THE BANK OF FINCASTLE AND SUBSIDIARY

Consolidated Financial Statements

Years Ended

December 31, 2018 and 2017

YHB CPAs & Consultants

INDEPENDENT AUDITOR'S REPORT

To the Board of Directors and Stockholders
The Bank of Fincastle
Fincastle, Virginia

Report on the Financial Statements
We have audited the accompanying consolidated financial statements of The Bank of Fincastle and subsidiary (the Bank), which comprise the consolidated balance sheet as of December 31, 2018, the related consolidated statements of operations, comprehensive loss, changes in stockholders' equity and cash flows for the year then ended, and the related notes to the consolidated financial statements (collectively, 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.

Auditor's Responsibility
Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the 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 auditor's 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 the Bank as of December 31, 2018, and the results of their operations and their cash flows for the year then ended in accordance with accounting principles generally accepted in the United States of America.

Other Matter
The financial statements of the Bank, as of and for the year ended December 31, 2017, were audited by other auditors, whose report, dated March 8, 2018, expressed an unmodified opinion on those statements.

Yount, Hyde & Barbour, P.C.

Roanoke, Virginia
March 26, 2019

THE BANK OF FINCASTLE AND SUBSIDIARY

CONSOLIDATED BALANCE SHEETS

December 31, 2018 and 2017

	2018	2017
ASSETS		
Cash and cash equivalents	$ 3,305,017	$ 3,724,989
Interest-bearing deposits with banks	4,507,162	3,234,718
Federal funds sold	132,000	1,088,000
Investment securities available for sale, at fair value	32,250,341	32,707,371
Restricted investment securities	235,450	240,550
Loans held for sale	573,000	-
Loans, net of allowance for loan losses of $2,676,945 at 2018 and $2,967,670 at 2017	148,820,724	138,047,309
Premises and equipment, net	5,099,030	5,808,484
Accrued interest receivable	600,216	554,791
Other real estate owned	2,107,010	5,623,193
Bank owned life insurance	5,552,722	5,426,072
Other assets	3,907,182	4,237,637
Total assets	$ 207,089,854	$ 200,693,114
LIABILITIES AND STOCKHOLDERS' EQUITY		
Liabilities		
Deposits		
Noninterest-bearing demand deposits	$ 61,018,397	$ 59,420,025
Interest-bearing deposits	118,093,537	114,036,967
Total deposits	179,111,934	173,456,992
Accrued interest payable	111,799	59,443
Reserve for losses on letters of credit	1,358,880	1,768,307
Other liabilities	1,208,295	896,520
Total liabilities	181,790,908	176,181,262
Stockholders' equity		
Common stock, $0.04 par value; 10,000,000 shares authorized, 9,999,999 shares at 2018 and 9,999,999 shares at 2017, issued and outstanding	400,000	400,000
Surplus	18,119,152	18,119,152
Retained earnings	7,218,340	6,369,845
Accumulated other comprehensive loss	(438,546)	(377,145)
Total stockholders' equity	25,298,946	24,511,852
Total liabilities and stockholders' equity	$ 207,089,854	$ 200,693,114

See accompanying notes to consolidated financial statements.

THE BANK OF FINCASTLE AND SUBSIDIARY

CONSOLIDATED STATEMENTS OF OPERATIONS

Years Ended December 31, 2018 and 2017

	2018	2017
INTEREST INCOME		
Interest and fees on loans	$ 7,267,180	$ 6,173,394
Interest on investment securities, taxable	529,153	522,970
Interest on investment securities, tax-exempt	-	4,128
Interest on interest bearing deposits in banks	105,162	145,056
Total interest income	7,901,495	6,845,548
INTEREST EXPENSE		
Interest on deposits	808,221	649,670
Interest on borrowings	5,146	8,224
Total interest expense	813,367	657,894
Net interest income	7,088,128	6,187,654
PROVISION FOR LOAN LOSSES	220,000	-
Net interest income after provision for loan losses	6,868,128	6,187,654
NONINTEREST INCOME		
Service charges on deposit accounts	141,886	156,406
Rental income	160,100	175,893
Debit and credit card fees	404,321	362,046
Other income	460,953	373,303
Total noninterest income	1,167,260	1,067,648
NONINTEREST EXPENSE		
Salaries and employee benefits	3,496,934	3,290,407
Occupancy and equipment	752,463	696,804
Data processing expenses	1,349,164	1,229,590
Legal and professional fees	434,529	555,465
Postage, stationery and supplies	93,325	117,668
FDIC insurance assessment	111,394	358,410
Losses (gains) on sale and write-downs of other real estate owned, net	167,968	(843,005)
Expenses of adversely classified items	118,110	1,578,958
(Gains) losses on letters of credit, net	(200,000)	1,888,000
Other expenses	723,203	657,727
Total noninterest expense	7,047,090	9,530,024
INCOME (LOSS) BEFORE INCOME TAXES	988,298	(2,274,722)
Income tax expense	139,803	1,362,641
NET INCOME (LOSS)	$ 848,495	$ (3,637,363)
Per share data:		
Income (Loss) per share	$ 0.08	$ (0.66)

See accompanying notes to consolidated financial statements.

THE BANK OF FINCASTLE AND SUBSIDIARY

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)

Years Ended December 31, 2018 and 2017

	2018	2017
NET INCOME (LOSS)	$ 848,495	$ (3,637,363)
OTHER COMPREHENSIVE INCOME (LOSS):		
Net unrealized loss arising during the period	(77,712)	(123,716)
Transfer of held to maturity securities to available for sale securities	-	(373,620)
Reclassification adjustment for gain included in net income (loss)	-	19,926
Net unrealized loss	(77,712)	(477,410)
Tax effect	(16,311)	(100,265)
Other comprehensive loss	(61,401)	(377,145)
COMPREHENSIVE INCOME (LOSS)	$ 787,094	$ (4,014,508)

THE BANK OF FINCASTLE AND SUBSIDIARY

CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY

Years ended December 31, 2018 and 2017

	Common Stock	Surplus	Retained Earnings	Accumulated Other Comprehensive Loss	Total
Balance at December 31, 2016	$ 91,277	$ 5,057,723	$ 10,007,207	$ -	$ 15,156,207
Proceeds from issuance of common stock	308,723	13,061,429	-	-	13,370,152
Net loss	-	-	(3,637,362)	-	(3,637,362)
Other comprehensive loss	-	-	-	(377,145)	(377,145)
Balance at December 31, 2017	400,000	18,119,152	6,369,845	(377,145)	24,511,852
Net income	-	-	848,495	-	848,495
Other comprehensive loss	-	-	-	(61,401)	(61,401)
Balance at December 31, 2018	400,000	18,119,152	7,218,340	(438,546)	25,298,946

See accompanying notes to consolidated financial statements.

THE BANK OF FINCASTLE AND SUBSIDIARY

CONSOLIDATED STATEMENTS OF CASH FLOWS

Years ended December 31, 2018 and 2017

	2018	2017
CASH FLOWS FROM OPERATING ACTIVITIES		
Net income (loss)	848,495	(3,637,363)
Adjustments to reconcile net income (loss) to net cash provided by (used in) operations:		
Net amortization of premiums on securities	20,019	31,259
Provision for loan losses	220,000	-
Depreciation and amortization	243,452	262,715
Net (gain) loss from sales of premises and equipment	(141,250)	15,916
Net gain from sales of other real estate owned	(545,545)	(138,187)
Loss from sale of securities available for sale	-	19,926
Increase in cash surrender value of life insurance	(126,650)	(130,634)
Write-downs of other real estate owned	183,896	402,875
Deferred income tax expense, net of allowance	136,181	1,554,048
(Increase) decrease in:		
Loans held for sale	(573,000)	734,701
Accrued interest receivable	(45,425)	(145,115)
Other assets	127,523	(165,460)
Increase (decrease) in:		
Accrued interest payable	52,356	(1,625)
Accrued losses on letters of credit	(409,427)	1,768,307
Other liabilities	311,775	71,330
Net cash provided by operating activities	302,400	642,693
CASH FLOWS FROM INVESTING ACTIVITIES		
Net (increase) decrease in interest-bearing deposits with banks	(1,272,444)	1,372,001
Net (increase) decrease in federal funds sold	956,000	(1,008,000)
Maturities of investment securities held to maturity	-	42,155,741
Purchases of investment securities held to maturity	-	(29,714,657)
Proceeds from sale of investment securities available for sale	-	5,200,864
Principal payments from investment securities	359,299	323,656
Proceeds from sales of restricted investment securities	5,100	10,400
Net increase in loans	(11,004,855)	(18,486,171)
Purchases of premises and equipment	(107,990)	(11,276)
Proceeds from sales of premises and equipment	271,818	-
Purchases of other real estate owned	-	(1,454,690)
Proceeds from sales of other real estate owned	4,415,757	3,190,472
Net cash provided by (used in) investing activities	(6,377,315)	1,578,340
CASH FLOWS FROM FINANCING ACTIVITIES		
Net increase (decrease) in deposits	5,654,942	(16,900,561)
Common stock issued	-	13,370,153
Net cash provided by (used in) financing activities	5,654,942	(3,530,408)
Net decrease in cash and cash equivalents	(419,973)	(1,309,375)
Cash and cash equivalents at beginning of year	3,724,989	5,034,364
Cash and cash equivalents at end of year	3,305,017	3,724,989

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Organization

The Bank of Fincastle (Bank) provides a variety of banking services to individuals and businesses through its six full-service branches and one drive-through branch located in Botetourt County. The Bank's primary deposit products are interest bearing and non-interest bearing checking accounts, certificates of deposit and savings accounts. Its primary lending products are commercial, real estate mortgage, construction, home equity, and consumer installment loans. The Bank is a Virginia state-chartered bank subject to regulation by the Bureau of Financial Institutions and the Federal Deposit Insurance Corporation. The Bank has a wholly-owned subsidiary, Bank of Fincastle Services, Inc., that owns interests in four limited liability companies that operate in real estate sales, title insurance, and residential mortgages. During 2016, the Bank formed ESF, LLC, another wholly owned subsidiary, to hold other real estate owned.

