total Unrealized Losses
December 31, 2017:					
U.S. Government Agencies	3	$ 2,520	$ -	$ 38	$ 38
Mortgage-Backed Securities	22	35,155	394	222	616
Private label mortgage-backed securities	1	1,989	-	11	11
Municipal securities	-	-	-	-	-
Marketable equity securities	1	12	-	116	116
	27	$ 39,676	$ 394	$ 387	$ 781
December 31, 2016:					
U.S. Government Agencies	5	$ 5,323	$ 51	$ 31	$ 82
Mortgage-Backed Securities	16	20,512	310	42	352
Private label mortgage-backed securities	1	1,768	-	232	232
Municipal securities	-	-	-	-	-
Marketable equity securities	1	71	-	57	57
	23	$ 27,674	$ 361	$ 362	$ 723

For 2017, the entire available-for-sale investment portfolio has a fair value of approximately $67 million of which approximately $40 million of the securities have some unrealized losses from their purchase price. The securities representing the unrealized losses in the available-for-sale portfolio all have modest duration risk, high credit ratings, and represents 60% of the carrying value. The unrealized losses that exist are the result of market changes in interest rates since the original purchase and credit deterioration.

Management systematically evaluates investment securities for other-than-temporary declines in fair value on a quarterly basis. This analysis requires management to consider various factors, which include (1) duration and magnitude of the decline in value, (2) the financial condition of the issuer and (3) structure of the security. An impairment loss is recognized in earnings only when (1) the Company intends to sell the debt security; (2) it is more likely than not the Company will be required to sell the security before recovery of its amortized cost basis or (3) the Company does not expect to recover the entire amortized cost basis of the security. In situations where the Company intends to sell or when it is more likely than not that the Company will be required to sell the security, the entire impairment loss must be recognized in earnings. In all other situations, only the portion of the impairment loss representing the credit loss must be recognized in earnings, with the remaining loss recognized in shareholder's equity as a component of other comprehensive income, net of deferred taxes, losses in the available-for-sale portfolio are temporary.

2. Investment Securities (continued)

The following is a summary of the amortized cost and approximate fair value of debt and equity securities available-for-sale by contractual maturity as of December 31, 2017 and 2016. Expected maturities will differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

	2017		2016	
(dollars in thousands)	Amortized Cost	Fair Value	Amortized Cost	Fair Value
U.S. Government Agency maturing				
Due after 1 year through 5 years	$ 4,996	$ 5,096	$ 4,995	$ 5,108
Due after 5 years through 10 years	3,095	3,382	3,255	3,519
Due after 10 years	2,200	2,212	2,695	2,674
Mortgage-backed securities maturing				
Due after 1 year through 5 years	677	683	101	102
Due after 5 years through 10 years	6,558	6,565	5,796	5,868
Due after 10 years	38,258	37,980	29,041	29,153
Private label mortgage-backed security maturing				
Due after 10 years	2,000	1,989	2,000	1,768
Municipal securities maturing				
Due after 1 year through 5 years	1,789	1,832	1,762	1,842
Due after 5 years through 10 years	2,079	2,209	1,523	1,660
Due after 10 years	4,577	4,854	5,170	5,501
Equity investments	128	12	128	71
Total	$ 66,357	$ 66,814	$ 56,466	$ 57,266

Proceeds from the sale of securities available-for-sale were $-0- and $10.9 million for the years ended December 31, 2017 and 2016, respectively, and resulted in net realized gains of $-0- for 2017 and net realized gains of $541 for 2016.

Securities of $38.9 and $34.0 million at December 31, 2017 and 2016 were pledged as collateral for public deposits and for other purposes required by law. At December 31, 2017 and 2016, the carrying value of securities underlying repurchase agreements were $7.6 and $7.0 million, respectively.

3. Loans Receivable

Loans receivable and allowance for loan losses consist of the following at December 31, 2017 and 2016:

(dollars in thousands)	2017	2016
Real estate - construction and land development	$ 33,899	$ 37,243
Real estate mortgage:		
Commercial properties	140,805	121,982
Residential properties	99,581	101,657
Total real estate mortgage	274,285	260,882
Commercial and industrial	33,186	28,251
Consumer	3,429	1,329
Total gross loans	310,900	290,462
Less unearned income and deferred fees, net	(1,341)	(1,366)
Loans, net	309,559	289,096
Allowance for loan/lease losses	(3,037)	(4,288)
Loans, net of allowance	$ 306,522	$ 284,808

Major loan concentrations are as follows:

(dollars in thousands)	2017	2016
Church loans collateralized by real estate	$ 55,787	$ 54,503
Commercial loans to churches	396	164
Total loans to churches	$ 56,183	$ 54,667

Substantially all of the Bank's loans have been made to borrowers within the Washington, DC metropolitan area. Accordingly, the ability of the Bank's borrowers to repay their loans is dependent upon the economy in the Washington, DC metropolitan area.

