

***QUEENSTOWN BANCORP
OF MARYLAND, INC.***



***2017
AUDITED
FINANCIAL
STATEMENTS***

AUDITED FINANCIAL STATEMENTS

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INDEPENDENT AUDITORS' REPORT

Board of Directors and Stockholders
Queenstown Bancorp of Maryland, Inc. and Subsidiary

We have audited the accompanying consolidated financial statements of Queenstown Bancorp of Maryland, Inc. and Subsidiary, which comprise the consolidated balance sheets as of December 31, 2017 and 2016, and the related consolidated statements of operations, changes in stockholders' 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.

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 audits 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.

Opinion

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Queenstown Bancorp of Maryland, Inc and Subsidiary as of December 31, 2017 and 2016, and the 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.

Dixon Hughes Goodman LLP

**Baltimore, Maryland
March 26, 2018**

QUEENSTOWN BANCORP OF MARYLAND, INC. AND SUBSIDIARY
CONSOLIDATED BALANCE SHEETS

(Dollars in thousands)

	December 31	
	2017	2016
ASSETS		
Cash and due from banks	\$ 4,703	6,103
Interest bearing deposits with banks	59,088	49,134
Total cash and cash equivalents	63,791	55,237
Securities available-for-sale (at fair value)	12,356	10,521
Federal Home Loan Bank stock (at cost)	430	416
Loans	377,627	386,044
Less allowance for loan losses	(5,297)	(5,910)
Loans, net	372,330	380,134
Premises and equipment, net	5,360	5,556
Bank owned life insurance	5,964	5,825
Other real estate	1,287	1,308
Deferred income taxes	964	1,443
Accrued interest receivable	1,497	1,449
Prepaid expenses	316	322
Other assets	424	474
TOTAL ASSETS	\$ 464,719	462,685
 LIABILITIES AND STOCKHOLDERS' EQUITY		
Noninterest bearing deposits	\$ 94,405	88,021
Interest bearing deposits	310,147	317,320
Total deposits	404,552	405,341
Accrued expenses and other liabilities	2,092	1,844
Total liabilities	406,644	407,185
Common stock - \$10 par value; 10,000,000 shares authorized, 1,226,125 shares issued at December 31, 2017; 1,259,330 shares issued at December 31, 2016;	12,261	12,593
Surplus	154	139
Retained earnings	45,727	42,846
Accumulated other comprehensive loss	(67)	(78)
Total stockholders' equity	58,075	55,500
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	\$ 464,719	462,685

See accompanying notes to consolidated financial statements.

QUEENSTOWN BANCORP OF MARYLAND, INC. AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF INCOME

(Dollars in thousands, except per share information)

	Years Ended		
	2017	2016	2015
INTEREST INCOME:			
Interest and fees on loans	\$ 19,227	19,598	19,771
Interest and dividends on investment securities	252	229	292
Other interest income	801	269	99
Total interest income	20,280	20,096	20,162
INTEREST EXPENSE:			
Interest on deposits	2,158	2,137	2,235
Net interest income	18,122	17,959	17,927
Provision for loan losses	600	990	1,241
Net interest income after provisions for loan losses	17,522	16,969	16,686
NONINTEREST INCOME:			
Service charges on deposit accounts	621	579	614
Other income	481	581	578
Net gain (loss) on sales of other real estate	167	(38)	(136)
Securities gains	-	-	22
Total noninterest income	1,269	1,122	1,078
NONINTEREST EXPENSES:			
Salaries and employee benefits	6,051	5,831	5,658
FDIC insurance premiums	189	502	571
Other real estate expenses	126	246	390
Data processing expenses	602	617	598
Occupancy expense of bank premises	628	610	647
Equipment expenses	347	322	313
Other expenses	1,647	1,505	1,402
Total noninterest expenses	9,590	9,633	9,579
Income before income taxes	9,201	8,458	8,185
Income tax expense	3,956	3,242	3,076
Net income	\$ 5,245	5,216	5,109
Basic and diluted net income per share	\$ 4.20	4.14	4.06
Basic weighted average shares outstanding	1,249,663	1,259,330	1,259,330
Diluted weighted average shares outstanding	1,249,852	1,259,330	1,259,330

See accompanying notes to consolidated financial statements.

QUEENSTOWN BANCORP OF MARYLAND, INC. AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(Dollars in thousands)

	Years Ended		
	2017	2016	2015
Net income	\$ 5,245	5,216	5,109
Other comprehensive income (loss), before tax:			
Securities available for sale:			
Unrealized holding gains (losses) arising during the period	36	(188)	(126)
Reclassification adjustment for gains (losses) included in net income	-	-	(30)
Other comprehensive income (loss), before tax	36	(188)	(156)
Income tax effect	(14)	74	62
Other comprehensive income (loss), net of tax	22	(114)	(94)
Total comprehensive income	<u>\$ 5,267</u>	<u>5,102</u>	<u>5,015</u>

QUEENSTOWN BANCORP OF MARYLAND, INC. AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY

For the Years Ended December 31, 2017, 2016 and 2015

(Dollars in thousands, except per share information)

	<u>Common Stock</u>		Surplus	Retained Earnings	Accumulated Other Comprehensive	Total
	Shares	Par Value			Income (Loss)	
	Balances at January 1, 2015	1,259,330			\$ 12,593	
Net Income	-	-	-	5,109	-	5,109
Other comprehensive income (loss), net of tax	-	-	-	-	(94)	(94)
Cash dividends (\$1.00 per share)	-	-	-	(1,259)	-	(1,259)
Balances at December 31, 2015	1,259,330	12,593	139	39,079	36	51,847
Net Income	-	-	-	5,216	-	5,216
Other comprehensive income (loss), net of tax	-	-	-	-	(114)	(114)
Cash dividends (\$1.15 per share)	-	-	-	(1,449)	-	(1,449)
Balances at December 31, 2016	1,259,330	12,593	139	42,846	(78)	55,500
Net Income	-	-	-	5,245	-	5,245
Other comprehensive income (loss), net of tax	-	-	-	-	22	22
Reclassification of remaining tax effects on deferred tax assets on securities available for sale	-	-	-	11	(11)	-
Stock repurchases	(33,205)	(332)	-	(830)	-	(1,162)
Stock option compensation	-	-	15	-	-	15
Cash dividends (\$1.25 per share)	-	-	-	(1,545)	-	(1,545)
Balances at December 31, 2017	<u>1,226,125</u>	<u>\$ 12,261</u>	<u>154</u>	<u>45,727</u>	<u>(67)</u>	<u>58,075</u>

