FINANCIAL STATEMENTS
AND INDEPENDENT AUDITORS' REPORT

# VERUS BANK OF COMMERCE

December 31, 2017 and 2016

FORTNER, BAYENS, LEVKULICH
& GARRISON, P.C.

**INDEPENDENT AUDITORS' REPORT**

Board of Directors
Verus Bank of Commerce
Fort Collins, Colorado

**Report on the Financial Statements**

We have audited the accompanying financial statements of Verus Bank of Commerce, which are comprised of the balance sheets as of December 31, 2017 and 2016, and the related statements of income, stockholders' equity and cash flows for the years then ended, and the related notes to the financial statements.

**Management's Responsibility for the Financial Statements**

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

**Auditors' Responsibility**

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

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditors' judgment, including the assessment of the risks of material misstatement of the 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 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 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 financial statements referred to above present fairly, in all material respects, the financial position of Verus Bank of Commerce at December 31, 2017 and 2016 and the results of its operations and its cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

Fortner, Bayens, Levkulich & Garrison, P.C.

Denver, Colorado
March 27, 2018

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**Certified Public Accountants • A Professional Corporation**

## Verus Bank of Commerce

## BALANCE SHEETS

| | December 31, 2017 | December 31, 2016 |
|---|---|---|
| | (in thousands) | |
| **ASSETS** | | |
| Cash and due from banks | $ 4,358 | $ 1,947 |
| Interest-bearing deposits with banks | 12,831 | 23,032 |
| Federal funds sold | 501 | 496 |
| Cash and cash equivalents | 17,690 | 25,475 |
| Interest-bearing time deposits with banks | 5,220 | 6,216 |
| Nonmarketable equity securities | 1,867 | 1,120 |
| Loans | 223,206 | 220,597 |
| Less allowance for loan losses | (1,956) | (1,946) |
| | 221,250 | 218,651 |
| Premises and equipment | 60 | 46 |
| Accrued interest receivable | 705 | 470 |
| Other assets | 950 | 1,410 |
| | $ 247,742 | $ 253,388 |
| **LIABILITIES AND STOCKHOLDERS' EQUITY** | | |
| Liabilities | | |
| Deposits | | |
| Noninterest-bearing | $ 50,074 | $ 54,745 |
| Interest-bearing | 136,069 | 160,756 |
| | 186,143 | 215,501 |
| Short-term borrowings | 23,600 | - |
| Accrued interest payable | 51 | 39 |
| Other liabilities | 5,142 | 4,796 |
| Total liabilities | 214,936 | 220,336 |
| Commitments (notes D and H) | | |
| Stockholders' equity | | |
| Preferred stock - $1,000 par value, 8,766 shares authorized; 0 shares issued and outstanding at December 31, 2017 and 2016, respectively | - | - |
| Common stock - $2.50 par value, 7,000,000 shares authorized; 5,331,837 and 5,339,614 shares issued and outstanding at December 31, 2017 and 2016, respectively | 13,330 | 13,349 |
| Capital surplus | 13,096 | 13,125 |
| Retained earnings | 6,380 | 6,578 |
| | 32,806 | 33,052 |
| | $ 247,742 | $ 253,388 |

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

## Verus Bank of Commerce

## STATEMENTS OF INCOME

| | Years Ended December 31, 2017 | Years Ended December 31, 2016 |
|---|---|---|
| | (in thousands) | |
| Interest and dividend income | | |
| Interest and fees on loans | $ 12,157 | $ 12,602 |
| Federal funds sold | 5 | 2 |
| Interest-bearing deposits with banks | 258 | 187 |
| Dividends | 85 | 91 |
| Total interest and dividend income | 12,505 | 12,882 |
| Interest expense | | |
| Deposits | 1,103 | 1,256 |
| Federal Home Loan Bank borrowings | 178 | 110 |
| Total interest expense | 1,281 | 1,366 |
| Net interest income | 11,224 | 11,516 |
| Reduction in allowance for loan losses | - | (300) |
| Net interest income after provision for loan losses | 11,224 | 11,816 |
| Noninterest income | | |
| Service charges on deposit accounts | 357 | 351 |
| Fees from servicing government-guaranteed loans | 15 | 24 |
| Gain on sale of foreclosed real estate | - | 91 |
| Other | 242 | 253 |
| Total noninterest income | 614 | 719 |
| Noninterest expense | | |
| Salaries and employee benefits | 3,181 | 3,049 |
| Occupancy and equipment | 335 | 347 |
| Other expenses | 1,050 | 1,064 |
| Total noninterest expense | 4,566 | 4,460 |
| Income before income taxes | 7,272 | 8,075 |
| Income tax expense | 3,098 | 2,918 |
| NET INCOME | $ 4,174 | $ 5,157 |
| Net income | $ 4,174 | $ 5,157 |
| Less: Preferred dividends | - | 4 |
| Net income available to common shareholders | $ 4,174 | $ 5,153 |

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

# Verus Bank of Commerce

## STATEMENTS OF STOCKHOLDERS' EQUITY

Years ended December 31, 2017 and 2016

| | Preferred Stock | Common Stock | Capital Surplus | Retained Earnings | Total |
|---|---|---|---|---|---|
| | | | (in thousands) | | |
| Balance at December 31, 2015 | $ 8,766 | $ 13,219 | $ 12,942 | $ 5,750 | $ 40,677 |
| Issuance of 60,789 shares of common stock | - | 152 | 215 | - | 367 |
| Repurchase of 8,635 shares of common stock | - | (22) | (32) | - | (54) |
| Repurchase of 8,766 shares of preferred stock | (8,766) | - | - | - | (8,766) |
| Comprehensive income | | | | | |
| Net income | - | - | - | 5,157 | 5,157 |
| Common stock dividends declared | - | - | - | (4,325) | (4,325) |
| Preferred stock dividends declared and paid | - | - | - | (4) | (4) |
| Balance at December 31, 2016 | - | 13,349 | 13,125 | 6,578 | 33,052 |
| Repurchase of 7,777 shares of common stock | - | (19) | (29) | - | (48) |
| Comprehensive income | | | | | |
| Net income | - | - | - | 4,174 | 4,174 |
| Common stock dividends declared | - | - | - | (4,372) | (4,372) |
| Balance at December 31, 2017 | $ - | $ 13,330 | $ 13,096 | $ 6,380 | $ 32,806 |

