TriCity
Bankshares
Corporation

2018
ANNUAL REPORT

Proxy

Financial Statements

To the innovators.

To the creators. The builders.

To the pioneers.

To the doers.

To the relentless, won't-take-no-for-an-answer types.

To the first ones in, last ones to leave.

To the sole proprietors.

To the trailblazers. The entrepreneurs.

To the business owners.

To the dreamers.

You inspire us.

We share your roots. Your passion.

We started small, too.

And we always remember those humble beginnings.

So go ahead. Make those dreams.

We can make them come true.

Your Dream Makers: Business Lending Team

Agatha and Dave Ulrich

"If you've got a dream, then you have to work in whatever way is necessary to make that dream come true. It's as simple as that."

Our Dreamer: Tri City founder Dave Ulrich, circa 1963

TriCity National Bank

Your hometown bank

www.tcnb.com

EQUAL HOUSING LENDER Member FDIC

Dear Shareholders,

I'm excited to share a few of the high points of what turned out to be a very dynamic year for our bank. We were successful in building upon the already outstanding financial performance of 2017, and 2018 was another record year!

Net profit before income taxes increased 18.3%, primarily due to record loan growth of $81.4 million. Net profit after income taxes increased 58.8%. Return on Assets increased from 0.75% to 1.21% and Return on Equity increased from 7.42% to 11.08%. Other key performance measuring ratios: Net Interest Margin, Efficiency Ratio and Capital Ratios, all improved during the course of the year.

But, in life as well as banking, it's always the "buts." Our future is not without many challenges, *but* we are proactive in identifying them. Loan growth from our assembled team of very successful loan officers, that are showcased on the inside cover of this report, is outpacing deposit growth. The investment portfolio can fund this projected loan growth for now. However, if deposit growth does not outpace loan growth, we will have a problem maintaining our low cost of funds. We MUST grow core deposits, *but* rest assured we have started many new innovative programs.

I'm proud of the progress we've made with employee diversity at all levels. We will continue to seek only the most qualified employees, who will assist the transitioning of our bank for future growth in delivering an unparalleled omni-channel experience. This will help as we look forward in 2019 and beyond, as we actively work on identifying and developing additional niche markets. Not only will this strengthen our bank, but as important, strengthen the communities we serve.

We are very enthusiastic about the future of our bank. By staying true to conservative banking philosophies and committing to *true* community banking, we will continue to focus on the needs of consumers and reinvest in the community to protect your investment. As always, I am very grateful for the tremendous efforts and dedication of our directors and employees.

Thank you for your continued support.

Sincerely,

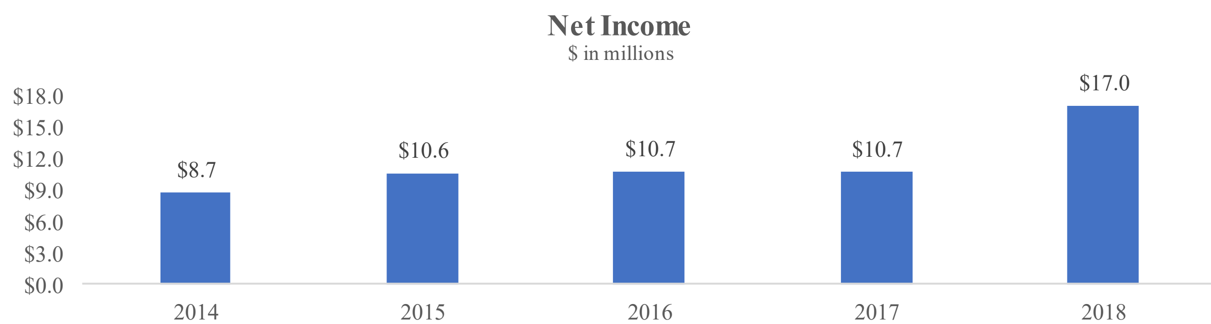
Brian T. McGarry

Brian T. McGarry
Chairman of the Board and Chief Executive Officer
Tri City Bankshares Corporation

2018 Financial Highlights

The Corporation posted net income of $17.0 million for the year ended December 31, 2018, an increase of $6.3 million, or 58.8%, compared to $10.7 million in 2017. Earnings per share increased to $1.90 for the year ended December 31, 2018 compared to $1.20 for the same period in 2017. The Corporation also paid annual dividends of $0.48 per share in both 2017 and 2018.

The increase in net income was due to three main drivers. First, core income was enhanced by an increase in interest income on loans due to loan growth of $81.4 million and a rising interest rate environment. This was partially offset by an increase in noninterest expense as management continued to make significant investments in employees, technology and facilities. Second, acquisition-related purchase accounting income increased due to pay-offs on loans with remaining discounts. Third, tax reform significantly reduced our federal income tax expense in 2018.



Income Statement

Net interest income was $49.4 million during 2018, an increase of $3.9 million or 8.5% over the prior year. The increase was due to a $3.6 million increase in interest income on loans and a $0.6 million increase in interest income on investments, which was partially offset by a $0.3 million increase in interest paid on deposits. The increase in interest income on loans was due to continued loan growth and rising interest rates. The increase in interest income on investments was due to an increase in the yield on both the investment portfolio and overnight funds as interest rates continued to rise in 2018. Interest income on total earning assets increased to 3.91% in 2018 compared to 3.57% in 2017. The Corporation's primary competitive advantage is that our entire funding base is made up of core deposits keeping our cost of funds remarkably low at 0.14% in 2018. As a result, net interest margin increased to 3.77% in 2018 compared to 3.45% in 2017.

There was no provision for loan losses during 2017 and 2018 due to continued improvement in asset quality discussed in detail below.

Noninterest income during 2018 was $16.8 million, an increase of $1.5 million or 9.8% from the prior year. The increase was primarily due to an increase in acquisition-related purchase accounting income, an increase in the gain on the sale of other real estate owned and an increase in debit card interchange income. As a result, core noninterest income to total assets was 1.20% in 2018 compared to 1.08% in 2017.

Noninterest expense was $44.7 million in 2018, an increase of $2.1 million or 4.8% compared to 2017. The increase was primarily due to increases in salary and benefits, net occupancy expense and furniture and equipment expenses. The increase in salary and benefits was driven by rewarding talented professionals, the hiring of additional officers and increasing hourly wages. The increase in net occupancy expense was due to the opening of a new branch location in Waukesha and the expansion of our corporate headquarters. The increase in furniture and equipment expense was due to both the additional facilities and the continued investment in technology infrastructure. Noninterest expense to total assets increased to 3.18% in 2018 from 3.02% in 2017. Management will continue to invest in many areas during 2019 to ensure the long-term success of the Corporation.

Operating earnings were supplemented by acquisition-related purchase accounting income of $1.7 million in 2018 compared to $1.0 million in 2017. While there is $7.0 million in purchase loan discount remaining on the acquired loan portfolio as of December 31, 2018, the timing of potential acquisition-related purchase accounting income is unpredictable. In addition, a portion of the remaining discount will be used to offset any additional charge-offs on the acquired portfolio.

Income tax expense was $4.6 million in 2018 compared to $7.5 million in 2017. Income tax expense was significantly impacted by the Tax Cuts and Jobs Act that was signed into law in December of 2017. In 2017 we were required to re-evaluate our deferred tax assets and liabilities resulting in a one-time income tax expense of $1.5 million. In 2018, we benefited from the new tax law which reduced our effective tax rate to 21.2% from approximately 33.0% in years past.

