2016 Audit Report

SUMMITBANK

Summit Bank

Financial Statements

Years Ended December 31, 2016 and 2015

C O N T E N T S

Summit Bank
BALANCE SHEETS

	December 31 2016		December 31 2015	
ASSETS				
Cash and cash equivalents:				
Cash and due from banks	$	17,907,789	$	16,979,714
Interest-bearing deposits with other banks		1,835,887		2,349,455
Deposits with Federal Reserve Bank		16,905,000		15,060,000
Total cash and cash equivalents		36,648,676		34,389,169
Investment securities available-for-sale, at estimated fair value		5,833,268		5,639,918
Loans, less allowance for loan losses		226,967,658		184,409,963
Interest receivable		827,948		675,759
FHLB and PCBB stock, at cost		723,600		655,200
Premises and equipment, net of accumulated depreciation		4,926,904		5,157,732
Deferred income taxes, net		1,079,967		1,076,967
Repossessed assets, net		1,016,304		988,141
Cash surrender value of bank-owned life insurance		3,655,538		3,088,422
Other assets		316,979		223,631
		245,348,166		201,915,733
Total assets	$	281,996,842	$	236,304,902
LIABILITIES and STOCKHOLDERS' EQUITY				
Liabilities:				
Deposits:				
Noninterest-bearing demand	$	89,511,363	$	59,410,270
Savings and interest-bearing demand		136,743,287		132,600,590
Time deposits		27,454,953		17,717,840
Total deposits		253,709,603		209,728,700
Interest payable		78,706		74,699
Other liabilities		1,684,865		3,305,369
Repurchase agreements		1,631,664		1,442,296
Total liabilities		257,104,838		214,551,064
Stockholders' equity:				
Preferred stock, no par value; 1,000,000 shares authorized; none issued		-		-
Common stock, no par value; 10,000,000 shares authorized, 3,549,766 and 3,510,239 shares outstanding in 2016 and 2015		13,529,594		13,231,581
Retained earnings		11,369,466		8,514,065
Accumulated other comprehensive income (loss)		(7,056)		8,192
Total stockholders' equity		24,892,004		21,753,838
Total liabilities and stockholders' equity	$	281,996,842	$	236,304,902

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

Summit Bank
STATEMENTS OF INCOME

	Year Ended December 31	
	2016	2015
Interest income:		
Interest and fees on loans	$ 12,420,262	$ 10,454,070
Interest on investment securities	114,446	120,182
Interest on deposits with other banks	146,775	81,692
Total interest income	12,681,483	10,655,944
Interest expense	413,568	318,331
Net interest income	12,267,915	10,337,613
Provision for loan losses	1,380,536	951,387
Net interest income after provision for loan losses	10,887,379	9,386,226
Noninterest income:		
Gains on sales of loans and securities	603,954	857,943
Bank card and interchange fees	228,053	174,526
Service charges on deposit accounts	143,887	152,388
Real estate lease income	132,272	137,006
Loan servicing fees	105,869	53,698
Bank owned life insurance income	67,116	77,279
Losses on sales and write-downs of repossessed assets, net	(378,005)	(121,171)
Other	200,016	121,199
Total noninterest income	1,103,162	1,452,868
Noninterest expense:		
Salaries and employee benefits	5,197,660	4,455,322
Occupancy and equipment expense	555,425	477,773
Data processing	477,148	415,961
Repossessed assets expenses	69,885	29,590
Other	1,090,410	1,048,836
Total noninterest expense	7,390,528	6,427,482
Income before income taxes	4,600,013	4,411,612
Income tax provision	1,744,612	1,671,436
Net income	$ 2,855,401	$ 2,740,176
Earnings per share:		
Basic	$ .81	$ .81
Diluted	$ .80	$ .80

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

Summit Bank
STATEMENTS OF COMPREHENSIVE INCOME

	Year Ended December 31	
	2016	2015
Net income	$ 2,855,401	$ 2,740,176
Other comprehensive income (loss):		
Change in unrealized gains (losses) on investment securities available-for-sale	(20,248)	(41,778)
Tax effect of the change in unrealized gains (losses) on investment securities available-for-sale	5,000	27,656
Comprehensive income	$ 2,840,153	$ 2,726,054

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

Summit Bank
STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY
For the Years Ended December 31, 2016 and 2015

	Common Stock		Retained Earnings	Accumulated Other Comprehensive Income (loss)	Total
	Shares	Amount			
Balance, December 31, 2014	3,252,498	$ 11,051,665	$ 5,773,889	$ 22,314	$ 16,847,868
Net income			2,740,176		2,740,176
Other comprehensive income (loss)				(14,122)	(14,122)
Sale of common stock, net of stock offering costs	201,497	1,965,964			1,965,964
Stock options exercised and related tax benefit	56,244	199,988			199,988
Share-based compensation	-	13,964			13,964
Balance, December 31, 2015	3,510,239	13,231,581	8,514,065	8,192	21,753,838
Net income			2,855,401		2,855,401
Other comprehensive income (loss)				(15,248)	(15,248)
Issuance of common stock, net	6	-			-
Stock options exercised and related tax benefit	31,080	180,477			180,477
Share-based compensation	8,441	117,536			117,536
Balance, December 31, 2016	3,549,766	$ 13,529,594	$ 11,369,466	$ (7,056)	$ 24,892,004

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

Summit Bank
STATEMENTS OF CASH FLOWS

	Year Ended December 31	
	2016	2015
Cash flows from operating activities:		
Net income	$ 2,855,401	$ 2,740,176
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation	342,541	296,254
Share-based compensation	117,536	13,964
Amortization of investment premiums, net	52,205	65,409
Provision for loan losses	1,380,536	951,387
Gains on sales of loans and securities	(603,954)	(857,943)
Bank-owned life insurance income	(67,116)	(77,279)
Losses on sales of repossessed assets, net	176,177	56,169
Write-downs of repossessed assets	201,828	65,001
Deferred income taxes	(3,000)	(425,656)
Change in:		
Interest receivable and other assets	(245,537)	(118,614)
Deferred loan fees	154,684	126,361
Interest payable and other liabilities	(1,616,497)	2,106
Net cash provided by operating activities	2,744,804	2,837,335
Cash flows from investing activities:		
Purchases of investment securities	(2,889,648)	(3,133,637)
Sales of investment securities	62,993	-
Purchases of FHLB stock	(68,400)	(138,500)
Principal payments and maturities of investment securities	2,563,060	2,470,900
Net proceeds from sales of loans	14,453,618	14,133,423
Purchases of loans	(3,694,160)	(1,724,997)
Proceeds from sales of repossessed assets	468,578	164,875
Purchase of bank owned life insurance	(500,000)	-
Loans originated, net of principal collected	(55,120,373)	(49,868,654)
Purchases of premises and equipment	(111,713)	(2,634,202)
Net cash used in investing activities	(44,836,045)	(40,730,792)
Cash flows from financing activities:		
Net increase in deposits	43,980,903	52,002,258
Proceeds from common stock offering, net of costs	-	1,965,964
Increase in repurchase agreements	189,368	170,185
Proceeds from stock options exercised	180,477	199,988
Payments on term borrowings	-	(41,797)
Net cash provided by financing activities	44,350,748	54,296,598
Net increase in cash and cash equivalents	2,259,507	16,403,141
Cash and cash equivalents, beginning of year	34,389,169	17,986,028
Cash and cash equivalents, end of year	$ 36,648,676	$ 34,389,169
Supplemental information:		
Cash paid during the year for interest	$ 409,561	$ 313,823
Cash paid during the year for income taxes	1,829,268	1,566,000
Change in unrealized losses on investment securities available-for-sale, net of deferred income taxes	(15,248)	(14,122)
Transfer of loans to repossessed assets	940,898	541,793

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

1. **Summary of Significant Accounting Policies**:

General – Summit Bank (the Bank) provides commercial banking, financing, real estate lending and other services primarily in Lane and Deschutes Counties in Oregon. The accounting and reporting policies of the Bank conform with accounting principles generally accepted in the United States of America (GAAP) and prevailing practices within the banking industry.

Financial Statement Presentation – The preparation of the financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of certain assets and liabilities and the 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. The most significant estimates are the allowance for loan losses and fair value estimates. The Bank has evaluated subsequent events through February 28, 2017, the date the financial statements were available to be issued. Certain prior year amounts have been reclassified to conform to the current year presentation.