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

# Verus Bank of Commerce

## STATEMENTS OF CASH FLOWS

| | Years Ended December 31, 2017 | 2016 |
|---|---|---|
| | (in thousands) | |
| Cash flows from operating activities | | |
| Net income | $ 4,174 | $ 5,157 |
| Adjustments to reconcile net income to net cash provided by operating activities | | |
| Depreciation and amortization | 26 | 40 |
| Reduction in allowance for loan losses | - | (300) |
| Federal Home Loan Bank stock dividends | (37) | (38) |
| Gain on sale of foreclosed real estate | - | (91) |
| Deferred income taxes | 413 | 157 |
| Net changes in: | | |
| Accrued interest receivable and other assets | (188) | 245 |
| Accrued interest payable and other liabilities | 358 | (475) |
| Net cash provided by operating activities | 4,746 | 4,695 |
| Cash flows from investing activities | | |
| Net change in interest-bearing time deposits with banks | 996 | (408) |
| Purchases of nonmarketable equity securities | (2,542) | (1,152) |
| Redemptions of nonmarketable equity securities | 1,832 | 1,827 |
| Loan originations and principal collections, net | (2,599) | 24,620 |
| Expenditures for premises and equipment | (40) | (7) |
| Proceeds from sale of foreclosed real estate | - | 289 |
| Net cash provided (used) by investing activities | (2,353) | 25,169 |
| Cash flows from financing activities | | |
| Net change in deposits | (29,358) | 6,481 |
| Payments of long-term borrowings | - | (2,500) |
| Change in short-term borrowings | 23,600 | (13,300) |
| Issuance of common stock | - | 367 |
| Repurchase of common stock | (48) | (54) |
| Repurchase of preferred stock | - | (8,766) |
| Cash dividends paid on common stock | (4,372) | (4,325) |
| Cash dividends paid on preferred stock | - | (4) |
| Net cash used in financing activities | (10,178) | (22,101) |
| Net change in cash and cash equivalents | (7,785) | 7,763 |
| Cash and cash equivalents at beginning of year | 25,475 | 17,712 |
| Cash and cash equivalents at end of year | $ 17,690 | $ 25,475 |
| SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION | | |
| Cash paid during the year for: | | |
| Interest | $ 1,269 | $ 1,369 |
| Income taxes | 2,300 | 3,432 |

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

## NOTE A - SUMMARY OF ACCOUNTING POLICIES

### Nature of Operations

The Verus Bank of Commerce (the Bank) provides a full range of banking and mortgage services to individual and corporate customers, principally in Larimer County, Colorado and the surrounding area. In 2010, Verus Acquisition Group, Inc. (Verus), a Bank holding company located in Fort Collins, Colorado purchased a 51% interest in the Bank.

The Bank provides banking services to individuals, businesses and other customers located in its community. A variety of deposit products are offered, including checking, savings, money market, individual retirement accounts and certificates of deposit. The principal market for the Bank's financial services is the community in which it is located and the areas immediately surrounding that community. The Bank is also subject to regulation by certain governmental agencies and undergoes periodic examinations by those regulatory agencies.

### Use of Estimates

The financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America. In preparing the financial statements, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities as of the date of the balance sheet and revenues and expenses for the period. Actual results could differ significantly from those estimates.

Material estimates that are particularly susceptible to significant change in the near-term relate to the determination of the allowance for loan losses and the valuation of foreclosed real estate.

In connection with the determination of the allowance for loan losses and the valuation of foreclosed real estate, management obtains independent appraisals for significant properties and assesses estimated future cash flows from borrowers' operations and the liquidation of loan collateral.

Management believes that the allowance for loan losses is adequate. While management uses available information to recognize losses on loans, changes in economic conditions may necessitate revisions in future years.

**Significant Group Concentrations of Credit Risk**

Most of the Bank’s activities are with customers located in the Larimer County, Colorado area. Note B discusses the types of lending that the Bank engages in.

**Cash and Cash Equivalents**

For purposes of the statements of cash flows, cash and cash equivalents include cash and balances due from banks, interest-bearing deposits with banks and federal funds sold.

**Interest-Bearing Time Deposits with Banks**

Interest-bearing time deposits with banks are carried at cost, mature within four years and are fully covered by federal deposit insurance.

**Nonmarketable Equity Securities**

Nonmarketable equity securities, consisting of Federal Home Loan Bank and Federal Reserve Bank stock, are recorded at cost.

**Loans**

The Bank primarily grants construction, land and land development and real estate loans to customers primarily in the Larimer County, Colorado area. The ability of the Bank's borrowers to honor their contracts is dependent upon the real estate and general economic conditions in this area.

Loans that management has the intent and ability to hold for the foreseeable future or until maturity or pay-off generally are reported at their outstanding unpaid principal balances adjusted for charge-offs and the allowance for loan losses. Interest income is accrued on the unpaid principal balance. Loan origination fees, net of certain direct origination costs, are deferred and recognized as an adjustment on the related loan yield using the effective yield method.

Past due loans are any loans for which payments of interest, principal or both have not been received within the timeframes designated by the loan agreements. Loans with payments in arrears but for which borrowers have resumed making scheduled payments are considered past due until arrearages are brought current. Loans that experience insignificant payment delays or payment shortfalls generally are not considered past due. Management determines the significance of payment delays and payment shortfalls on a case-by-case basis, taking into consideration all of the circumstances surrounding the loan and the borrower, including the length of the delay, the reasons for the delay, the borrower’s prior payment record, and the amount of the shortfall in relation to the principal and interest owed.

The accrual of interest on all loans is discontinued at the time a loan is 90 days delinquent unless the loan is well secured and in process of collection. Additionally, loans are placed on nonaccrual at an earlier date if collection of principal or interest is considered doubtful. When placing a loan on nonaccrual status, interest accrued to date is generally reversed and is charged against the current year's interest income. Payments received on a loan on nonaccrual status are applied against the balance of the loan. A loan is returned to accrual status when principal and interest are no longer past due and collectability is no longer doubtful.