Balance Sheet

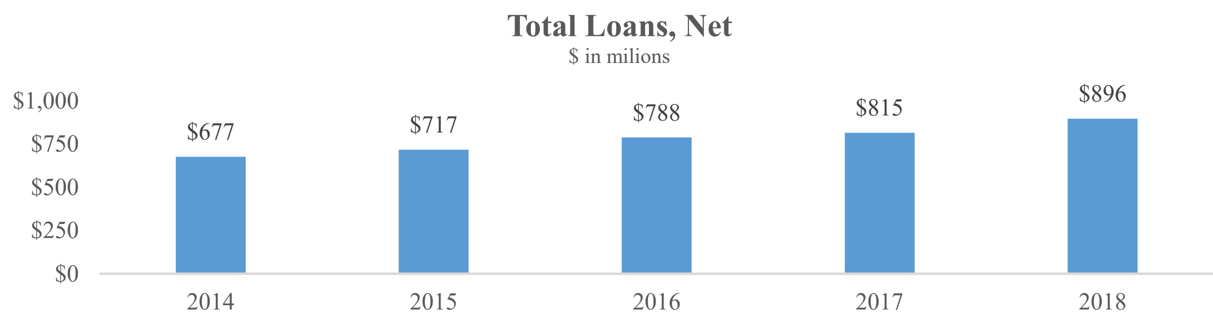
Total assets were $1.4 billion as of December 31, 2018, a decrease $8.3 million or 0.6% compared to December 31, 2017.

Cash and due from Corporations was $64.4 million as of December 31, 2018 compared to $84.0 million as of December 31, 2017. The decrease was primarily due to an increase in loans and a decrease in deposits. Included in the cash and due from banks is $21.2 million invested at the Federal Reserve. The yield on those funds continued to increase as the Federal Reserve raised short-term interest rates during 2018.

The investment portfolio was $371.0 million as of December 31, 2018 compared to $444.5 million as of December 31, 2017, a decrease of $73.5 million. The run-off of the investment portfolio was used to fund significant loan growth during 2018. The investment portfolio is made up of 49.3% collateralized mortgage obligations ("CMO"), 38.9% mortgage backed securities ("MBS") and 11.8% municipal bonds. The CMO and MBS investments provide the Corporation with relatively stable cash flows over time that can be reinvested in either loans or investment securities or provide us with additional liquidity to manage our cost of funds.

Total loans, net of the allowance for loan losses, increased $81.4 million or 10.0% to $896.5 million and represents the highest level of loans in our history. While our renewed focus on loan growth over the last several years has been successful, we remain committed to strong credit discipline, which we believe is the most prudent approach for the long-term health and profitability of the Corporation.

Historically, the majority of our loans have been fixed-rate with maturities of three years or less. With rising interest rates and increased competition for the best loans there has been significant pressure in the market to make longer term fixed-rate loans. While we have continued to make more 5 year fixed rate loans over the last several years, we have built in prepayment penalties to protect the Corporation should interest rates fall.



As shown in the table below, the loan portfolio remains well diversified. Over the years as market forces and regulations continue to evolve, our portfolio has migrated from residential real estate to commercial real estate. In addition, we continue to focus on growing the multifamily segment of the portfolio due to evolving demographics as millennials are delaying single-family home ownership relative to previous generations.

Loan Portfolio Composition

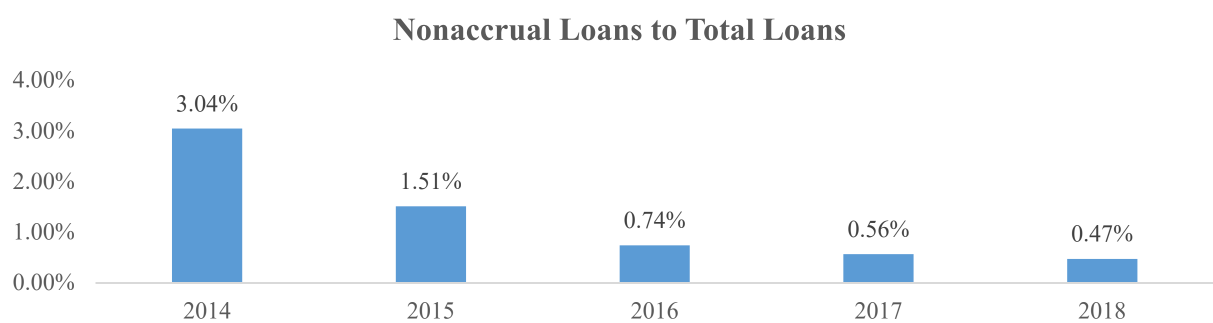
$ in thousands

	December 31, 2017		December 31, 2018	
	Loan Balance	Percent of Total Loans	Loan Balance	Percent of Total Loans
Commercial & Industrial	$43,444	5.26%	$47,457	5.23%
Real Estate:				
Commercial	458,376	55.50%	487,664	53.74%
Residential	193,555	23.44%	196,613	21.67%
Multifamily	76,952	9.32%	99,446	10.96%
Construction	46,214	5.60%	68,278	7.52%
Installment & Other	7,301	0.88%	8,006	0.88%
Total	$825,842	100.00%	$907,464	100.00%

Total deposits were $1.2 billion as of December 31, 2018, a decrease $17.7 million or 1.4% compared to December 31, 2017. As interest rates continued to rise throughout 2018, we saw a modest decline in both money market accounts and certificates of deposit. This was offset by an increase in demand deposits generated primarily from new loan relationships. After two years of small declines in deposits, management is in the process of implementing several strategies to increase core deposits in order to fund future loan growth while maintaining a strong liquidity position.

Asset Quality

All of our asset quality measures continued to improve since we acquired a failed bank from the FDIC in 2009. Nonaccrual loans to total loans decreased to 0.47% in 2018 from 0.56% in 2017. Charge-offs net of recoveries to total loans also decreased to -0.03% in 2018 compared to 0.06% in 2017. The allowance for loan losses to total loans remained strong at 1.21% as of December 31, 2018 compared to 1.30% as of December 31, 2017. In addition, we only had one property totaling $104,400 in other real estate owned at the end of 2018.



Capital

Total stockholders' equity at December 31, 2018 increased $9.1 million to $153.0 million compared to $143.9 million at December 31, 2017. The increase in stockholders' equity during 2018 was due to an increase of $12.6 million in retained earnings which was partially offset by a decrease in accumulated other comprehensive income of $3.5 million. Total equity to total assets increased from 10.17% at December 31, 2017 to 10.88% at December 31, 2018. Book value per share was $17.18 at December 31, 2018 compared with $16.16 December 31, 2017.

The Board of Directors firmly believes in maintaining a strong capital base for the Corporation. The Board of Directors will continue to monitor the Corporation's strategy, future earnings, on-going regulatory requirements, and other factors when approving future dividends.

This report contains statements that may constitute forward-looking statements that speak of the Corporation's plans, goals, beliefs or expectations, refer to estimates or use similar terms. Forward-looking statements are subject to significant risks and uncertainties. The Corporation's actual results may differ materially from the results discussed in such forward-looking statements.