Cash and Cash Equivalents – For purposes of reporting cash flows, cash and cash equivalents are cash on-hand and due from banks. Such amounts include both interest-bearing and non interest-bearing deposits with other banks, short-term time deposits, and federal funds sold on an overnight basis and may exceed amounts insured by the Federal Deposit Insurance Corporation (FDIC).

Investment Securities – The Bank classifies all investment securities as available-for-sale. Securities available-for-sale are held for indefinite periods of time and may be sold in response to changes in market interest rates, shifts in the maturity mix or concentration of bank assets or liabilities or to alleviate liquidity demands. Securities designated as available-for-sale are reported at estimated fair value. Unrealized gains and losses are excluded from earnings and are included in other comprehensive income (loss) in stockholders' equity, net of applicable deferred taxes.

Gains and losses realized on sales of securities are recognized using the specific identification method. Interest income on debt securities is included in income using the effective interest method. Interest income includes accretion and amortization of discounts and premiums resulting from securities purchased at other than par value. Both are calculated using a "constant yield" methodology either to maturity (for non-callable securities) or to "worst call date" for callable securities. Premiums and discounts on mortgage backed securities are amortized/accreted based upon current and expected future rates of prepayments on the securities.

The Bank evaluates its securities classified as available-for-sale for other-than-temporary impairments (OTTI) in accordance with GAAP. Accordingly, the Bank assesses whether it intends to sell or it is more likely than not that it will be required to sell a security before recovery of its amortized cost basis less any current-period credit losses.

For investment securities that are considered other-than-temporarily impaired and that the Bank does not intend to sell and will not be required to sell prior to recovery of the amortized cost basis, the Bank would separate the amount of the impairment into the amount that is credit related (credit loss component) and the amount due to all other factors. The credit loss component would be recognized in earnings and would be the difference between the security's amortized cost basis and the present value of its expected future cash flows discounted at the security's effective yield. The remaining difference between the security's fair value and the present value of expected future cash flows would be due to factors that are not credit related and, therefore, would not be required to be recognized as losses in the income statement, but would be recognized in other comprehensive income (loss). Management believes that any unrealized losses on investment securities at December 31, 2016 and December 31, 2015 are temporary.

Loans and Income Recognition – Loans are stated at the amount of unpaid principal, reduced by deferred loan origination fees and an allowance for loan losses. Interest on loans is calculated using the simple-interest method on daily balances of the principal amount outstanding. Accrual of interest is discontinued on a loan when management believes, after considering economic and business conditions and collection efforts, that the borrower's financial condition is such that collection of the interest is doubtful. In accordance with GAAP, payments received on nonaccrual loans are applied to the principal balance and no interest income is recognized. Interest income is subsequently recognized only to the extent cash payments are received satisfying all delinquent principal and interest amounts, and the prospects for future payments in accordance with the loan agreement appear relatively certain. A nonaccrual loan may be restored to accrual status when none of its principal and interest is due and unpaid and the Bank expects full repayment of the remaining contractual principal and interest, or when it otherwise becomes well secured and in the process of collection. Loan origination fees, net of associated direct costs, if significant, are amortized by the interest or straight-line method over the contractual life of the loan as an adjustment of the yield of the related loan.

Allowance for Loan Losses – The allowance for loan losses is established through a provision for loan losses charged to expense. Loans are charged off against the allowance when management believes that the collectability of the principal is unlikely. The allowance is an amount that management considers adequate to absorb possible losses on existing loans that may become uncollectible based on evaluations of the collectability of loans and prior loss experience. The allowance for loan losses consists of general and specific components.

The general component covers all non-impaired loans. For all such loans – other than small commercial equipment loans – the general component is based on the Bank's risk rating system and historical loss experience adjusted for qualitative factors. The Bank calculates its historical loss rates by using a combination of (1) a weighted-average of the Bank's most recent 36 months of loss history, with more weight applied to more current months, and (2) historical loss data for Oregon and certain peer banks. The Bank calculates and applies its historical loss rates by individual loan types in its portfolio. These historical loss rates are adjusted for qualitative and environmental factors including, but not limited to: changes in the concentrations, trends and current nature of the loan portfolio, overall portfolio quality, results from internal and external loan reviews, review of specific problem loans, and current economic conditions that may affect the borrower's ability to pay.

Small commercial equipment loans are reserved for as a pool of smaller-balance homogeneous loans. The methodology employed to assign reserve rates is migration analysis wherein probable loss rates are established as migration occurs through risk ratings. The Bank revisits these loss rates at regular intervals, and adjusts the applicable rates as dictated through loss experience. As individual loans migrate downward through established risk ratings, increasing reserves as estimated by the aforementioned migration analysis are held against the individual balances.

The specific component of the allowance relates to loans that are considered impaired. A loan is considered impaired when management believes that it is probable that all amounts will not be collected according to the contractual terms. An impaired loan is valued using the estimated fair value of the loan's collateral (less estimated costs to sell) or related government guaranty, the present value of expected cash flows discounted at the loan's effective interest rate, or the observable market price of the loan. These estimates are necessarily subjective and may be adjusted as more current information becomes available. Any adjustment could be significant.

Federal and state bank regulatory agencies, as an integral part of their examination process, periodically review the Bank's reserve for loan losses. Such agencies may require the Bank to recognize additions to the reserve in the future based on their judgment of the information available to them at the time of their examinations.

Allowance for Unfunded Loan Commitments – The Bank maintains a separate reserve for estimated losses related to unfunded loan commitments. The Bank estimates the amount of probable losses related to unfunded loan commitments by applying an estimated loss factor to the expected amount of commitments that will actually require funding. In accordance with industry practice and regulatory guidance, the reserve for estimated losses related to unfunded loan commitments is included in other liabilities in the accompanying balance sheets. Changes in the reserve for estimated losses related to unfunded loan commitments are recorded in provision for loan loss in the accompanying statements of income.

Federal Home Loan Bank (FHLB) and Other Bank Stock – FHLB and other bank stock consists of the following at December 31:

	2016	2015
FHLB stock	$ 283,600	$ 215,200
PCBB stock	440,000	440,000
	$ 723,600	$ 655,200

The Bank's investment in FHLB stock is carried at cost, which approximates its fair value. As a member of the FHLB system, the Bank is required to maintain a minimum level of investment in FHLB stock based on specific percentages of its outstanding mortgages, total assets and FHLB advances. At December 31, 2016, the Bank's minimum required investment was $283,600. Stock redemptions may be requested at par value and are made at the discretion of the FHLB. The Bank evaluates its FHLB stock for impairment as needed. The Bank's determination of whether this investment is impaired is based on its assessment of the ultimate recoverability of cost rather than by recognizing temporary declines in value.

The Bank also holds an investment in its primary correspondent bank, Pacific Coast Bankers' Bank (PCBB). This investment is accounted for under the cost method.

Premises and Equipment – Premises and equipment are stated at cost, net of accumulated depreciation. Additions, betterments and replacements of major units are capitalized. Expenditures for normal maintenance, repairs and replacements of minor units are charged to expense as incurred. Gains or losses realized from sales or retirements are reflected in current operations. Depreciation is computed by the straight-line method over the estimated useful lives of the assets.

Impairment of Long-lived Assets – The Company accounts for long-lived assets at amortized cost. Management reviews long-lived assets for possible impairment whenever events or circumstances indicate that the carrying amount of such assets may not be recoverable. If there is an indication of impairment, management would prepare an estimate of future cash flows (undiscounted and without interest charges) expected to result from the use of the asset and its eventual disposition. If these estimated cash flows were less than the carrying amount of the asset, an impairment loss would be recognized to write down the asset to its estimated fair value

Repossessed Assets – Repossessed assets consist of commercial equipment and commercial real property (OREO) and are considered held-for-sale. Repossessed assets are initially recorded at fair value at the date of acquisition based on current appraisals and management's estimate of value, establishing a new cost basis. Subsequent to acquisition, valuations are periodically performed by management and the assets are carried at the lower of carrying amount or fair value less estimated costs to sell. Any revenue and expenses from operations are included in other noninterest expense. Gains and losses on sales, write-downs, and changes in valuation allowances are recorded in non-interest income.

Bank-owned Life Insurance (BOLI) - The Bank is owner and beneficiary of BOLI on certain Bank officers. The BOLI is recorded at the cash surrender value (net of surrender charges) of the insurance contracts. Income from BOLI policies is recognized when earned and is included in noninterest income.

Advertising – Advertising costs are charged to expense during the period in which they are incurred. Advertising expenses were $67,604 and $60,325 for the years ended December 31, 2016 and 2015, respectively.