QUEENSTOWN BANCORP OF MARYLAND, INC. AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF CASH FLOWS

(Dollars in thousands)

	Years Ended		
	2017	2016	2015
OPERATING ACTIVITIES:			
Net Income	\$ 5,245	5,216	5,109
Adjustments to reconcile net income to net cash provided by operating activities:			
Premium amortization on securities	90	75	50
Depreciation and amortization	376	364	362
Gains on sales of securities	-	-	(22)
Net (gain) loss on sales of other real estate	(167)	38	136
Provision for loan losses	600	990	1,241
Deferred tax (benefit) expense	459	(373)	17
Stock option compensation	15	-	-
Net changes in:			
Accrued interest receivable	(48)	(192)	64
Accrued expenses and other liabilities	248	90	(34)
Prepaid expenses	6	(168)	116
Other operating activities	107	(186)	731
Net cash provided by operating activities	<u>6,931</u>	<u>5,854</u>	<u>7,770</u>
INVESTING ACTIVITIES:			
Purchases of securities available-for-sale	(4,830)	(3,479)	(1,154)
Proceeds from sales of securities available-for-sale	-	-	824
Proceeds from calls and maturities of securities available-for-sale	500	795	50
Principal payments received on securities available-for-sale	2,444	1,414	1,224
Net decrease (increase) in loans	5,689	5,172	(13,096)
Purchases of FHLB stock	(14)	(8)	-
Proceeds from redemption of FHLB stock	-	-	3
Purchases of premises and equipment	(180)	(226)	(92)
Purchases and improvements of other real estate	(32)	-	-
Proceeds from sales of other real estate	1,531	1,369	2,204
Net cash provided (used) by investing activities	<u>5,108</u>	<u>5,037</u>	<u>(10,037)</u>
FINANCING ACTIVITIES:			
Net (decrease) increase in deposits	(789)	11,816	5,313
Purchases of common stock	(1,151)	-	-
Dividends paid	(1,545)	(1,449)	(1,259)
Net cash (used) provided by financing activities	<u>(3,485)</u>	<u>10,367</u>	<u>4,054</u>
Net increase in cash and due from banks	8,554	21,258	1,787
Cash and cash equivalents at beginning of year	55,237	33,979	32,192
Cash and cash equivalents at end of year	<u>\$ 63,791</u>	<u>55,237</u>	<u>33,979</u>
Supplemental disclosures:			
Interest payments	\$ 2,185	2,141	2,294
Income tax payments	3,497	3,695	3,029
Noncash investing and financing activities:			
Loan charge-offs	1,553	1,155	1,614
Transfers to other real estate owned	1,311	1,301	945

See accompanying notes to consolidated financial statements.

QUEENSTOWN BANCORP OF MARYLAND, INC. AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEARS ENDED DECEMBER 31, 2017, 2016 AND 2015 (Dollars in thousands, except per share information)

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The accounting and reporting policies of the Company, which includes Queenstown Bancorp of Maryland, Inc. and its wholly owned subsidiary, Queenstown Bank of Maryland (the Bank), conform to accounting principles generally accepted in the United States of America and to general practices in the banking industry. Certain reclassifications have been made to amounts previously reported to conform with the classifications made in 2017.

Basis of Presentations

The consolidated financial statements include the accounts of Queenstown Bancorp of Maryland, Inc. and its subsidiary, Queenstown Bank of Maryland, with all significant intercompany transactions eliminated.

Nature of Operations

The Company provides a full range of banking services to individuals and businesses through its main office and five branches in Queen Anne's County and one branch each in Talbot County and Caroline County Maryland. Its primary deposit products are certificates of deposit and demand, savings, NOW and money market accounts. Its primary lending products are commercial and consumer loans and real estate mortgages. The Company's loan portfolio has a concentration of residential and commercial real estate loans in Queen Anne's County and the surrounding area.

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Securities

At the purchase date, the Company classifies securities as held to maturity or available for sale. Interest and dividend income on securities are recognized in interest income on the accrual basis. Premiums and discounts on securities are amortized as an adjustment to yield using the interest method.

Debt securities acquired with both the intent and ability to hold to maturity are classified as held to maturity and reported at amortized cost. Federal Home Loan Bank stock is carried at cost and is restricted as to marketability.

Securities classified as available-for-sale are used as part of the Company's asset/liability management strategy. Sales may occur in response to changes in interest rate conditions, balance sheet composition or other economic factors. All debt securities classified as available for sale are reported at estimated fair value, with unrealized gains and losses reported as accumulated other comprehensive income or loss, net of deferred income taxes, in the stockholders' equity section of the Consolidated Balance Sheets.

Gains or losses realized from the sale of securities are determined by specific identification and are included in noninterest income. The Company evaluates each investment security in an unrealized loss position for other than temporary impairment. If management determines that all contractual obligations from an investment may not be received, then other than temporary impairment would be recognized. The unrealized loss for other than temporary impairment on debt and equity securities are reported in current period earnings.

Loans

Loans are stated at their principal balance outstanding net of deferred loan fees and costs. Overdrafts are included in loans outstanding. Interest income on loans is accrued at the contractual rate on the principal amount outstanding. The Company places loans, except for installment, on nonaccrual when any portion of the principal or interest is ninety days past due and collateral is insufficient to discharge the debt in full. Interest accrual may also be discontinued earlier if, in management's opinion, collection is unlikely. Generally, installment loans are not placed on nonaccrual, but are charged off when they are over 100 days past due. Interest received on impaired loans placed on nonaccrual status is generally applied to reduce the carrying value of the loan or, if principal is considered fully collectible, recognized as interest income. For all other loans, loan balances are charged off when it becomes evident that such balances are not fully collectible. For loans secured by real estate, the excess of the loan balances over the net realizable value of the property collateralizing the loan is charged off. Accrual of interest resumes when the loan is brought current and the borrower demonstrates the ability to service the debt on a current basis.

Loans are considered impaired, based upon current information and circumstances, if it is probable that the Company will not collect all principal and interest payments according to contractual terms. Restructured loans, meeting the definition of troubled debt restructurings, are considered impaired loans. Impaired loans do not include large groups of smaller balance homogeneous loans that are evaluated collectively for impairment such as consumer installment loans. The allowance for loan losses related to impaired loans is included in the allowance for loan losses applicable to other than impaired loans. The impairment of a loan is measured by the present value of expected future cash flows discounted at the loan's effective interest rate, or the fair value of the collateral if the repayment is expected to be provided by the collateral.