Tri City Bankshares Corporation
Selected Financial Data

	For the Year Ended December 31,				
	2014	**2015**	**2016**	**2017**	**2018**
Results of Operations					
Interest income	$ 41,031,315	$ 40,830,614	$ 44,091,245	$ 47,094,056	$ 51,298,986
Interest expense	1,285,720	1,146,131	1,241,042	1,562,534	1,878,617
Net interest income	39,745,595	39,684,483	42,850,203	45,531,522	49,420,369
Provision for loan losses ("PLL")	3,000,000	3,000,000	900,000	-	-
Net interest income after PLL	36,745,595	36,684,483	41,950,203	45,531,522	49,420,369
Core noninterest income	13,854,562	15,851,292	15,149,208	15,322,514	16,828,433
One-time income	1,001,628	3,167,791	-	-	-
Noninterest expense	39,122,018	39,802,394	40,988,691	42,668,461	44,735,236
Income before income taxes	12,479,767	15,901,172	16,110,720	18,185,575	21,513,566
Deferred tax adjustment	-	-	-	1,500,190	-
Income taxes	3,768,500	5,332,852	5,382,714	6,005,916	4,552,500
Net income	$ 8,711,267	$ 10,568,320	$ 10,728,006	$ 10,679,469	$ 16,961,066
Balance Sheet Data					
Assets	$ 1,251,880,603	$ 1,332,293,272	$ 1,427,301,200	$ 1,414,721,950	$ 1,406,431,804
Securities	357,659,154	446,840,309	440,788,027	444,488,998	371,017,618
Total loans	688,644,509	728,697,339	799,628,467	825,842,074	907,464,082
Allowance for loan losses	(12,103,357)	(11,590,900)	(11,256,774)	(10,732,652)	(10,994,385)
Total loans, net	676,541,152	717,106,439	788,371,693	815,109,422	896,469,697
Deposits	1,120,507,223	1,195,119,232	1,284,805,692	1,267,051,615	1,249,302,645
Borrowings	-	-	-	-	-
Total stockholders' equity	127,836,562	133,771,359	138,186,448	143,865,498	153,014,924
Loan to deposits	60.38%	60.00%	61.36%	64.33%	71.76%
Per Share Data					
Earnings per share	$ 0.98	$ 1.19	$ 1.20	$ 1.20	$ 1.90
Cash dividend declared	$ -	$ 0.48	$ 0.48	$ 0.48	$ 0.48
Book value per share	$ 14.36	$ 15.02	$ 15.52	$ 16.16	$ 17.18
Shares outstanding	8,904,915	8,904,915	8,904,915	8,904,915	8,904,915
Performance Ratios					
Return on assets	0.70%	0.79%	0.75%	0.75%	1.21%
Return on equity	6.81%	7.90%	7.76%	7.42%	11.08%
Interest on earning assets	3.67%	3.48%	3.49%	3.57%	3.91%
Cost of funds	0.12%	0.10%	0.10%	0.12%	0.14%
Net interest margin	3.55%	3.38%	3.39%	3.45%	3.77%
Core noninterest income to assets	1.11%	1.19%	1.06%	1.08%	1.20%
Noninterest expense to assets	3.13%	2.99%	2.87%	3.02%	3.18%
Efficency Ratio	72.99%	71.67%	70.67%	70.12%	67.53%
Asset Quality Ratios					
Nonaccrual loans to total loans	3.04%	1.51%	0.74%	0.56%	0.47%
Past due loan >30 days to total loans	3.07%	1.31%	1.01%	0.80%	0.82%
Net charge-offs to total loans	0.47%	0.48%	0.15%	0.06%	-0.03%
Other real estate owned to total assets	0.38%	0.24%	0.03%	0.01%	0.01%
Allowance for loan losses to total loans	1.76%	1.59%	1.41%	1.30%	1.21%
Capital Ratios					
Total equity to total assets	10.21%	10.04%	9.68%	10.17%	10.88%
Leverage capital ratio	10.39%	10.28%	10.06%	10.50%	11.23%
Tier 1 risk based capital ratio	16.70%	16.64%	15.99%	15.97%	16.02%
Total risk based capital ratio	17.95%	17.89%	17.24%	17.21%	17.13%

Independent Auditors' Report

Board of Directors and Stockholders
Tri City Bankshares Corporation

Report on the Financial Statements

We have audited the accompanying consolidated financial statements of Tri City Bankshares Corporation and subsidiaries (the "Corporation"), which comprise the consolidated balance sheets as of December 31, 2018 and 2017, and the related consolidated statements of income, comprehensive income, stockholders' equity, and cash flows for the years then ended, and the related notes to the consolidated financial statements.

Management's Responsibility for the Financial Statements

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

Auditors' Responsibility

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

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of the Corporation as of December 31, 2018 and 2017, and the results of its operations and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Report on Internal Control over Financial Reporting

We also have audited, in accordance with auditing standards generally accepted in the United States of America, the Corporation's internal control over financial reporting as of December 31, 2018, based on criteria established in *Internal Control-Integrated Framework (2013),* issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated March 13, 2019 expressed an unqualified opinion.

Baker Tilly Virchow Krause, LLP

Milwaukee, Wisconsin
March 15, 2019

TRI CITY BANKSHARES CORPORATION

CONSOLIDATED BALANCE SHEETS

As of December 31, 2018 and 2017

ASSETS

	2018	2017
Cash and due from banks	$ 64,379,595	$ 84,043,266
Federal funds sold	990,830	2,414,518
Total Cash and Cash Equivalents	65,370,425	86,457,784
Securities available for sale, at fair value	371,017,618	444,488,998
Loans, less allowance for loan losses of $10,994,385 and $10,732,652 as of 2018 and 2017, respectively	896,469,697	815,109,422
Premises and equipment - net	15,750,707	14,863,076
Bank owned life insurance	39,255,799	38,301,624
Accrued interest receivable and other assets	18,567,558	15,501,046
TOTAL ASSETS	$ 1,406,431,804	$ 1,414,721,950

LIABILITIES AND STOCKHOLDERS' EQUITY

	2018	2017
LIABILITIES		
Deposits		
Demand	$ 300,283,663	$ 293,775,453
Savings and NOW	876,046,750	886,571,718
Other time	72,972,232	86,704,444
Total Deposits	1,249,302,645	1,267,051,615
Accrued interest payable and other liabilities	4,114,235	3,804,837
Total Liabilities	1,253,416,880	1,270,856,452
STOCKHOLDERS' EQUITY		
Cumulative preferred stock, $1 par value 200,000 shares authorized, no shares issued	-	-
Common stock, $1 par value, 15,000,000 shares authorized, 8,904,915 shares issued and outstanding in 2018 and 2017	8,904,915	8,904,915
Additional paid-in-capital	26,543,470	26,543,470
Accumulated other comprehensive loss	(6,327,324)	(2,790,043)
Retained earnings	123,893,863	111,207,156
Total Stockholders' Equity	153,014,924	143,865,498
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	$ 1,406,431,804	$ 1,414,721,950

See accompanying notes to consolidated financial statements.