Income Taxes – Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between financial statement carrying amounts of existing assets and liabilities and their respective tax basis. Deferred tax assets and liabilities are calculated on differences between financial statement and tax basis of assets and liabilities using tax rates in effect for the year in which the differences are expected to reverse. A valuation allowance is recognized if, based on the available evidence, it is determined it is more likely than not some portion or all of the deferred tax assets will not be realized. As changes in tax laws or rates are enacted, deferred tax assets and liabilities are adjusted through the provision for income taxes.

Uncertain tax positions that meet the more likely than not recognition threshold are measured to determine the amount of benefit to recognize. An uncertain tax position is measured at the amount of benefit that management believes has a greater than 50% likelihood of realization upon settlement. The Bank's policy is to recognize interest and penalties related to income tax settlements as a component of income tax expense.

The Bank files income tax returns for federal and State of Oregon jurisdictions. The Bank's federal and state tax returns for years subsequent to 2012 remain open to examination. There is no material impact of potential tax uncertainties on the Bank's financial condition or results of operations at December 31, 2016.

Transfers of financial assets - Transfers 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 Bank, (2) the transferee obtains the right (free of conditions that constrain it from taking advantage of that right) to pledge or exchange the transferred assets, and (3) the Bank does not maintain effective control over the transferred assets through an agreement to repurchase them before their maturity.

Derivative Instruments – The Bank uses derivative financial instruments (interest rate swaps) to limit exposure to changes in interest rates related to specific loan assets. Derivatives entered into by the Bank are designated as fair value hedges and generally exhibit perfect effectiveness between changes in the value of the interest rate swap and the hedged instrument (loan asset). All derivatives and related hedged loans are recognized in the balance sheet at their fair value. Changes in the fair value of a derivative that is highly effective, along with the loss or gain on the hedged loan asset that is attributable to the hedged risk, are recorded in current-period earnings. The Bank formally documents all relationships between hedging instruments and hedged assets, as well as its risk-management objective and strategy for undertaking various hedged transactions. The Bank also formally assesses, both at the hedge's inception and on an ongoing basis, whether the derivatives that are used in hedging transactions are highly effective in offsetting changes in fair values of hedged items.

The Bank would discontinue hedge accounting when: (a) it is determined that a derivative is no longer effective in offsetting changes in the fair value of the associated hedged loan asset; (b) the derivative expires or is sold, terminated, or exercised; or (c) management determines that designation of the derivative as a hedge instrument is no longer appropriate. The hedged loan asset would no longer be adjusted for changes in fair value and the derivative would be carried at its fair value in the balance sheet, with changes in its fair value recognized in current-period earnings.

Stockholders' Equity and Earnings Per Share – Basic earnings per share are computed by dividing net income by the weighted average number of shares outstanding during the period. Diluted earnings per share include the effect of common stock equivalents that would arise from the exercise of stock options and the vesting of restricted stock and restricted stock units discussed in Note 9. During 2016, the Bank completed a three-for-two stock split, effected in the form of a stock dividend, on the shares of the Bank's common stock. All references in the financial statements and notes to the number of shares outstanding, per-share amounts, and stock option data of the Bank's common stock have been restated to reflect the effect of the stock split for all periods presented.

Share-Based Compensation – GAAP requires companies to measure compensation expense for all share-based payments based on the fair value of the awards at the grant date and recognize such costs as an expense over the requisite service period (which is generally the vesting period). See Note 9 for discussion of the Bank's share-based compensation arrangements.

SBA Loans Sales and Servicing—The Bank sells or transfers loans, including the government guaranteed portion of the loans (with loan servicing retained) for proceeds equal to the principal amount of loans, as adjusted to yield interest to the investor based upon the current market rates. The Bank records an asset representing the right to service loans for others when it sells a loan and retains the servicing rights which are included in other assets. The carrying value of loans sold is allocated between the loan and the servicing rights, based on their relative fair values. The fair value of servicing rights is estimated by discounting estimated future cash flows from servicing using discount rates that approximate current market rates and using estimated prepayment rates. The servicing rights, if any, are carried at the lower of cost or market and are amortized in proportion to, and over the period of the estimated net servicing income, assuming prepayments.

For purposes of evaluating and measuring impairment, servicing rights are based on a discounted cash flow methodology, current prepayment speeds and market discount rates. Impairment is measured as the amount by which the carrying value of servicing rights for a loan asset exceeds its fair value. The Bank held no servicing rights assets as of December 31, 2016 and 2015. An impairment charge was recorded for the year ended December 31, 2015 of $26,916 related to early retirement of a loan asset. No impairment charges were recorded in 2016 related to servicing assets.

New Accounting Pronouncements - In May 2014, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) No. 2014-09, *Revenue from Contracts with Customers* (ASU 2014-09). ASU 2014-09 implements a common revenue standard that clarifies the principles for recognizing revenue. The core principle of ASU 2014-09 is that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. To achieve that core principle, an entity should apply the following steps: (1) identify the contract(s) with a customer, (2) identify the performance obligations in the contract, (3) determine the transaction price, (4) allocate the transaction price to the performance obligations in the contract, and (5) recognize revenue when (or as) the entity satisfies a performance obligation. ASU 2014-09 is effective for annual periods, and interim reporting periods within those annual periods, beginning after December 15, 2017. The Bank does not expect the adoption of ASU 2014-09 to have a material impact on the Bank's future financial statements.

In January 2016, the FASB issued ASU 2016-01, *Financial Instruments – Overall: Recognition and Measurement of Financial Assets and Financial Liabilities* (ASU 2016-01). ASU 2016-01 generally requires equity investments – except those accounted for under the equity method of accounting or those that result in consolidation of the investee – to be measured at fair value with changes in fair value recognized in net income. However, an entity may choose to measure equity investments that do not have readily determinable fair values at cost minus impairment, if any, plus or minus changes resulting from observable price changes in orderly transactions for the identical or a similar investment of the same issuer. ASU 2016-01 is intended to simplify the impairment assessment of equity investments without readily determinable fair values by requiring a qualitative assessment to identify impairment. ASU 2016-01 also eliminates certain disclosures related to the fair value of financial instruments and requires entities to use the exit price notion when measuring the fair value of financial instruments for disclosure purposes. ASU 2016-01 is effective for fiscal years beginning after December 15, 2017, including interim periods within those fiscal years. The Bank is currently evaluating the impact that the adoption of ASU 2016-01 will have on the Bank's future financial statements.

In February 2016, the FASB issued ASU 2016-02, *Leases* (ASU 2016-02). ASU 2016-02 is intended to increase transparency and comparability among organizations by requiring the recognition of lease assets and lease liabilities on the balance sheet and disclosure of key information about leasing arrangements. The principal change required by ASU 2016-02 relates to lessee accounting, and is that for operating leases, a lessee is required to (1) recognize a right-of-use asset and a lease liability, initially measured at the present value of the lease payments, in the statement of financial position, (2) recognize a single lease cost, calculated so that the cost of the lease is allocated over the lease term on a generally straight-line basis, and (3) classify all cash payments within operating activities in the statement of cash flows. For leases with a term of 12 months or less, a lessee is permitted to make an accounting policy election by class of underlying asset not to recognize lease assets and lease liabilities. If a lessee makes this election, it should recognize lease expense for such leases generally on a straight-line basis over the lease term. ASU 2016-02 also changes disclosure requirements related to leasing activities, and requires certain qualitative disclosures along with specific quantitative disclosures. ASU 2016-02 is effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. The Bank is currently evaluating the impact that the adoption of ASU 2016-02 will have on the Bank’s future financial statements.

In June 2016, the FASB issued ASU 2016-13, *Financial Instruments - Credit Losses* (ASU 2016-13). ASU 2016-13 replaces the existing incurred losses methodology for estimating allowances with a current expected credit losses methodology with respect to most financial assets measured at amortized cost and certain other instruments, including trade and other receivables, loans, held to maturity investment securities and off-balance sheet commitments. In addition, ASU 2016-13 requires credit losses relating to available for sale debt securities to be recorded through an allowance for credit losses rather than a reduction of the carrying amount. ASU 2016-13 also changes the accounting for purchased credit-impaired debt securities and loans. ASU 2016-13 retains many of the disclosure requirements in current GAAP and expands certain disclosure requirements. ASU 2016-13 is effective for fiscal years beginning after December 15, 2019, including interim periods within those fiscal years. The Bank is currently evaluating the impact that the adoption of ASU 2016-13 will have on the Bank's future financial statements.