Critical Accounting Policy

Management believes the policies with respect to the methodology for the determination of the allowance for loan losses, the deferred tax asset valuation allowance, and the other real estate owned valuation involve a high degree of complexity. Management must make difficult and subjective judgments which often require assumptions or estimates about highly uncertain matters. Changes in these judgements, assumptions, or estimates could cause reported results to differ materially. These critical policies and their application are periodically reviewed with the Audit Committee and Board of Directors.

Principles of Consolidation

The consolidated financial statements include the accounts of The Bank of Fincastle and its wholly-owned subsidiary, Bank of Fincastle Services, Inc. All significant inter-company transactions and balances have been eliminated.

Business Segments

The Bank reports its activities as a single business segment. In determining proper segment definition, the Bank considers the materiality of a potential segment and components of the business about which financial information is available and regularly evaluated, relative to resource allocation and performance assessment.

Cash and Cash Equivalents

For the purpose of presentation in the Consolidated Statement of Cash Flows, cash and cash equivalents are defined as those amounts included in the balance sheet captions "Cash and cash equivalents."

Use of Estimates

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

Material estimates that are particularly susceptible to significant change relate to the determination of the allowance for loan losses, the valuation of real estate acquired in connection with foreclosures or in satisfaction of loans, and the deferred tax asset valuation allowance. In connection with the determination of the allowance for loan losses and valuation of other real estate owned, management obtains independent appraisals for significant properties.

Substantially all of the Bank's loan portfolio consists of loans in its market area. Accordingly, the ultimate collectability of a substantial portion of the Bank's loan portfolio and the recovery of a substantial portion of the carrying amount of other real estate owned are susceptible to changes in market conditions in Botetourt and adjacent counties.

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

While management uses available information to recognize loan and other real estate owned losses, future additions to the allowance for loan losses or write-down of other real estate owned may be necessary based on changes in local economic conditions. In addition, regulatory agencies, as a part of their routine examinations process, periodically review the Bank's allowance for loan losses and valuation of other real estate owned. Such agencies may require additions to the allowance for loan losses or further write-downs on other real estate owned based on their judgments about information available to them at the time of their examinations. Because of these factors, it is reasonably possible that the allowance for loan losses and other real estate owned losses may change materially in the near term.

Investment Securities

Debt securities that management has the positive intent and ability to hold to maturity are classified as "held to maturity" and recorded at amortized cost. Securities held principally for the purpose of being sold in the near future are classified as trading and recorded at fair value, with unrealized gains and losses included in earning. Securities that are not classified as held to maturity or trading, are classified as "available for sale" and recorded at fair value, with unrealized gains and losses reported in other comprehensive income. The amortization of premiums and accretion of discounts on securities are recognized in interest income using methods approximating the interest method over the period-to-maturity. Gains or losses on the sale of securities are recognized on a specific identification basis.

Declines in the fair value of held to maturity and available for sale securities below their cost that are deemed to be other than temporary are reflected in earnings as realized losses. In estimating other-than-temporary impairment losses, management considers several factors including the length of time and the extent to which the fair value has been less than cost, the financial condition and near-term prospects of the issuer, and the intent and ability of the Bank to retain its investment in the issuer for a period of time sufficient to allow for any anticipated recovery in fair value.

Loans

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 net of deferred origination fees. Interest is accrued and credited to income based on the principal amount outstanding. The accrual of interest on impaired loans is discontinued when, in management's opinion, the borrower may be unable to meet payments as they become due. When interest accrual is discontinued, all unpaid accrued interest is reversed. Interest income is subsequently recognized only to the extent cash payments are received. The loan is returned to accrual status when the facts and circumstances indicate that the borrower has regained the ability to meet required payments. Past due status of loans is determined based on contractual terms. Loans held for sale in the secondary market are recorded at the lower of cost or estimated fair value. Net unrealized losses, if any, are recognized through a valuation allowance by charges to income.

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Risk factors evaluated include the economic environment's impact on each portfolio segment and the following specific risk factors:

- Commercial real estate loans carry risk associated with either the net operating income generated from the lease of the real estate collateral or income generated from the sale of the collateral. Other risk factors include the credit-worthiness of the sponsor and the value of the collateral.
- Residential real estate loans for consumer purposes carry risks associated with the continued credit-worthiness of the borrower and the value of the collateral. Residential real estate loans for investment purposes carry risks associated with the continued credit-worthiness of the borrower, the value of the collateral, and either the net operating income generated from the lease of the real estate collateral or income generated from the sale of the collateral.
- Real estate construction loans carry risk associated with the credit-worthiness of the borrower, project completion within budget, sale after completion and the value of the collateral.
- Commercial non-real estate loans represent a small portion of the portfolio and carry risk associated with the operations of the business and the value of the collateral, if any.
- Consumer non-real estate and other loans represent a small portion of the portfolio and carry risk associated with the credit-worthiness of the borrower and the value of the collateral, if any.

Allowance for Loan Losses

The allowance for loan losses is maintained at a level which, in management's judgment, is adequate to absorb credit losses inherent in the loan portfolio. The amount of the allowance is based on management's evaluation of the collectability of the loan portfolio, including the nature of the portfolio, credit concentrations, and trends in historical loss experience, specific impaired loans, and economic conditions. The allowance is increased by a provision for loan losses, which is charged to expense and reduced by charge-offs, net of recoveries. Loans are charged against the allowance when management believes that the uncollectability of the loan balance is confirmed. Subsequent recoveries, if any, are credited to the allowance. Management's evaluation of the allowance for loan losses is inherently subjective as it requires estimates that are susceptible to significant revision as more information becomes available.

The allowance consists of specific, general and unallocated components. The specific component relates to loans that are classified as impaired, for which an allowance is established when the discounted cash flows (or collateral value or observable market price) of the loan is lower than its carrying value. The general component covers non-impaired loans and is based on historical loss experience adjusted for qualitative factors. An unallocated component is maintained to cover uncertainties that could affect management's estimate of probable losses. The unallocated component of the allowance reflects the margin of imprecision inherent in the underlying assumptions used in the methodologies for estimating specific and general losses in the portfolio.

A loan is considered impaired when, based on current information and events, it is probable that the Bank will be unable to collect the scheduled payments of principal or interest when due according to the contractual terms of the loan agreement. Factors considered by management in determining impairment include payment status, collateral value, and the probability of collecting scheduled principal and interest payments when due. Loans that experience insignificant payment delays and payment shortfalls generally are not classified as impaired. 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. Impairment is measured on a loan-by-loan basis by either the present value of expected future cash flows discounted at the loan's effective interest rate, the loan's obtainable market price, or the fair value of the collateral less estimated selling costs if the loan is collateral dependent.

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Troubled Debt Restructuring

In situations where, for economic or legal reasons related to a borrower's financial condition, management may grant a concession to the borrower that it would not otherwise consider. The related loan is classified as a troubled debt restructuring ("TDR"). Management strives to identify borrowers in financial difficulty early and work with them to modify their loan to more affordable terms before their loan reaches nonaccrual status. These modified terms may include rate reductions, principal forgiveness, payment forbearance and other actions intended to minimize the economic loss and to avoid foreclosure or repossession of the collateral. In cases where borrowers are granted new terms that provide for a reduction of either interest or principal, management measures any impairment on the restructuring as noted above for impaired loans.

Premises and Equipment

Land is stated at cost. Bank premises and equipment are stated at cost less accumulated depreciation. Depreciation is charged to operating expense over the estimated useful lives of the assets on the straight-line method.

	Useful Lives
Buildings and improvements	10-40
Furniture and equipment	3-10

Costs of maintenance and repairs are charged to expense as incurred, and improvements are capitalized.

Other Real Estate Owned

Real estate properties acquired through, or in lieu of, foreclosure are initially recorded at the lower of the recorded investment in the property or its fair value less estimated selling costs at the date of foreclosure, establishing a new cost basis. After foreclosure, valuations are periodically performed by management and the real estate is carried at the lower of carrying amount or fair value less estimated costs to sell. Revenues and expenses from operations related to the properties and changes in the carrying value are included in other operating expenses. Gains and losses on the sale of these properties are recorded in income in the year of the sale.

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.

Income Taxes

The federal income tax returns for the Bank and its subsidiary are filed on a consolidated basis. The provision for income taxes is based on amounts reported in the consolidated statements of operations, after exclusion of nontaxable income and nondeductible expenses, and consists of taxes currently due plus deferred taxes on temporary differences in the recognition of income and expense for tax and financial statement purposes. Deferred income taxes have been determined using the liability method of accounting for income taxes. Under this method, deferred tax assets and liabilities are determined based on the difference between the financial statement carrying amounts and tax bases of assets and liabilities and gives current recognition to changes in tax rates and laws.

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Deferred income tax liabilities relating to unrealized gains (or the deferred tax asset in the case of unrealized losses) on investment securities available for sale are recorded in other liabilities (assets). These items are recorded as an adjustment to accumulated comprehensive income in the financial statements and not included in earnings until realized. Deferred tax assets are recognized if it is more likely than not, based on the technical merits, that the tax position will be realized or sustained upon examination. The term more likely than not means a likelihood of more than 50 percent; the terms examined and upon examination also include resolution of the related appeals or litigation processes, if any. A tax position that meets the more-likely-than-not recognition threshold is initially and subsequently measured as the largest amount of tax benefit that has a greater than 50 percent likelihood of being realized upon settlement with a taxing authority that has full knowledge of all relevant information. The determination of whether or not a tax position has met the more-likely-than-not recognition threshold considers the facts, circumstances, and information available at the reporting date and is subject to management's judgment. Deferred tax assets are reduced by a valuation allowance if, based on the weight of evidence available, it is more likely than not that some portion or all of a deferred tax asset will not be realized.

Interest and penalties associated with income tax positions are classified as interest expense on the Consolidated Statements of Operations.

Deferred Tax Asset Valuation Allowance

A valuation allowance is required for deferred tax assets if, based on available evidence, it is more likely than not that all or some of the asset may not be realized due to the inability to generate sufficient taxable income in the period and/or of the character necessary to utilize the benefit of the deferred tax asset. In making this assessment, all sources of taxable income available to realize the deferred tax asset are considered, including future reversals of existing temporary differences, tax planning strategies, and future taxable income exclusive of reversing temporary differences and carry-forwards. The predictability that future taxable income, exclusive of reversing temporary differences, will occur is the most subjective of these four sources.