TRI CITY BANKSHARES CORPORATION

CONSOLIDATED STATEMENTS OF INCOME

For the Years Ended December 31, 2018 and 2017

	2018	2017
INTEREST INCOME		
Loans	$ 40,568,593	$ 36,977,923
Investment securities		
Taxable	8,952,530	8,360,243
Tax exempt	937,217	990,432
Federal funds sold and due from banks	821,320	746,132
Other	19,326	19,326
Total Interest Income	51,298,986	47,094,056
INTEREST EXPENSE		
Deposits	1,876,309	1,562,397
Other borrowings	2,308	137
Total Interest Expense	1,878,617	1,562,534
Net Interest Income before Provision for Loan Losses	49,420,369	45,531,522
Provision for loan losses	-	-
Net Interest Income after Provision for Loan Losses	49,420,369	45,531,522
NONINTEREST INCOME		
Service charges on deposits	5,083,707	5,321,610
Debit card interchange	4,195,302	3,791,955
ATM	1,578,543	1,498,400
Merchant services	877,408	810,544
Loan servicing income	456,126	295,340
Net gain on sale of loans	412,969	592,511
Increase in bank owned life insurance	954,175	1,045,495
Non-accretable loan discount	1,106,574	329,920
Gain on sale of other real estate owned	379,595	49,960
Other income	1,784,034	1,586,779
Total Noninterest Income	16,828,433	15,322,514
NONINTEREST EXPENSES		
Salaries and employee benefits	25,333,246	23,992,590
Net occupancy costs	4,192,205	3,695,212
Furniture and equipment expenses	2,454,050	2,123,209
Data processing expense	4,065,041	4,412,296
Professional fees	1,285,585	1,453,794
Telecommunications expense	977,828	745,514
Advertising and promotional	714,439	771,054
FDIC and other regulatory assessments	719,991	762,946
Operation of other real estate owned	40,604	70,557
Office supplies	800,440	917,017
Postage	574,106	628,880
Other expense	3,577,701	3,095,392
Total Noninterest Expense	44,735,236	42,668,461
Total Income before Taxes	21,513,566	18,185,575
Less: Income tax expense	4,552,500	7,506,106
NET INCOME	$ 16,961,066	$ 10,679,469

See accompanying notes to consolidated financial statements.

TRI CITY BANKSHARES CORPORATION

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

For the Years Ended December 31, 2018 and 2017

	2018	2017
NET INCOME	$ 16,961,066	$ 10,679,469
Other comprehensive loss, net of tax:		
Securities available for sale:		
Net changes in unrealized losses on securities available for sale	(4,861,644)	(1,212,829)
Tax effect	1,324,361	486,769
Total Other Comprehensive Loss, net of tax:	(3,537,283)	(726,060)
COMPREHENSIVE INCOME	$ 13,423,783	$ 9,953,409

See accompanying notes to consolidated financial statements.

TRI CITY BANKSHARES CORPORATION

CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY

For the Years Ended December 31, 2018 and 2017

	Common Stock	Additional Paid-in Capital	Accumulated Other Comprehensive Loss	Retained Earnings	Total
BALANCES - January 1, 2017	$ 8,904,915	$ 26,543,470	$ (1,569,545)	$ 104,307,608	$ 138,186,448
Net income	-	-	-	10,679,469	10,679,469
Net changes in unrealized loss on securities available for sale	-	-	(1,212,829)	-	(1,212,829)
Tax effect	-	-	486,769	-	486,769
Total Comprehensive Income					9,953,409
Reclassification due to the adoption of ASU No. 2018-02			(494,438)	494,438	-
Cash dividends - ($0.48 per share)	-	-	-	(4,274,359)	(4,274,359)
BALANCES - December 31, 2017	8,904,915	26,543,470	(2,790,043)	111,207,156	143,865,498
Net income	-	-	-	16,961,066	16,961,066
Net changes in unrealized loss on securities available for sale	-	-	(4,861,644)	-	(4,861,644)
Tax effect	-	-	1,324,363	-	1,324,363
Total Comprehensive Income					13,423,785
Cash dividends - ($0.48 per share)	-	-	-	(4,274,359)	(4,274,359)
BALANCES - December 31, 2018	$ 8,904,915	$ 26,543,470	$ (6,327,324)	$ 123,893,863	$ 153,014,924

See accompanying notes to consolidated financial statements

TRI CITY BANKSHARES CORPORATION

CONSOLIDATED STATEMENTS OF CASH FLOWS

For the Years Ended December 31, 2018 and 2017

	2018	2017
CASH FLOWS FROM OPERATING ACTIVITIES		
Net Income	$ 16,961,066	$ 10,679,469
Adjustments to reconcile net income to net cash flows from operating activities:		
Depreciation	1,797,531	1,638,018
Amortization and accretion of servicing rights, premiums and discounts	892,540	3,046,396
Net gain on sale of loans	(412,969)	(592,511)
Core deposit intangible amortization	-	63,272
Provision for loan losses	-	-
Benefit for deferred income taxes	201,372	1,774,319
Proceeds from sales of loans held for sale	14,254,144	24,486,095
Originations of loans held for sale	(13,948,464)	(24,065,284)
Increase in cash surrender value of life insurance	(954,175)	(1,045,495)
Gain on sale of other real estate owned	(379,595)	(49,960)
Net change in fair value of other real estate owned	(2,330)	2,330
Net change in fair value of mortgage servicing rights	(68,308)	98,943
Gain on disposal of premises and equipment	(24,479)	(1,022)
Net change in:		
Accrued interest receivable and other assets	(3,096,523)	(1,728,877)
Accrued interest payable and other liabilities	1,432,391	(1,791,773)
Net cash flows from operating activities	16,652,201	12,513,920
CASH FLOWS FROM INVESTING ACTIVITIES		
Activity in available for sale securities:		
Maturities, prepayments and calls	66,238,016	80,641,670
Purchases	-	(89,352,469)
Net increase in loans	(80,406,158)	(26,111,100)
Purchase of premises and equipment	(2,730,237)	(1,081,497)
Proceeds from sale of other real estate owned	1,112,595	738,000
Proceeds from sales of premises and equipment	69,553	50,698
Net cash used in investing activities	(15,716,231)	(35,114,698)
CASH FLOWS FROM FINANCING ACTIVITIES		
Net decrease in deposits	(17,748,970)	(17,754,077)
Dividends paid	(4,274,359)	(4,274,359)
Net cash flows used in from financing activities	(22,023,329)	(22,028,436)
Net change in cash and cash equivalents	(21,087,359)	(44,629,214)
CASH AND CASH EQUIVALENTS - BEGINNING OF YEAR	86,457,784	131,086,998
CASH AND CASH EQUIVALENTS - END OF YEAR	$ 65,370,425	$ 86,457,784

See accompanying notes to consolidated financial statements

TRI CITY BANKSHARES CORPORATION

CONSOLIDATED STATEMENTS OF CASH FLOWS

For the Years Ended December 31, 2018 and 2017

(continued)

	2018	2017
SUPPLEMENTAL CASH FLOW DISCLOSURES		
Cash paid for interest	$ 1,880,633	$ 1,555,893
Cash paid for income taxes	3,785,000	6,550,000
SUPPLEMENTAL CASH FLOW DISCLOSURES		
Loans receivable transferred to other real estate owned	$ 712,400	$ 343,690
Mortgage servicing rights resulting from sales of loans	107,289	171,700

See accompanying notes to consolidated financial statements

NOTE 1 - Summary of Significant Accounting Policies

The consolidated financial statements of Tri City Bankshares Corporation (the "Corporation") include the accounts of its wholly owned subsidiary, Tri City National Bank (the "Bank") (collectively, the "Corporation"). The Bank includes the accounts of its wholly owned subsidiaries, Tri City Capital Corporation, a Nevada investment subsidiary, Title Service of Southeast Wisconsin, Inc., a title company subsidiary, TCNB Whole Health Investment Fund LLC, TCNB Aurora Investment Fund LLC, TCNB Fire Loan Pool IF LLC and TCNB FCI Loan Pool IF LLC subsidiaries to facilitate tax credit investments. All significant intercompany accounts and transactions have been eliminated in consolidation.