The Company's goal is to mitigate risks from an unforeseen threat to the loan portfolio as a result of an economic downturn or other negative influences. Plans that aid in mitigating these potential risks in managing the loan portfolio include: enforcing loan policies and procedures, evaluating the borrower's business plan through the loan term, identifying and monitoring primary and alternative sources of repayment, and obtaining adequate collateral to mitigate loss in the event of liquidation. Specific reserves are established based upon credit and/or collateral risks on an individual loan basis. A risk rating system is used to estimate potential loss exposure and to provide a measuring system for setting general and specific reserve allocations.

The Company maintains a general valuation allowance for each portfolio segment. These portfolio segments include commercial and industrial, commercial real estate, real estate construction, residential real estate, and consumer and other with risk characteristics described as follows:

3. Loans Receivable (continued)

As of December 31, 2017, the real estate loan portfolio constituted 88% of the total loan portfolio. This can be broken down further into the following categories: 11% construction and land development, 45% commercial real estate and 32% residential real estate loans, as a percent of total loans.

The Company's construction and land development loans are secured by real property where the loan funds will be used to acquire land and to construct or improve appropriately zoned real property for the creation of income producing or owner occupied commercial properties. Borrowers are generally required to put equity into the project at levels determined by the loan committee and usually are underwritten with a maximum term of 24 months.

Commercial real estate loans are secured by improved real property which is generating income in the normal course of business. Debt service coverage, assuming stabilized occupancy, must be satisfied to support a permanent loan. The debt service coverage ratio is ordinarily at 1.40 to 1.00. These loans are generally underwritten with a term not greater than 10 years or the remaining useful life of the property, whichever is lower. The preferred term is between 5 to 7 years, with amortization to a maximum of 25 years.

Residential real estate loans are secured by the improved real property of the borrower and are usually underwritten with a term of 1 to 5 years, but may be underwritten with terms up to 30 years.

The Company also makes commercial and industrial loans for a variety of purposes, which include working capital, equipment and accounts receivable financing. This category represents about 11% of the loan portfolio at December 31, 2017. Loans in this category generally carry a variable interest rate. Commercial loans meet reasonable underwriting standards, including appropriate collateral and cash flow necessary to support debt service. Personal guarantees are generally required, but may be limited.

Approximately 1% of the loan portfolio at December 31, 2017 consisted of home equity loans and lines of credit and other consumer loans. These loans, while making up a small portion of the loan portfolio, demand the same emphasis on underwriting and credit evaluation as other types of loans advanced by the Company.

3. Loans Receivable (continued)

A summary of transactions in the allowance for loan losses is as follows for the years ended December 31, 2017 and 2016. The beginning balances and provision amounts have changed to more closely reflect the underlying calculation of the allowance for loan losses:

(dollars in thousands)	Construction and Land Development	Commercial Real Estate	Residential Real Estate	Commercial and Industrial	Consumer	Total
Balance, beginning of year 2017	$ 519	$ 1,518	$ 1,293	$ 890	$ 68	$ 4,288
Provision charged to operations	-	460	20	4	16	500
Loans charged off	-	(1,706)	(76)	(15)	(105)	(1,902)
Recoveries	-	30	88	9	24	151
Balance, end of year 2017	$ 519	$ 302	$ 1,325	$ 888	$ 3	$ 3,037
Ending balance:						
Individually evaluated for impairment	-	15	93	80	-	188
Collectively evaluated for impairment	519	287	1,232	808	3	2,849
Total	$ 519	$ 302	$ 1,325	$ 888	$ 3	$ 3,037
Loans:						
Individually evaluated for impairment	1,871	6,550	2,090	2,081	-	12,592
Collectively evaluated for impairment	32,028	134,255	97,491	31,105	3,429	298,308
Total	$ 33,899	$ 140,805	$ 99,581	$ 33,186	$ 3,429	$ 310,900
Balance, beginning of year 2016	$ 253	$ 1,197	$ 1,492	$ 1,074	$ 55	$ 4,071
Provision charged to operations	266	264	(295)	129	136	500
Loans charged off	-	(89)	(14)	(355)	(159)	(617)
Recoveries	-	146	110	42	36	334
Balance, end of year 2016	$ 519	$ 1,518	$ 1,293	$ 890	$ 68	$ 4,288
Ending balance:						
Individually evaluated for impairment	-	-	209	76	-	285
Collectively evaluated for impairment	519	1,518	1,084	814	68	4,003
Total	$ 519	$ 1,518	$ 1,293	$ 890	$ 68	$ 4,288
Loans:						
Ending balance:						
Individually evaluated for impairment	1,497	4,032	5,665	1,397	-	12,591
Collectively evaluated for impairment	35,746	117,950	95,992	26,854	1,329	277,871
Total	$ 37,243	$ 121,982	$ 101,657	$ 28,251	$ 1,329	$ 290,462

Impairment is based on estimated collateral values for loans individually evaluated for impairment.

3. Loans Receivable (continued)

Credit quality indicators as of December 31, 2017 and 2016 are as follows:

Internally assigned grade:

Pass – loans in this category have strong asset quality and liquidity along with a multi-year track record of profitability.