In assessing the need for a valuation allowance, the Bank considered both positive and negative evidence to estimate whether sufficient future taxable income will be generated to permit use of the existing deferred tax assets. A significant piece of objective negative evidence evaluated was the cumulative loss incurred over the three year period ended December 31, 2017. Such objective evidence limits the ability to consider other subjective positive evidence, such as the forecasted future earnings of the Bank.

On the basis of this evaluation, as of December 31, 2018, a valuation allowance of $1.39 million has been recorded to recognize only the portion of the deferred tax asset that is more likely than not to be realized. The amount of the deferred tax asset considered realizable, however, could be adjusted if estimates of future taxable income during the carry-forward period are reduced or increased or if objective negative evidence in the form of cumulative losses is no longer present and additional weight is given to subjective evidence such as the Bank’s forecast for future earnings.

Earnings (Loss) Per Share

Basic earnings (loss) per share represent income available to common shareholders divided by the weighted average number of shares of common stock outstanding during the period. Diluted earnings (loss) per share reflect additional common shares that would have been outstanding if dilutive potential common shares had been issued, as well as any adjustment to income that would result from the assumed issuance. The Bank had no potentially diluted common stock outstanding, as of December 31, 2018 and 2017.

Earnings (loss) per share are computed based on 9,999,999 and 5,497,783 weighted average common shares outstanding during the years ended December 31, 2018 and 2017, respectively.

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Comprehensive Income (Loss)

Comprehensive income consists of net income and other comprehensive income. Other comprehensive income (loss) includes unrealized gains (losses) on securities available for sale.

Credit Related Financial Instruments

In the ordinary course of business, the Bank has entered into off-balance sheet financial instruments consisting of commitments to extend credit and commercial and standby letters of credit. Such financial instruments are recorded in the financial statements when they are funded or related fees are incurred or received.

The Bank does not utilize interest-rate exchange agreements or interest-rate futures contracts.

Fair Value of Financial Instruments

Generally accepted accounting principles ("GAAP") define fair value as 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. The Bank determines the fair values of its financial instruments based on the fair value hierarchy established by GAAP which requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value.

Advertising Costs

Advertising costs are expensed as incurred. Advertising expenses of $176,613 and $122,537 were incurred for the years ended December 31, 2018 and 2017, respectively.

Reclassifications

Certain reclassifications have been made to the 2017 financial statements to conform to classifications used in 2018. Reclassifications were insignificant and had no effect on prior year net income or stockholders' equity.

Adoption of New Accounting Standards

During 2018, the Bank adopted ASU 2016-01: *Financial Instruments - Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities.* The amendments in ASU 2016-01, among other things: (1) 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; (2) requires public business entities to use the exit price notion when measuring the fair value of financial instruments for disclosure purposes; (3) Requires separate presentation of financial assets and financial liabilities by measurement category and form of financial asset (i.e., securities or loans and receivables); and (4) eliminates the requirement for public business entities to disclose the method(s) and significant assumptions used to estimate the fair value that is required to be disclosed for financial instruments measured at amortized cost. The adoption of ASU No. 2016-01 did not have a material impact on the Bank's consolidated financial statements. In accordance with (2) above, the Bank measured the fair value of its loan and deposit portfolios as of December 31, 2018 using an exit price notion (see Note 21 Fair Value Measurement).

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

During 2018, the Bank adopted ASU 2016-10: *Revenue from Contracts with Customers (Topic 606): Identifying Performance Obligations and Licensing*. This standard is on the recognition of revenue from contracts with customers with the core principle being for companies to recognize revenue to depict the transfer of goods or services to customers in amounts that reflect the consideration to which the company expects to be entitled in exchange for those goods or services. The new standard also results in enhanced disclosures about revenue, provides guidance for transactions that were not previously addressed comprehensively and improves guidance for multiple-element arrangements. Our revenue is comprised of net interest income on financial assets and liabilities, which is explicitly excluded from the scope of the new guidance, and noninterest income. The contracts that are in scope of the guidance are primarily related to service charges on deposit accounts, cardholder and merchant income, other service charges and fees, sales of other real estate and miscellaneous fees. We have performed an analysis of contracts for customer service charges, ATM fees and miscellaneous income. The adoption of ASU 2016-10 did not have a material impact on the Bank's consolidated financial statements.

Recent Accounting Pronouncements

In February 2016, the FASB issued ASU 2016-02: *Leases (Topic 842)*. Among other things, in the amendments in ASU 2016-02, lessees will be required to 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. Certain targeted improvements were made to align, where necessary, lessor accounting with the lessee accounting model and Topic 606, Revenue from Contracts with Customers. The amendments in this ASU are effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. Early application is permitted upon issuance. Lessees (for capital and operating leases) and lessors (for sales-type, direct financing, and operating leases) must apply a modified retrospective transition approach for leases existing at, or entered into after, the beginning of the earliest comparative period presented in the financial statements. The modified retrospective approach would not require any transition accounting for leases that expired before the earliest comparative period presented. Lessees and lessors may not apply a full retrospective transition approach. The FASB made subsequent amendments to Topic 842 in July 2018 through ASU 2018-10: *Codification Improvements to Topic 842, Leases* and ASU 2018-11: *Leases Topic 842: Targeted Improvements*. Among these amendments is the provision in ASU 2018-11 that provides entities with an additional (and optional) transition method to adopt the new leases standard. Under this new transition method, an entity initially applies the new leases standard at the adoption date and recognizes a cumulative-effect adjustment to the opening balance of retained earnings in the period of adoption. Consequently, an entity's reporting for the comparative periods presented in the consolidated financial statements in which it adopts the new leases standard will continue to be in accordance with current GAAP (Topic 840, Leases).

During June 2016, the FASB issued ASU 2016-13: Financial Instruments – *Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments*. The amendments in this ASU, among other things, require the measurement of all expected credit losses for financial assets held at the reporting date based on historical experience, current conditions, and reasonable and supportable forecasts. Financial institutions and other organizations will now use forward-looking information to better inform their credit loss estimates. Many of the loss estimation techniques applied today will still be permitted, although the inputs to those techniques will change to reflect the full amount of expected credit losses. In addition, the ASU amends the accounting for credit losses on available-for-sale debt securities and purchased financial assets with credit deterioration. For public companies that are not SEC filers, the amendments in this ASU are effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2020. The Bank is currently assessing the impact that ASU 2016-13 will have on its consolidated financial statements.

The Bank has formed a committee to address the compliance requirements, data gathering, archiving and analysis efforts. Additionally, the Bank has purchased a software solution that will assist in complying with this regulation. The Bank expects to begin operating in a parallel environment with the existing loss model in mid-2019.

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

During March 2017, the FASB issued ASU 2017-08: *Receivables—Nonrefundable Fees and Other Costs (Subtopic 310-20), Premium Amortization on Purchased Callable Debt Securities*. The amendments in this ASU shorten the amortization period for certain callable debt securities purchased at a premium. Upon adoption of the standard, premiums on these qualifying callable debt securities will be amortized to the earliest call date. Discounts on purchased debt securities will continue to be accreted to maturity. The amendments are effective for fiscal years beginning after December 15, 2018, and interim periods within those fiscal years. Early adoption is permitted, including adoption in an interim period. Upon transition, entities should apply the guidance on a modified retrospective basis, with a cumulative-effect adjustment to retained earnings as of the beginning of the period of adoption and provide the disclosures required for a change in accounting principle. The Bank is currently assessing the impact that ASU 2017-08 will have on its consolidated financial statements.

In August 2018, the FASB issued ASU 2018-13: *Fair Value Measurement (Topic 820): Disclosure Framework—Changes to the Disclosure Requirements for Fair Value Measurement*. The amendments modify the disclosure requirements in Topic 820 to add disclosures regarding changes in unrealized gains and losses, the range and weighted average of significant unobservable inputs used to develop Level 3 fair value measurements and the narrative description of measurement uncertainty. Certain disclosure requirements in Topic 820 are also removed or modified. The amendments are effective for fiscal years beginning after December 15, 2019, and interim periods within those fiscal years. Certain of the amendments are to be applied prospectively while others are to be applied retrospectively. The Bank does not expect the adoption of ASU 2018-13 to have a material impact on its consolidate financial statements.

NOTE 2 - RESTRICTIONS ON CASH

To comply with Federal Reserve regulations, the Bank is required to maintain certain average cash reserve balances. The daily average cash reserve requirement was approximately $359,000 and $362,000 for the years ended December 31, 2018 and 2017, respectively. The Bank is also required to maintain minimum balances with a correspondent bank. This balance was $250,000 at December 31, 2018 and 2017.

NOTE 3 - INVESTMENT SECURITIES

The amortized cost and estimated market value of investment securities at December 31, 2018 and 2017 as follows:

December 31, 2018	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Securities Available for Sale				
U.S. government agency & treasury securities	$ 28,808,896	$ 30	$ (423,599)	$ 28,385,327
Corporate debt securities	2,038,940	-	(81,360)	1,957,580
SBA pool securities	495,854	-	(5,513)	490,341
Mortgage-backed securities	1,461,772	-	(44,679)	1,417,093
Totals	$ 32,805,462	$ 30	$ (555,151)	$ 32,250,341

December 31, 2017	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Securities Available for Sale				
U.S. government agency & treasury securities	$ 28,808,090	$ 51	$ (457,003)	$ 28,351,138
Corporate debt securities	2,048,125	-	-	2,048,125
SBA pool securities	501,470	9,236	-	510,706
Mortgage-backed securities	1,827,095	-	(29,693)	1,797,402
Totals	$ 33,184,780	$ 9,287	$ (486,696)	$ 32,707,371

The amortized cost and estimated market value of debt securities at December 31, 2018, by contractual maturity, are shown below. Expected maturities will differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

Securities available for sale	Amortized Cost	Fair Value
Due within one year	$ 17,549,726	$ 17,396,312
Due after one year through five years	11,259,170	10,989,015
Due after five years through ten years	3,005,246	2,904,657
Due after ten years	991,320	960,357
	$ 32,805,462	$ 32,250,341

NOTE 3 - INVESTMENT SECURITIES (CONTINUED)

Securities with a carrying value of $17,707,310 and $17,644,020 were pledged at December 31, 2018 and 2017, respectively, to secure public deposits and for other purposes required or permitted by law.