The consolidated financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America ("U.S. GAAP") and conform to general practices within the banking industry.

The Corporation grants commercial, real estate and installment loans and accepts deposits primarily in Southeastern Wisconsin. The Corporation is subject to competition from other financial institutions and nonfinancial institutions providing financial products. Additionally, the Corporation is subject to the regulations of certain regulatory agencies and undergo periodic examination by those regulatory agencies.

Use of Estimates

In preparing consolidated financial statements in conformity with U.S. GAAP, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities as of the date of the balance sheet and 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 in the near term relate to the determination of the allowance for loan losses, deferred taxes, other than temporary impairment of securities and fair values of financial instruments.

Cash and Cash Equivalents

For purposes of reporting cash flows, cash and cash equivalents include cash and balances due from banks and Federal funds sold, all of which mature within ninety days. The Corporation maintained amounts due from banks that exceeded federally insured limits as of December 31, 2018. The Corporation has not experienced any losses in such accounts.

Securities

Securities are classified as available for sale when the Corporation intends to hold them for an indefinite period of time but not necessarily to maturity. Securities available for sale are accounted for on a trade date basis and carried at fair value, with unrealized holding gains and losses excluded from net income and reported in accumulated other comprehensive income (loss), net of tax. Gains and losses on sales are recorded on the trade date and determined using the specific identification method.

Declines in the fair value of securities below their cost that are other-than-temporary due to credit issues are reflected as "Other than temporary impairment of securities" in the consolidated statements of income. In estimating other-than-temporary losses, management considers: (1) the length of time and extent that fair value has been less than cost, (2) the financial condition and near-term prospects of the issuer, and (3) the Corporation's ability and intent to hold the security for a period sufficient to allow for any anticipated recovery in fair value. The difference between the present values of the cash flows expected to be collected and the amortized cost basis is the credit loss. The credit loss is the portion of the other-than-temporary impairment that is recognized in earnings and is a reduction to the cost basis of the security. The portion of other-than-temporary impairment related to all other factors is included in other comprehensive loss, net of tax.

NOTE 1 - Summary of Significant Accounting Policies (cont.)

Loans Held For Investment

Loans that management has the intent and ability to hold for the foreseeable future or until maturity or payoff are reported at the amount of unpaid principal, reduced by an allowance for loan losses and any deferred fees or costs in originating loans. Interest income is accrued and credited to income on a daily basis based on the unpaid principal balance. Loan origination fees, net of certain direct loan origination costs, are deferred and recognized as an adjustment of the loan yield using an effective interest method. The accrual of interest income on impaired loans is discontinued when, in the opinion of management, there is reasonable doubt as to the borrower's ability to meet payment of interest or principal when they become due. When interest accrual is discontinued, all unpaid accrued interest is reversed. Cash collections on impaired loans are credited to the loan receivable balance and no interest income is recognized on those loans until the principal balance is current. Loans are returned to accrual status when the principal and interest amounts contractually due are brought current and future payments are reasonably assured. A troubled debt restructuring (“TDR”) includes a loan modification where a borrower is experiencing financial difficulty and the Corporation grants a concession to that borrower that the Corporation would not otherwise consider except for the borrower’s financial difficulties. All TDRs are classified as impaired loans. TDRs may be on accrual or non-accrual status based upon the performance of the borrower and management’s assessment of collectability. TDRs deemed non-accrual may return to accrued status based on performance in accordance with terms of the restructuring, generally 6 months.

Consistent with regulatory guidance, charge-offs are taken when specific loans, or portions thereof, are considered uncollectible and of such little value that their continuance as bankable assets is not warranted. The Corporation’s policy is to promptly charge these loans off in the period the uncollectible loss amount is reasonably determined. The Corporation promptly charges-off commercial and real estate loans, or portions thereof, when available information confirms that specific loans are uncollectible based on information that includes, but is not limited to, (1) the deteriorating financial condition of the borrower, (2) declining collateral values, and/or (3) legal action, including bankruptcy, that impairs the borrower’s ability to adequately meet its obligations. All consumer loans 120 days past due and all other loans with principal and interest 180 days or more past due will be reviewed for potential charge-off at least quarterly.

Loans Acquired Through Purchase

Loans acquired through the completion of a purchase, including loans that have evidence of deterioration of credit quality since origination and for which it is probable, at acquisition, that the Corporation will be unable to collect all contractually-required payments receivable, are initially recorded at fair value with no valuation allowance. Loans are evaluated individually at the date of acquisition to determine if there is evidence of deterioration of credit quality since origination. Loans where there is evidence of deterioration of credit quality since origination may be aggregated and accounted for as a pool of loans if the loans being aggregated have common risk characteristics. Contractually-required payments for interest and principal that exceed the undiscounted cash flows expected at acquisition, or the “nonaccretable difference,” are not recognized as a yield adjustment, a loss accrual or a valuation allowance. Non-accretable discount may be taken to non-interest income if a loan pays-off or if the non-accretable discount is greater than a charge-off taken. Subsequent decreases to the expected cash flows will generally result in a provision for loan losses. Subsequent increases in cash flows result in a reversal of the provision for loan losses to the extent of prior charges or a reclassification of the difference from non-accretable discount to accretable discount with a positive impact on interest income. The difference between the undiscounted cash flows expected at acquisition and the investment in the loan, or the “accretable yield,” is recognized as interest income on a level-yield method over the life of the loan. Increases in expected cash flows subsequent to the initial investment are recognized prospectively through adjustment of the yield on the loan over its remaining life. Decreases in expected cash flows are recognized as provision for loan losses. If the Corporation does not have the information necessary to reasonably estimate expected cash flows, it may use the cost recovery method or cash basis method of income recognition. Valuation allowances on these impaired loans reflect only losses incurred after the acquisition (meaning the present value of all cash flows expected at acquisition that ultimately are not to be received).

Loans Held for Sale

Loans originated and intended for sale in the secondary market are carried at the lower of cost or estimated market value in the aggregate. Net unrealized gains or losses are recognized through a valuation allowance by charges to income. All sales are made without recourse.

NOTE 1 - Summary of Significant Accounting Policies (cont.)

Allowance for Loan Losses

The allowance for loan losses reflects management's best estimate of the probable and inherent losses on loans and is based on a risk model developed and implemented by management and approved by the Corporation's Board of Directors.

The allowance for loan losses is a valuation allowance for probable and inherent losses incurred in the loan portfolio. Management maintains allowances for loan losses at levels deemed adequate to absorb estimated probable credit losses inherent in the loan portfolio. The adequacy of the allowances is determined based on periodic evaluations of the loan portfolios and other relevant factors. The allowance is comprised of both a specific component and a general component. Even though the entire allowance is available to cover losses on any loan, specific allowances are provided on impaired loans pursuant to accounting standards. The general allowance is based on historical loss experience, adjusted for qualitative and environmental factors.

In determining the general allowance management has segregated the loan portfolio by loan class. For each class of loan, a historical loss factor is computed. In determining the appropriate period of activity to use in computing the historical loss factor management reviews trends in net charge-off ratios. It is management’s intention to utilize a period of activity that is most reflective of current experience. Changes in the historical period are made when there is a distinct change in the trend of net charge-off experience. Management adjusts the historical loss factors for the impact of the following qualitative factors: asset quality, changes in volume and terms, policy changes, ability of management, economic trends, industry conditions, changes in credit concentrations and competitive/legal factors. In determining the impact, if any, of an individual qualitative factor, management compares the current underlying facts and circumstances surrounding a particular factor with those in the historical periods, adjusting the historical loss factor in a directionally consistent manner with changes in the qualitative factor. Management separately evaluates both the Corporation’s historical portfolio as well as acquired loans that have renewed and are eligible to be considered as part of the general allowance. Management will continue to analyze the qualitative factors on a quarterly basis, adjusting the historical loss factor both up and down, to a factor deemed appropriate for the probable and inherent risk of loss in its portfolio.