Troubled debt restructurings are loans for which concessions in terms have been made as a result of the borrower experiencing financial difficulty. Generally, concessions granted to customers include lower interest rates and modification of the payment stream to lower or defer payments. Interest on troubled debt restructurings is accrued under the new terms if the loans are performing and full collection of principal and interest is expected. However, interest accruals are discontinued on troubled debt restructurings that meet the Bank's nonaccrual criteria.

Generally, loans are charged off in whole or in part on a loan-by-loan basis after they become significantly past due and based upon management's review of the collectability of all or a portion of the loan unless the loan is in the process of restructuring. Charge off amounts are determined based upon the carrying amount of loans and the amount estimated to be collectible as determined by analyses of expected future cash flows and the liquidation of loan collateral.

**Allowance for Loan Losses**

The allowance for loan losses is a valuation allowance for probable incurred credit losses, and is established through a provision for loan losses charged to earnings. Loan losses are charged against the allowance when management believes the uncollectibility of a loan balance is confirmed. Subsequent recoveries, if any, are credited to the allowance.

The allowance consists of specific and general components as follows:

> The specific component relates to loans that are considered impaired, and is comprised of valuation allowances calculated on a loan-by-loan basis. Impaired loans are all specifically identified loans for which it is probable that the Bank will not collect all amounts due according to the contractual terms of the loan agreement. Factors considered by management in determining whether a loan is impaired include payment status, collateral value, the borrower's financial condition and overall loan quality as determined by an internal loan grading system. Included in impaired loans are all nonaccrual loans and all accruing troubled debt restructurings. Loans that experience insignificant payment delays or payment shortfalls generally are not considered impaired. For impaired loans for which repayment is expected solely from the collateral, impairment is measured based on the fair value of the collateral. For other impaired loans, impairment may be measured based on the fair value of the collateral or on the present value of expected future cash flows discounted at the loan's original effective interest rate. When the measure of the impaired loan is less than the recorded investment in the loan, the impairment is recorded through a valuation allowance.

The general component relates to non-impaired loans, and is based on historical loss experience adjusted for the effects of qualitative factors that are likely to cause estimated credit losses as of the evaluation date to differ from the portfolio's historical loss experience. Qualitative factors include the following: economic conditions; industry conditions; changes in lending policies and procedures; trends in the volume and terms of loans; the experience, ability and depth of lending staff; levels and trends in delinquencies; levels and trends in charge-off and recovery activity; levels and trends of loan quality as determined by an internal loan grading system; and portfolio concentrations.

Although the allowance contains a specific component, the entire allowance is available for any loan that, in management's judgment, should be charged-off.

On a monthly basis, management estimates the allowance balance required using the criteria identified above in relation to the relevant risks for each of the Bank's major loan segments. Significant overall risk factors for both the Bank's real estate, commercial and consumer portfolios include the strength of the real estate market and the strength of economy in the Bank's lending area.

The quality of the Bank's loan portfolio is assessed as a function of the levels of past due loans and impaired loans, and internal credit quality ratings which are updated monthly by management. The ratings on the Bank's internal credit scale are broadly grouped into the categories "non-classified" and "classified." Non-classified loans are those loans with minimal identified credit risk, as well as loans with potential credit weaknesses which deserve management's attention but for which full collection of contractual principal and interest is not significantly at risk. Classified loans are those loans that have well-defined weakness that put full collection of contractual principal or interest at risk, and classified loans for which it is probable that the Bank will not collect all contractual principal or interest are also considered impaired. The credit quality ratings are an important part of the Bank's overall credit risk management process and are considered in the determination of the allowance for loan losses.

Determination of the allowance is inherently subjective as it requires estimates that are susceptible to significant revision as more information becomes available. In addition, various regulatory agencies, as an integral part of their examination process, periodically review the Bank's allowance. Such agencies may require the Bank to recognize additional losses based on their judgments about information available to them at the time of their examination.

**Off- Balance Sheet Financial Instruments**

In the ordinary course of business, the Bank enters into off-balance-sheet financial instruments consisting of commitments to extend credit, unused lines of credit, standby letters of credit and undisbursed loans in process. These financial instruments are recorded in the financial statements when they are funded.

In conjunction with the determination of the allowance for loan losses, and using the same criteria, the Bank determines the extent of credit risk on its off-balance sheet financial instruments and whether there are probable incurred credit losses on those instruments for which a loss provision is necessary. The Bank has determined that there is minimal credit risk on its off-balance sheet financial instruments, and accordingly has not recorded a loss provision or allowance for those instruments.

**Foreclosed Real Estate**

Real estate acquired through, or in lieu of, loan foreclosure are held for sale and are initially recorded at fair value less cost to sell at the date of foreclosure, establishing a new cost basis. Subsequent to foreclosure, valuations are periodically performed by management and the assets are carried at the lower of carrying amount or fair value less cost to sell. Revenue and expenses from operations and changes in the valuation allowance are included in other expenses.

**Premises and Equipment**

Land is carried at cost. Buildings, leasehold improvements, furniture and equipment are carried at cost, less accumulated depreciation computed on the straight-line method over the estimated useful lives of the assets or the expected terms of the lease for financial statement purposes. Expected terms include lease option periods to the extent that the exercise of such option is reasonable assured. Normal costs of maintenance and repairs are charged to expense as incurred.

**Income Taxes**

Deferred income tax assets and liabilities are determined using the liability (or balance sheet) method. Under this method, the net deferred tax asset or liability is determined based on the tax effects of the temporary differences between the book and tax bases of the various balance sheet assets and liabilities and gives current recognition to changes in tax rates and laws.

The Bank has adopted guidance issued by the Financial Accounting Standards Board with respect to accounting for uncertainty in income taxes. A tax position is recognized as a benefit only if it is "more likely than not" that the tax position would be sustained in a tax examination, with a tax examination being presumed to occur. The amount recognized is the largest amount of tax benefit that is greater than 50% likely of being realized on examination. For tax purposes, not meeting the "more likely than not" test, no tax benefit is recorded. Deferred tax assets are reduced by a valuation allowance if, based on the weight of evidence available, it is more likely than not that a portion of the deferred tax asset may not be realized within a year. The Bank is no longer subject to examination by taxing authorities for years before 2014.