Special mention – loans in this category are currently protected but are potentially weak. The credit risk may be relatively minor yet constitute an increased risk in light of the circumstances surrounding a specific loan.

Substandard – loans in this category show signs of continuing negative financial trends and unprofitability and therefore, are inadequately protected by the current soundness and paying capacity of the obligor or of the collateral pledged, if any.

Doubtful – loans in this category are illiquid and highly leveraged, have negative net worth, cash flow, and trending serious losses. The possibility of loss is extremely high; however, because of certain important and reasonably specific pending factors which may work to the advantage and strengthening of the asset, its classification as loss is deferred until a more exact status may be determined.

The information for each of the credit quality indicators is updated on a quarterly basis in conjunction with the determination of the adequacy of the allowance for loan losses.

Loan portfolio credit exposure - Credit risk profile by internally assigned grade:

(dollars in thousands)	Pass	Special Mention	Substandard	Doubtful	Total Loans
December 31, 2017					
Construction and land development	$ 32,027	$ -	$ 1,872	$ -	$ 33,899
Commercial real estate	131,087	2,953	6,765	-	140,805
Residential properties	97,829	-	1,752	-	99,581
Commercial and industrial	27,619	796	4,771	-	33,186
Consumer	3,429	-	-	-	3,429
Total	$ 291,991	$ 3,749	$ 15,160	$ -	$ 310,900

	Pass	Special Mention	Substandard	Doubtful	Total Loans
December 31, 2016					
Construction and land development	$ 35,746	$ -	$ -	$ 1,497	$ 37,243
Commercial real estate	116,810	44	5,128	-	121,982
Residential properties	99,842	-	1,815	-	101,657
Commercial and industrial	23,838	1,120	3,293	-	28,251
Consumer	1,329	-	-	-	1,329
Total	$ 277,565	$ 1,164	$ 10,236	$ 1,497	$ 290,462

Information on impaired loans for the years ended December 31, 2017 and 2016 is as follows:

(dollars in thousands)	Unpaid Contractual Principal Balance	Recorded Investment With No Allowance	Recorded Investment With Allowance	Total Recorded Investment	Related Allowance	Average Recorded Investment	Interest Income Recognized
December 31, 2017							
Construction and land development	$ 1,871	$ 1,871	$ -	$ 1,871	$ -	$ 1,871	$ 24
Commercial real estate	6,550	2,025	4,525	6,550	15	7,347	99
Residential real estate	2,090	447	1,643	2,090	93	5,269	160
Commercial and industrial	2,081	1,675	406	2,081	80	2,843	52
Consumer	-	-	-	-	-	-	-
Total	$ 12,592	$ 6,018	$ 6,574	$ 12,592	$ 188	$ 17,330	$ 335
December 31, 2016							
Construction and land development	$ 1,497	$ 1,497	$ -	$ 1,497	$ -	$ 2,093	$ 158
Commercial real estate	4,032	4,032	-	4,032	-	3,870	146
Residential real estate	5,665	3,325	2,340	5,665	209	5,870	167
Commercial and industrial	1,397	1,120	277	1,397	76	1,605	13
Consumer	-	-	-	-	-	-	-
Total	$ 12,591	$ 9,974	$ 2,617	$ 12,591	$ 285	$ 13,438	$ 484

The following table presents, by class of loan, an aging analysis and the recorded investments in loans past due as of December 31, 2017 and 2016.

	Accruing Interest				
(dollars in thousands)	Current	30-89 Days Past Due	More Than 90 Days Past Due	Total Nonaccrual	Total Loans
December 31, 2017					
Construction and land development	$ 31,918	$ -	$ 110	$ 1,871	$ 33,899
Commercial real estate	133,260	817	178	6,550	140,805
Residential real estate	90,958	5,915	618	2,090	99,581
Commercial and industrial	26,993	1,215	2,897	2,081	33,186
Consumer	3,398	30	1	-	3,429
Total	$ 286,527	$ 7,977	$ 3,804	$ 12,592	$ 310,900
December 31, 2016					
Construction and land development	$ 37,243	$ -	$ -	$ -	$ 37,243
Commercial real estate	115,703	1,596	651	4,032	121,982
Residential real estate	93,828	5,454	559	1,816	101,657
Commercial and industrial	25,112	1,742	-	1,397	28,251
Consumer	1,076	253	-	-	1,329
Total	$ 272,962	$ 9,045	$ 1,210	$ 7,245	$ 290,462

The following table presents Information on performing and nonaccrual loans as of December 31, 2017 and 2016.