Loan origination fees and certain direct loan origination costs are being deferred and the net amount is amortized over the contractual life of the loan as an adjustment to the loan's yield.

Allowance for Loan Losses

The allowance for loan losses is maintained at a level which, in management's judgment, is adequate to absorb credit losses inherent in the loan portfolio. The allowance is determined by management's evaluation of the loan and lease portfolio based on such factors as the differing economic risks associated with each loan category, the current financial condition of specific borrowers, the economic environment in which borrowers operate, the level of delinquent loans, the value of any collateral and, where applicable, the existence of any guarantees or indemnification. As a result, these judgments are inherently subjective and involve material estimates that may be susceptible to significant change. The allowance is increased by the loan loss provision charged to operating expenses and reduced by charge-offs, net of recoveries. The provision for loan losses is based on the ongoing review of the loan portfolios, past loss experience and current economic conditions which could impact the borrowers' repayment performance.

Premises and Equipment

Premises and equipment are stated at cost less accumulated depreciation and amortization. The Company's policy is to provide for depreciation of physical properties over their estimated useful lives or the lease term (whichever is shorter) as a charge to operations at straight-line rates. Expenditures for maintenance, repairs and minor renewals are charged to operations; expenditures for betterments are charged to the property accounts. Upon retirement or other disposition of properties, the carrying value and the related accumulated depreciation or amortization are removed from the accounts.

Advertising Costs

Advertising costs are expensed as incurred.

Off-Balance Sheet Credit Risk

The Company issues financial or standby letters of credit that represent conditional commitments to fund transactions by the Company, typically to guarantee performance of a customer to a third party related to borrowing arrangements. The credit risk associated with issuing letters of credit is essentially the same as occurs when extending loan facilities to borrowers. The Company monitors the exposure to the letters of credit as part of its credit review process. Extensions of letters of credit, if any, would become part of the loan balance outstanding and would be evaluated in accordance with Company's credit policies. Potential exposure to loss for unfunded letters of credit if deemed necessary would be recorded in other liabilities.

Other Real Estate

Real estate properties acquired through, or in lieu of, loan foreclosure are held for sale and carried at the lower of fair value minus estimated costs of disposal or cost. Fair value is based on independent appraisals and other relevant factors. At the time of acquisition any excess of loan balance over fair value is charged to the allowance for loan losses. At December 31, 2017 residential properties included in other real estate totaled \$506 thousand.

Income Taxes

Deferred income taxes are calculated by applying enacted statutory tax rates to temporary differences consisting of all significant items which are reported for tax purposes in different years than for accounting purposes. Deferred tax assets are recognized only to the extent that it is more likely than not that such amounts will be realized based on considerations of available evidence. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date.

Per Share Data

Basic net income per share is computed by dividing the net income by the weighted average number of shares of common stock outstanding during the year presented. Net income per share is computed by dividing net income by the weighted average number of shares of common stock plus the assumed conversions of common stock equivalents outstanding using the treasury method.

Subsequent Events

Subsequent events have been evaluated for potential recognition and disclosure through the date of the independent auditors' report, the date these consolidated financial statements were available to be issued.

Statement of Cash Flows

For purposes of reporting cash flows, cash equivalents are composed of cash and due from banks and interest bearing deposits with banks.

Comprehensive Income

Accounting principles generally accepted in the United States of America require that recognized revenue, expenses, gains, and losses be included in net income. However, 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 stockholders' equity section of the consolidated balance sheet. Such items, along with net income, are components of comprehensive income.

2. SECURITIES

The amortized cost, gross unrealized gains and losses, and fair values of securities are as follows:

	December 31, 2017			
	Amortized Cost	Gross	Gross	Fair Value
		Unrealized Gains	Unrealized Losses	
Available-for-sale				
U.S. government agencies	\$ 839	1	2	838
U.S. government sponsored agencies	2,000	-	28	1,972
Residential mortgage-backed	9,151	60	148	9,063
Obligations of states and political subdivisions	458	25	-	483
Totals	\$ 12,448	86	178	12,356

	December 31, 2016			
	Amortized Cost	Gross	Gross	Fair Value
		Unrealized Gains	Unrealized Losses	
Available-for-sale				
U.S. government agencies	\$ 1,042	3	-	1,045
U.S. government sponsored agencies	\$ 1,000	-	-	1,000
Residential mortgage-backed	8,147	85	234	7,998
Obligations of states and political subdivisions	461	17	-	478
Totals	\$ 10,650	105	234	10,521

The table below shows our securities' gross unrealized losses and fair value, aggregated by category and length of time that individual securities have been in a continuous unrealized loss position, at December 31, 2017 and 2016.

	Less than 12 months		12 months or more		Total	
	Fair	Unrealized	Fair	Unrealized	Fair	Unrealized
	Value	Loss	Value	Loss	Value	Loss
As of December 31, 2017						
Residential mortgage backed	\$ 4,204	39	5,321	139	9,525	178
As of December 31, 2016						
Residential mortgage backed	\$ 4,270	140	1,213	94	5,483	234

The residential mortgage backed portfolio at December 31, 2017 is composed of GNMA, FNMA, or FHLMC mortgage backed securities.

We retain temporarily impaired securities because we have the ability to hold them until they recover in value or mature.

The amortized cost and fair values of debt securities at December 31, 2017 by contractual maturity are shown below. 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.

	Available-for-Sale	
	Amortized Cost	Fair Value
As of December 31, 2017		
Due in one year or less	\$ -	-
Due after one through five years	2,000	1,972
Due after five years through ten years	369	371
Due after ten years	928	950
	<u>3,297</u>	<u>3,293</u>
Residential mortgage-backed securities	9,151	9,063
Totals	<u>\$ 12,448</u>	<u>12,356</u>

There were no sales of securities in 2017 nor 2016. Gross realized gains on sales of available for sale securities were \$ 22 thousand in 2015.

At December 31, 2017 and 2016, securities with a carrying value of \$ 8,016 thousand and \$5,840 thousand respectively, were pledged as collateral for certain government deposits and for other purposes as required or permitted by law.