**Transfers of Financial Assets**

Transfers of financial assets are accounted for as sales when control over the assets has been relinquished. Control over transferred assets is deemed to be relinquished when the assets have been isolated from the Bank, 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 the Bank does not maintain effective control over the transferred assets through an agreement to repurchase them before their maturity.

**Fair Value Measurement**

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

Level 1 – Quoted prices (unadjusted) for identical assets or liabilities in active markets that the entity has the ability to access as of the measurement date.

Level 2 – Significant other observable inputs other than Level 1 prices such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data.

Level 3 – Significant unobservable inputs that reflect a bank's own assumptions about the assumptions that market participants would use in pricing an asset or liability.

**Subsequent Events**

Management evaluates events occurring subsequent to the balance sheet date, through the date the financial statements are eligible to be issued, to determine whether the events require recognition or disclosure in the financial statements. If a subsequent event evidences conditions existing at the balance sheet date, the effects are recognized in the financial statements (recognized subsequent event). If a subsequent event evidences conditions arising after the balance sheet date, the effects are not recognized in the financial statements but rather disclosed in the notes to the financial statements (non-recognized subsequent events). The effects of subsequent events are only recognized if material, or disclosed if the financial statements would otherwise be misleading.

With respect to the December 31, 2017 financial statements, Management has considered subsequent events through March 27, 2018.

## New Accounting Pronouncements

The Financial Accounting Standards Board has issued Accounting Standards Updates which are not effective for the Bank until future periods, but which have the potential to significantly impact the Bank's financial statements although the Bank has not yet completed evaluations of the impact on its financial statements and its accounting and reporting practices:

Accounting Standards Update 2016-01, Financial Instruments – Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities. Under the new standard, certain equity investments are required to be carried at fair value, with changes in fair value recognized in net income. This applies to equity investments with readily determinable fair values that are not consolidated or carried on the equity method. Debt securities classified as available-for-sale will continue to be carried at fair value with changes in fair value recorded through other comprehensive income. The standard also reduces or eliminates several financial reporting disclosure requirements. The standard is effective for the Bank beginning January 1, 2019; however, in 2015, the Bank early adopted a provision that eliminates the disclosures of the fair values of financial instruments carried at amortized cost. Other provisions of the standard are not expected to have a significant impact to the financial statements.

Accounting Standards Update 2016-13, Financial Instruments – Credit Losses (Topic 326): In June 2016, FASB issued guidance to replace the incurred loss model with an expected loss model, which is referred to as the current expected credit loss (CECL) model. The CECL model is applicable to the measurement of credit losses on financial assets measured at amortized cost, including loan receivables, held-to-maturity debt securities, and reinsurance receivables. It also applies to off-balance sheet credit exposures not accounted for as insurance (loan commitments, standby letters of credit, financial guarantees, and other similar instruments) and net investments in leases recognized by a lessor.

Transition

- For debt securities with other-than-temporary impairment (OTTI), the guidance will be applied prospectively.

- Existing purchased credit impaired (PCI) assets will be grandfathered and classified as purchased credit deteriorated (PCD) assets at the date of adoption. The asset will be grossed up for the allowance for expected credit losses for all PCD assets at the date of adoption and will continue to recognize the noncredit discount in interest income based on the yield of such assets as of the adoption date. Subsequent changes in expected credit losses will be recorded through the allowance.

- For all other assets within the scope of CECL, a cumulative-effect adjustment will be recognized in retained earnings as of the beginning of the first reporting period in which the guidance is effective.

The ASU will take effect for public business entities (PBEs) for fiscal years beginning after December 15, 2019, including interim periods within those fiscal years. For PBEs that do not meet the definition of an SEC filer, the standard will be effective for fiscal years beginning after December 15, 2020, including interim periods with those fiscal years. For all other entities, the standard will be effective for fiscal years beginning after December 15, 2020, and interim periods within the fiscal years beginning after December 15, 2021. All entities may early adopt for fiscal years beginning after December 15, 2018, including interim periods in those fiscal years.

Accounting Standards Update 2016-02 – Leases (Topic 842): In February 2016, the FASB amended existing guidance that requires lessees recognize the following for all leases (with the exception of short -term leases) at the commencement date (1) A lease liability, which is a lessee‘s obligation to make lease payments arising from a lease, measured on a discounted basis; and (2) A right-of-use asset, which is an asset that represents the lessee’s right to use, or control the use of, a specified asset for the lease term. Under the new guidance, lessor accounting is largely unchanged.

These amendments are effective for public business entities for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years (i.e., January 1, 2019, for a calendar year entity). Nonpublic business entities should apply the amendments for fiscal years beginning after December 15, 2019 (i.e., January 1, 2020, for a calendar year entity), and interim periods within fiscal years beginning after December 15, 2020. Early application is permitted for all public business entities and all nonpublic business entities upon issuance.

Accounting Standards Update 2017-04 – Intangibles – Goodwill and Other (Topic 350): Simplifying the Test for Goodwill Impairment, which eliminates Step 2 from the goodwill impairment test, so an entity no longer has to perform procedures to determine the fair value at the impairment testing date of its assets and liabilities. Instead, the goodwill impairment test is performed by comparing the fair value of a reporting unit with its carrying amount and recognizing an impairment charge for the amount by which the carrying amount exceeds the reporting unit’s fair value. The standard is effective for annual or interim goodwill impairment tests in fiscal years beginning after December 15, 2021, with early adoption permitted.

**Comprehensive Income**

Comprehensive income consists of net income and other comprehensive income. The Bank has no other comprehensive income for the years ended December 31, 2017 and 2016.

**Reclassifications**

Certain reclassifications have been made to 2016 amounts to conform to the current year presentation. Reclassifications had no effect on prior year income or stockholders’ equity.