(dollars in thousands)	Construction and Land Development	Commercial Real Estate	Residential Real Estate	Commercial and Industrial	Consumer	Total
December 31, 2017						
Impaired performing	$ -	$ -	$ -	$ -	$ -	$ -
Restructured performing	-	-	3,451	-	-	3,451
Nonperforming (nonaccrual)	1,871	6,550	1,199	2,081	-	11,701
Restructured nonperforming	-	-	891	-	-	891
	$ 1,871	$ 6,550	$ 5,541	$ 2,081	$ -	$ 16,043
Performing	32,028	134,255	94,040	31,105	3,429	294,857
Total	$ 33,899	$ 140,805	$ 99,581	$ 33,186	$ 3,429	$ 310,900
December 31, 2016						
Impaired performing	$ 1,497	$ -	$ -	$ -	$ -	$ 1,497
Restructured performing	-	-	3,849	-	-	3,849
Nonperforming (nonaccrual)	-	4,032	1,398	1,397	-	6,827
Restructured nonperforming	-	-	418	-	-	418
	$ 1,497	$ 4,032	$ 5,665	$ 1,397	$ -	$ 12,591
Performing	35,746	117,950	95,992	26,854	1,329	277,871
Total	$ 37,243	$ 121,982	$ 101,657	$ 28,251	$ 1,329	$ 290,462

The following tables present Information on troubled debt restructurings for the years ended December 31, 2017 and 2016.

(dollars in thousands)	Number of Loans	Pre-modification Outstanding Recorded Investment	Post-modification Outstanding Recorded Investment
December 31, 2017	3	$688	$656
December 31, 2016	3	$1,067	$1,031

The following table summarizes troubled debt restructurings which have re-defaulted (defined as past due 90 days) during the years ended December 31, 2017 and 2016 that were restructured within the twelve months prior to such re-default:

(dollars in thousands)	Number of Loans	Amount Defaults
December 31, 2017	4	$564
December 31, 2016	2	$287

All of the modifications and defaults in years ended 2017 and 2016 were residential loans.

Troubled debt restructuring modifications during the years ended December 31, 2017 and 2016 consisted of reductions in principal, changes in interest rates and maturity extensions. Troubled debt restructurings are considered as part of the qualitative and quantitative analysis in the determining the adequacy of the allowance for loan losses.

Performing TDRs were in compliance with their modified terms and there are no further commitments associated with these loans.

Consumer mortgage loans collateralized by residential real estate property that were in process of foreclosure totaled $261 and $184 as of December 31, 2017 and 2016, respectively. Commercial mortgage loans collateralized by commercial real estate property that were in process of foreclosure totaled $2,035 and $-0- as of December 31, 2017 and 2016, respectively At December 31, 2017, the Bank did not hold any OREO. At December 2016, the Bank held one residential property in OREO totaling $155.

Loans serviced for others and not reflected in the balance sheets are $1,213 and $1,377 at December 31, 2017 and 2016, respectively. Servicing loans for others generally consists of collecting mortgage payments, maintaining escrow accounts, disbursing payments to investors and foreclosure processing. Loan servicing income is recorded on the accrual basis and includes servicing fees from investors and certain charges collected from borrowers, such as late payment fees. There were no mortgage servicing rights capitalized during 2017 and 2016.

4. Premises And Equipment

The major categories of premises and equipment are as follows:

(dollars in thousands)	2017	2016
Land	$ 1,937	$ 572
Bank premises	7,716	5,305
Furniture, fixtures and equipment	9,146	9,114
Leasehold improvements	1,050	1,050
Work in process	1,583	936
Total	21,432	16,977
Accumulated depreciation and amortization	(12,397)	(11,901)
Premises and equipment, net	$ 9,035	$ 5,076

Work in process contains all expenses incurred on various assets until they are converted into working condition. The work in process account primarily contained expenses related to a building renovation and improvements to a parking lot. Both properties are owned by the Bank.

Depreciation expense for the years ended December 31, 2017 and 2016 was $495 and $514, respectively.

5. Deposits

At December 31, 2017 and 2016, certificates of deposit of $250 or more totaled $15 million and $14 million, respectively. These deposit totals do not include certificates of deposit held through the Certificate of Deposit Account Registry Service (CDARS) program which holds reciprocal balances at less than $250. At December 31, 2017 and 2016, the Bank held certificates of deposit through the CDARS program which totaled $44 million for both years. At December 31, 2017 the scheduled maturities of certificates of deposits of $250 or more are as follows:

(dollars in thousands)	
2018	$ 12,022
2019	1,881
2020	-
2021	695
2022 and thereafter	-
	$ 14,598

6. Short-Term Borrowing

The following table summarizes information for short-term borrowings for the years ended December 31:

	2017		2016	
(dollars in thousands)	**Amount**	**Rate**	**Amount**	**Rate**
At year end:				
Federal Home Loan Bank advances	$ 45,000	1.41%	$ 10,000	0.67%
Retail repurchase agreements	6,760	0.20%	5,903	0.20%
Total	$ 51,760		$ 15,903	
Average for the year:				
Federal Home Loan Bank advances	$ 20,417	1.03%	$ 22,333	0.36%
Retail repurchase agreements	6,934	0.20%	6,393	0.20%
Total	$ 27,351		$ 28,726	
Maximum month end balance:				
Federal Home Loan Bank advances	$ 45,000		$ 35,000	
Retail repurchase agreements	8,190		7,695	
Total	$ 53,190		$ 42,695	

Securities sold under agreements to repurchase are securities sold to customers, at the customers' request, under a "roll-over" contract that matures in one business day. The underlying securities sold are Government agency securities which are segregated in the Bank's custodial accounts from other investment securities.