2. Restricted Assets:

By regulation, the Bank must meet reserve requirements as established by the Federal Reserve Board (FRB) ($2,675,000 and $1,835,000 at December 31, 2016 and 2015, respectively). Accordingly, the Bank complies with such requirements by holding cash on hand and maintaining average reserve balances on deposit with its primary correspondent bank in accordance with the regulations.

3. Investment Securities Available for Sale:

The tables below detail the amortized cost and estimated fair values of available-for-sale investment securities, as well as identify the amount of any unrealized losses and the length of time these unrealized losses existed as of the dates indicated:

	December 31, 2016							
	Available-for-Sale				Securities in Continuous Unrealized Loss Position for Less Than 12 Months		Securities in Continuous Unrealized Loss Position for 12 Months or Longer	
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value	Estimated Fair Value	Unrealized Loss	Estimated Fair Value	Unrealized Loss
Obligations of U.S. Government and U.S. sponsored agencies	$ 1,631,729	$ -	$ (5,490)	$ 1,626,239	$ 1,626,239	$ (5,490)	$ -	$ -
Corporate debt securities	500,000	-	(2,316)	497,684	249,801	(199)	247,883	(2,117)
Mortgage-backed securities	3,708,595	12,176	(11,426)	3,709,345	1,852,253	(11,426)	-	-
	$ 5,840,324	$ 12,176	$ (19,232)	$ 5,833,268	$ 3,728,293	$ (17,115)	$ 247,883	$ (2,117)

	December 31, 2015							
	Available-for-Sale				Securities in Continuous Unrealized Loss Position for Less Than 12 Months		Securities in Continuous Unrealized Loss Position for 12 Months or Longer	
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value	Estimated Fair Value	Unrealized Loss	Estimated Fair Value	Unrealized Loss
Obligations of U.S. Government and U.S. sponsored agencies	$ 480,414	$ -	$ (2,484)	$ 477,930	$ 477,930	$ (2,484)	$ -	$ -
Corporate debt securities	500,000	-	(1,802)	498,198	249,374	(627)	248,824	(1,175)
Mortgage-backed securities	4,646,268	29,378	(11,856)	4,663,790	2,090,451	(11,856)	-	-
	$ 5,626,682	$ 29,378	$ (16,142)	$ 5,639,918	$ 2,817,755	$ (14,967)	$ 248,824	$ (1,175)

The unrealized losses on the Bank's investment securities were primarily attributable to increases in market interest rates subsequent to their purchase by the Bank. The Bank expects the fair value of these securities to recover as the securities approach their maturity dates or sooner if market yields for such securities decline. The Bank does not believe that these securities are other than temporarily impaired because of their credit quality or related to any issuer or industry specific event. Based on management's evaluation and intent, the unrealized losses related to the investment securities in the above tables are considered temporary.

The amortized cost and estimated fair value of investment securities at December 31, 2016 are shown below by contractual maturity or projected average life depending on the type of security. Obligations of U.S. government sponsored agencies and corporations are shown by contractual maturity. Mortgage backed securities are disclosed by projected average life.

	Available-for-Sale		
	Amortized Cost	Percentage of Total Amortized Cost	Estimated Fair Value
Due in one year or less	$ 1,206,433	20%	$ 1,209,805
Due after one year through five years	4,135,476	71%	4,130,904
Due after five years through ten years	498,415	9%	492,559
	$ 5,840,324	100%	$ 5,833,268

Proceeds from sales of investment securities available-for-sale during the year ended December 31, 2016 were $62,993; such sales resulted in a gross realized gain of $2,251 which was included in 2016 earnings. There were no sales of investment securities during the year ended December 31, 2015.

At December 31, 2016, investment securities with a total estimated fair value of $5,249,469 and amortized cost of $5,255,478 were pledged for FHLB borrowings, repurchase agreements and other purposes. At December 31, 2015, investment securities with a total estimated fair value of $4,546,152 and amortized cost of $4,535,561 were pledged for FHLB borrowings, repurchase agreements and other purposes.

4. **Loans and Allowance for Loan Losses**:

Major classifications of loans at December 31 are as follows:

	2016	% of Gross Loans	2015	% of Gross Loans
Real Estate				
Acquisition, Development & Construction	$ 13,084,669	5.7%	$ 9,711,242	5.2%
Commercial	66,358,372	28.7%	47,958,763	25.5%
Multifamily	13,407,702	5.8%	9,226,539	4.9%
Owner Occupied	49,615,057	21.5%	46,804,574	24.9%
Commercial and Industrial				
Small Commercial Equipment	31,711,511	13.7%	26,253,166	14.0%
Other Commercial & Industrial	40,050,800	17.3%	34,034,852	18.1%
Consumer				
Secured	14,537,993	6.3%	11,742,725	6.3%
Unsecured	2,318,364	1.0%	2,059,709	1.1%
	$ 231,084,468	100.0%	$ 187,791,570	100.0%
Deferred Loan Origination Fees, net	(740,395)		(585,711)	
	$ 230,344,073		$ 187,205,859	
Allowance for Loan Losses	(3,376,415)		(2,795,896)	
Loans receivable, net	$ 226,967,658		$ 184,409,963	

Loans serviced for others are not included in the accompanying balance sheets. The unpaid principal balances of such serviced loans were $23,251,161 and $20,756,223 at December 31, 2016 and December 31, 2015, respectively.

The loan portfolio at December 31, 2016 and 2015 includes $40,442,382 and $31,462,526, respectively, of loans which have rates of interest that change more often than annually, exclusive of fixed rate loans that total $49,409,369 and $32,069,869, respectively that are effectively converted to variable rate loans via interest rate swaps. The December 31, 2016 loan portfolio includes $4,330,403 of loans with interest rates at their contractual floors.

The following is an analysis of impaired loans as of December 31, 2016:

	Impaired Loans with Allowance			Impaired Loans without Allowance		Total Impaired Loans	
	Recorded Investment	Unpaid Principal Balance	Related Allowance	Recorded Investment	Unpaid Principal Balance	Recorded Investment	Unpaid Principal Balance
Commercial and Industrial							
Small Commercial Equipment							
Nonaccrual	$ -	$ -	$ -	$ -	$ -	$ -	$ -
Other	-	-	-	-	-	-	-
Other Commercial & Industrial							
Nonaccrual	194,325	193,873	48,744	-	-	194,325	193,873
Other	117,871	117,444	20,120	-	-	117,871	117,444
Subtotals	312,196	311,317	68,864	-	-	312,196	311,317
Consumer							
Secured							
Nonaccrual	-	-	-	-	-	-	-
Other	-	-	-	277,601	276,367	277,601	276,367
Unsecured							
Nonaccrual	-	-	-	-	-	-	-
Other	38,634	38,509	9,240	-	-	38,634	38,509
Subtotals	38,634	38,509	9,240	277,601	276,367	316,235	314,876
Totals	$ 350,830	$ 349,826	$ 78,104	$ 277,601	$ 276,367	$ 628,431	$ 626,193

The following is an analysis of impaired loans as of December 31, 2015:

	Impaired Loans with Allowance			Impaired Loans without Allowance		Total Impaired Loans	
	Recorded Investment	Unpaid Principal Balance	Related Allowance	Recorded Investment	Unpaid Principal Balance	Recorded Investment	Unpaid Principal Balance
Commercial and Industrial							
Small Commercial Equipment							
Nonaccrual	$ 64,980	$ 61,071	$ 9,161	$ -	$ -	$ 64,980	$ 61,071
Other	-	-	-	-	-	-	-
Other Commercial & Industrial							
Nonaccrual	-	-	-	-	-	-	-
Other	167,947	167,915	17,492	51,443	51,361	219,390	219,276
Subtotals	232,927	228,986	26,653	51,443	51,361	284,370	280,347
Consumer							
Secured							
Nonaccrual	-	-	-	-	-	-	-
Other	-	-	-	264,836	263,831	264,836	263,831
Unsecured							
Nonaccrual	-	-	-	-	-	-	-
Other	39,667	39,686	9,260	-	-	39,667	39,686
Subtotals	39,667	39,686	9,260	264,836	263,831	304,503	303,517
Totals	$ 272,594	$ 268,672	$ 35,913	$ 316,279	$ 315,192	$ 588,873	$ 583,864

The following tables present the average recorded investment in impaired loans and interest income recognized for the periods indicated:

	Year Ended December 31, 2016	
	Average Recorded Investment	Interest Recognized on Impaired Loans
Real Estate	$ -	$ -
Commercial and Industrial		
Small Commercial Equipment	13,754	-
Other Commercial & Industrial	277,819	15,118
Consumer	-	-
Secured	262,080	18,233
Unsecured	39,230	2,356
Total	$ 592,883	$ 35,707

	Year Ended December 31, 2015	
	Average Recorded Investment	Interest Recognized on Impaired Loans
Real Estate		
Acquisition, Development & Construction	$ 565,783	$ 21,723
Other	-	-
Commercial and Industrial		
Small Commercial Equipment	15,564	18,981
Other Commercial & Industrial	265,331	24,150
Consumer		
Secured	266,815	18,480
Unsecured	40,471	2,431
Total	$ 1,153,964	$ 85,765

The cash basis interest income on impaired loans was not materially different than the interest recognized on impaired loans as shown in the above tables.