Specific allowances are determined as a result of the impairment process. When a loan is identified as impaired it is evaluated for loss using either the fair value of collateral method or the present value of cash flows method. If the present value of expected cash flows or the fair value of collateral exceeds the Corporation’s carrying value of the loan, no loss is anticipated and no specific reserve is established. However, if the Corporation’s carrying value of the loan is greater than the present value of expected cash flows or fair value of collateral, a specific reserve is established. In either situation, loans identified as impaired are excluded from the calculation of the general reserve.

The allowance for loan losses is increased by provisions charged to earnings and reduced by charge-offs, net of recoveries. The adequacy of the allowance for loan losses is reviewed and approved by the Corporation's Board of Directors on a quarterly basis. In addition, various regulatory agencies periodically review the allowance for loan losses. These agencies may suggest additions to the allowance for loan losses based on their judgments of collectability based on information available to them at the time of their examination.

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 Corporation, (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 Corporation does not maintain effective control over the transferred assets through an agreement to repurchase them before their maturity.

Mortgage Servicing Rights

The Corporation records a mortgage servicing right (“MSR”) asset when it continues to service borrower payments and perform maintenance activities on loans sold to secondary market investors. In the period in which the loan is sold to the secondary market investors, the gain on sale of the loan is increased by the value of the initial MSR.

The Corporation initially records servicing rights at the time of the sale of the loans to the secondary market investors. The Corporation uses the amortization method for the subsequent measurement of its MSR assets. Under the amortization method, the Corporation amortizes the value of its MSR assets in proportion to and over the life of the loan on a per loan basis. An impairment analysis is prepared on a quarterly basis by estimating the fair value of the MSR assets and comparing that value to the carrying amount. A valuation allowance is established when the carrying amount exceeds fair value. The fair value of the MSR assets is determined by using a discounted cash flow model, which estimates the present value of the future net cash flows of the servicing portfolio based on various factors, such as servicing costs, expected prepayment speeds and discount rates.

NOTE 1 - Summary of Significant Accounting Policies (cont.)

Mortgage Servicing Rights (continued)

At December 31, 2018 and 2017, the Corporation services real estate loans for investors in the secondary market, which are not included in the accompanying consolidated balance sheets, of approximately $221 million and $238 million, respectively. The related MSR assets were $1,444,069 and $1,455,810 at December 31, 2018 and 2017, respectively, and are included in accrued interest receivable and other assets on the consolidated balance sheets. MSR assets are reported net of a valuation allowance of $30,365 and $98,943 at December 31, 2018 and 2017, respectively.

Premises and Equipment

Land is carried at cost. Depreciable assets are stated at cost less accumulated depreciation. Provisions for depreciation are computed on straight-line methods over the estimated useful lives of the assets, which range from 3 to 10 years for furniture and equipment and 15 to 40 years for buildings and lease-hold improvements. Repairs and maintenance costs are expensed as incurred.

Other Real Estate Owned

Other real estate owned ("OREO") comprises real estate acquired in partial or full satisfaction of loans. OREO is recorded at fair value less estimated selling costs at the date of transfer, establishing a new cost basis, with any excess of the related loan balance over the fair value less expected selling costs charged to the allowance for loan losses. Subsequently, properties are evaluated and if fair value declines, a valuation allowance is recorded through operation of other real estate owned expense. The amount the Corporation ultimately recovers on repossessed assets may differ substantially from the net carrying value of these assets because of future market factors beyond the Corporation's control. Net costs of maintaining and operating the properties are expensed to operation of other real estate owned as incurred on the consolidated statements of income.

New Market Tax Credits

As part of its Community Reinvestment Act responsibilities and due to their favorable economics, the Corporation invests in tax credit-motivated projects primarily in the markets it serves. These projects are directed at tax credits issued under the federal New Markets Tax Credits program. As a result of the transactions, the Corporation has several Investment Fund subsidiaries. The Investment Fund subsidiaries are a limited partner in several community development entities ("CDEs"). The Corporation is not the general partner, does not have controlling ownership and is not the primary beneficiary in any of these limited partnerships and thus, the limited partnerships have not been consolidated. These investments are accounted for using the equity method of accounting and are evaluated for impairment at the end of each reporting period (see Note 7 – New Market Tax Credits - Variable Interest Entities).

Federal Reserve Bank Stock

The Corporation's investment in Federal Reserve Bank ("FRB") stock meets the minimum amount required by current regulations and is carried at cost, which approximates fair value.

Off-Balance Sheet Financial Instruments

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

NOTE 1 - Summary of Significant Accounting Policies (cont.)

Derivative Financial Instruments

The Corporation offers interest rate swap products directly to qualified commercial borrowers. The Corporation economically hedges client derivative transactions by entering into offsetting interest rate swap contracts executed with a third party. The derivative contracts have mirror-image terms, which results in the positions' changes in fair value primarily offsetting through earnings each period. The credit risk and risk of non-performance embedded in the fair value calculations is different between the dealer counterparties and the commercial borrowers which may result in a difference in the changes in the fair value of the mirror-image swaps. The Corporation incorporates credit valuation adjustments to appropriately reflect both its own non-performance risk and the counterparty's risk in the fair value measurements. When evaluating the fair value of its derivative contracts for the effects of non-performance and credit risk, the Corporation considered the impact of netting and any applicable credit enhancements such as collateral postings, thresholds and guarantees.

At December 31, 2018, the aggregate amortizing notional value of interest rate swaps with various commercial borrowers was $14.0 million. The Corporation receives fixed rates and pays floating rates based upon LIBOR on the swaps with commercial borrowers. Commercial borrower swaps are completed independently with each borrower and are not subject to master netting arrangements. These commercial borrower swaps were reported on the consolidated balance sheets as a derivative asset and liability of $530,321 in accrued interest receivable and other assets and accrued interest payable and other liabilities. In the event of default on a commercial borrower interest rate swap by the counterparty, a right of offset exists to allow for the commercial borrower to set off amounts due against the related commercial loan. As of December 31, 2018, no interest rate swaps were in default and therefore all values for the commercial borrower swaps are recorded on a gross basis on the consolidated balance sheets.

Advertising Costs

All advertising costs incurred by the Corporation are expensed in the period in which they are incurred and recorded in noninterest expense.

Income Taxes

The Corporation files a consolidated Federal income tax return and combined state income tax returns. Income tax expense is recorded based on the liability method. Deferred income tax assets and liabilities are computed annually for differences between the financial statement and tax bases of assets and liabilities that will result in taxable or deductible amounts in the future based on enacted tax laws and rates applicable to the periods in which the differences are expected to affect taxable income. As changes in tax laws or rates are enacted, deferred tax assets and liabilities are adjusted through the provision for income taxes. The differences relate principally to the allowance for loan losses, mortgage servicing rights, deferred loan fees, and premises and equipment. Valuation allowances are established when necessary to reduce deferred income tax assets to the amount expected to be realized. The Corporation also accounts for the uncertainty in income taxes related to the recognition and measurement of a tax position taken or expected to be taken in an income tax return. The Corporation follows the applicable accounting guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure, and transition related to the uncertainty in these income tax positions. It is the Corporation's policy to include interest and penalties in tax expense.