3. LOANS

At December 31, 2017 and 2016, loans are as follows:

	2017	2016
Real estate:		
Construction and land development	\$ 20,699	32,918
Secured by farmland	38,491	37,582
Commercial	102,536	98,501
Residential	189,231	191,071
Commercial and agricultural	18,777	18,312
Consumer	7,893	7,660
Total	<u>\$ 377,627</u>	<u>386,044</u>

A summary of current, past due, and nonaccrual loans as of December 31, 2017 and 2016 was as follows:

	Current	30-89 Days Past Due	90 Days or more Past Due and accruing	Nonaccrual	Total
As of December 31, 2017					
Real estate:					
Construction and land development loans	\$ 19,814	77	-	808	20,699
Secured by farmland	38,206	285	-	-	38,491
Commercial	99,377	1,445	1,212	502	102,536
Residential	182,479	4,126	484	2,142	189,231
Commercial and agricultural	18,207	508	62	-	18,777
Consumer	7,760	133	-	-	7,893
Total	<u>\$ 365,843</u>	<u>6,574</u>	<u>1,758</u>	<u>3,452</u>	<u>377,627</u>

	Current	30-89 Days Past Due	90 Days or more Past Due and accruing	Nonaccrual	Total
As of December 31, 2016					
Real estate:					
Construction and land development loans	\$ 31,596	52	-	1,270	32,918
Secured by farmland	37,139	-	443	-	37,582
Commercial	94,961	2,973	88	479	98,501
Residential	184,314	3,689	262	2,806	191,071
Commercial and agricultural	18,224	85	-	3	18,312
Consumer	7,574	86	-	-	7,660
Total	\$ 373,808	6,885	793	4,558	386,044

Loans on which the accrual of interest has been discontinued totaled \$3,452 and \$4,558 thousand at December 31, 2017 and 2016 respectively. Interest that would have been accrued on these loans totaled \$157 thousand and \$195 thousand for the years ended December 31, 2017 and 2016 respectively. At December 31, 2017 residential mortgages in the process of foreclosure total \$434 thousand.

4. ALLOWANCE FOR LOAN LOSSES

Changes in the allowance for credit losses for the year ended December 31, 2017 and 2016 were as follows:

	Real estate construction	Real estate residential	Real estate farmland and commercial	Commercial and agriculture	Consumer	Total
As of December 31, 2017						
Beginning Balance	\$ 1,466	2,256	1,835	256	97	5,910
Provision for loan losses	-	-	600	-	-	600
Net charge-offs:						
Charge-offs	(28)	(242)	(1,230)	-	(51)	(1,551)
Recoveries	136	104	3	49	46	338
Net charge-offs	108	(138)	(1,227)	49	(5)	(1,213)
Ending balance	\$ 1,574	2,118	1,208	305	92	5,297
As of December 31, 2016						
Beginning Balance	\$ 1,664	1,948	1,814	368	114	5,908
Provision for loan losses	-	754	236	-	-	990
Net charge-offs:						
Charge-offs	(264)	(489)	(223)	(120)	(59)	(1,155)
Recoveries	66	43	8	8	42	167
Net charge-offs	(198)	(446)	(215)	(112)	(17)	(988)
Ending balance	\$ 1,466	2,256	1,835	256	97	5,910

Although the above allocation is performed, the allowance for loan losses is general in nature and is available to absorb losses from any loan type.

The process for calculating the adequacy of the allowance for loan losses encompasses loss estimates attributable to specific troubled credits identified during the credit review process and estimates of losses inherent in other loans not reviewed specifically. The process of determining the level of the allowance for loan losses involves classifying the loans according to characteristics of loss risk for nonperforming and criticized loans and by type of loan for all other loans. For nonaccrual loans, loans over 89 days past due accruing and any other criticized loans according to the Company's loan rating system, the loans are first reviewed for specific loss measurement. Measurement of the specific loss component is based on expected future cash flows, collateral values and other relevant factors impacting the borrower's ability to pay. The Company utilizes a loan rating system which is applied to all loans but is particularly designed for monitoring loss characteristics of the real estate and commercial loan portfolios. Loan ratings are continually monitored by the loan officer and the credit review department in accordance with the loan rating guidelines established in the loan policy. Factors considered in assigning loan ratings include borrower specific cash flows and financial condition analyses, collateral values, payment status and other relevant data impacting repayment ability. Loss allocations assigned to the various loan type pools are continually monitored and adjusted for adequacy based on trends in portfolio charge-offs and recoveries, trends in portfolio delinquencies and impaired loans, changes in the risk profile of the pools, and changes in trends within the local economy.

Loans that have their terms restructured (e.g., interest rates, loan maturity date, payment and amortization period, etc.) in circumstances that provide payment relief or other concessions to a borrower experiencing financial difficulty are considered trouble debt restructured loans. All restructurings that constitute concessions to a troubled borrower are considered impaired loans that may either be in accruing status or non-accruing status. Troubled debt restructurings are considered to be impaired loans and for purposes of establishing the allowance for credit losses are evaluated for impairment giving consideration to the impact of the modified loan terms and the present value of the loans expected cash flows. Impairment of troubled debt restructurings that have subsequently defaulted may also be measured based on the loans observable market price or the fair value of collateral if the loan is collateral-dependent. Non-accruing restructured loans may return to accruing status provided there is a sufficient period of payment performance in accordance with the restructure terms. Loans may be removed from the restructured category in the year subsequent to the restructuring if their revised loans terms are considered to be consistent with terms that can be obtained in the credit market for loans with comparable risk. At December 31, 2017 restructured loans totaled \$6,957 thousand, of which \$6,272 thousand were accruing and \$685 thousand were non-accruing. Restructured loans at December 31, 2016 totaled \$7,116 thousand, of which \$6,102 thousand were accruing and \$1,014 thousand were non-accruing.

The following table provides information with respect to impaired loans as of and for the years ended December 31, 2017 and 2016.