Risk Elements – The Bank manages credit risk through lending limit constraints, credit review, approval policies and extensive ongoing internal monitoring. Additionally, credit risk is managed via diversification of the loan portfolio by loan, industry and borrower type as well as limits on the aggregation of debt to a single borrower. The Bank also obtains periodic credit file reviews from independent third-parties as part of its ongoing credit monitoring process. The following are the loan segment risk characteristics of the Bank's portfolio:

Acquisition, development & construction– includes both loans and lines of credit for the purpose of purchasing, carrying and developing land into commercial developments or residential subdivisions. Also included in this designation are loans and lines of credit for construction of residential, multi-family and commercial buildings. Generally, the primary source of repayment is dependent upon the sale or refinance of the real estate collateral. The bank attempts to mitigate the risks associated with this type of credit by limiting concentration exposure and utilizing enhanced underwriting procedures as outlined in proprietary policies and procedures as approved by the board of directors not less than annually.

Commercial real estate – loans in this category are assigned to one of two specific subcategories:

- Owner Occupied – includes loans secured by business facilities to finance business operations, equipment and owner-occupied facilities for commercial customers. Generally, the primary source of repayment is the operating cash flow from business activities of the owner of the property or related entity. These loans are underwritten in such a way as to ensure the highest probability of repayment in full, according to board-approved policies and procedures.

- Commercial – includes loans to finance income-producing commercial properties. Loans in this class include retail centers, hotels, office buildings, single-tenant retail buildings, warehouses and other properties where the source of repayment on the credit comes primarily from non-related tenant lease income. There are board-approved enhanced underwriting procedures in place that govern the approval and funding of these types of loans, ensuring the highest probability of full repayment of principal.

Multi-family real estate – these loans are secured by – and are generally repaid by the lease income from – real estate properties built to house 5 or more families in a single property or complex. Apartment buildings and complexes are the major collateral in this category. This category, however, does not include 1-4 family rental properties. These loans are underwritten in such a way as to ensure the highest probability of repayment in full, according to board-approved policies and procedures.

Commercial & industrial - loans in this category are assigned to one of two specific subcategories:

- Small Commercial Equipment – includes loans secured by commercial equipment, typically rolling stock. These loans possess homogeneous risk characteristics unique to small business lending. These risks are mitigated via ongoing industry trend analysis and through concentration limits on the portfolio as a whole as well as within industry subclasses.
- Other Commercial and Industrial – The primary source of repayment for these loans is generally cash flow from continuing business operations. These loans are underwritten according to board-approved internal policies and procedures

Consumer loans – the bank engages in limited consumer lending of both a secured and unsecured nature. This primarily takes the form of Home Equity Lines of Credit and personal and professional lines of credit which may or may not be secured by tangible collateral. These loans are underwritten in such a way as to ensure the highest probability of repayment in full, according to board-approved policies and procedures.

Risk Rating – The monitoring process of the Bank's loan portfolio includes periodic reviews of individual loans with a risk rating assigned to each loan. Risk ratings are assigned according to various qualitative and quantitative measurements.

- Risk ratings 1 – 6 represent increasing degrees of risk within the regulatory definition of “Pass” credits as ratings move from 1 to 6. Regulatory bodies do not draw distinction between these categories; as such, assignment of these ratings is for internal management purposes only.
- Risk Rating 7 – loans in this category adhere to the regulatory definition of “Special Mention” credits. A Special Mention asset has potential weaknesses that deserve management’s close attention. If left uncorrected, these potential weaknesses may result in deterioration of the repayment prospects for the asset or in the institution’s credit position at some future date. Special Mention assets are not adversely classified and do not expose the institution to sufficient risk to warrant adverse classification.
- Risk Rating 8 – loans in this category adhere to the regulatory definition of “Substandard.” Loans classified Substandard are inadequately protected by the current sound worth and paying capacity of the obligor or of the collateral pledged, if any. Loans so classified must have a well-defined weakness or weaknesses that jeopardize the liquidation of the debt. They are characterized by the distinct possibility that the bank will sustain some loss if the deficiencies are not corrected.
- Risk Rating 9 – loans in this category adhere to the regulatory definition of “Doubtful.” Loans classified Doubtful have all of the weaknesses inherent in those classified Substandard with the added characteristic that the weaknesses make collection or liquidation in full, on the basis of currently known facts, conditions and values, highly questionable and improbable.
- Risk Rating 10 – loans in this category adhere to the regulatory definition of “Loss.” Loans classified Loss are uncollectible and of such little value that their continuance as a bankable asset is not warranted. When identified, these loans are charged off.

Loans risk rated 8, 9 or 10 are reviewed regularly to assess the ability of the borrowers to service all interest and principal obligations and, as a result the risk ratings may be adjusted accordingly. In the event that full collection of principal and interest is not reasonably assured, the loan is appropriately downgraded and if warranted, placed on non-accrual status even though the loan may be current as to principal and interest payments. Additionally, an assessment is made as to whether an impairment of a loan warrants specific reserves or a write down of the loan.

The following tables present the Bank’s loan portfolio by loan type and credit quality indicator as of December 31, 2016 and 2015:

	As of December 31, 2016 Loan Grade				
	Pass (Ratings 1-6)	Special Mention (Rating 7)	Substandard (Rating 8)	Doubtful (Rating 9)	Totals
Real Estate					
Acquisition, Development & Construction	$ 13,084,669	$ -	$ -	$ -	$ 13,084,669
Commercial	64,248,323	2,110,049	-	-	66,358,372
Multifamily	13,407,702	-	-	-	13,407,702
Owner Occupied	47,460,814	2,154,243	-	-	49,615,057
Commercial and Industrial					
Small Commercial Equipment	31,083,857	373,320	254,334	-	31,711,511
Other Commercial & Industrial	39,031,409	182,658	836,733	-	40,050,800
Consumer					
Secured	14,277,081	-	260,912	-	14,537,993
Unsecured	2,318,364	-	-	-	2,318,364
Total	$ 224,912,219	$ 4,820,270	$ 1,351,979	$ -	$ 231,084,468
Percentage of Total Portfolio	97.33%	2.09%	0.59%	0.00%	100.00%

	As of December 31, 2015 Loan Grade				
	Pass (Ratings 1-6)	Special Mention (Rating 7)	Substandard (Rating 8)	Doubtful (Rating 9)	Totals
Real Estate					
Acquisition, Development & Construction	$ 9,711,242	$ -	$ -	$ -	$ 9,711,242
Commercial	47,104,674	-	854,089	-	47,958,763
Multifamily	9,226,539	-	-	-	9,226,539
Owner Occupied	44,104,174	2,202,692	497,708	-	46,804,574
Commercial and Industrial					
Small Commercial Equipment	26,031,573	120,784	39,738	61,071	26,253,166
Other Commercial & Industrial	33,129,674	119,355	785,823	-	34,034,852
Consumer					
Secured	11,649,319	-	93,406	-	11,742,725
Unsecured	2,059,709	-	-	-	2,059,709
Total	$ 183,016,904	$ 2,442,831	$ 2,270,764	$ 61,071	$ 187,791,570
Percentage of Total Portfolio	97.46%	1.30%	1.21%	0.03%	100.00%

The following tables present an aged analysis of past due and nonaccrual loans at December 31, 2016 and 2015:

	As of December 31, 2016						
	30-59 Days Past Due Still Accruing	60-89 Days Past Due Still Accruing	Greater than 90 Days Past Due Still Accruing	Nonaccrual	Total Past Due and Nonaccrual	Total Current	Total Loans Receivable
Real Estate							
Acquisition, Development & Construction	$ -	$ -	$ -	$ -	$ -	$ 13,084,669	$ 13,084,669
Commercial	-	-	-		-	66,358,372	66,358,372
Multifamily	-	-	-	-	-	13,407,702	13,407,702
Owner Occupied	-	-	-	-	-	49,615,057	49,615,057
Commercial and Industrial							
Small Commercial Equipment	918,170	239,221	-	254,334	1,411,725	30,299,786	31,711,511
Other Commercial & Industrial	-	-	-	193,873	193,873	39,856,927	40,050,800
Consumer							
Secured	-	-	-	-	-	14,537,993	14,537,993
Unsecured	-	-	-	-	-	2,318,364	2,318,364
Total	$ 918,170	$ 239,221	$ -	$ 448,207	$ 1,605,598	$ 229,478,870	$ 231,084,468
Percentage of Total Portfolio	0.40%	0.10%	0.00%	0.19%	0.69%	99.31%	100.00%