Earnings Per Share

Basic earnings per share is computed based upon the weighted average number of common shares outstanding during each year. The Corporation had no potentially dilutive shares outstanding during the periods ended December 31, 2018 and 2017.

Segment Reporting

The Corporation has determined that it has one reportable segment - community banking. The Corporation offers a range of financial products and services to external customers, including: accepting deposits and originating residential, consumer and commercial loans. Revenues for each of these products and services are disclosed in the consolidated statements of income.

Employee Benefit Plan

The Corporation has established a defined contribution 401(k) profit-sharing plan for qualified employees. The Corporation's policy is to fund contributions as accrued.

NOTE 1 - Summary of Significant Accounting Policies (cont.)

Bank Owned Life Insurance

The Corporation is the owner and primary beneficiary of life insurance policies on certain employees. Bank owned life insurance is reported at the cash surrender value of the policies. The earnings on the policies are recognized as a component of noninterest income. The policies can be liquidated, if necessary, with tax costs associated. However, the Corporation intends to hold these policies and, accordingly, the Corporation has not provided for deferred income taxes on the earnings from the increase in cash surrender value.

Reclassifications

Certain 2017 amounts have been reclassified to conform to the 2018 presentation. The reclassifications have no effect on previously reported consolidated net income, basic earnings per share, and consolidated stockholders' equity.

Revenue Recognition

As disclosed below, as of January 1, 2018, the Corporation adopted ASU 2014-09 *Revenue from Contracts with Customers - Topic 606* and all subsequent ASUs that modified ASC 606. The Corporation has elected to apply the ASU and all related ASUs using the modified retrospective implementation method. The implementation of the guidance had no material impact on the measurement or recognition of revenue of prior periods, however, additional disclosures have been added in accordance with the ASU.

The Corporation generally fully satisfies its performance obligations on its contracts with customers as services are rendered and the transaction prices are typically fixed; charged either on a periodic basis or based on activity. Because performance obligations are satisfied as services are rendered and the transaction prices are fixed, there is little judgment involved in applying Topic 606 that significantly affects the determination of the amount and timing of revenue from contracts with customers. The main types of revenue contracts included in non-interest income within the consolidated statements of operations are as follows.

- ***Service charges on deposits*** - Service charges on deposits consist of transaction-based fees, account maintenance fees, and overdraft services fees for various retail and business checking customers. Transaction-based fees, which includes services such as wire transfer fees and statement rendering fees are recognized at the time the transaction is executed as that is the point in time the Corporation fulfills the customer’s request. All deposit liabilities are considered to have one-day terms and therefore related fees are recognized as non-interest income at the time when the services are provided to the customer. Account maintenance fees, which relate primarily to monthly maintenance, are earned over the course of a month, representing the period over which the Corporation satisfies the performance obligation. Overdraft fees are recognized at the point in time that the overdraft occurs. Service charges on deposits are withdrawn directly from the customer’s account balance.

- ***Debit Card Interchange Income -*** The Corporation earns interchange fees from debit cardholder transactions conducted through VISA payment network. Interchange fees from cardholder transactions represent a percentage of the underlying transaction value and are recognized daily, concurrently with the transaction processing services provided to the cardholder.

- ***ATM Income -*** The Corporation earns income on automated teller machine (“ATM”) transactions. This income includes fees when noncustomers use the Corporation’s ATM network, when the Corporation’s customers use other ATM networks and interchange income on transaction activity that occurs on the Corporation’s ATM network. Income from these activities are recognized concurrently when the transactions occurs.

- ***Merchant Services Income*** - The Corporation earns merchant services income for selling and servicing merchant card processing to customers. The Corporation uses TSYS Merchant Solutions LLC to process the credit/debit cards at point of sale. The Corporation receives monthly payment for servicing the merchant terminals, which is earned over the course of the month, representing the period over which the Corporation satisfies the performance obligation. A per transaction fee and a percent of the overall transaction amount makes up the monthly merchant service fee collected from each customer. In addition, merchant services sell merchant terminal machines which is recognized at the time of sale.

NOTE 1 - Summary of Significant Accounting Policies (cont.)

Revenue Recognition (continued)

- ***Gain/Losses on Sale of OREO –*** The Corporation records a gain or loss from the sale of OREO when control of the property transfers to the buyer, which generally occurs at the time of an executed deed. When the Corporation finances the sale of OREO to the buyer, the Corporation assesses whether the buyer is committed to perform their obligations under the contract and whether collectability of the transaction price is probable. Once these criteria are met, the OREO asset is derecognized and the gain or loss on sale is recorded upon the transfer of control of the property to the buyer. In determining the gain or loss on the sale, the Corporation adjusts the transaction prices and related gain (loss) on sale if a significant financing component is present.

- ***Other Non-Interest Income –*** The main items in this category are other loan closing related fees, prepayment fees and title fees which are all recognized at the time the transaction is executed as that is the point in time the Corporation fulfills the customer's request. Also included in other income are financial advisory fees which are contractually agreed with each customer and earned over time as the Corporation provides the contracted monthly or quarterly services.

Subsequent Events

Subsequent events were evaluated through March 15, 2019, the date the consolidated financial statements were available to be issued.

The Corporation is the owner and beneficiary of life insurance policies on certain employees. In January 2019, one of the insured individuals passed away. At December 31, 2018, the Corporation had policies with a total cash surrender value of approximately $1.5 million on that insured individual. The Corporation has filed claims with the various life insurance companies and expects to receive approximately $2.3 million in death benefits.

NOTE 1 - Summary of Significant Accounting Policies (cont.)

Accounting Pronouncements Effective in 2018

During May 2014, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) No. 2014-09*, Revenue from Contracts with Customers (Topic 606).* ASU No. 2014-09 establishes principles for recognizing revenue upon the transfer of promised goods or services to customers, in an amount that reflects the expected consideration received in exchange for those goods or services. ASU No. 2014-09 also resulted in enhanced disclosures, both qualitative and quantitative, about revenue in order to help financial statement users understand the nature, amount, timing and uncertainty of revenue and related cash flows. ASU No. 2014-09 establishes a five-step model which entities must follow to recognize revenue and removes inconsistencies and weaknesses in existing guidance. However, the guidance does not apply to revenue associated with financial instruments, including loans and investment securities that are accounted for under other U.S. GAAP, which comprises a significant portion of the Corporation's revenue stream. ASU No. 2014-09 became effective for the Corporation on January 1, 2018. The Corporation elected to implement the new guidance using the modified retrospective application, with the cumulative effect recorded as an adjustment to opening retained earnings upon adoption. The adoption of ASU No. 2014-09 did not have a material effect on the operating results or financial position of the Corporation and there was no cumulative effect adjustment required to be recorded. Additional disclosure has been added to Note 1 in the section titled Revenue Recognition to discuss the Corporation's primary sources of noninterest revenue.

In January 2016, the FASB issued ASU No. 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:

•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.

•Requires public business entities to use the exit price notion when measuring the fair value of financial instruments for disclosure purposes.

•Requires separate presentation of financial assets and financial liabilities by measurement category and form of financial asset (i.e., securities or loans and receivables).

•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.