Restricted investment securities, which are carried at cost, consist of stock in the Federal Home Loan Bank of Atlanta (FHLB) and Community Bankers' Bank, a correspondent bank. The FHLB requires financial institutions to purchase stock in the FHLB in order to borrow from it. The Bank's stock in Community Bankers' Bank is restricted in the fact that the stock may only be repurchased by that institution.

All of the Bank's investment securities were transferred from held to maturity to available for sale as of November 30, 2017. The total amortized cost of the securities was $36,391,381 and the net unrealized loss was $373,620 as of the date of the transfer. Management made the decision to transfer the investment securities primarily for liquidity purposes.

Proceeds from the sale of available for sale securities were $5,200,864 with gross realized losses of $19,926 during the year ended December 31, 2017. There were no sales or maturities of available for sale securities during the year ended December 31, 2018.

The following table shows the unrealized losses and related fair values in the Bank's available for sale investment securities portfolios as of December 31, 2018 and 2017, respectively. This information is aggregated by investment category and by length of time that individual securities have been in a continuous unrealized loss position at December 31, 2018 and 2017. There were thirty-two securities with an unrealized loss position due to interest rate movement as of December 31, 2018 compared to thirty-one securities with an unrealized loss position as of December 31, 2017. No impairment has been recognized on any of the securities in a loss position because management believes that these unrealized losses are primarily attributable to changes in interest rates and financial market conditions and are not the result of credit deterioration of specific securities. As management has the ability and intent to hold debt securities for the foreseeable future and it is not more likely than not that the Bank will be required to sell the securities before recovery of their amortized cost basis, which may be maturity, no declines are deemed to be other-than-temporary.

	Less Than 12 Months		12 Months or More		Total	
December 31, 2018	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
U.S. government agency & treasury securities	989,770	(10,044)	25,395,557	(413,555)	26,385,327	(423,599)
Corporate debt securities	1,957,580	(81,360)	-	-	1,957,580	(81,360)
SBA pool securities	490,341	(5,513)	-	-	490,341	(5,513)
Mortgage-backed securities	-	-	1,417,093	(44,679)	1,417,093	(44,679)
Total	3,437,691	(96,917)	26,812,650	(458,234)	30,250,341	(555,151)

	Less Than 12 Months		12 Months or More		Total	
December 31, 2017	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
U.S. government agency & treasury securities	8,103,763	(155,377)	19,247,644	(301,626)	27,351,407	(457,003)
Mortgage-backed securities	1,797,402	(29,693)	-	-	1,797,402	(29,693)
Total	9,901,165	(185,070)	19,247,644	(301,626)	29,148,809	(486,696)

NOTE 4 – LOANS

Net Loans for December 31, 2018 and 2017 consist of the following:

	2018	2017
Real Estate Construction	$ 17,237,893	$ 16,306,014
Residential Real Estate	42,346,391	45,808,297
Commercial Real Estate	64,540,354	49,852,152
Commercial	25,612,085	26,691,533
Consumer	1,843,757	2,356,983
Gross Loans	151,580,480	141,014,979
Deferred fees	(82,811)	-
Allowance for loan losses	(2,676,945)	(2,967,670)
	$ 148,820,724	$ 138,047,309

Loans held for sale of $573,000 and $0 were outstanding at December 31, 2018 and 2017, respectively.

Real Estate Construction loans consist of lines of credit for subdivision development, speculative construction, and personal and commercial real estate construction. Residential Real Estate loans consist primarily of first and second residential adjustable rate mortgages and home equity lines of credit. Commercial Real Estate loans consist of owner occupied and non-owner occupied commercial properties. Commercial loans consist of loans to commercial customers that are unsecured or secured by business assets other than real estate. Consumer loans consist of loans to individuals that are unsecured or secured by vehicles or other personal assets.

Construction lending is generally considered to involve a higher degree of credit risk than long-term permanent financing. If the estimate of construction costs proves to be inaccurate, the Bank may be compelled to advance additional funds to complete the construction with repayment dependent, in part, on the success of the ultimate project rather than the ability of a borrower or guarantor to repay the loan. If the Bank is forced to foreclose on a project prior to completion, there is no assurance that it will be able to recover the entire unpaid portion of the loan. In addition, the Bank may be required to fund additional amounts to complete a project and may have to hold the property for an indeterminate period of time.

The Bank has a concentration of credit in commercial real estate loans of $54.2 million as of December 31, 2018. These loans consist of acquisition, development and construction loans, multi-family residential property, and non-owner occupied non-farm non-residential property. Of these commercial real estate loans, a further concentration of $12.0 million applies specifically to real estate builders and developers as of December 31, 2018.

NOTE 4 – LOANS (CONTINUED)

The following is an aging of the loan portfolio. The table includes both performing and accruing loans as well as non-performing obligations that are in a non-accruing status. Delinquency data for the year ended December 31, 2018 and 2017 is presented as follows:

December 31, 2018

	30-59 Days Past Due	60-89 Days Past Due	Greater Than 90 Days	Total Past Due	Current	Total Loans	Recorded Investments > 90 Days Accruing
Real Estate Construction	$ -	$ -	$ -	$ -	$ 17,237,893	$ 17,237,893	$ -
Residential Real Estate	91,698	-	259,280	350,978	41,995,413	42,346,391	-
Commercial Real Estate	153,118	267,717	1,288,551	1,709,386	62,830,968	64,540,354	-
Commercial	49,996	20,955	-	70,951	25,541,134	25,612,085	-
Consumer	-	-	2,205	2,205	1,841,552	1,843,757	-
Total	$ 294,812	$ 288,672	$ 1,550,036	$ 2,133,520	$ 149,446,960	$ 151,580,480	$ -

December 31, 2017

	30-59 Days Past Due	60-89 Days Past Due	Greater Than 90 Days	Total Past Due	Current	Total Loans	Recorded Investments > 90 Days Accruing
Real Estate Construction	$ -	$ -	$ 11,600	$ 11,600	$ 16,294,414	$ 16,306,014	$ -
Residential Real Estate	283,807	576,521	269,322	1,129,650	44,678,647	45,808,297	-
Commercial Real Estate	272,512	-	351,600	624,112	49,228,040	49,852,152	-
Commercial	68,645	-	-	68,645	26,622,888	26,691,533	-
Consumer	2,316	-	-	2,316	2,354,667	2,356,983	-
Total	$ 627,280	$ 576,521	$ 632,522	$ 1,836,323	$ 139,178,656	$ 141,014,979	$ -

Nonaccrual loans amounted to $3,039,454 and $4,106,047 at December 31, 2018 and 2017 respectively. The breakdown of nonaccrual loans at December 31, 2018 and 2017 was as follows:

	2018	2017
Real Estate Construction	$ 1,299,803	$ 2,262,099
Residential Real Estate	418,531	1,189,533
Commercial Real Estate	1,288,551	585,769
Commercial	30,364	68,646
Consumer	2,205	-
	$ 3,039,454	$ 4,106,047

NOTE 4 – LOANS (CONTINUED)

Management considers several credit quality indicators in its evaluation of the current or potential risk inherent in the loan portfolio. These indicators include but are not limited to credit reports, collateral values, financial statement and tax return information, cash flows, historic payment experience, economic trends and trends in net charge-offs. Every loan is assigned a risk rating grade at the time of loan origination. Management reviews the risk ratings for potential changes on a quarterly basis. The risk ratings are an important element in management's methodology for calculating the allowance for loan losses and determining the necessary amount of loan loss provision. Bank management monitors and reviews loans on an ongoing basis using watch lists of large loans and loans that have been identified due to payment delinquencies or other deficiencies. Management reviews loans for impairment and assesses the adequacy of the allowance for loan losses on a quarterly basis. The assessment of the allowance is based on specific allowances for impaired loans, and allowances for other classified loans, historical loss experience on loan pools and adjustments for economic factors.

The Bank utilizes a risk grading matrix to assign a risk grade to each of its loans. Credits are graded on a scale of 1 to 9. A description of the general characteristics of the nine risk grades is as follows:

Risk Rating 1: Prime (Minimal Risk)

To qualify as a "1", a credit must be either fully secured by cash or secured by a portfolio of marketable securities within margin. Borrowers receiving this rating would be of unquestionable strength with access to capital markets.

Risk Rating 2: Good (Above Average)

To qualify as a "2", a credit must be with a borrower exhibiting strong financial trends. The borrower must be a high-rated company whose management, profitability, liquidity and leverage ratios are very strong and above industry averages. Characteristics of such credits should include:

- Well collateralized credits with sound primary and secondary repayment sources
- Strong debt capacity and coverage; debt to income ratio not higher than 25% for consumer loans and debt service coverage ratio (DSCR) not lower than 2:1 on commercial loans
- Good management in all key positions
- Individuals or guarantors showing substantial liquid net worth and income or alternative funds sources to retire the debt as agreed.

Risk Rating 3: Good (Average Risk)

To qualify as a "3" the criteria of management, industry, profitability, liquidity and leverage must be generally strong and comparable to industry averages. A company rated "3", typically would show the following characteristics:

- Good debt capacity and coverage; debt to income not higher than 30% on consumer loans and DSCR not lower than 1.5: 1 on commercial loans.
- Sound primary and secondary repayment sources
- Industry has only moderate cyclical characteristics
- Good management in all key positions
- Stable earnings with positive or steady trends.

Individual borrowers or guarantors should show average to above average liquid net worth and sufficient income or alternative fund sources to retire the debt as agreed. To qualify as a "3", a commercial credit should be performing to expectations, with evidence that the borrower is continuing to generate adequate cash flow to service the debt. There should be no significant departure from the intended sources and timing of repayment. Unsecured credits, or slightly out-of-margin collateralized credits would qualify for a "3".

NOTE 4 – LOANS (CONTINUED)

Risk Rating 4: Acceptable

To qualify as a “4” assets in this class typically exhibit the following weaknesses which are offset with 2 or more acceptable mitigating factors. The weaknesses are:

- Limited asset base or liquidity
- Individual or Guarantors with limited repayment history or delinquent repayment history > 2 years old.
- Out-of-margin collateral or unsecured

Assets in this class may demonstrate a debt to income ratio higher than 30%, but lower than 40% on consumer loans, and DSCR lower than 1.5:1, but not lower than 1.15: 1, for commercial loans. These assets include credits with positive operating trends and satisfactory financial conditions which are achieving performance expectations. However, the Bank has identified certain risk elements that require close monitoring to ensure expected levels of performance.