	2017	2016
Impaired loans with a valuation allowance	\$ 4,091	5,427
Impaired loans without a valuation allowance	6,117	6,968
Total impaired loans	<u>\$ 10,208</u>	<u>12,395</u>
Allowance for loan losses applicable to impaired loans	\$ 430	514
Allowance for loan losses applicable to other loans	4,867	5,396
Total allowance for loan losses	<u>\$ 5,297</u>	<u>5,910</u>
Average recorded investment in impaired loans	\$ 12,066	12,292

The following table provides information on impaired loans by loan category as of December 31, 2017 and 2016:

	Unpaid Recorded principal investment	balance	Related allowance	Average recorded investment
As of December 31, 2017				
With a related allowance recorded:				
Real estate – construction	\$	-	-	173
Real estate – residential		3,134	340	3,290
Real estate – commercial & farmland		957	90	1,296
Total	\$	4,091	430	4,759
As of December 31, 2017				
Without a related allowance recorded:				
Real estate – construction	\$	1,112	-	1,324
Real estate – residential		3,477	-	3,722
Real estate – commercial & farmland		1,528	-	1,494
Total	\$	6,117	-	6,540
As of December 31, 2016				
With a related allowance recorded:				
Real estate – construction	\$	346	42	230
Real estate – residential		3,446	353	2,802
Real estate – commercial & farmland		1,635	119	1,624
Commercial & Agricultural		-	-	35
Total	\$	5,427	514	4,691
As of December 31, 2016				
Without a related allowance recorded:				
Real estate – construction	\$	1,537	-	2,403
Real estate – residential		3,968	-	4,148
Real estate – commercial & farmland		1,460	-	1,044
Commercial & Agricultural		3	-	6
Total	\$	6,968	-	7,601

The following table summarizes the loan risk ratings applied to the Company's real estate mortgages and commercial loans as of December 31, 2017 and 2016. Criticized loans are considered inadequately protected by the current paying capacity of the borrower or of the collateral pledged, if any. These loans have weaknesses that jeopardize the liquidation of the debt. Loans not meeting the definition of criticized are considered pass rated loans.

	Real estate construction	Real estate residential	Real estate farmland and commercial	Commercial and agriculture
As of December 31, 2017				
Pass	\$ 19,413	183,290	137,657	18,567
Criticized accrual	174	4,103	2,868	210
Criticized nonaccrual	1,112	1,838	502	-
Total	\$ 20,699	189,231	141,027	18,777
As of December 31, 2016				
Pass	\$ 30,789	183,193	127,484	18,140
Criticized accrual	859	5,072	8,120	169
Criticized nonaccrual	1,270	2,806	479	3
Total	\$ 32,918	191,071	136,083	18,312

At December 31, 2017 and 2016 the allocation of the allowance for loan losses summarized on the basis of impairment methodology was as follows:

	Real estate construction	Real estate residential	Real estate farmland and commercial	Commercial and Agricultural	Consumer	Total
As of December 31, 2017						
Individually evaluated for impairment	\$ -	340	90	-	-	430
Collectively evaluated for impairment	1,574	1,778	1,118	305	92	4,867
Total	\$ 1,574	2,118	1,208	305	92	5,297
As of December 31, 2016						
Individually evaluated for impairment	\$ 42	353	119	-	-	514
Collectively evaluated for impairment	1,424	1,903	1,716	256	97	5,396
Total	\$ 1,466	2,256	1,835	256	97	5,910

The recorded investment in loans summarized based on impairment methodology as of December 31, 2017 and 2016 was as follows:

	Real estate construction	Real estate residential	Real estate farmland and commercial	Commercial and Agricultural	Consumer	Total
As of December 31, 2017						
Individually evaluated for impairment	\$ 1,112	6,611	2,485	-	-	10,208
Collectively evaluated for impairment	19,587	182,620	138,542	18,777	7,893	367,419
Total	<u>\$ 20,699</u>	<u>189,231</u>	<u>141,027</u>	<u>18,777</u>	<u>7,893</u>	<u>377,627</u>
As of December 31, 2016						
Individually evaluated for impairment	\$ 1,883	7,414	3,095	3	-	12,395
Collectively evaluated for impairment	31,035	183,657	132,988	18,309	7,660	373,649
Total	<u>\$ 32,918</u>	<u>191,071</u>	<u>136,083</u>	<u>18,312</u>	<u>7,660</u>	<u>386,044</u>

Information on troubled debt restructurings for the year ended December 31, 2017 and 2016 is as follows:

	Number of contracts	Pre-modification outstanding recorded investment	Post-modification outstanding recorded investment
As of December 31, 2017			
Real estate – residential accrual	20	\$ 5,210	\$ 4,288
Real estate – commercial accrual	3	2,037	1,984
Real estate – residential nonaccrual	3	692	423
Real estate – commercial nonaccrual	2	405	262
Total	<u>28</u>	<u>\$ 8,344</u>	<u>\$ 6,957</u>
As of December 31, 2016			
Real estate – residential accrual	16	\$ 4,301	\$ 3,902
Real estate – commercial accrual	5	2,247	2,201
Real estate – residential nonaccrual	4	1,057	810
Real estate – commercial nonaccrual	1	288	204
Total	<u>26</u>	<u>\$ 7,893</u>	<u>\$ 7,117</u>

The troubled debt restructured loans above have been re-amortized. At December 31, 2017 there are no commitments to lend additional funds to any borrower whose loan terms have been modified in a troubled debt restructuring. Information on the payment status of troubled debt restructurings is as follows:

	2017	2016
Current	\$ 4,537	6,005
30-89 days past due accruing	606	98
90 days or more past due accruing nonaccruals	1,129	-
Total	<u>\$ 6,957</u>	<u>7,117</u>

5. PREMISES AND EQUIPMENT

Premises and equipment consisted of the following:

	December 31	
	2017	2016
Land	\$ 1,908	1,908
Leasehold improvements	167	167
Buildings and land improvements	6,251	6,195
Furniture and equipment	2,011	1,887
	<u>10,337</u>	<u>10,157</u>
Accumulated depreciation and amortization	(4,977)	(4,601)
Premises and equipment – net	<u>\$ 5,360</u>	<u>5,556</u>

Depreciation expense was \$376 thousand, \$364 thousand and \$362 thousand for each of the years ended December 31, 2017, 2016 and 2015, respectively.

The Bank has lease obligations for branch locations. Future minimum lease payments subsequent to 2017 are \$39 thousand for 2018, \$34 thousand for 2019 and \$22 thousand for 2020.