	As of December 31, 2015						
	30-59 Days Past Due Still Accruing	60-89 Days Past Due Still Accruing	Greater than 90 Days Past Due Still Accruing	Nonaccrual	Total Past Due and Nonaccrual	Total Current	Total Loans Receivable
Real Estate							
Acquisition, Development & Construction	$ -	$ -	$ -	$ -	$ -	$ 9,711,242	$ 9,711,242
Commercial	-	-	-		-	47,958,763	47,958,763
Multifamily	-	-	-	-	-	9,226,539	9,226,539
Owner Occupied	-	-	-	-	-	46,804,574	46,804,574
Commercial and Industrial							
Small Commercial Equipment	300,960	105,068	-	74,509	480,537	25,772,629	26,253,166
Other Commercial & Industrial	-	-	-	-	-	34,034,852	34,034,852
Consumer							
Secured	-	-	-	-	-	11,742,725	11,742,725
Unsecured	-	-	-	-	-	2,059,709	2,059,709
Total	$ 300,960	$ 105,068	$ -	$ 74,509	$ 480,537	$ 187,311,033	$ 187,791,570
Percentage of Total Portfolio	0.16%	0.06%	0.00%	0.04%	0.26%	99.74%	100.00%

The Bank reports certain loans as troubled debt restructurings (TDRs) when the Bank grants a concession(s) to a borrower experiencing financial difficulties that it would not otherwise consider. Examples of such concessions include extending the maturity date(s) or providing a lower interest rate than would normally be available for a transaction of similar risk. A TDR loan is considered to be impaired and is individually evaluated for impairment. Loans reported as TDRs accruing interest totalled $38,509 and $39,686 at December 31, 2016 and 2015 respectively.

There were no loans modified and recorded as TDRs during 2016 or 2015. There were no TDR loans restructured during 2016 or 2015, nor were there any TDRs which incurred a payment default within twelve months of the restructure date during 2016 or 2015. There were no commitments to lend additional funds to borrowers whose loans have been modified and recorded as TDRs at December 31, 2016. Determination of the allowance for credit losses for TDR loans does not differ materially from the process for other loans in the Bank's portfolio.

Changes in the allowance for loan losses for the year ended December 31, 2016 are as follows:

	Beginning Balance	Charge-offs	Recoveries	Provision	Ending Balance	Specific Reserve	General Allocation
Real Estate							
Acquisition, Development & Construction	$ 142,833	$ -	$ -	$ 66,587	$ 209,420	$ -	$ 209,420
Commercial	456,991		2,140	69,683	528,814	-	528,814
Multifamily	74,813			76,994	151,807	-	151,807
Owner Occupied	452,695			(41,762)	410,933	-	410,933
Commercial and Industrial							
Small Commercial Equipment	1,071,933	(816,899)	32,774	1,038,494	1,326,302	-	1,326,302
Other Commercial & Industrial	446,877			128,986	575,863	68,864	506,999
Consumer							
Secured	124,435			22,635	147,070	-	147,070
Unsecured	25,319			887	26,206	9,240	16,966
Total	$ 2,795,896	$ (816,899)	$ 34,914	$ 1,362,504	$ 3,376,415	$ 78,104	$ 3,298,311

Changes in the allowance for loan losses for the year ended December 31, 2015 are as follows:

	Beginning Balance	Charge-offs	Recoveries	Provision	Ending Balance	Specific Reserve	General Allocation
Real Estate							
Acquisition, Development & Construction	$ 99,056	$ -	$ -	$ 43,777	$ 142,833	$ -	$ 142,833
Commercial	385,512		2,824	68,655	456,991	-	456,991
Multifamily	74,141			672	74,813	-	74,813
Owner Occupied	323,068			129,627	452,695	-	452,695
Commercial and Industrial							
Small Commercial Equipment	873,741	(408,624)		606,816	1,071,933	9,161	1,062,772
Other Commercial & Industrial	383,877			63,000	446,877	17,492	429,385
Consumer							
Secured	109,350			15,085	124,435	-	124,435
Unsecured	12,913			12,406	25,319	9,260	16,059
Total	$ 2,261,658	$ (408,624)	$ 2,824	$ 940,038	$ 2,795,896	$ 35,913	$ 2,759,983

5. **Premises and equipment:**

Premises and equipment at December 31 consists of the following:

	2016	2015
Land	$ 1,862,215	$ 1,862,215
Building and improvements	3,828,418	3,798,891
Computer equipment and software	556,121	520,334
Furniture and equipment	807,047	760,647
Total	7,053,801	6,942,087
Accumulated depreciation	(2,126,897)	(1,784,355)
Property, net	$ 4,926,904	$ 5,157,732

The Bank owns its headquarters building and leases to others approximately 50% of the building. Rental income recorded under noncancelable leases as well as other month-to-month agreements totalled $132,272 and $137,006 for the years ended December 31, 2016 and 2015, respectively, and is recorded in noninterest income. At December 31, 2016, future expected rental revenues to be received under such noncancelable leases are as follows:

2017	$ 67,460
2018	34,560
2019	19,719
Total	$ 121,739

6. **Time Deposits:**

Individual time deposits that met or exceeded the FDIC insurance coverage limit of $250,000 totalled $1,418,851 at December 31, 2016. There were no individual time deposits that met or exceeded the FDIC insurance coverage limit of $250,000 at December 31, 2015.

At December 31, 2016, the scheduled annual maturities of time deposits is as follows:

2017	$	25,636,966
2018		158,987
2019		7,000
2020		1,652,000
	$	27,454,953

7. **Borrowings**:

The Bank has repurchase agreements (REPOs) of $1,631,664 (average rate 0.20%) and $1,442,296 (average rate 0.24%) at December 31, 2016 and 2015, respectively. A REPO represents an agreement between the Bank and a customer to collateralize funds deposited by the customer in an interest-bearing repurchase sweep account. Investment securities are pledged by the Bank as collateral in an amount equal to the REPOs.

The Bank has a borrowing line with the FHLB equal to a maximum of 35% of the Bank's total assets, subject to limits based on collateral consisting of FHLB stock, funds on deposit with FHLB and eligible portions of the Bank's loan and securities portfolios. The available borrowing line at December 31, 2016 is approximately $9,800,000.

The Bank has secured and unsecured federal funds borrowing lines available with correspondent banks totalling $11,000,000 at December 31, 2016. The Bank had no outstanding borrowings against these lines at December 31, 2016. The Bank has a borrowing line available with the Federal Reserve Discount Window totalling approximately $4,400,000 at December 31, 2016, which is secured by a portion of the Bank's loan portfolio. The Bank had no outstanding borrowings against this line at December 31, 2016.

8. **Benefit Plans**:

The Bank has a defined contribution 401(k) profit sharing plan covering substantially all employees. Employer contributions are determined annually by the Board of Directors. Employer contributions were $137,811 and $115,858 in 2016 and 2015, respectively.

The Bank has a deferred cash incentive plan for the benefit of certain key employees and a directors' deferred compensation plan for the Bank's directors. Bank contributions to these plans totalled $69,300 and $63,650 in 2016 and 2015, respectively.