Risk Rating 5: Pass/Watch

Assets in this class typically exhibit the following:

- Limited asset base and liquidity
- Debt service capacity is strained, but the primary source of repayment is still viable
- Might be a start-up venture that is dependent on guarantor strength

These credits have elements of risk that may be mitigated with an SBA or VSBFA Government Guarantee/Credit Enhancement.

Also included in this category are credits with negative operating trends or companies achieving performance expectations at a much slower pace than anticipated.

This rating may also include loans which exhibit satisfactory credit quality, but which are improperly structured as evidenced by excessive renewals, unusually long repayment schedules, the lack of a specific repayment plan, or which exhibit un-mitigated loan policy exceptions or documentation deficiencies.

NOTE 4 – LOANS (CONTINUED)

Risk Rating 6: Other Assets Especially Mentioned (Special Mention)

Assets in this category are currently protected but are potentially weak. These assets constitute an undue and unwarranted credit risk but not to the point of justifying a classification of substandard. The risk of loss may be relatively minor, yet constitute an unwarranted risk in light of the circumstances surrounding the specific asset. Other assets especially mentioned have potential weaknesses which may, if not checked or corrected, weaken the asset or inadequately protect the Bank's credit position at some future date.

Loans which may be detailed in this category include the following characteristics:

- Credits that the lending officer may be unable to supervise properly because of a lack of expertise
- Inadequate loan agreements or failure to obtain proper documentation
- The condition of and control over collateral is uncertain
- An adverse trend in the obligor's operation or an imbalanced position in the balance sheet which has not reached a point where the liquidation is jeopardized
- Economic or market conditions which may, at some future date, result in the deterioration of the repayment prospects for the credit.
- Any other major deviations from prudent lending practices

This category should not be used to list loans which bear risks usually associated with the particular type of financing. It must be evident that the risk is increasing beyond that at which the loan originally would have been granted. Loans in which actual weaknesses are evident and significant should be considered for a lower classification.

Credits in this class are formally monitored on a quarterly basis and presented to the board for review.

Risk Rating 7: Substandard Assets

A substandard asset is inadequately protected by the current sound worth and paying capacity of the obligor or of the collateral pledged, if any. Assets that are classified substandard 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. Loss potential, while existing in the aggregate amount of substandard assets, does not have to exist in individual assets classified substandard.

Risk Rating 8: Doubtful Assets

An asset classified doubtful has all the weaknesses inherent in one classified “substandard” with the added characteristic that the weaknesses make collection or liquidation in full, on the basis of currently existing facts, conditions, and values, highly questionable and improbable. The possibility of loss is extremely high, but because of certain important and reasonably specific pending factors which may work to strengthen the asset, its classification as “loss” is deferred until its more exact status may be determined. Pending factors include proposed merger, acquisition, or liquidation procedures, capital injection, perfecting liens on additional collateral and refinancing plans.

NOTE 4 – LOANS (CONTINUED)

Risk Rating 9: Loss Assets

An asset is defined as "Loss" and implies there is no possibility of repayment under the current terms and conditions, and the outstanding balance represents a negative asset of the Bank. When a loan balance is classified in this manner, it must be charged against the Allowance for Loan Losses ("ALL") in the quarter in which it is identified. The identification of loss leaves no room for payment under current terms and conditions, but it does not mean that recovery is not possible at some future date. Items classified as loss should be placed on nonaccrual status, charged to the ALL and worked for collection, with principal recoveries being credited to the ALL, and interest recoveries credited to current income.

The following tables are an analysis of risk grades by category for the loan portfolio as of December 31, 2018 and 2017:

December 31, 2018

	Real Estate Construction	Residential Real Estate	Commercial Real Estate	Commercial	Consumer	Risk Category Total
Pass Grades 1-4	$ 12,316,930	$ 35,474,903	$ 51,704,590	$ 24,388,827	$ 1,774,064	$ 125,659,314
Watch Grade 5	3,298,383	2,088,595	6,690,508	580,503	45,763	12,703,752
Special Mention Grade 6	322,778	2,685,420	3,589,599	396,535	21,725	7,016,057
Substandard Grade 7	1,299,802	2,097,473	2,555,657	246,220	2,205	6,201,357
Doubtful Grade 8	-	-	-	-	-	-
Loss Grade 9	-	-	-	-	-	-
Total	$ 17,237,893	$ 42,346,391	$ 64,540,354	$ 25,612,085	$ 1,843,757	$ 151,580,480

December 31, 2017

	Real Estate Construction	Residential Real Estate	Commercial Real Estate	Commercial	Consumer	Risk Category Total
Pass Grades 1-4	$ 13,182,849	$ 38,382,425	$ 43,776,640	$ 25,861,932	$ 2,290,570	$ 123,494,416
Watch Grade 5	616,509	2,313,288	2,188,736	460,870	56,704	5,636,107
Special Mention Grade 6	232,101	228,096	-	-	8,624	468,821
Substandard Grade 7	2,274,555	4,884,488	3,886,776	368,731	1,085	11,415,635
Doubtful Grade 8	-	-	-	-	-	-
Loss Grade 9	-	-	-	-	-	-
Total	$ 16,306,014	$ 45,808,297	$ 49,852,152	$ 26,691,533	$ 2,356,983	$ 141,014,979

NOTE 4 – LOANS (CONTINUED)

The Bank's loan portfolio also includes certain loans that have been modified in a troubled debt restructuring, where economic concessions have been granted to borrowers who have experienced or are expected to experience financial difficulties. These concessions typically result from the Bank's loss mitigation activities and could include reductions in the interest rate, payment extensions, forgiveness of principal, forbearance or other actions. The Bank had eleven modified loans totaling $2,736,615 that were considered troubled debt restructurings during the year ended December 31, 2018. These included four residential real estate loans with a balance of $1,134,076, five commercial real estate loans with a balance of $1,508,272, and two commercial loans with a balance of $94,267. During the year ended December 31, 2017 the Bank had eleven modified loans totaling $3,442,715 that were considered troubled debt restructurings. These included four residential real estate loans with a balance of $1,163,184, six commercial real estate loans with a balance of $2,262,520, and one commercial loan with a balance of $17,011.

The following table sets forth the Bank's Troubled Debt Restructurings that were restructured during the years ended December 31, 2018 and 2017:

	December 31, 2018		
	Number of Contracts	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment
Real Estate Construction	-	$ -	$ -
Residential Real Estate	-	-	-
Commercial Real Estate	-	-	-
Commercial	1	86,403	86,403
Consumer	-	-	-
Total	1	$ 86,403	$ 86,403

	December 31, 2017		
	Number of Contracts	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment
Real Estate Construction	-	$ -	$ -
Residential Real Estate	-	-	-
Commercial Real Estate	1	86,778	86,778
Commercial	-	-	-
Consumer	-	-	-
Total	1	$ 86,778	$ 86,778

Debt restructured during 2018 included one term extensions without a principal reduction or principle deferred.

As of December 31, 2018 and 2017, there were no Troubled Debt Restructurings that subsequently defaulted within twelve months of the date of restructuring.

For purposes of this disclosure, the Bank defines default as any payment that occurs more than 90 days past the due date, charge-off or foreclosure subsequent to modification.

As of December 31, 2018 and 2017, the balance of other real estate owned includes no foreclosed residential real estate properties recorded as a result of obtaining physical possession of the property. As of December 31, 2018, there were two residential real estate loans in the process of foreclosure.

NOTE 5 - ALLOWANCE FOR LOAN LOSSES

The following is a summary roll forward of the allowance for loan losses by class from December 31, 2017 through December 31, 2018:

	Real Estate Construction	Residential Real Estate	Commercial Real Estate	Commercial	Consumer	Total
Allowance for loan losses:						
December 31, 2017 balance	$ 971,657	$ 129,678	$ 1,055,160	$ 806,503	$ 4,672	$ 2,967,670
Charge offs	(34,959)	(53,899)	(593,610)	(1,297)	(22,399)	(706,164)
Recoveries	40,801	100,601	35,553	8,811	9,673	195,439
Provision	(25,446)	90,974	354,233	(213,408)	13,647	220,000
December 31, 2018 balance	$ 952,053	$ 267,354	$ 851,336	$ 600,609	$ 5,593	$ 2,676,945
Alllowance for loan losses:						
Individually evaluated for impairment	-	92,752	189,675	-	-	282,427
Collectively evaluated for impairment	952,053	174,602	661,661	600,609	5,593	2,394,518
December 31, 2018 balance	$ 952,053	$ 267,354	$ 851,336	$ 600,609	$ 5,593	$ 2,676,945
Loans receivable:						
Individually evaluated for impairment	1,299,802	1,327,370	2,555,657	-	-	5,182,829
Collectively evaluated for impairment	15,938,091	41,019,021	61,984,697	16,000,690	1,843,757	136,786,256
Guaranteed loans	-	-	-	9,611,395	-	9,611,395
Principal loan balances as of December 31, 2018:	$ 17,237,893	$ 42,346,391	$ 64,540,354	$ 25,612,085	$ 1,843,757	$ 151,580,480

The following is a summary roll forward of the allowance for loan losses by class from December 31, 2016 through December 31, 2017:

	Real Estate Construction	Residential Real Estate	Commercial Real Estate	Commercial	Consumer	Total
Allowance for loan losses:						
December 31, 2016 balance	$ 992,954	$ 324,165	$ 1,264,006	$ 812,327	$ 26,083	$ 3,419,535
Charge offs	(208,058)	(228,774)	(599,506)	(161,440)	(7,135)	(1,204,913)
Recoveries	299,087	33,378	280,944	132,952	6,687	753,048
Provision	(112,326)	909	109,716	22,664	(20,963)	-
December 31, 2017 balance	$ 971,657	$ 129,678	$ 1,055,160	$ 806,503	$ 4,672	$ 2,967,670
Alllowance for loan losses:						
Individually evaluated for impairment	-	70,176	65,292	69	-	135,537
Collectively evaluated for impairment	971,657	59,502	989,868	806,434	4,672	2,832,133
December 31, 2017 balance	$ 971,657	$ 129,678	$ 1,055,160	$ 806,503	$ 4,672	$ 2,967,670
Loans receivable:						
Individually evaluated for impairment	2,274,555	2,874,305	3,898,882	89,406	-	9,137,148
Collectively evaluated for impairment	14,031,459	42,933,992	45,953,270	26,602,127	2,356,983	131,877,831
Principal loan blances as of December 31, 2017:	$ 16,306,014	$ 45,808,297	$ 49,852,152	$ 26,691,533	$ 2,356,983	$ 141,014,979