## NOTE B - LOANS AND ALLOWANCE FOR LOAN LOSSES

A summary of the balances of loans follows:

| | December 31, 2017 | December 31, 2016 |
|---|---|---|
| | (in thousands) | |
| Construction, land and land development | | |
| Residential 1-4 family | $ 3,029 | $ 4,738 |
| Other | 17,090 | 13,413 |
| | 20,119 | 18,151 |
| Real estate | | |
| Residential 1-4 family | 23,776 | 25,226 |
| Multifamily | 8,915 | 10,358 |
| Commercial | 158,816 | 155,772 |
| Farmland | 3,483 | 2,548 |
| | 194,990 | 193,904 |
| Commercial and industrial | 7,962 | 8,219 |
| Consumer and other | 135 | 323 |
| | $ 223,206 | $ 220,597 |

At December 31, 2017, the Bank had approximately $42,889,000 of SBA 504 and $1,170,000 of SBA 7A loans. Management believes these loans are considered liquid assets given the active and mature secondary market for these loans as well as their associated premiums. Management includes these assets as part of its liquidity measurement and includes them in the Bank's Contingent Liquidity Plan, which is updated quarterly. These loans may be periodically sold for liquidity purposes and to manage industry concentrations and interest rate risk.

Transactions in the allowance for loan losses are as follows:

| | Year ended December 31, 2017 (in thousands) | | | | |
|---|---|---|---|---|---|
| | Construction, land and land development | Real estate | Commercial and industrial | Consumer and other | Total |
| Balance at December 31, 2016 | $ 166 | $ 1,643 | $ 135 | $ 2 | $ 1,946 |
| Provision for loan losses | (10) | 101 | (90) | (1) | - |
| Charge-offs | - | - | (40) | - | (40) |
| Recoveries | - | - | 50 | - | 50 |
| Net (charge-offs) recoveries | - | - | 10 | - | 10 |
| Balance at December 31, 2017 | $ 156 | $ 1,744 | $ 55 | $ 1 | $ 1,956 |

| | Year ended December 31, 2016 (in thousands) | | | | |
|---|---|---|---|---|---|
| | Construction, land and land development | Real estate | Commercial and industrial | Consumer and other | Total |
| Balance at December 31, 2015 | $ 104 | $ 2,032 | $ 103 | $ 1 | $ 2,240 |
| Provision for loan losses | 62 | (389) | 26 | 1 | (300) |
| Charge-offs | - | - | - | - | - |
| Recoveries | - | - | 6 | - | 6 |
| Net (charge-offs) recoveries | - | - | 6 | - | 6 |
| Balance at December 31, 2016 | $ 166 | $ 1,643 | $ 135 | $ 2 | $ 1,946 |

Components of the allowance for losses, and the related carrying amount of loans for which the allowance is determined, are as follows:

| | December 31, 2017 (in thousands) | | | | |
|---|---|---|---|---|---|
| | Construction, land and land development | Real estate | Commercial and industrial | Consumer and other | Total |
| **Allocation of Allowance To:** | | | | | |
| Impaired loans - evaluated individually | $ - | $ - | $ - | $ - | $ - |
| Impaired loans - evaluated collectively | - | - | - | - | - |
| Total impaired loans | - | - | - | - | - |
| Unimpaired loans - evaluated collectively | 156 | 1,744 | 55 | 1 | 1,956 |
| | $ 156 | $ 1,744 | $ 55 | $ 1 | $ 1,956 |
| **Recorded Investment In:** | | | | | |
| Impaired loans - evaluated individually | $ - | $ - | $ - | $ - | $ - |
| Impaired loans - evaluated collectively | - | - | - | - | - |
| Total impaired loans | - | - | - | - | - |
| Unimpaired loans - evaluated collectively | 20,119 | 194,990 | 7,962 | 135 | 223,206 |
| | $ 20,119 | $ 194,990 | $ 7,962 | $ 135 | $ 223,206 |

| | December 31, 2016 (in thousands) | | | | |
|---|---|---|---|---|---|
| | Construction, land and land development | Real estate | Commercial and industrial | Consumer and other | Total |
| **Allocation of Allowance To:** | | | | | |
| Impaired loans - evaluated individually | $ - | $ - | $ 40 | $ - | $ 40 |
| Impaired loans - evaluated collectively | - | 46 | - | - | 46 |
| Total impaired loans | - | 46 | 40 | - | 86 |
| Unimpaired loans - evaluated collectively | 166 | 1,597 | 95 | 2 | 1,860 |
| | $ 166 | $ 1,643 | $ 135 | $ 2 | $ 1,946 |
| **Recorded Investment In:** | | | | | |
| Impaired loans - evaluated individually | $ - | $ - | $ 81 | $ - | $ 81 |
| Impaired loans - evaluated collectively | - | 91 | - | - | 91 |
| Total impaired loans | - | 91 | 81 | - | 172 |
| Unimpaired loans - evaluated collectively | 18,151 | 193,813 | 8,138 | 323 | 220,425 |
| | $ 18,151 | $ 193,904 | $ 8,219 | $ 323 | $ 220,597 |

Information relative to impaired loans is as follows:

| | As of and for the year ended December 31, 2017 (in thousands) | | | | | | |
|---|---|---|---|---|---|---|---|
| | Recorded Investment In Impaired Loans With No Valuation Allowance | Recorded Investment In Impaired Loans With A Valuation Allowance | Total Impaired Loans | Valuation Allowance On Impaired Loans | Contractual Principal Of Impaired Loans | Commitments To Extend Credit On Impaired Loans | Average Impaired Loans |
| Construction, land and land development | | | | | | | |
| Residential 1-4 family | $ - | $ - | $ - | $ - | $ - | $ - | $ - |
| Other | - | - | - | - | - | - | 26 |
| | - | - | - | - | - | - | 26 |
| Real estate | | | | | | | |
| Residential 1-4 family | - | - | - | - | - | - | - |
| Multifamily | - | - | - | - | - | - | - |
| Commercial | - | - | - | - | - | - | - |
| Farmland | - | - | - | - | - | - | - |
| | - | - | - | - | - | - | - |
| Commercial and industrial | - | - | - | - | - | - | - |
| Consumer and other | - | - | - | - | - | - | - |
| | $ - | $ - | $ - | $ - | $ - | $ - | $ 26 |

| | As of and for the year ended December 31, 2016 (in thousands) | | | | | | |
|---|---|---|---|---|---|---|---|
| | Recorded Investment In Impaired Loans With No Valuation Allowance | Recorded Investment In Impaired Loans With A Valuation Allowance | Total Impaired Loans | Valuation Allowance On Impaired Loans | Contractual Principal Of Impaired Loans | Commitments To Extend Credit On Impaired Loans | Average Impaired Loans |
| Construction, land and land development | | | | | | | |
| Residential 1-4 family | $ - | $ - | $ - | $ - | $ - | $ - | $ - |
| Other | - | - | - | - | - | - | - |
| | - | - | - | - | - | - | - |
| Real estate | | | | | | | |
| Residential 1-4 family | - | - | - | - | - | - | - |
| Multifamily | - | - | - | - | - | - | - |
| Commercial | - | 91 | 91 | 46 | 91 | - | 640 |
| Farmland | - | - | - | - | - | - | - |
| | - | 91 | 91 | 46 | 91 | - | 640 |
| Commercial and industrial | - | 81 | 81 | 40 | 81 | - | 120 |
| Consumer and other | - | - | - | - | - | - | - |
| | $ - | $ 172 | $ 172 | $ 86 | $ 172 | $ - | $ 760 |

Interest income recognized on impaired loans was immaterial for the years ended December 31, 2017 and 2016.