9. **Stock Option and Equity Compensation Plans**:

The Bank has employee and nonemployee equity compensation plans (the Plans) that reserve shares of stock for issuance to employees and directors in the form of stock options, restricted stock, or restricted stock units (RSUs). Under the Plans, the exercise price (for options) or the fair value (for restricted stock and RSUs) of awards granted must equal the market price of the Bank's stock on the date of the grant. Options granted under the Plans have a maximum term of ten years. Vesting generally occurs over periods ranging from one to three years. Information with respect to all stock-based awards granted under the Plans during the years ended December 31, 2016 and 2015 is as follows:

	2016	2015
Stock based awards available for grant, beginning of year	294,000	22,218
Options terminated at expiration of 2005 Plan	-	(22,218)
2015 Plan authorized stock based awards	-	330,000
Options granted	(15,000)	(28,500)
Restricted stock and restricted stock units granted	(10,515)	(7,500)
Stock based awards available for grant, end of year	268,485	294,000

The following table presents the activity related to stock options under the Plans for the years ended December 31:

	2016		2015	
	Options Outstanding	Weighted-average exercise price	Options Outstanding	Weighted-average exercise price
Balance, beginning of year	171,009	$4.78	200,553	$3.87
Granted:				
Employees	15,000	10.33	28,500	9.54
Exercised	(31,080)	5.81	(56,244)	3.56
Expired	-	n/a	(1,800)	n/a
Balance, end of year	154,929	$5.26	171,009	$4.78
Exercisable, end of year	125,179		126,534	

The following table presents additional information regarding stock options outstanding as of December 31, 2016 :

		December 31, 2016	
Expiration	Average exercise price per share	Exercisable	Outstanding
2017	$ 7.00	1,347	1,347
2018	$ 4.96	13,050	13,050
2019	$ 3.16	44,700	44,700
2020	$ 2.75	25,692	25,692
2021	$ 2.47	5,040	5,040
2023	$ 4.16	21,600	21,600
2025	$ 9.54	11,250	28,500
2026	$ 10.33	2,500	15,000
		125,179	154,929
Aggregate intrinsic value		$824,886	$851,978

The total intrinsic value of stock options exercised was $153,942 and $371,451 for the years ended December 31, 2016 and 2015 respectively.

There were 8,441 shares of restricted stock and RSU awards that vested during the year ended December 31, 2016 with a total fair value of $79,865. There were 29,725 and 5,625 options that vested during the years ended December 31, 2016 and 2015 with a total fair value of $37,671 and $13,964, respectively. As of December 31, 2016, there was $66,291 of total unrecognized compensation cost related to nonvested stock options which is expected to be recognized over a weighted-average period of 1.7 years.

The fair value of options granted under the Plans are estimated on the date of the grant using the Black-Scholes option pricing model. The fair value of the grants is amortized on a straight line basis over the requisite vesting periods. The expected life of options granted represents the period of time that they are expected to be outstanding. The expected life is determined based on historical experience with similar options, giving consideration to the contractual terms and vesting schedules. Expected volatility was estimated at the date of grant based on the historical volatility of the Bank's common stock. Dividends during the expected life are assumed to be zero. The risk-free interest rate is derived from the observed short term U.S. Treasury yield at the time of the grant. The Black-Scholes model used the following assumptions for the stock options granted during the years indicated:

	Risk Free Rate	Expected Life (years)	Expected Volatility	Expected Dividends
2016	0.58%	9.0	15.7%	0.00%
2015	0.25%	10.0	21.3%	0.00%

The weighted average fair value of options granted in 2016 and 2015 was $2.14 and $2.60, respectively.

There were a total of 10,515 shares of restricted stock granted during 2016, of which 941 shares vested in 2016 and 9,574 are expected to vest during 2017-2019. The fair value of restricted stock and RSUs awarded under the Plans is measured based on the number of shares granted and the market price of the Bank's common stock on the date of grant. This amount is recognized as an expense over the corresponding requisite service period. As of December 31, 2016, the total unrecognized compensation expense related to restricted stock awards granted amounted to $97,805, which is expected to be recognized during 2017-2019.

Weighted average shares outstanding at December 31 are as follows:

	2016	2015
Basic	3,521,549	3,360,359
Common stock equivalents attributable to stock based grants outstanding	67,613	65,703
Fully Diluted	3,589,162	3,426,062

10. **Other Expense**:

Other expense for the years ended December 31 is comprised of the following:

	2016	2015
Regulatory assessments	$ 177,824	$ 132,816
Professional services	142,565	230,896
Loan expenses and collection	105,194	57,356
Advertising, marketing and public relations	191,634	159,227
Printing, supplies and postage	131,996	136,260
Correspondent bank fees	54,552	29,796
Communications	92,938	80,967
Other operating expenses	193,707	221,518
Total other expense	$ 1,090,410	$ 1,048,836

11. **Income Taxes**:

The income tax provision consists of the following for the years ended December 31, 2016 and 2015:

	2016	2015
Current		
Federal	$ 1,353,414	$ 1,675,299
State	394,198	405,493
Deferred	(3,000)	(409,356)
Total income tax provision	$ 1,744,612	$ 1,671,436

The income tax provision results in effective tax rates that are different than the federal income tax statutory rate. The nature of the differences for the years ended December 31, 2016 and 2015 are as follows:

	2016	2015
Expected federal income tax provision at statutory rates	$ 1,564,004	$ 1,499,949
State taxes	230,737	221,287
Permanent differences	(37,553)	(42,726)
Other	(12,576)	(7,074)
Total income tax provision	$ 1,744,612	$ 1,671,436

The tax effects of temporary differences that give rise to deferred tax assets and liabilities as of December 31, 2016 and 2015 are as follows:

	2016	2015
Deferred tax assets:		
Allowance for loan losses	$ 1,081,843	$ 1,167,330
Accrued vacation	9,754	9,492
Repossessed assets	66,997	65,937
Deferred compensation	85,278	64,907
Share-based compensation	45,859	-
Unrealized losses on investment securities	2,736	-
Secondary accrued interest	3,173	3,173
Total deferred tax assets	$ 1,295,640	$ 1,310,839
Deferred tax liabilities:		
Depreciation	$ (64,964)	$ (138,025)
Loan origination costs	(98,538)	(72,246)
Prepaid expenses and other	(19,511)	(18,437)
Other	(32,660)	(5,164)
Total deferred tax liabilities	(215,673)	(233,872)
Total net deferred tax assets	$ 1,079,967	$ 1,076,967

The Bank has determined that it is not required to establish a valuation allowance for the net deferred tax assets as of December 31, 2016 and 2015, as management believes it is more likely than not that the net deferred tax assets will be realized through reversals of existing taxable temporary differences and future taxable income.

12. Commitments and Contingencies:

In order to meet the financing needs of its clients, the Bank commits to extensions of credit and issues standby letters of credit. The Bank's exposure to credit loss in the event of nonperformance by the other party to the financial instrument for commitments to extend credit and standby letters of credit is represented by the contractual notional amount of those instruments. The Bank uses the same credit policies in making commitments and conditional obligations as it does for on-balance-sheet instruments.

Commitments to extend credit are agreements to lend to a client as long as there is no violation of any conditions established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. Since some of the commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements.

Standby letters of credit written are conditional commitments issued by the Bank to guarantee the performance of a client 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 clients.

To manage interest rate risk, the Bank enters into interest rate swaps that effectively convert fixed rate loans into variable rate instruments earning a margin over the one month or three month LIBOR rate. These fair value hedges have been structured to be perfectly effective, thus no ineffectiveness is recognized in earnings. Cash and investment securities totalling of $5,389,849 held by counterparties are pledged as security for these interest rate swaps.

Financial instruments with off-balance-sheet risk at December 31 are as follows:

	2016	2015
Commitments to extend credit	$ 59,173,828	$ 42,885,534
Standby letters of credit	$ 1,699,157	$ 2,949,909
Interest rate swaps (receive variable - pay fixed, maturing 2016-2031):		
Principal amount of hedged loans	$ 49,409,369	$ 32,069,869
Credit risk amount (included in other liabilities)	208,047	1,664,245
Total fair value of hedged loans	$ 49,617,416	$ 33,734,114

Due to the nature of its activities, the Bank is periodically subject to litigation arising in the ordinary course of business. In the opinion of management, liabilities arising from these actions, if any, will not have a material effect on the Bank's financial position, results of operations, and cash flows as of and for the year ended December 31, 2016.

The Bank has entered into employment agreements with certain key employees, which provide for contingent payments upon a change in control of the Bank, as defined in the agreements.

13. **Related Party Transactions**:

In the normal course of business, the Bank has granted loans to officers and directors and to companies with which they are associated. Such loans are made on substantially the same terms, including interest rates and collateral, as those prevailing at the time for comparable transactions with unrelated parties. Activity with respect to these loans during the years ended December 31 was as follows:

	2016	2015
Balance, beginning of year	$ 4,930,054	$ 5,449,205
Additions or renewals	-	-
Amounts collected	(873,782)	(519,151)
Balance, end of year	$ 4,056,272	$ 4,930,054

In addition, there were $338,197 in commitments to extend credit to officers and directors, including related entities, at December 31, 2016 which are included as part of commitments in Note 12.

During 2015, the Bank executed a sale of a pool of commercial loans with a total book value of $2,019,559 to a director, the terms of which were substantially similar to comparable transactions that the Bank has made with unrelated parties.