The following is an analysis by class of impaired loans as of December 31, 2018:

	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Interest Income Recognized
With no related allowance:					
Real Estate Construction	$ 1,299,802	$ 1,299,802	$ -	$ 1,716,713	$ 3,485
Residential Real Estate	852,957	852,404	-	1,397,971	96,621
Commercial Real Estate	1,437,168	1,438,224	-	2,648,328	134,050
Commercial	-	-	-	63,028	12,906
Consumer	-	-	-	-	-
With an allowance recorded:					
Real Estate Construction	$ -	$ -	$ -	$ -	$ -
Residential Real Estate	475,324	474,966	92,752	477,817	23,377
Commercial Real Estate	1,121,994	1,117,433	189,675	1,144,953	58,780
Commercial	-	-	-	-	-
Consumer	-	-	-	-	-
Total:					
Real Estate Construction	$ 1,299,802	$ 1,299,802	$ -	$ 1,716,713	$ 3,485
Residential Real Estate	1,328,281	1,327,370	92,752	1,875,788	119,998
Commercial Real Estate	2,559,162	2,555,657	189,675	3,793,281	192,830
Commercial	-	-	-	63,028	12,906
Consumer	-	-	-	-	-
	$ 5,187,245	$ 5,182,829	$ 282,427	$ 7,448,810	$ 329,219

The following is an analysis by class of impaired loans as of December 31, 2017:

	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Interest Income Recognized
With no related allowance:					
Real Estate Construction	$ 2,274,625	$ 2,274,555	$ -	$ 3,044,059	$ 24,993
Residential Real Estate	2,442,330	2,438,100	-	3,701,582	135,919
Commercial Real Estate	3,190,543	3,182,686	-	4,094,233	161,664
Commercial	80,787	80,684	-	375,091	11,355
Consumer	-	-	-	2,166	122
With an allowance recorded:					
Real Estate Construction	$ -	$ -	$ -	$ -	$ -
Residential Real Estate	1,289,614	1,286,878	70,176	1,076,542	46,996
Commercial Real Estate	927,035	923,590	65,292	935,281	48,318
Commercial	8,753	8,722	69	12,052	652
Consumer	-	-	-	-	-
Total:					
Real Estate Construction	$ 2,274,625	$ 2,274,555	$ -	$ 3,044,059	$ 24,993
Residential Real Estate	3,731,944	3,724,978	70,176	4,778,124	182,915
Commercial Real Estate	4,117,578	4,107,276	65,292	5,029,514	209,982
Commercial	89,540	89,406	69	387,143	12,007
Consumer	-	-	-	2,166	122
	$ 10,213,687	$ 10,196,215	$ 135,537	$ 13,241,006	$ 430,019

No additional funds are committed to be advanced in connection with impaired loans.

NOTE 6 - PREMISES AND EQUIPMENT

Premises and equipment and accumulated depreciation for December 31, 2018 and 2017 are summarized as follows:

	2018	2017
Land and land improvements	$ 1,833,735	$ 2,418,591
Buildings	5,410,749	5,531,595
Furniture and equipment	1,275,737	1,224,759
	8,520,221	9,174,945
Less accumulated depreciation	(3,421,191)	(3,366,461)
	$ 5,099,030	$ 5,808,484

Depreciation expense amounted to $231,135 and $239,821 for the years ended December 31, 2018 and 2017, respectively.

NOTE 7 – BANK OWNED LIFE INSURANCE

The Bank has invested in bank owned life insurance. The earnings from these policies will be used to offset employee benefit costs. The cash surrender value of these policies was $5,552,722 and $5,426,072 as of December 31, 2018 and 2017, respectively. The increase in cash surrender value of these policies is included in other income on the accompanying consolidated statements of operations and amounted to $126,650 and $130,634 for the years ended December 31, 2018 and 2017, respectively.

NOTE 8 – INVESTMENT IN LIMITED LIABILITY COMPANIES

The Bank's wholly owned subsidiary, Bank of Fincastle Services, Inc., owns interests in four limited liability companies that are accounted for by the equity method. The amount of these investments was $1,031,380 and $988,180 at December 31, 2018 and 2017 respectively. The income from these limited liability companies is included in other income on the accompanying consolidated statement of operations and amounted to $43,200 and $192,666 for the years ended December 31, 2018 and 2017, respectively.

NOTE 9 - DEPOSITS

The aggregate amount of time deposits in denominations of $250,000 or more at December 31, 2018 and 2017 was $4,051,064 and $3,424,167, respectively.

At December 31, 2018, the scheduled maturities of certificates of deposits, including individual retirement accounts, were as follows:

2019	$ 21,295,505
2020	14,958,790
2021	5,054,986
2022	2,616,319
2023	1,372,661
	$ 45,298,261

Demand deposit accounts with overdraft balances that were reclassified as loans amounted to $15,024 and $5,632 at December 31, 2018 and 2017, respectively.

NOTE 10 - INCOME TAXES

The actual tax expense differs from the expected tax expense computed by applying the federal statutory tax rate to income before income taxes as follows:

Nondeductible interest expense	-	66
State income tax, net of federal tax benefit	3,622	4,247
Other nondeductible expenses	901	685
Other differences	2,639	25,243
General business credit carryover	(48,305)	(48,307)
Deferred tax adjustment due to reduced federal statutory rate of 21%	-	2,059,928
Deferred tax asset valuation change	-	140,000
Reported income tax expense (benefit)	$ 139,803	$ 1,362,641

The tax effects of temporary timing differences that give rise to significant components of the net deferred tax asset, included in other assets, as of December 31, 2018 and 2017 are as follows:

	2018	2017
Deferred tax assets:		
Allowance for loan losses	$ 70,309	$ 161,838
Interest on nonaccrual loans	236,493	153,810
Write-downs on other real estate owned	122,768	237,017
Deferred compensation	99,926	105,195
Charitable contribution carryforward	6,308	4,737
Deferred gain on sale of other real estate owned	118,446	4,521
Accrued losses on letters of credit	285,364	371,344
Reserve for premiums on guaranteed loans	10,454	6,930
Net tax credit carryforward	189,970	141,665
Net operating loss carryforward	2,272,581	2,355,129
Net unrealized loss on securities available for sale	116,575	100,265
Deferred tax assets	3,529,194	3,642,451
Deferred tax liabilities:		
Depreciation	(69,455)	(60,860)
Investment in pass-through entity	(10,108)	(12,089)
Deferred tax liabilities	(79,563)	(72,949)
Deferred tax asset valuation allowance	(1,390,000)	(1,390,000)
Net deferred tax asset	$ 2,059,631	$ 2,179,502

NOTE 10 - INCOME TAXES (CONTINUTED)

The provision for income taxes consists of the following components:

	2018	2017
Current expense (benefit)	$ 3,622	$ (51,407)
Deferred tax benefit	136,181	1,554,048
	$ 139,803	$ 1,502,641

On December 22, 2017, the President signed into law the "Tax Cuts and Jobs Act" (TCJA) that significantly reforms the Internal Revenue Code of 1986, as amended. The TCJA includes various changes to corporate income tax laws, including a reduction of the corporate income tax rate from a maximum rate of 35% to a flat rate of 21% for tax years beginning after December 31, 2017. As a result, the Bank re-measured its deferred tax assets and liabilities based upon the newly enacted U.S. statutory federal income tax rate of 21%, which is the tax rate at which these assets and liabilities are expected to reverse in the future. As a result of the new law, the Bank recognized a net tax expense of $2,059,928, as described in the rate reconciliation table above. The deferred tax asset and liabilities as of December 31, 2017 reflect the revaluation adjustment.

Management does not believe that the Bank has any liability related to uncertain tax positions. The Bank's tax filings for the years after 2015 are open for examination by the Internal Revenue Service. As of December 31, 2018, the Bank had a net operating loss carryover in the amount of $10,821,819. Of this amount, $9,682,935 will expire in 2036 and $1,138,884 in 2037. The Bank also had general business tax credit carryovers in the amount of $189,970. Of this amount, $45,051 will expire in 2035, $48,307 in 2036, $48,307 in 2037, and $48,305 in 2038

NOTE 11 - PENSION PLAN

The Bank has a 401(k) and profit sharing plan. The plan covers all employees who meet the minimum service and age requirements. The plan provides for elective salary deferrals by eligible employees and 100% matching contributions by the Bank up to 3% of employee compensation. The Bank may also make discretionary profit sharing contributions for eligible employees at various percentages based on years of service. The Bank did not make a discretionary profit sharing contribution during the year ended December 31, 2018. The Bank's matching contributions to the 401(k) plan and profit sharing plan contributions amounted to $57,606 and $55,845 for the years ended December 31, 2018 and 2017, respectively.

NOTE 12 - TRANSACTIONS WITH RELATED PARTIES

The Bank conducts banking transactions in the ordinary course of business with directors, principal officers, and their immediate families and affiliated companies (commonly referred to as related parties). Such transactions were made in the ordinary course of business on substantially the same terms and conditions, including interest rates and collateral, as those prevailing at the same time for comparable transactions with other customers, and did not, in the opinion of management, involve more than normal credit risk or present other unfavorable features.

Aggregate loan transactions with related parties were as follows:

	2018	2017
Balance, beginning of year	$ 825,039	$ 2,349,313
New loans originated	584,866	363,273
Repayments	(816,163)	(1,887,547)
Balance, end of year	$ 593,742	$ 825,039

NOTE 12 - TRANSACTIONS WITH RELATED PARTIES (CONTINUED)

The Bank's subsidiary owns a 51% interest in a mortgage company that sells real estate loans on the secondary market. The Bank provides funding for these loans until they are sold by the mortgage company. These loans are presented as loans held for sale on the consolidated balance sheet and amounted to $573,000 at 2018. There were no outstanding balances of these loans at December 31, 2017.The total balance of deposit accounts with related parties and affiliated companies of the Bank's subsidiary were $4,171,187 and $5,370,830 as of December 31, 2018 and 2017, respectively.