6. DEPOSITS

A breakdown of interest bearing deposits at December 31, 2017 and 2016, by type of account is as follows:

	2017	2016
Savings and money market accounts	\$ 93,905	89,173
Interest bearing demand accounts	40,344	38,022
Time deposits of less than \$100,000	74,245	77,984
Time deposits of \$100,000 through \$250,000	67,491	72,007
Time deposits of more than \$250,000	34,162	40,134
Total interest bearing deposits	<u>\$ 310,147</u>	<u>317,320</u>

At December 31, 2017, the scheduled maturities of time deposits are as follows:

2018	\$ 76,883
2019	52,763
2020	19,552
2021	17,757
2022	8,943

Interest on deposits for the years ended December 31, 2017, 2016 and 2015 consisted of the following:

	2017	2016	2015
Savings and money market	\$ 153	151	142
Interest bearing demand accounts	69	49	28
Time deposits of \$100,000 or more	1,289	1,300	1,388
Other time deposits	647	637	677
Total interest on deposits	<u>\$ 2,158</u>	<u>2,137</u>	<u>2,235</u>

7. BORROWINGS AND CREDIT FACILITIES

Short-term borrowings consist of advances from the Federal Home Loan Bank of Atlanta with original maturities of up to one year and federal funds purchased from correspondent banks. There were no short-term borrowings outstanding during 2017 and 2016.

At December 31, 2017, credit available under the FHLB credit facility approximates \$84 million with letters of credit issued for the benefit of public funds depositors of \$31 million outstanding. The Bank is required to maintain an investment in stock of the FHLB in the amount of \$430 thousand as a condition for the credit facility. The Bank has also pledged its portfolio of 1-4 family first and second mortgage loans plus home equity loans as collateral for this credit facility. Principal balances outstanding on these mortgage loans total approximately \$189 million at December 31, 2017.

8. STOCKHOLDERS' EQUITY

The Board of Directors has approved plans authorizing the Company to purchase shares of its common stock. Purchased shares will be used for corporate purposes including issuance under the Company's stock based compensation plans. The number of shares remaining available for purchase under the plans was 150,155 shares at December 31, 2017.

Cash dividends paid to the holding company by its wholly owned subsidiary, Queenstown Bank of Maryland were \$2,707 thousand for 2017.

The Company and the Bank are subject to various regulatory capital requirements. 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. Regulatory non-objection may be required to pay certain dividends. 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 the Company's assets, liabilities, and certain off-balance sheet items as calculated under regulatory capital practices. The Company's capital amounts and classification 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 amounts and ratios (as set forth in the following table) of total and Tier I Capital (as defined in the regulations) to risk-weighted assets (as defined). As of December 31, 2017, the capital levels of the Company and the Bank exceed all capital adequacy requirements to which they are subject.

As of December 31, 2017, the most recent notification from the Bank's primary regulators categorized the Bank as well capitalized under the prompt corrective action regulations. To be categorized as well capitalized, a bank must maintain a minimum total risk-based, Tier I risk-based and Tier I leverage ratios as set forth in the following tables. There are no conditions or events since the last notifications that management believes have changed the Bank's category. Actual capital amounts and ratios are presented in the following table for the Company and the Bank.

	Amount	Actual Ratio	For Capital Adequacy Purposes	To Be Well Capitalized Under Prompt Corrective Action Provisions
As of December 31, 2017				
Total capital (to risk weighted assets):				
Company (consolidated)	\$62,320	18.71%	8%	
Bank	62,291	18.71%	8%	10%
Tier I capital (to risk weighted assets):				
Company (consolidated)	58,142	17.46%	6%	
Bank	58,113	17.45%	6%	8%
Common equity tier I				
Company (consolidated)	58,142	17.46%	4.50%	
Bank	58,113	17.45%	4.50%	6.50%
Tier I capital (to average assets):				
Company (consolidated)	58,142	12.15%	4%	
Bank	58,113	12.15%	4%	5%
As of December 31, 2016				
Total capital (to risk weighted assets):				
Company (consolidated)	\$59,926	17.31%	8%	
Bank	59,886	17.30%	8%	10%
Tier I capital (to risk weighted assets):				
Company (consolidated)	55,578	16.05%	6%	
Bank	55,538	16.05%	6%	8%
Common equity tier I				
Company (consolidated)	55,578	16.05%	4.50%	
Bank	55,538	16.05%	4.50%	6.50%
Tier I capital (to average assets):				
Company (consolidated)	55,578	11.77%	4%	
Bank	55,538	11.76%	4%	5%

9. INCOME TAXES

The Tax Cut and Jobs Act enacted in December 2017 reduced the federal corporate marginal income tax rate from 34% to 21% effective January 1, 2018. As a result of the Tax Act, the fourth quarter included a one-time charge recorded as income tax expense relating to the re-measurement of the Company's deferred tax assets. The accounting for the changes in tax law resulted in stranded tax effects within accumulated other comprehensive income for items that were originally recognized in other comprehensive income rather than in net income. The FASB recently issued an accounting standard update allowing companies to reclassify stranded tax effects resulting from the Tax Act from accumulated other comprehensive income to retained earnings.

Applicable income taxes on net income for 2017, 2016 and 2015 consist of the following:

	2017	2016	2015
Current income tax expense:			
Federal	\$ 2,775	2,856	2,432
State	726	759	627
	<u>3,501</u>	<u>3,615</u>	<u>3,059</u>
Deferred income tax (benefit) expense:			
Federal	442	(290)	8
State	13	(83)	9
	<u>455</u>	<u>(373)</u>	<u>17</u>
Total income tax expense	\$ 3,956	3,242	3,076

Components of deferred income tax expense (benefit) for 2017, 2016 and 2015 consist of the following:

	2017	2016	2015
Federal rate reduction	\$ 400	-	-
Provision for loan losses	45	(355)	131
Loan fees and costs	53	3	28
Deferred compensation	(80)	(79)	(69)
Depreciation and amortization	(6)	16	(29)
Deferred interest income	(8)	(19)	(6)
Other real estate owned sales	55	61	(38)
Stock option compensation	(4)	-	-
Total deferred income tax (benefit) expense	\$ 455	(373)	17

A reconciliation of income taxes computed at the maximum statutory federal tax rate to total income taxes for the years ended December 31, 2017, 2016, and 2015 follows:

	2017		2016		2015	
	Amount	Percent	Amount	Percent	Amount	Percent
Tax computed at statutory rate	\$ 3,128	34.00%	2,876	34.0%	2,783	34.0%
Increase (decrease) resulting from						
Tax-exempt interest income	(48)	-0.50%	(34)	-0.4%	(82)	-1.0%
Bank owned life insurance income	(38)	-0.40%	(52)	-0.6%	(47)	-0.5%
State income tax, net of federal income tax benefit	488	5.30%	445	5.3%	420	5.1%
Federal deferred tax rate reduction	400	4.30%	-	0.0%	-	0.0%
Other	26	0.30%	7	-	2	-
Total income taxes	\$ 3,956	43.00%	3,242	38.3%	2,231	37.6%