The Bank periodically borrows under a secured line of credit from the Federal Home Loan Bank to meet short-term liquidity needs. At December 31, 2017, advances totaling $45 million from the Federal Home Loan Bank were secured by a blanket lien on the Bank's qualifying commercial and residential mortgages. At December 31, 2016, advances totaling $10 million from the Federal Home Loan Bank were secured by a blanket lien on the Bank's qualifying residential mortgages. The total credit available to the Bank at December 31, 2017 and 2016 was $105 and $55 million, respectively, based on qualifying collateral of $150 and $63 million, respectively. The Bank normally borrows in short term increments of 90 day or less maturities at fixed rates; however, varied rates and term products are available to the Bank.

The Bank also had an unsecured line of credit of $3 million with a correspondent available for overnight borrowing during 2017 and 2016. During 2017, $3 million was drawn for 10 days. There were no amounts drawn on the line of credit during 2016 or at December 31, 2017 and 2016, respectively.

7. Regulatory Matters

The Company and the Bank are subject to various regulatory capital requirements by the federal banking agencies. Failure to meet minimum capital requirements can initiate certain mandatory and possibly additional discretionary actions by regulators that, if undertaken, could have a direct material effect on the Company's and the Bank's financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, the Company and the Bank must meet specific capital guidelines that involve quantitative measures of their assets, liabilities, and certain off-balance sheet items as calculated under regulatory accounting practices. The Bank's capital amounts and its classification under the regulatory framework for prompt corrective action are also subject to qualitative judgments by the regulators about components, risk weightings, and other factors.

Quantitative measures established by regulation to ensure capital adequacy require the Company and the Bank to maintain minimum amounts and ratios of Total and Tier 1 capital, as defined in the regulations, to risk-weighted assets, as defined, and of Tier 1 Capital, as defined, to average assets, as defined. Management believes, as of December 31, 2017 and 2016, that the Company and Bank meet all the capital adequacy requirements to which they are subject.

As of December 31, 2017, the most recent notification from the FDIC categorized the Bank as well capitalized under the regulatory framework for prompt corrective action. To be categorized as adequately capitalized, the Bank must maintain minimum total risk-based, Tier 1 risk-based, and Tier 1 leverage ratios, as set forth in the table below. There are no conditions or events since that notification that management believes have changed the institution's category.

In addition, in order to avoid restrictions on capital distributions or discretionary bonus payments to executives, the Bank must maintain a "capital conservation buffer" on top of its minimum risk-based capital requirements. The capital conservation buffer requirement began to phase in beginning January 2016 at 0.625% of risk-weighted assets and will increase by that amount each year until fully implemented in January 2019. The buffer must consist solely of Tier 1 Common Equity and the buffer applies to all three measurements: Common Equity Tier 1, Tier 1 capital and Total capital.

The Company's and the Bank's required and actual capital amounts and ratios, inclusive of the capital conservation buffer, at December 31, 2017 and 2016, are set forth in the following table:

	Actual		Minimum Required for Capital Adequacy Purposes		To be Categorized as Well Capitalized Under Prompt Corrective Action Provisions	
(dollars in thousands)	Amount	Ratio	Amount	Ratio	Amount	Ratio
As of December 31, 2017:						
CET1 (to risk-weighted assets)						
Company	$ 34,695	11.16%	$ 17,878	5.750%	$ N/A	N/A
Bank	34,413	11.08%	17,862	5.750%	20,191	6.50%
Total capital (to risk-weighted assets)						
Company	37,733	12.14%	28,760	9.250%	N/A	N/A
Bank	37,451	12.06%	28,734	9.250%	31,064	10.00%
Tier 1 capital (to risk-weighted assets)						
Company	34,695	11.16%	22,541	7.250%	N/A	N/A
Bank	34,413	11.08%	22,521	7.250%	24,851	8.00%
Tier 1 capital (to average assets)						
Company	34,695	8.25%	16,815	4.000%	N/A	N/A
Bank	34,413	8.19%	16,804	4.000%	21,005	5.00%
As of December 31, 2016:						
CET1 (to risk-weighted assets)						
Company	$ 34,013	12.42%	$ 14,037	5.125%	$ N/A	N/A
Bank	33,729	12.32%	14,027	5.125%	17,790	6.50%
Total capital (to risk-weighted assets)						
Company	37,447	13.67%	23,624	8.625%	N/A	N/A
Bank	37,161	13.58%	23,606	8.625%	27,369	10.00%
Tier 1 capital (to risk-weighted assets)						
Company	34,013	12.42%	18,146	6.625%	N/A	N/A
Bank	33,729	12.32%	18,132	6.625%	21,896	8.00%
Tier 1 capital (to average assets)						
Company	34,013	8.70%	15,630	4.000%	N/A	N/A
Bank	33,729	8.64%	15,622	4.000%	19,527	5.00%

8. Income Taxes

The provision for income taxes consists of the following (**in thousands**) for the years ended December 31:

	2017	2016
Current income tax expense (benefit):		
Federal income tax	$ (22)	$ 683
State income tax	171	188
Total current income tax expense	149	871
Deferred income tax expense (benefit):		
Federal income tax	$ 730	$ (155)
State income tax	36	(231)
Total deferred income tax expense	766	(386)
Total income tax expense	$ 915	$ 485

The components of the deferred tax benefit resulting from net temporary differences are as follows (**in thousands**) for the years ended December 31:

	2017	2016
Income before taxes	$ 1,582	$ 2,399
Federal income tax rate	34%	34%
Tax expense at statutory rate	538	816
Differences resulting from:		
State tax expense, net of federal tax effect	63	109
Bank owned life insurance	(83)	(80)
Tax-exempt interest	(60)	(74)
Nondeductible expenses	30	34
Federal tax rate change	320	-
True ups and other	107	(320)
Provision for income taxes	$ 915	$ 485
Effective tax rate	58%	20%

The major components of deferred tax assets and (liabilities) are summarized at December 31, 2017 and 2016, as follows (**in thousands**):

	2017	2016
Allowance for loan losses	$ 542	$ 1,364
Accrued bonus	42	72
Deferred loan costs	182	260
AMT credit	219	478
Nonaccrual interest income	117	149
Depreciation	(183)	(266)
Federal and State NOL carryforwards	55	-
Contributions carryforward	4	-
Unrealized gains on AFS securities	(195)	(319)
Net deferred tax asset	$ 783	$ 1,738

The Tax Cuts and Jobs Act (the Act) was enacted on December 22, 2017. The Act reduces the U.S. federal corporate tax rate from 34% to 21% for years beginning on or after January 1, 2018. The Company recorded a provisional amount to deferred tax expense of $320 thousand, which was primarily due to a re-measurement of deferred tax assets and liabilities at the newly enacted rate. The Company is analyzing certain aspects of the Act along with the recently issued FASB guidance on reclassification of the tax effects stranded in OCI, which could potentially affect the measurement of these balances or give rise to new deferred tax amounts.

9. Profit Sharing Plan

The Company has a profit sharing plan, qualifying under Section 401(k) of the Internal Revenue Code, for those employees who meet the eligibility requirements set forth in the plan. The plan does not require the Company to match the participants' contributions. The Company contributions to the plan were $216 and $217 for 2017 and 2016, respectively.

10. Employee Stock Ownership Plan

In 1986, the Bank implemented an Employee Stock Ownership Plan ("ESOP") that covers substantially all full-time employees. No contributions were made in 2017 or 2016. During 2006, the ESOP was terminated and rolled into the existing 401K plan thus becoming a KSOP. Shares held by the participants totaled 13,630 or 2.28% of the Company's stock at December 31, 2017. The Company is required to pay distributions of the fair value of stock based upon the ESOP's criteria. At December 31, 2017, based upon a value of $36.65 per share, the conditional required ESOP repurchase distribution totaled $500.

11. Commitments and Contingencies

In the normal course of business, there are outstanding various commitments and contingent liabilities, such as commitments to extend credit, which are not shown in the accompanying consolidated financial statements (dollars in thousands). The Company does not anticipate any material losses as a result of these transactions. At December 31, 2017 and 2016 the Bank had commitments to fund loans outstanding for approximately $25 million and $20 million, respectively. The Bank also had standby letters of credit outstanding at December 31, 2017 and 2016 in the amount of $1,176 and $914 respectively. Such commitments and standby letters of credit are subject to the Bank's normal underwriting standards. Since many of the commitments are expected to expire without being completely drawn upon, the total commitment amounts do not necessarily represent future cash requirements.

At December 31, 2017, the Bank was committed for future minimum annual payments under non-cancelable long-term lease agreements for the rental of office space as follows (dollars in thousands):

2018	$	446
2019		389
2020		367
2021		230
2022		-
Later years		-
Total minimum lease payments	$	1,432

Rent expense for years ended December 31, 2017 and 2016 was $526 and $622, respectively.

12. Fair Value Measurements And Estimated Fair Value of Financial Instruments

The Company has adopted FASB ASC Topic 820, "Fair Value Measurements " and FASB ASC Topic 825, "the Fair Value Option for Financial Assets and Financial Liabilities" which provides a framework for measuring and disclosing fair value under generally accepted accounting principles. FASB ASC Topic 820 requires disclosures about the fair value of assets and liabilities recognized in the balance sheet in periods subsequent to initial recognition, whether the measurements are made on a recurring basis (for example, available for sale investment securities) or on a nonrecurring basis (for example, impaired loans).

FASB ASC Topic 820 defines fair value as the exchange price that would be received for an asset or paid to transfer a liability (an 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. FASB ASC Topic 820 also establishes a fair value hierarchy, which requires an entity to maximize the use of observable

inputs and minimize the use of unobservable inputs when measuring fair value.
The Company utilizes fair value measurements to record fair value adjustments to certain assets and to determine fair value disclosures. Securities available for sale and loans held for sale are recorded at fair value on a recurring basis. Additionally, from time to time, the Company may be required to record at fair value other assets on a nonrecurring basis, such as impaired loans and REO. These nonrecurring fair value adjustments typically involve application of lower of cost or market accounting or write-downs of individual assets.