NOTE 13 - LEASES

The Bank leases land on which three of its branches are located under non-cancelable operating leases with original terms of ten years. One of these leases has an option to renew for additional five-year terms. Two of these leases have expired and are leased under a month-to-month basis as of December 31, 2018. The Bank also leases space for one other branch location under a five-year lease with options to renew for additional five-year terms. At December 31, 2018 future minimum lease payments are as follows:

2019	$	16,800
2020		6,750
	$	23,550

Rent expense under these leases amounted to $62,280 and $61,320 for the years ended December 31, 2018 and 2017.

NOTE 14 - 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 standby letters of credit. These instruments involve, to varying degrees, elements of credit risk in excess of the amount recognized in the consolidated balance sheet.

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 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.

A summary of commitments as of December 31, 2017 and 2016 is as follows:

	2018		2017	
Commitments to extend credit	$	26,018,019	$	21,435,324
Standby letters of credit and financial guarantees written	$	6,233,826	$	6,344,330

Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. Since many of the commitments are expected to expire without being drawn upon, the total 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 of the customer. Collateral held varies but may include securities, accounts receivable, inventory, property, plant and equipment, and income-producing commercial properties.

NOTE 14 - FINANCIAL INSTRUMENTS WITH OFF-BALANCE-SHEET RISK (CONTINUED)

Standby letters of credit are conditional commitments issued by the Bank to guarantee the performance of a customer to a third party. Those guarantees are primarily issued to support public and private borrowing arrangements, including commercial paper, bond financing and similar transactions. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loan facilities to customers. Collateral held varies but may include securities, accounts receivable, inventory, property, plant and equipment, and income-producing commercial properties.

In 2017, management accrued $1,888,000 of estimated expenses to fulfill potential obligations on letters of credit related to certain properties in other real estate and certain impaired loans. The Bank incurred $209,427 and $119,693 related to these letters of credit in 2018 and 2017, respectively. The accrued liability was $1,358,880 as of December 31, 2018 and $1,768,307 as of December 31, 2017.

NOTE 15 - CONCENTRATIONS OF CREDIT RISK

Substantially all of the Bank’s loans, commitments to extend credit, and standby letters of credit have been granted to customers in the Bank’s market area and such customers are generally depositors of the Bank. The concentrations of credit by type of loan are set forth in Note 4 - Loans. The distribution of commitments to extend credit approximates the distribution of loans outstanding. Standby letters of credit are granted primarily to commercial borrowers. Although the Bank has a reasonably diversified loan portfolio, a substantial portion of its debtors’ ability to honor their contracts is dependent upon economic conditions in Botetourt and Roanoke counties.

The Bank has established operating policies relating to the credit process and collateral in loan originations. Loans to purchase real and personal property are generally collateralized by the related property with loan amounts established based on certain percentage limitations of the property's total stated or appraised value. Credit approval is primarily a function of the evaluation of the creditworthiness of the individual borrower or project based on available financial information and collateral.

The Bank maintains a cash balance with a correspondent bank that, from time to time, exceeds the $250,000 insurance limits of the Federal Deposit Insurance Corporation. The Bank has not experienced losses in its account and believes it is not exposed to significant credit risk on cash and cash equivalents.

NOTE 16 – DEFERRED COMPENSATION AGREEMENT

In December 2005, the Bank entered into a deferred compensation agreement with a key employee which fully vested on January 2, 2013. The agreement provides for a benefit of approximately $4,200 per month for ten years following the termination of active employment, death or disability, or a lump sum payment of the unpaid obligation in the event of a change in ownership or effective control or in the ownership of a substantial portion of assets of the Bank. The employee retired in 2015 and the Bank made payments under the agreement of which $2,061 and $10,716 was charged to expense for the years ended December 31, 2018 and 2017, respectively. The accrued liability under this agreement was $293,622 and $301,177 at December 31, 2018 and 2017, respectively.

NOTE 17 – SUPPLEMENTAL CASH FLOW INFORMATION

The following is supplemental information for the statement of cash flows as of December 31, 2018 and 2017:

	2018	2017
Supplemental disclosure of cash paid during the year for:		
Interest	$ 761,011	$ 669,441
Taxes	6,000	24,466
Non-cash investing and financing activities		
Loans transferred to other real estate owned (OREO)	$ 11,440	$ 1,387,343
Fixed assets transferred to OREO	455,741	434,904
Other assets transferred to OREO	70,743	-
Unrealized (losses) on securities available for sale	77,712	103,790
Unrealized loss on transfer of securities held to maturity to available for sale	-	373,620

NOTE 18 – LINES OF CREDIT

The Bank has established credit availability with a correspondent bank for unsecured borrowings of federal funds of $10.0 million. The Bank also has established a credit availability of $15.7 million with the Federal Home Loan Bank for borrowings secured by the Bank's portfolio of 1-4 family first mortgages, commercial real estate loans, and investment portfolio securities. There were no outstanding balances borrowed from these sources as of December 31, 2018 or 2017.

NOTE 19 - RESTRICTION ON PAYMENT OF DIVIDENDS

The Bank, as a Virginia banking corporation, may pay dividends only out of its retained earnings. Regulatory authorities may limit payment of dividends by any bank when it is determined that such a limitation is in the public interest and necessary to ensure financial soundness of the bank.

NOTE 20 - REGULATORY MATTERS

The Bank is subject to various regulatory capital requirements administered by federal and state 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 Bank's financial statements.

Under regulatory capital adequacy guidelines and the regulatory framework for prompt corrective action, the Bank must meet specific capital guidelines that involve quantitative measures of the Bank's 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 amounts and ratios (set forth in the table below) of Total Capital, Tier I Capital, and Common Equity Tier 1 Capital to risk-weighted assets, and of Tier I Capital - Leverage to average assets, as all of these terms are defined in the regulations. Management believes, as of December 31, 2018 and 2017, that the Bank met all capital adequacy requirements to which it is subject.

The most recent notification of the Federal Deposit Insurance Corporation (FDIC) as of December 31, 2018 categorized the Bank as well capitalized under the regulatory framework for prompt corrective action. To be categorized as well capitalized, the Bank must maintain minimum total risk-based, Tier I risk-based, common equity Tier 1 risk-based and Tier I-leverage ratios as set forth in the table. There are no conditions or events since that notification that management believes have changed the Bank’s category.

Final rules implementing BASEL III regulatory capital guidance for U.S. banks (Basel III rules) became effective January 1, 2015. The Basel III rules established a capital conservation buffer that was phased in beginning January 1, 2016 and will be fully phased in by January 1, 2019. Under the Basel III rules, a bank must hold a capital conservation buffer above the adequately capitalized risk-based capital ratios. The capital conservation buffer requirement will be gradually phased in starting with 0.625% on January 1, 2016 and increased each year until it is fully implemented at 2.5% on January 1, 2019. If banks do not maintain the required capital conservation buffer, their ability to pay dividends, repurchase shares, or pay discretionary bonuses could be limited. As of December 31, 2018, the Bank met the capital conservation buffer requirement.

NOTE 20 - REGULATORY MATTERS

The Bank's actual capital amounts and ratios as of December 31, 2018 and 2017 are as follows (dollars in thousands):

December 31, 2018	Actual		Minimum for Capital Adequacy Purposes		Minimum to be Well Capitalized Under Prompt Corrective Action Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
Total Capital (to Risk Weighted Assets)	$ 26,393	16.17%	$ 13,058	8.00%	$ 16,322	10.00%
Tier I Capital (to Risk Weighted Assets)	$ 24,329	14.90%	$ 9,793	6.00%	$ 13,058	8.00%
Common Equity Tier 1 Capital (to Risk Weighted Assets)	$ 24,329	14.90%	$ 7,345	4.50%	$ 10,609	6.50%
Tier I Capital - Leverage (to Average Assets)	$ 24,329	11.89%	$ 8,184	4.00%	$ 10,230	5.00%

December 31, 2017	Actual		Minimum for Capital Adequacy Purposes		Minimum to be Well Capitalized Under Prompt Corrective Action Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
Total Capital (to Risk Weighted Assets)	$ 25,394	16.16%	$ 12,569	8.00%	$ 15,711	10.00%
Tier I Capital (to Risk Weighted Assets)	$ 23,393	14.89%	$ 9,427	6.00%	$ 12,569	8.00%
Common Equity Tier 1 Capital (to Risk Weighted Assets)	$ 23,393	14.89%	$ 7,070	4.50%	$ 10,212	6.50%
Tier I Capital - Leverage (to Average Assets)	$ 23,393	11.75%	$ 7,960	4.00%	$ 9,950	5.00%

NOTE 21 - FAIR VALUE MEASUREMENTS

Accounting standards provide a framework for measuring and disclosing fair value information about assets and liabilities recognized in the balance sheet. Fair value is defined as the amount that would be received to sell an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants. Fair value is best determined based upon quoted market prices. In cases where quoted market prices are not available, fair values are based on estimates using present value or other valuation techniques. Those techniques are significantly affected by the assumptions used, including the discount rate and estimates of future cash flows. In that regard, the derived fair value estimates cannot be substantiated by comparison to individual markets and, in many cases, could not be realized in immediate settlement of the instruments. Certain financial instruments and all nonfinancial instruments are excluded from these disclosure requirements. Accordingly, the aggregate fair value amounts presented do not represent the underlying value of the Bank and its subsidiary.

In accordance with accounting principles, the Bank groups assets and liabilities generally measured at fair value in three levels, based on the markets in which the assets and liabilities are traded and the reliability of the assumptions that are used to determine fair value. The three levels of the fair value hierarchy are as follows:

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

Level 2 – Observable inputs including quoted prices for similar assets or liabilities in active markets; quoted prices for identical or similar assets or liabilities in markets that are less active, and model-based valuation techniques for which significant assumptions can be derived primarily from or corroborated by observable data in the market.