Significant components of the Company's deferred tax assets and liabilities at December 31, 2017 and 2016 are as follows:

	2017	2016
Deferred tax assets:		
Allowances for credit losses	\$ 631	949
Deferred compensation	375	458
Deferred interest income	55	71
Stock options	27	38
Other real estate losses	80	169
Others	3	4
Unrealized loss on securities available-for-sale	26	51
Total deferred tax assets	1,197	1,740
Deferred tax liabilities:		
Accumulated depreciation and amortization	83	136
Loan fees and costs	150	161
Total deferred tax liabilities	233	297
Net deferred tax assets	964	1,443

Management has determined that no valuation allowance is required as it is more likely than not that the net deferred tax assets will be fully realizable in future years.

10. RETIREMENT PLANS AND OTHER EMPLOYEE BENEFIT AGREEMENTS

The Company has a Section 401(k) profit sharing plan which covers substantially all employees who meet certain service requirements. Employer contributions to the plan include a discretionary contribution and matching contributions of a percentage of employee elective salary deferral contributions. Employer contributions included in operating expenses for 2017, 2016 and 2015 were \$142 thousand, \$136 thousand, and \$131 thousand, respectively.

The Company has provided additional retirement benefits as well as pre-retirement death benefits to selective executives through deferred compensation agreements. The deferred compensation plan agreements provide for monthly benefit payments for ten years after retirement. Benefit payments were \$22 thousand in 2017. There were no benefit payments in 2016. The Company is accruing the present value of these benefits over the remaining number of years to the employees' retirement dates. Benefit accruals included in operating expenses for 2017, 2016 and 2015 were \$152 thousand, \$167 thousand, and \$175 thousand, respectively. The accrued liability for deferred compensation agreements is \$1,257 thousand at December 31, 2017 and \$1,127 thousand at December 31, 2016.

The Company provides retirement benefits to directors. The agreements provide for annual benefit payments for ten years after retirement. There were no benefit payments in 2017. The Company is accruing the present value of these benefits over the remaining number of years to the directors' retirement dates. Benefit accruals included in operating expenses for 2017 and 2016 were \$72 thousand and \$33 thousand, respectively. The plan was adopted in 2016, therefore there were no accruals for 2015.

11. STOCK-BASED COMPENSATION

The Company has a qualified incentive stock option plan for officers and employees and a nonqualified stock option plan for directors. The total number of shares of Common Stock that may be optioned is 126,000 for the incentive plan and 63,000 for the nonqualified plan. The total number of shares of Common Stock that are remaining in the incentive plan is 104,800. Information with respect to the options granted is as follows:

	2017		2016		2015	
	Options Outstanding	Weighted Average Exercise price	Options Outstanding	Weighted Average Exercise price	Options Outstanding	Weighted Average Exercise price
Balance, January 1	48,840	\$ 48.32	65,040	\$ 48.24	75,080	\$ 47.47
Options granted	21,200	34.00	-	-	-	-
Options exercised	-	-	-	-	-	-
Options forfeited	-	-	-	-	-	-
Options expired	16,040	49.70	16,200	48.00	10,040	42.50
Balance, December 31	54,000	\$ 42.29	48,840	\$ 48.32	65,040	\$ 48.24
Options exercisable, December 31	37,040	\$ 46.08	48,840	\$ 48.32	65,040	\$ 48.24

Stock options outstanding at December 31, 2017 were as follows:

Exercise Price Range	Issued and Outstanding Options			Exercisable (Vested) Options		
	Number Outstanding	Weighted Average Remaining Life (years)	Weighted Average Exercise Price	Number Exercisable	Weighted Average Remaining Life (years)	Weighted Average Exercise Price
December 31, 2017						
\$0.00 through \$34.99	30,000	7.51	\$ 34.00	13,040	5.15	\$ 34.00
\$35.00 through \$54.99	24,000	1.10	52.65	24,000	1.10	52.65
Totals:	54,000	4.66	\$ 42.29	37,040	2.52	\$ 46.08

The maximum term of stock options granted under the plans is 10 years.

Stock based compensation costs of \$15 thousand were recognized for the year ended December 31, 2017. There were no stock based compensation costs for 2016 and 2015. Related income tax benefits of \$ 3 thousand were recognized for the year ended December 31, 2017.

The fair value of stock option awards granted on or after January 1, 2006 was determined by using a lattice option-pricing model utilizing a range of assumptions related to dividend yield, volatility, risk-free interest rate, and employee exercise behavior. Dividend yield is based on historical experience and expected future dividend actions. Expected volatility is based on a blend of historical stock price volatility and volatility of similarly publicly traded bank stocks. The risk-free interest rate is based on the U.S. Treasury yield curve at the time of grant. The Company estimated forfeitures based on historical data. There were no options granted in 2016 and 2015.

The fair value of the stock options granted for the year ended December 31, 2017 was estimated at \$ 4.69 per option on the date of grant based on the following assumptions :

Dividend yield	3.42%
Volatility	20.00%
Risk free interest rate	1.98%
Expected life--years	6

As of December 31, 2017, the total remaining unrecognized compensation cost related to non-vested stock options was \$73 thousand, which will be amortized over the expected life of these options.

12. RELATED PARTY TRANSACTIONS

In the ordinary course of business, the Company makes extensions of credit to its directors and their associates and several of its policy making officers on substantially the same terms, including interest rates and collateral, as those prevailing for comparable transactions with other customers. Extensions of credit outstanding, both direct and indirect, to directors and policy making officers of the Company totaled \$10,947 thousand and \$12,998 thousand at December 31, 2017 and 2016, respectively.

13. RESTRICTED CASH BALANCES

The Federal Reserve requires banks to maintain certain minimum cash balances consisting of vault cash and deposits in the Federal Reserve Bank or in other commercial banks. The amount of such reserves are based on percentages of certain deposit types and at December 31, 2017 totaled \$4,372 thousand. The company has balances due from correspondent banks in excess of FDIC insured deposit limits. These correspondent banks meet the regulatory definitions of well capitalized financial institutions.