The Bank had no troubled debt restructurings as of December 31, 2017. The Bank had one troubled debt restructuring with a principal balance of $91,000 and a related provision of $46,000 as of December 31, 2016.

The carrying amounts of loans by performance status and credit quality indicator are as follows:

| December 31, 2017 (in thousands) | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | Loans By Past Due and Performance Status | | | | | Loans By Credit Quality Indicator | | |
| | Accruing Loans | | | | | | Classified | |
| | Current | 30-89 Days Past Due | 90 Days or More Past Due | Nonaccrual Loans | Total Loans | Non-classified | Unimpaired | Impaired |
| Construction, land and land development | | | | | | | | |
| Residential 1-4 family | $ 3,029 | $ - | $ - | $ - | $ 3,029 | $ 3,029 | $ - | $ - |
| Other | 17,090 | - | - | - | 17,090 | 17,016 | 74 | - |
| | 20,119 | - | - | - | 20,119 | 20,045 | 74 | - |
| Real estate | | | | | | | | |
| Residential 1-4 family | 23,776 | - | - | - | 23,776 | 23,743 | 33 | - |
| Multifamily | 8,915 | - | - | - | 8,915 | 8,915 | - | - |
| Commercial | 158,816 | - | - | - | 158,816 | 154,064 | 4,752 | - |
| Farmland | 3,483 | - | - | - | 3,483 | 3,483 | - | - |
| | 194,990 | - | - | - | 194,990 | 190,205 | 4,785 | - |
| Commercial and industrial | 7,962 | - | - | - | 7,962 | 7,872 | 90 | - |
| Consumer and other | 135 | - | - | - | 135 | 135 | - | - |
| | $ 223,206 | $ - | $ - | $ - | $ 223,206 | $ 218,257 | $ 4,949 | $ - |

December 31, 2016
(in thousands)

| | Loans By Past Due and Performance Status | | | | | Loans By Credit Quality Indicator | | |
|---|---|---|---|---|---|---|---|---|
| | Accruing Loans | | | | | | Classified | |
| | Current | 30-89 Days Past Due | 90 Days or More Past Due | Nonaccrual Loans | Total Loans | Non-classified | Unimpaired | Impaired |
| Construction, land and land development | | | | | | | | |
| Residential 1-4 family | $ 4,738 | $ - | $ - | $ - | $ 4,738 | $ 4,738 | $ - | $ - |
| Other | 13,413 | - | - | - | 13,413 | 13,316 | 97 | - |
| | 18,151 | - | - | - | 18,151 | 18,054 | 97 | - |
| Real estate | | | | | | | | |
| Residential 1-4 family | 25,226 | - | - | - | 25,226 | 24,966 | 260 | - |
| Multifamily | 10,358 | - | - | - | 10,358 | 10,358 | - | - |
| Commercial | 155,681 | - | - | 91 | 155,772 | 152,727 | 2,954 | 91 |
| Farmland | 2,548 | - | - | - | 2,548 | 2,548 | - | - |
| | 193,813 | - | - | 91 | 193,904 | 190,599 | 3,214 | 91 |
| Commercial and industrial | 8,138 | - | - | 81 | 8,219 | 8,138 | - | 81 |
| Consumer and other | 323 | - | - | - | 323 | 323 | - | - |
| | $ 220,425 | $ - | $ - | $ 172 | $ 220,597 | $ 217,114 | $ 3,311 | $ 172 |

## NOTE C – FORECLOSED REAL ESTATE

A summary of the activity in foreclosed real estate held for sale is as follows:

| | Year Ended December 31, 2017 | 2016 |
|---|---|---|
| | (in thousands) | |
| Balance at beginning of year | $ - | $ 198 |
| Transfers from loans | - | - |
| Valuation allowances recorded | - | - |
| Dispositions | - | (198) |
| Balance at end of year | $ - | $ - |

Net income from foreclosed real estate included in noninterest expenses is as follows:

| | Year Ended December 31, 2017 | 2016 |
|---|---|---|
| | (in thousands) | |
| Net gain on disposition | $ - | $ 91 |
| Valuation allowances recorded | - | - |
| Other related expenses | - | (7) |
| | $ - | $ 84 |

**NOTE D - PREMISES AND EQUIPMENT**

Premises and equipment, less accumulated depreciation and amortization consisted of the following:

| | December 31, 2017 | 2016 |
|---|---|---|
| | (in thousands) | |
| Leasehold improvements | $ 658 | $ 652 |
| Furniture, fixtures and equipment | 1,331 | 1,297 |
| | 1,989 | 1,949 |
| Accumulated depreciation and amortization | (1,929) | (1,903) |
| | $ 60 | $ 46 |

The Bank rents office space under an operating lease. The lease is for five years with renewal options. Rent expense in 2017 and 2016 was $191,000.

Future lease payments under the lease are as follows:

| Years ending December 31, | (in thousands) |
|---|---|
| 2018 | $ 135 |
| 2019 | 138 |
| 2020 | 11 |
| 2021 | - |
| 2022 | - |
| Thereafter | - |
| | $ 284 |

## NOTE E – DEPOSITS

The aggregate amount of time deposits in denominations of $250,000 or more at December 31, 2017 and 2016 was $19,565,000 and $26,776,000, respectively.