Deposits from officers and directors totalled $9,140,639 and $10,600,505 at December 31, 2016 and 2015, respectively.

14. **Fair Value Measurements**:

GAAP defines fair value, establishes a framework for measuring fair value, and requires certain disclosures about fair value measurements. The categories of fair value measurement prescribed by GAAP are as follows:

- Level 1: Fair value of the asset or liability is determined using unadjusted quoted prices in active markets for identical assets or liabilities.

- Level 2: Fair value of the asset or liability is determined using inputs other than quoted prices that are observable for the applicable asset or liability, either directly or indirectly, such as quoted prices for similar (as opposed to identical) assets or liabilities in active markets and quoted prices for identical or similar assets or liabilities in markets that are not active.

- Level 3: Fair value of the asset or liability is determined using unobservable inputs that are significant to the fair value measurement and reflect management's own assumptions regarding the applicable asset or liability.

The following disclosures are made in accordance with provisions of GAAP. The use of different assumptions and estimation methods could have a significant effect on fair value amounts. Accordingly, the estimates of fair value herein are not necessarily indicative of the amounts that might be realized in a current market exchange.

The carrying amount and estimated fair value of the Bank's financial instruments are as follows at the dates indicated:

December 31 2016	Carrying Amount	Level I	Level II	Level III	Estimated Fair Value
Assets:					
Cash and cash equivalents	$ 36,648,676	$ 36,648,676	$ -	$ -	$ 36,648,676
Investment securities available-for-sale	5,833,268	-	5,833,268	-	5,833,268
Hedged loans	49,617,416	-	49,617,416	-	49,617,416
Other loans, net of allowance for loan losses	177,350,242	-	182,240,245	272,726	182,512,971
Interest receivable	827,948	-	827,948	-	827,948
FHLB and PCBB stock	723,600	-	723,600	-	723,600
Cash surrender value of bank owned life insurance	3,655,538	-	3,655,538	-	3,655,538
Liabilities:					
Demand and savings deposits	226,254,650	226,254,650	-	-	226,254,650
Time deposits	27,454,953	-	27,455,726	-	27,455,726
Repurchase agreements	1,631,664	-	1,631,664	-	1,631,664
Term borrowings	-		-	-	-
Interest rate swap agreements	208,047		208,047	-	208,047

December 31 2015		Carrying Amount		Level I		Level II		Level III		Estimated Fair Value
Assets:										
Cash and cash equivalents	$	34,389,169	$	34,389,169	$	-	$	-	$	34,389,169
Investment securities available-for-sale		5,639,918		-		5,639,918		-		5,639,918
Hedged loans		33,734,114		-		33,734,114		-		33,734,114
Other loans, net of allowance for loan losses		150,675,849		-		156,510,856		236,680		156,747,536
Interest receivable		675,759		-		675,759		-		675,759
FHLB and PCBB stock		655,200		-		655,200		-		655,200
Cash surrender value of bank owned life insurance		3,088,422		-		3,088,422		-		3,088,422
Liabilities:										
Demand and savings deposits		192,010,860		192,010,860		-		-		192,010,860
Time deposits		17,717,840		-		17,718,676		-		17,718,676
Repurchase agreements		1,442,296		-		1,442,296		-		1,492,296
Term borrowings		-		-		-		-		-
Interest rate swap agreements		1,664,245		-		1,664,245		-		1,664,245

The following methods were used to estimate the fair value of each class of financial instrument above:

Cash and Cash Equivalents – The fair value approximates carrying the amount.

Investment Securities Available-for-Sale– Fair value is estimated using quoted market prices from similar securities. All available-for-sale investment securities are measured at estimated fair value on a recurring basis at the dates indicated in the table above and are included within Level II.

Loans – Fair value of fixed-rate loans is estimated by discounting the future cash flows using the current rates at which similar loans would be made to borrowers with similar credit characteristics and for the same remaining maturities. Variable rate loans not at contractual floors have carrying amounts that are a reasonable estimate of fair value.

Interest Receivable – Fair value approximates the carrying amount.

FHLB and PCBB stock – Fair value approximates the carrying amount.

Cash Surrender Value of Bank-owned Life Insurance – Fair value approximates the carrying amount.

Deposits – Fair value of demand, interest-bearing demand and savings deposits is the amount payable on demand at the reporting date. Fair value of time deposits is estimated using the interest rates currently offered for deposits of similar remaining maturities. The estimated fair values of deposits do not take into account the benefit that results from the low-cost funding such deposits provide.

Repurchase agreements – The carrying amount is a reasonable estimate of fair value because of the short-term nature of these borrowings.

Interest Rate Swap Agreements – Fair value of interest rate swap agreements is estimated based upon quoted prices for similar instruments in the over the counter swaps market. All interest rate swap agreements and hedged loans are measured at estimated fair value on a recurring basis at the dates indicated in the table above and are included within Level II.

Off-balance Sheet Financial Instruments – The majority of the Bank's commitments to extend credit have variable rates and are cancellable if the client's credit quality deteriorates. Therefore, the associated fair values are not significant and are not included in the tables above.

The following tables present assets that are measured at estimated fair value on a nonrecurring basis at the dates indicated:

		Estimated fair value measurements using		
December 31 2016	Total estimated fair value	Level I	Level II	Level III
Repossessed assets	$ 1,016,304	$ -	$ -	$ 1,016,304
Impaired loans	$ 272,726	$ -	$ -	$ 272,726
December 31 2015				
Repossessed assets	$ 988,141	$ -	$ -	$ 988,141
Impaired loans	$ 236,680	$ -	$ -	$ 236,680

	Valuation technique	Significant unobservable inputs
Repossessed assets	Market approach	Appraised value of collateral less selling costs
Impaired loans	Market and income approach	Discounted cash flows or appraised value of collateral less selling costs

The Bank considers third party appraisals in determining the fair value of repossessed assets. Appraisals are adjusted by the Bank in consideration of economic and market conditions that could impact the value of the assets.

The fair values presented above represent management's best estimates based on a range of methodologies and assumptions. Where appropriate, expected cash flows are discounted using an applicable rate considering the time of collection, credit risk, and the discount for the uncertainty of the flows.

There were no transfers to or from Level III during 2016 or 2015.

15. **Regulatory Matters**:

The Bank is subject to the regulations of certain federal and state agencies and receives periodic examinations by those regulatory authorities. In addition, the Bank is subject to various regulatory capital requirements administered by 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 financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, the Bank must meet specific capital guidelines that involve quantitative measures of assets, liabilities, and certain off-balance-sheet items as calculated under regulatory accounting practices. The Bank'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 Bank to maintain minimum ratios (set forth in the following table below) of Total Tier 1 and Common Equity Tier I capital to risk-weighted assets, and of Tier I capital to leverage assets, all as defined in the regulations. As of December 31, 2016, the most recent notification from the FDIC categorized the Bank as "Well Capitalized" as defined by regulations. To be categorized as "Well Capitalized", the Bank must maintain minimum Total risk-based, Tier I and Common Equity Tier 1 risk-based, and Tier I leverage ratios as set forth in the table below. There are no conditions or events since that notification that management believes have changed the Bank's category.

The Bank's actual capital amounts (in thousands) and ratios are as follows at the dates indicated:

	Actual		For Capital Adequacy Purposes		To be Well Capitalized Under Prompt Corrective Action Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
December 31, 2016						
Total capital (to risk-weighted assets)	$ 27,948	11.47%	$ 19,485	8.00%	$ 24,357	10.00%
Tier I capital (to risk-weighted assets)	$ 24,899	10.22%	$ 14,614	6.00%	$ 19,485	8.00%
Common Equity Tier I (to risk-weighted assets)	$ 24,899	10.22%	$ 10,961	4.50%	$ 15,832	6.50%
Tier I capital (to leverage assets)	$ 24,899	9.34%	$ 10,666	4.00%	$ 13,332	5.00%
December 31, 2015						
Total capital (to risk-weighted assets)	$ 24,306	11.88%	$ 16,362	8.00%	$ 20,452	10.00%
Tier I capital (to risk-weighted assets)	$ 21,746	10.63%	$ 12,271	6.00%	$ 16,362	8.00%
Common Equity Tier I (to risk-weighted assets)	$ 21,746	10.63%	$ 9,203	4.50%	$ 13,294	6.50%
Tier I capital (to leverage assets)	$ 21,746	9.41%	$ 9,243	4.00%	$ 11,554	5.00%

The Federal Deposit Insurance Corporation has not reviewed these financial statements for accuracy or relevance.