14. FINANCIAL INSTRUMENTS

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

The Company's exposure to credit losses in the event of nonperformance by the other party to these financial instruments are represented by the contractual amount of the instruments. The Company uses the same credit policies in making commitments and conditional obligations as it does for on-balance sheet instruments. Included in other liabilities are allowances for losses on unfunded credit commitments of \$ 135 thousand and \$146 thousand at December, 2017 and December 2016 respectively. There were no provisions for losses on unfunded letters of credit in 2017, 2016 and 2015. .

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

Standby letters of credit are conditional commitments issued by the Company to guarantee the performance of a customer to a third party. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loan facilities to customers.

A summary of the contract amounts of the Company's financial instruments with off-balance sheet risk at December 31, 2017 is as follows:

Commitments to extend credit	\$37,178 thousand
Standby letters of credit	\$5,083 thousand

The Company discloses fair value information about financial instruments for which it is practicable to estimate the value, whether or not such financial instruments are recognized on the balance sheet. Fair value is the amount at which a financial instrument could be exchanged in a current transaction between willing parties, other than in a forced sale or liquidation, and is best evidenced by quoted market price, if one exists.

Quoted market prices, if available, are shown as estimates of fair value. Because no quoted market prices exist for a substantial portion of the Company's financial instruments, the fair value of such instruments has been derived based on management's assumptions with respect to future economic conditions, the amount and timing of future cash flows and estimated discount rates. Different assumptions could significantly affect these estimates. Accordingly, the net realizable value could be materially different from the estimates presented. In addition, the estimates are only indicative of individual financial instrument values and should not be considered an indication of the fair value of the Company taken as a whole.

The following methods and assumptions were used to estimate the fair value of each category of financial instrument for which it is practicable to estimate value:

Cash and due from banks and federal funds sold: The carrying amounts reported are considered to approximate their fair values.

- Investment securities: Fair values for investment securities are based on quoted market prices, where available. If quoted market prices are not available, fair values are based on quoted market prices of comparable instruments.
- Loans: For variable-rate loans that reprice frequently and with no significant change in credit risk, fair values are based on carrying amounts. The fair values for other loans are estimated using discounted cash flow analysis, based on interest rates currently being offered for loans with similar terms to borrowers of similar credit quality. Loan fair value estimates include judgments regarding future expected loss experience and risk characteristics. The carrying amount of accrued interest receivable approximates its fair value.
- Deposits: The fair value disclosed for deposits with no defined maturity are, by definition, equal to the amount payable on demand at the reporting date (that is, their carrying amounts.) The fair values for certificates of deposit are estimated using a discounted cash flow calculation that applies interest rates currently being offered on certificates to a schedule of aggregated contractual maturities on such time deposits. The carrying amount of accrued interest payable approximates fair value.
- Borrowings: The fair value is estimated based on interest rates currently available for debt with similar terms and remaining maturities.

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

	2017		2016	
	Carrying Value	Estimated Fair Value	Carrying Value	Estimated Fair Value
Financial assets:				
Cash and due from banks	\$ 4,703	4,703	\$ 6,103	6,103
Interest bearing deposits with banks	59,088	59,088	49,134	49,134
Investment securities:				
Available-for-sale	12,356	12,356	10,521	10,521
Federal Home Loan Bank stock	430	430	416	416
Loans, net of allowance	372,330	373,722	380,134	375,538
Accrued interest receivable	1,497	1,497	1,449	1,449
Financial liabilities:				
Deposits	404,552	401,539	405,341	403,649
Accrued interest payable	212	212	239	239

15. FAIR VALUE MEASUREMENTS

Effective January 1, 2008, the Company adopted the Financial Accounting Standard Board's ("FASB") guidance on, *Fair Value Measurements* which provides a framework for measuring and disclosing fair value under generally accepted accounting principles. This guidance 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's guidance 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. This guidance 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 standard describes three levels of inputs that may be used to measure fair value.

Fair Value Hierarchy

Level 1 – Quoted prices in active markets for identical assets or liabilities

Level 2 – Other significant observable inputs (including quoted prices in active markets for similar assets or liabilities)

Level 3 – Significant unobservable inputs (including the Company's own assumptions in determining the fair value of assets or liabilities)

The following table presents fair value measurements on a recurring basis as of December 31, 2017 and 2016:

	2017			Fair
	Level 1	Level 2	Level 3	Value
U.S. government agencies securities	\$ -	838	-	838
U.S. government sponsored agencies	-	1,972	-	1,972
Residential mortgage backed securities	-	9,063	-	9,063
Obligations of states and political subdivisions	-	483	-	483
Total	\$ -	12,356	-	12,356

	2016			Fair
	Level 1	Level 2	Level 3	Value
U.S. government agencies securities	\$ -	1,045	-	1,045
U.S. government sponsored agencies	\$ -	1,000	-	1,000
Residential mortgage backed securities	-	7,998	-	7,998
Obligations of states and political subdivisions	-	478	-	478
Total	\$ -	10,521	-	10,521

Securities available-for-sale are based on quoted market prices, where available. If quoted market prices are not available, fair values are based on quoted market prices of comparable instruments.

The Bank may also be required, from time to time, to measure certain other financial assets and liabilities at fair value on a nonrecurring basis in accordance with accounting principles generally accepted in the United States of America. The following table presents fair value measurements on a non-recurring basis as of December 31, 2017 and 2016:

2017				
	Level 1	Level 2	Level 3	Fair Value
Impaired loans	\$ -	-	9,778	9,778
Other real estate	-	-	1,287	1,287
Total	\$ -	-	11,065	11,065

2016				
	Level 1	Level 2	Level 3	Fair Value
Impaired loans	\$ -	-	11,881	11,881
Other real estate	-	-	1,308	1,308
Total	\$ -	-	13,189	13,189

Loans which are deemed to be impaired are primarily valued on a nonrecurring basis at the fair values of the underlying real estate collateral. Such fair values are derived as follows:

Level 3 inputs are independent appraisals and other available market evaluations used by management in estimating fair value.

In accordance with the provisions of ASC 360, foreclosed real estate were adjusted to their fair values, resulting in an impairment charge, which was included in earnings for the year. Foreclosed real estate assets have been valued using a market approach. The fair values were determined using independent appraisals and other available market evaluations, which the Bank considers to be level 3 inputs. Appraised values are discounted, where appropriate, to reflect selling costs.