Under FASB ASC Topic 820, the Company groups assets and liabilities at fair value in three levels, based on the markets in which the assets and liabilities are traded and the reliability of the assumptions used to determine the fair value.

These hierarchy levels are:

Level 1 Valuation for assets and liabilities traded in active exchange markets. Valuations are obtained from readily available pricing sources for Market transactions involving identical assets or liabilities.

Level 2 Valuations for assets and liabilities traded in less active dealer or broker markets. Valuations are obtained from third party pricing services for identical or comparable assets or liabilities which use observable inputs other than Level 1 prices, such as quoted prices for similar assets or liabilities; quoted prices in active markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities.

Level 3 Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities.

A financial instrument's level within the fair value hierarchy is based on the lowest level of input that is significant to the fair value measurement.
The types of instruments valued based on quoted market prices in active markets include most U.S. government and agency securities, liquid mortgage products, active listed equities and most money market securities. Such instruments are generally classified within Level 1 or Level 2 of the fair value hierarchy. As required by FASB ASC Topic 820, the Company does not adjust the quoted price for such instruments.

The types of instruments valued based on quoted prices in markets that are not active, broker or dealer quotations, or alternative pricing sources with reasonable levels of price transparency include most investment-grade and high-yield corporate bonds, less liquid mortgage products, less liquid equities, state, municipal and provincial obligations and certain physical commodities.

Such instruments are generally classified within Level 2 of the fair value hierarchy. Level 3 is for positions that are not traded in actual markets or are subject to transfer restrictions, valuations are adjusted to reflect illiquidity and/or non-transferability, and such adjustments are generally based on available market evidence, management's best estimate is used.

Impaired loans are evaluated and valued at the time the loan is identified as impaired, at the lower of cost or market value. Market value is measured based on the value of the collateral securing these loans and is classified at a Level 3 in the fair value hierarchy. Collateral may be real estate and/or accounts receivable. The value of real estate collateral is determined based on appraisal by qualified licensed appraisers hired by the Company. The value of business equipment, inventory and accounts receivable collateral is based on the net book value on the business' financial statements and, if necessary, discounted based on management's review and analysis. Appraised and reported values may be based upon knowledge changes in market

conditions from the time of valuation, and/or management's expertise and knowledge of the client and client's business. Impaired loans are reviewed and evaluated on at least a quarterly basis for additional impairment and adjusted accordingly, based on the same factors identified above.

Foreclosed properties are adjusted to fair value upon transfer of the loans to foreclosed properties. Subsequently, foreclosed properties are carried at the lower of carrying value or fair value. The estimated fair value for foreclosed properties included in Level 3 is determined by independent market based appraisals and other available market information, less cost to sell, that may be reduced further based on market expectations or an executed sales agreement. If fair value of the collateral deteriorates subsequent to initial recognition, the Company records the foreclosed properties as a nonrecurring Level 3 adjustment. Valuation techniques are consistent with those techniques applied in prior periods.

The following table sets forth the Company's financial assets and liabilities that were accounted for or disclosed at fair value on a recurring basis as of December 31, 2017 and 2016:

(dollars in thousands)	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total Fair Value
December 31, 2017				
Assets:				
Investments securities available-for-sale :				
U.S. Government Agency	$ -	$ 10,690	$ -	$ 10,690
Mortgage-Backed Securities	-	11,019	-	11,019
Collateralized Mortgage Obligations	-	34,209	-	34,209
Private label mortgage-backed securities	-	1,989	-	1,989
Municipal securities	-	8,895	-	8,895
Equity securities	12	-	-	12
Total	$ 12	$ 66,802	$ -	$ 66,814
December 31, 2016				
Assets:				
Investments securities available-for-sale :				
U.S. Government Agency	$ -	$ 11,301	$ -	$ 11,301
Mortgage-Backed Securities	-	13,795	-	13,795
Collateralized Mortgage Obligations	-	21,328	-	21,328
Private label mortgage-backed securities	-	1,768	-	1,768
Municipal securities	-	9,003	-	9,003
Equity securities	71	-	-	71
Total	$ 71	$ 57,195	$ -	$ 57,266

The following table sets forth the Company's financial assets and liabilities that were accounted for or disclosed at fair value on a nonrecurring basis as of December 31, 2017 and 2016:

(dollars in thousands)	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total Fair Value
December 31, 2017				
Assets:				
Impaired loans :				
Construction and land development	$ -	$ -	$ 1,871	$ 1,871
Commercial real estate	-	-	6,550	6,550
Residential real estate	-	-	2,090	2,090
Commercial and industrial	-	-	2,081	2,081
Consumer	-	-	-	-
Real estate owned	-	-	-	-
Total	$ -	$ -	$ 12,592	$ 12,592
December 31, 2016				
Assets:				
Impaired loans :				
Construction and land development	$ -	$ -	$ 1,497	$ 1,497
Commercial real estate	-	-	4,032	4,032
Residential real estate	-	-	5,665	5,665
Commercial and industrial	-	-	1,397	1,397
Consumer	-	-	-	-
Real estate owned	-	-	155	155
Total	$ -	$ -	$ 12,746	$ 12,746

The Company has determined the fair value of its financial instruments using the following assumptions:

Cash and Cash Equivalents and Short-term Investments, Accrued Interest Receivable and Payable, and Repurchase Agreements – The fair value was estimated to equal the carrying value due to the short-term nature of these financial instruments.