At December 31, 2017, the scheduled maturities of certificates of deposit are as follows:

| Years ending December 31, | (in thousands) |
|---|---|
| 2018 | $ 30,164 |
| 2019 | 8,245 |
| 2020 | 1,238 |
| 2021 | 3,834 |
| 2022 | 408 |
| Thereafter | 938 |
| | $ 44,827 |

## NOTE F – BORROWINGS

At December 31, 2017 and 2016, there were no outstanding long term borrowings (debt with original maturities of more than one year).

At December 31, 2017, short-term borrowings of $23,600,000 consisted of Federal Home Loan Bank fixed-rate advances with an interest rate of 1.47%. At December 31, 2016, there were no outstanding short term borrowings.

At December 31, 2017 and 2016, loans totaling $114,164,000 and $119,439,000 were pledged to secure all Federal Home Loan Bank borrowings. At December 31, 2017, the Bank had additional borrowing capacity at the Federal Home Loan Bank of approximately $53,071,000.

At December 31, 2017, the Bank maintained various additional short and long-term lines of credit, with available facilities of $24,700,000.

## NOTE G – INCOME TAXES

Following is an analysis of income taxes included in the statements of income:

| | 2017 | 2016 |
|---|---|---|
| | (in thousands) | |
| Current tax expense | | |
| Federal | $ 2,350 | $ 2,416 |
| State | 335 | 345 |
| | 2,685 | 2,761 |
| Deferred tax expense | | |
| Federal | 361 | 137 |
| State | 52 | 20 |
| | 413 | 157 |
| | $ 3,098 | $ 2,918 |

Listed below are the components of the net deferred tax assets, which are included in other assets:

| | December 31, | |
|---|---|---|
| | 2017 | 2016 |
| | (in thousands) | |
| Deferred tax assets | | |
| Allowance for loan losses | $ 482 | $ 720 |
| Organizational costs | 76 | 144 |
| Deferred loan fees | 182 | 235 |
| Other, net | 74 | 124 |
| Total deferred tax assets | 814 | 1,223 |
| Deferred tax liabilities | | |
| FHLB dividends | (17) | (13) |
| Total deferred tax liabilities | (17) | (13) |
| Net deferred tax asset | $ 797 | $ 1,210 |

The reasons for the differences between the statutory federal income tax rate and the effective tax rate are summarized as follows:

| | Year Ended December 31, | |
|---|---|---|
| | 2017 | 2016 |
| | (percentage) | |
| Statutory federal tax rate | 34.00 | 34.00 |
| Increase (decrease) resulting from: | | |
| State tax, net of federal tax benefit | 3.51 | 2.98 |
| Revaluation of deferred tax asset | 5.51 | - |
| Other | (0.42) | (0.84) |
| Effective rate | 42.60 | 36.14 |

On December 22, 2017, The Tax Cut and Jobs Act was signed into law by the President. This bill, among other provisions, reduced the corporate tax rate to 21% from a previous rate of 34% for the Bank, effective January 1, 2018. As required, the Bank's net deferred tax asset was revalued at the 21% rate, resulting in a charge to income of approximately $401,000 in 2017.

## NOTE H - FINANCIAL INSTRUMENTS WITH OFF-BALANCE SHEET RISK

The Bank 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 stand-by letters of credit.

Those instruments involve, to a varying degree, elements of credit risk in excess of the amount recognized in the statement of financial position. The contract amounts of those instruments reflect the extent of involvement the Bank has in particular classes of financial instruments.

The Bank's exposure to credit loss in the event of non-performance by the other party to the financial instrument for commitments to extend credit and stand-by 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.

At December 31, 2017 and 2016, the following financial instruments were outstanding whose contract amounts represent credit risk:

| | 2017 | 2016 |
|---|---|---|
| | (in thousands) | |
| Commitments to extend credit | $ 36,756 | $ 26,443 |
| Letters of credit | 1,533 | 1,076 |

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 may expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. The Bank evaluates each customer's credit-worthiness on a case-by-case basis. The amount of collateral obtained if deemed necessary by the Bank upon extension of credit is based on management's credit evaluation. Collateral held varies, but may include accounts receivable, inventory, property, plant and equipment and income-producing commercial properties.

Stand-by letters of credit are conditional commitments issued by the Bank 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.

## NOTE I - EMPLOYEE BENEFIT AND COMPENSATION PLANS

### 401(k) Plan

The Bank maintains a 401(k) retirement plan whereby substantially all employees who meet certain age and length of service requirements may participate in the plan. For 2017 and 2016, expense attributable to the Plan amounted to approximately $59,000.

### Employment Agreements

The Bank has employment agreements with its CEO and President. The agreements establish a salary that is increased annually based on performance factors relating to Bank earnings, asset growth and asset quality. The CEO and President are also entitled to participate in annual bonuses based on Bank earnings and asset quality. These are subject to annual review and approval by the Board.

### Stock Appreciation Rights

The Bank has a Stock Appreciation Rights (SAR) plan for senior officers. Under the plan, participants are granted a number of SARs at the discretion of the Bank's Board of Directors. Each SAR entitles the holder to the book value appreciation in one share of the Bank's common stock for the periods following the date of grant. The value of the stock appreciation vests immediately, at which time the holder is entitled to receive the value in cash. Expense attributable to the plan in 2017 and 2016 was $539,000 and $522,000, respectively. All expenses were paid as part of 2017 and 2016 compensation, and no liability related to this expense existed as of December 31, 2017 and 2016.

## NOTE J – RELATED PARTY TRANSACTIONS

In the ordinary course of business, the Bank may make loans to executive officers, directors and principal shareholders of the Bank, including their immediate families and companies in which they are principal owners. At December 31, 2017 and 2016, total loans to these persons approximated $5,300,000 and $4,300,000, respectively. Deposits by related parties held by the Bank at December 31, 2017 and 2016 were approximately $3,868,000 and $4,732,000, respectively.

## NOTE K – STOCKHOLDERS' EQUITY AND DIVIDENDS

### Preferred Stock

In 2011, the Bank issued 8,766 shares of perpetual, non-cumulative preferred stock ($1,000 per share liquidation preference) to the Bank's majority shareholder, Verus. The transaction was in conjunction with Verus's issuance of preferred stock to the United States Department of Treasury as part of the Treasury's Small Business Lending Fund (SBLF) program.