Level 3 – Unobservable inputs that are based on model-based valuation techniques using one or more significant inputs or assumptions that are unobservable in the market. These unobservable assumptions reflect estimates of assumptions that market participants would use in pricing the asset or liability. Valuation techniques include the use of option pricing models, discounted cash flow models, and similar techniques.

NOTE 21 - FAIR VALUE MEASUREMENTS (CONTINUED)

The estimated fair values of the Bank's financial instruments as of December 31, 2018 and 2017 are as follows (dollars in thousands):

	Fair Value as of December 31, 2018				
Financial Assets	Carrying Amount	Fair Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Cash and due from banks	$ 3,305	$ 3,305	$ 3,305		
Interest bearing deposits with banks	4,507	4,507	4,507		
Federal funds sold	132	132	132		
Investment securities	32,250	32,250		32,250	
Restricted investment securities	235	235			235
Loans held for sale	573	573		573	
Loans, net of allowance for loan losses	148,821	145,228			145,228
Accrued interest receivable	600	600		600	
Financial Liabilities					
Noninterest-bearing deposits	$ 61,018	$ 61,018		$ 61,018	
Interest-bearing deposits	118,094	118,084			118,084
Accrued interest payable	112	112		112	

	Fair Value as of December 31, 2017				
Financial Assets	Carrying Amount	Fair Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Cash and due from banks	$ 3,725	$ 3,725	$ 3,725		
Interest bearing deposits with banks	3,235	3,235	3,235		
Federal funds sold	1,088	1,088	1,088		
Investment securities held to maturity	32,707	32,707		32,707	
Restricted investment securities	241	241			241
Loans, net of allowance for loan losses	138,047	133,405			133,405
Accrued interest receivable	555	555		555	
Financial Liabilities					
Noninterest-bearing deposits	$ 59,420	$ 59,420		$ 59,420	
Interest-bearing deposits	114,037	125,169			125,169
Accrued interest payable	59	59		59	

NOTE 21 - FAIR VALUE MEASUREMENTS (CONTINUED)

Fair value measurements are disclosed based on whether the assets or liabilities are valued on a recurring or nonrecurring basis. The following is a description of the valuation methodologies used for assets measured at fair value as well as the general classification of such assets pursuant to the valuation hierarchy:

Recurring basis:

Investment securities available for sale are recorded at fair value on a recurring basis. Fair value measurement is based upon quoted market prices, when available (Level 1). If quoted market prices are not available, fair values are measured utilizing independent valuation techniques of identical or similar securities for which significant assumptions are derived primarily from or corroborated by observable market data. Third party vendors compile prices from various sources and may determine the fair value of identical or similar securities by using price models that consider observable market data (Level 2). Mortgage-backed securities are included in Level 2 if observable inputs are available. In certain cases securities have been valued using unobservable inputs including discounted cash flow methodologies or similar techniques that require management judgment or estimation. Such securities are included in Level 3. The table below present the recorded amount of assets and liabilities measured at fair value on a recurring basis (dollars in thousands).

December 31, 2018	Total	Level 1	Level 2	Level 3
Investment Securities Available for Sale:				
U.S. government agency & treasury securities	$ 28,385	$ -	$ 28,385	$ -
Corporate debt securities	1,958	-	1,958	-
SBA pools	490	-	490	-
Mortgage-backed securities	1,417	-	1,417	-
Totals	$ 32,250	$ -	$ 32,250	$ -

December 31, 2017	Total	Level 1	Level 2	Level 3
Investment Securities Available for Sale:				
U.S. government agency & treasury securities	$ 28,351	$ -	$ 28,351	$ -
Corporate debt securities	2,048	-	2,048	-
SBA pools	511	-	511	-
Mortgage-backed securities	1,797	-	1,797	-
Totals	$ 32,707	$ -	$ 32,707	$ -

NOTE 21 - FAIR VALUE MEASUREMENTS (CONTINUED)

Nonrecurring basis:

Impaired Loans – Loans are determined to be impaired when, in the judgment of management based on current information, it is probable that all amounts due will not be collected according to the contractual terms of the loan when due. The measurement of loss associated with impaired loans can be based on either the observable market price of the loan, the fair value of the collateral that secures the loan or the present value of expected cash flows from the loan. Collateral may be in the form of real estate, personal property or business assets including equipment, inventory and accounts receivable. The value of real estate collateral may be determined by an appraisal using an income or market valuation approach by an independent licensed appraiser (Level 2). Management may use other valuation methods that include unobservable inputs or assumptions for other types of collateral, if an appraisal is not available for real estate collateral or if management determines that the value of real estate collateral is impaired below the appraised value (Level 3). The fair value of an impaired loan may also be based on the present value of expected cash flows which include unobservable inputs and assumptions (Level 3).

Other real estate owned – Loans transferred to other real estate owned may be adjusted to fair value at the time of foreclosure or written down to fair value if management obtains information that the fair value is less than the carrying value of the real estate. Fair value may be based on independent observable market prices or appraised values of the collateral (Level 2). Management may determine that the fair value of other real estate owned is further impaired below the appraised value or an appraisal may not be available. Fair value is then determined by management using other valuation methods that include unobservable inputs and assumptions (Level 3).

The following table summarizes the Bank's assets that were measured at fair value on a nonrecurring basis as of December 31, 2018 and 2017:

Description	Balance as of December 31, 2018	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Impaired loans	$ 1,309,972	$ -	$ -	$ 1,309,972
Other real estate	$ 2,107,010	$ -	$ -	$ 2,107,010

Description	Balance as of December 31, 2017	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Impaired loans	$ 2,083,653	$ -	$ -	$ 2,083,653
Other real estate	$ 5,623,193	$ -	$ 63,000	$ 5,560,193

NOTE 21 - FAIR VALUE MEASUREMENTS (CONTINUED)

The following table presents quantitative information about Level 3 Fair Value Measurements (in thousands):

Description	Fair Value	Valuation Techniques	Unobservable Inputs	Range	Weighted Average
As of December 31, 2018:					
Assets					
Impaired Loans	$ 1,310	Discounted appraised value	Estimated selling cost	10% - 15%	11%
		Discounted cash flow analysis	Discount for lack of marketability and age of appraisal	0% - 5%	0%
Other real estate owned	2,107	Discounted appraised value	Market rate for borrower	6.25% - 7.5%	7%
			Discount for lack of marketability and age of appraisal	10%	10%
As of December 31, 2018:					
Assets					
Impaired Loans	$ 2,084	Discounted appraised value	Estimated selling cost	10% - 15%	11%
		Discounted cash flow analysis	Discount for lack of marketability and age of appraisal	0% - 5%	0%
Other real estate owned	5,623	Discounted appraised value	Market rate for borrower	5.25% - 6.5%	6%
			Discount for lack of marketability and age of appraisal	10%	10%

NOTE 22 - ISSUANCE OF COMMON STOCK

The Bank issued 7,718,084 shares of common stock on July 28, 2017 at $1.85 per share for total proceeds of $14, 278,455. Issuance costs of $908,303 were incurred which were deducted from the proceeds resulting in net proceeds from the issuance of stock of $13,370,152.

NOTE 23 – REVENUE RECOGNITION

On January 1, 2018, the Bank adopted ASU No. 2016-10 “Revenue from Contracts with Customers” (Topic 606) and all subsequent ASUs that modified Topic 606. As stated in Note 1 Summary of Significant Accounting Policies, the implementation of the new standard did not have a material impact on the measurement or recognition of revenue; as such, a cumulative effect adjustment to opening retained earnings was not deemed necessary. Results for reporting periods beginning after January 1, 2018 are presented under Topic 606, while prior period amounts were not adjusted and continue to be reported in accordance with our historic accounting under Topic 605.

Topic 606 does not apply to revenue associated with financial instruments, including revenue from loans and securities. In addition, certain noninterest income streams such as fees associated with mortgage servicing rights, financial guarantees, derivatives, and certain credit card fees are also not in scope of the new guidance. Topic 606 is applicable to noninterest revenue streams such as trust and asset management income, deposit related fees, interchange fees, merchant income, and annuity and insurance commissions. However, the recognition of these revenue streams did not change significantly upon adoption of Topic 606. Substantially all of the Bank's revenue is generated from contracts with customers. Noninterest revenue streams in-scope of Topic 606 are discussed below.

NOTE 23 – REVENUE RECOGNITION

Service Charges on Deposit Accounts

Service charges and fees on deposit accounts consist of account analysis fees (i.e., net fees earned on analyzed business and public checking accounts), monthly service fees, check orders, and other deposit account related fees. The Bank's performance obligation for account analysis fees and monthly service fees is generally satisfied, and the related revenue recognized, over the period in which the service is provided. Check orders and other deposit account related fees are largely transactional based, and therefore, the Bank's performance obligation is satisfied, and related revenue recognized, at a point in time. Payment for service charges on deposit accounts is primarily received immediately or in the following month through a direct charge to customers' accounts.

Debit and Credit Card Fees

Debit and credit card fees are primarily comprised of debit and credit card income, merchant services income, and other service charges. Debit and credit card income is primarily comprised of interchange fees earned whenever the Bank's debit and credit cards are processed through card payment networks such as Visa. Merchant services income mainly represents fees charged to merchants to process their debit and credit card transactions, in addition to account management fees. The Bank's performance obligation for fees, exchange, and other service charges are largely satisfied, and related revenue recognized, when the services are rendered or upon completion. Payment is typically received immediately or in the following month.

Other Income

Other fees consist of safe deposit rents, ATM surcharges, wire fees, check cashing fees, and other miscellaneous income. These fees are largely transaction-based; therefore, the Bank's performance obligation is satisfied and the resultant revenue is recognized at the point in time the service is rendered. Payments for transaction-based fees are generally received immediately or in the following month by a direct charge to the customer's account.

NOTE 24 - SUBSEQUENT EVENTS

In accordance with FASB ASC Topic 855-10, the Bank evaluates subsequent events that have occurred after the balance sheet date but before the financial statements are issued. There are two types of subsequent events: (1) recognized, or those that provide additional evidence about conditions that existed at the date of the balance sheet, including the estimates inherent in the process of preparing financial statements, and (2) non-recognized, or those that provide evidence about conditions that did not exist at the date of the balance sheet but arose after that date. Subsequent events have been evaluated through March 26, 2019, which is the date the financial statements were available to be issued.