Securities – The fair value was estimated based on quoted market prices, dealer quotes and prices obtained from independent pricing services.

Loans – The fair value was estimated by discounting the estimated future cash flows using current rates on loans with similar credit risks and terms. It was assumed that no prepayments would occur due to the short-term nature of the portfolio (five years or less) and based upon the Company's historical experience.

Loans Held For Sale – for this table loans held for sale are shown at fair value based on the contracted sales price.

Deposits – The fair values disclosed for demand deposits are, by definition, equal to the amount payable on demand at the reporting date (that is, their carrying amounts). The carrying amounts of variable-rate money market accounts, savings accounts, and interest checking accounts approximate their fair values at the reporting date. Fair values for fixed-rate CDs arc estimated using a discounted cash flow calculation that applies interest rates currently being offered on certificates to a schedule of aggregated expected monthly maturities on time deposits.

Commitments to Fund Loans and Stand by Letters of Credit – The majority of the Bank's commitments to grant loans and standby letters of credit are generally unassignable by either the bank or the borrower; they only have value to the Bank and the borrower.

The fair value estimates presented are based on pertinent information available as of December 31, 2016 and 2015. However, considerable judgment is required to interpret market data to develop the estimates of fair value. Accordingly, the estimates presented are not necessarily indicative of the amounts that the Company could realize in a current market transaction. The use of different methodologies may have a material effect on the estimated fair value amounts.

The estimated fair values of the Company's financial instruments at December 31, 2017 and 2016 are as follows:

	2017		2016	
(dollars in thousands)	**Carrying Value**	**Estimated Fair Value**	**Carrying Value**	**Estimated Fair Value**
Financial Assets:				
Cash and cash equivalents	$ 18,715	$ 18,715	$ 18,115	$ 18,115
Short-term investments	3,408	3,408	1,912	1,912
Investment securities	66,814	66,814	57,266	57,266
Loans held for sale	1,566	1,598	1,136	1,161
Loans, net	306,522	307,053	284,808	288,346
Accrued interest receivable	1,185	1,185	1,215	1,215
Financial Liabilities:				
Deposits	334,915	333,156	330,828	330,664
Short-term borrowings	51,760	51,749	15,903	15,903
Accrued interest payable	118	118	125	125

13. Related Party Transactions

In the normal course of banking business, loans are made to officers and directors on substantially the same terms, including interest rates and collateral on loans, as those prevailing at the same time for comparable transactions with non-related parties and do not involve more than normal risk of collectability or present other unfavorable features. The following table presents an analysis of activity for loans to related parties at December 31, 2017 and 2016:

(dollars in thousands)	2017	2016
Balance, beginning of year	$ 4,202	$ 4,367
Principal additions	2	-
Principal payments	(167)	(165)
Balance, end of year	$ 4,037	$ 4,202

At December 31, 2017 and 2016, related party deposits totaled $468,204 and $651,949, respectively.

14. Other Noninterest Expense

Other expenses in the Consolidated Statements of Income include the following:

(dollars in thousands)	2017	2016
Business development	$ 229	$ 121
Director fees	194	171
Other taxes	172	143
Other insurance	136	123
Other**	1,176	636
	$ 1,907	$ 1,194

** The increase in other expense is attributable primarily to non-recurring expense of $505 during 2017.

15. Preferred Stock

On March 13, 2009, pursuant to the TARP Capital Purchase Program established by the United States Department of the Treasury under the Emergency Economic Stabilization Act of 2008, the Company issued 6,000 shares of Fixed Rate Cumulative Perpetual Preferred Stock, Series B, par value $1.00 per share to the Treasury for aggregate consideration of $6,000,000. The Series B Preferred Stock paid a cumulative preferred dividend of 5% per annum per $1,000 of liquidation amount. On September 3, 2010, the Series B preferred stock was cancelled and exchanged for Series D preferred stock under the CDCI program. In the exchange, the dividend payment was reduced from 5% per annum to 2% per annum. The Series B and Series D Preferred Stock were treated as Tier 1 capital without limitation.

On December 30, 2016, the Company redeemed all 6,000 shares outstanding of the Series D preferred stock at a discount. During 2016, the United States Department of the Treasury (the "Treasury"), offered all financial institutions who had participated in the Community Development Capital Initiative ("CDCI") to submit bids for early redemption. The funds for the redemption came from existing financial resources of the Bank and the Company. The discounted redemption had a positive impact on shareholder value and going forward will reduce the drain on capital that occurred as a result of the dividend payments.