The SBLF is a dedicated investment fund that encourages lending to small businesses by providing capital to qualified community banks. The SBLF is structured to encourage small business lending through a tiered dividend structure where the dividend rate, for Verus, on the preferred stock is based on the growth of the Bank's small business lending. The initial dividend rate payable on SBLF capital is, at most, 5%, and the rate falls to 1% if a bank's small business lending increases by 10% or more. Banks that increase their lending by less than 10% pay dividend rates between 2% and 4%. If a bank's lending does not increase in the first two years after issuance, however, the dividend rate increases to 7%. Four and one-half years after issuance, the dividend rate for all banks increases to 9%. Dividends on the SBLF preferred stock are payable quarterly in arrears each January 1, April 1, July 1 and October 1. Verus's dividend rate in 2015 was approximately 1%.

In January 2016, the Bank redeemed all outstanding 8,766 shares of preferred stock for $8,766,000.

### Dividends

Federal banking regulations place certain restrictions on dividends paid by the Bank to its shareholders. Approval by the banking regulators is required if the total of all dividends declared by the Bank exceeds the total of its net profits for the year combined with its retained net profits of the preceding two years.

In addition, dividends paid by the Bank would be prohibited if the effect thereof would cause the Bank's capital to be deemed below the applicable minimum capital requirements.

## NOTE L - MINIMUM REGULATORY CAPITAL REQUIREMENTS

Quantitative measures established by regulation to ensure capital adequacy require the Bank to maintain minimum amounts and ratios (set forth in the following table) of total and Tier 1 capital (as defined in the regulations) to risk-weighted assets (as defined), Common Equity Tier 1 capital (as defined in the regulations) to risk-weighted assets (as defined), and of Tier 1 capital (as defined) to average assets (as defined). Management believes, as of December 31, 2017 and 2016, that the Bank meets all capital adequacy requirements to which it is subject.

When fully phased in on January 1, 2019, the Basel III capital rules will require the Bank to maintain a minimum ratio of common equity tier 1 capital to risk-weighted assets of at least 4.5%, plus a 2.5% "capital conservation buffer" (which is added to the 4.5% common equity tier 1 capital ratio as the buffer is phased in, effectively resulting in a minimum ratio of common equity tier 1 capital to risk-weighted assets of 7% upon full phase in). The Bank will also be required to maintain a tier 1 capital to risk-weighted assets ratio of 6.0% (8.5% including the capital conservation buffer), a total capital to risk-weighted assets ratio of 8.0% (10.5% including the capital conservation buffer), and a tier 1 capital to quarterly average assets ratio of 4.0%.

The aforementioned capital conservation buffer phases in at 0.625% annually over a four year period beginning January 1, 2016, and is designed to absorb losses during periods of economic stress. Banking institutions with capital ratios above the base minimums but below the effective minimums (which include the buffer) will face constraints on dividends, equity repurchases and compensation based on the amount of the shortfall.

The following tables present actual and required capital ratios for the Bank under the Basel III Capital Rules. The minimum required capital amounts presented include the minimum required capital levels as of December 31, 2017 and 2016 based on the phase-in provisions of the Basel III Capital Rules and the minimum required capital levels as of January 1, 2019 when the Basel III Capital Rules have been fully phased-in, and include the capital conservation buffer. Capital levels required to be considered well capitalized are based on prompt corrective action regulations, as amended to reflect changes under the Basel III Capital Rules.

| | Actual | | Minimum required for capital adequacy purposes - Basel III phase-in schedule | | To be well capitalized under Prompt Corrective Action Regulations | |
|---|---|---|---|---|---|---|
| | Amount | Ratio | Amount | Ratio | Amount | Ratio |
| | | | (in thousands) | | | |
| **<u>As of December 31, 2017</u>** | | | | | | |
| Total capital (to risk weighted assets) | $ 33,953 | 15.1% | $ 20,779 | 9.250% | $ 22,464 | 10.0% |
| Tier 1 capital (to risk weighted assets) | 31,997 | 14.2 | 16,287 | 7.250 | 17,971 | 8.0 |
| Common Tier 1 capital (to risk weighted assets) | 31,997 | 14.2 | 12,917 | 5.750 | 14,602 | 6.5 |
| Tier 1 capital (to average assets) | 31,997 | 13.2 | 9,712 | 4.000 | 12,140 | 5.0 |
| **<u>As of December 31, 2016</u>** | | | | | | |
| Total capital (to risk weighted assets) | $ 33,659 | 15.3% | $ 18,985 | 8.625% | $ 22,012 | 10.0% |
| Tier 1 capital (to risk weighted assets) | 31,713 | 14.4 | 14,583 | 6.625 | 17,610 | 8.0 |
| Common Tier 1 capital (to risk weighted assets) | 31,713 | 14.4 | 11,281 | 5.125 | 14,308 | 6.5 |
| Tier 1 capital (to average assets) | 31,713 | 12.5 | 10,139 | 4.000 | 12,673 | 5.0 |

## NOTE M – FAIR VALUE MEASUREMENT

The Bank used the following methods and significant assumptions to estimate fair value:

*Impaired loans* – The Bank does not record loans at fair value on a recurring basis. However, from time to time, fair value adjustments are recorded on these loans to reflect (1) partial write-downs that are based on the current appraised or market-quoted value of the underlying collateral or (2) the full charge-off of the loan carrying value. In some cases, the properties for which market quotes or appraised values have been obtained are located in areas where comparable sales data is limited, outdated, or unavailable. Fair value estimates for impaired loans are obtained from real estate brokers or other third-party consultants (Level 3).

*Foreclosed Real Estate* - Nonrecurring adjustments to certain commercial and residential real estate properties classified as foreclosed real estate are measured at the lower of carrying amount or fair value, less costs to sell. Fair values are generally based on third party appraisals of the property, resulting in Level 3 classification. In cases where the carrying amount exceeds the fair value, less costs to sell, an impairment loss is recognized.

At December 31, 2017 and 2016, there were no collateral dependent impaired loans.

At December 31, 2017 and 2016, the Bank held no foreclosed real estate.

During 2017 and 2016, there were no changes or amounts in Level 3 assets or liabilities recorded at fair value on a recurring basis.