ASU No. 2016-01 became effective for the Corporation on January 1, 2018 and was adopted on a prospective basis. The adoption had no effect on the Corporation's financial position or results of operations but it did impact disclosures of certain items. The Corporation eliminated the disclosures related to the methods a.0nd assumptions used to estimate fair value for financial instruments measured at amortized cost. It also revised its measurement of fair value to include an exit price notion when measuring the fair value of financial instruments for disclosure purposes. The revision did not have a significant impact on the fair value disclosures.

Deferred tax assets ("DTA") related to available for sale ("AFS") securities losses that were revalued as of December 31, 2017 as noted above created a "stranded tax effects" in accumulated other comprehensive loss due to enactment of the Act. The issue arose due to the nature of U.S. GAAP recognition of tax rate change effects on the AFS DTA revaluation as an adjustment to income tax provision. In January 2018, FASB issued ASU 2018-02, *Income Statement – Reporting Comprehensive Income (Topic 202).* The Corporation early adopted the provisions of the ASU 2018-02 and recorded a one-time reclassification of $494,438 from accumulated other comprehensive loss to retained earnings for the stranded tax effects resulting from the newly enacted corporate tax rate. The amount of the reclassification was the difference between the 35 percent historical corporate tax rate and the newly enacted 21 percent corporate tax rate. See the consolidated statements of changes in stockholders' equity for details of the reclassification.

NOTE 1 - Summary of Significant Accounting Policies (cont.)

Accounting Pronouncements for Future Adoption

In June 2016, the FASB issued ASU 2016-13, *Financial Instruments – Credit Losses (Topic 326) Measurement of Credit Losses on Financial Instruments*. ASU 2016-13 requires credit losses on most financial assets measured at amortized cost and certain other instruments to be measured using an expected credit loss model (referred to as the current expected credit loss model). Under this model, entities will estimate credit losses over the entire contractual term of the instrument (considering estimated prepayments, but not expected extensions or modifications unless reasonable expectation of a troubled debt restructuring exists) from the date of initial recognition of that instrument.

The ASU also replaces the current accounting model for purchased credit impaired loans and debt securities. The allowance for credit losses for purchased financial assets with a more-than insignificant amount of credit deterioration since origination ("PCD assets"), should be determined in a similar manner to other financial assets measured on an amortized cost basis. However, upon initial recognition, the allowance for credit losses is added to the purchase price ("gross up approach") to determine the initial amortized cost basis. The subsequent accounting for PCD financial assets is the same expected loss model described above.

Further, the ASU made certain targeted amendments to the existing impairment model for available-for-sale (AFS) debt securities. For an AFS debt security for which there is neither the intent nor a more-likely-than-not requirement to sell, an entity will record credit losses as an allowance rather than a write-down of the amortized cost basis.

The Corporation must adopt this guidance in 2021. Management has engaged a third party vendor to assist in the implementation of the standard and is in the process of analyzing loan level data for modeling purposes. Management is currently evaluating the impact of adoption of the new standard on the consolidated operations, financial position and cash flows of the Corporation.

In February 2016, the FASB issued ASU 2016-02, *Leases (Topic 842).* The amendments in this update increase transparency and comparability among organizations by recognizing lease assets and lease liabilities on the balance sheet and disclosing key information about leasing arrangements. For leases with a term of 12 months or less, the amendments permit lessees to make an accounting policy election by class of underlying assets not to recognize lease assets and lease liabilities. For finance leases, the amendments in this update require a lessee to 1) recognize a right-of-use asset and a lease liability, initially measured at the present value of the lease payments, on the balance sheet; 2) recognize interest on the lease liability separately from amortization of the right-of-use asset in the statement of comprehensive income; 3) classify repayments of the principal portion of the lease liability within financing activities and payments of interest on the lease liability and variable lease payments within operating activities in the statement of cash flows. For operating leases, the amendments in this update require a lessee to 1) recognize a right-of-use asset and a lease liability, initially measured at the present value of the lease payments, on the balance sheet; 2) recognize a single lease cost, calculated so that the cost of the lease is allocated over the lease term on a generally straight-line basis; 3) classify all cash payments within operating activities in the statement of cash flows. The Corporation must adopt this guidance in 2019. The Corporation leases several locations. Management is currently evaluating the impact of adoption of the standard on the consolidated operations, financial position and cash flows of the Corporation.

In July 2018, the FASB issued ASU 2018-11, *Leases (Topic 842)*. This ASU allows entities the option to initially apply the new lease standard at the adoption date and recognize the cumulative-effect adjustment to the opening balance of retained earnings in the period of adoption. This additional transition method changes only when an entity is required to initially apply the transition requirements of the new leases standard; it does not change how those requirements apply. This ASU also provides a practical expedient to not separate nonlease components from the associated lease component. Lessor practical expedient is limited to circumstances in which the nonlease component(s) otherwise would be accounted for under the new revenue guidance and both (1) the timing and pattern of transfer are the same for the nonlease component(s) and associated lease component and (2) the lease component, if accounted for separately, would be classified as an operating lease. The Corporation must adopt the leasing standards in 2019.

In August 2017, the FASB issued ASU 2017-12 *Derivatives and Hedging (Topic 815).* This ASU permits hedge accounting for risk component in hedging relationships involving nonfinancial risk and interest rate risk as follows:

•For a cash flow hedge of a forecasted purchase or sale of a nonfinancial asset, an entity could designate as the hedged risk the variability in cash flows attributable to changes in a contractually specified component stated in the contract. The amendments remove the requirement in current U.S. GAAP that only the overall variability in cash flows or variability related to foreign currency risk could be designated as the hedged risk in a cash flow hedge of a nonfinancial asset.

NOTE 1 - Summary of Significant Accounting Policies (cont.)

•For a cash flow hedge of interest rate risk of a variable-rate financial instrument, an entity could designate as the hedged risk the variability in cash flows attributable to the contractually specified interest rate. By eliminating the concept of benchmark interest rates for hedges of variable-rate instruments in current U.S. GAAP, the amendments remove the requirement to designate only the overall variability in cash flows as the hedged risk in a cash flow hedge of a variable-rate instrument indexed to a nonbenchmark interest rate.

•For a fair value hedge of interest rate risk, the amendments add the Securities Industry and Financial Markets Association ("SIFMA") Municipal Swap Rate as an eligible benchmark interest rate in the United States in addition to those already permitted under current U.S. GAAP (the U.S. Treasury Rate, the London Interbank Offered Rate ("LIBOR") Swap Rate, and the Fed Funds Effective Swap Rate (or Overnight Index Swap ("OIS") Rate). This allows an entity that issues or invests in fixed-rate tax-exempt financial instruments to designate as the hedged risk changes in fair value attributable to interest rate risk related to the SIFMA Municipal Swap Rate rather than overall changes in fair value.

This ASU requires an entity to present the earnings effect of the hedging instrument in the same income statement line item in which the earnings effect of the hedged item is reported. This ASU also requires tabular disclosures related to the effect on the income statement of fair value and cash flow hedges and related to cumulative basis adjustments for fair value hedges. In October 2018, the FASB issued ASU 2018-16, "Derivatives and Hedging (Topic 815)." This ASU permits the use of the OIS rate based on the secured overnight financing rate as a U.S. benchmark interest rate for hedge accounting purposes in addition to those mentioned above. These ASUs are effective for the Corporation in 2019. Management is currently evaluating the impact of adoption of the standard on the consolidated operations, financial position and cash flows of the Corporation.

In August 2018, the FASB issued ASU 2018-13, *Fair Value Measurement (Topic 820).* This ASU modifies disclosure requirements on fair value measurements. The following disclosure requirements were removed: (1) the amount of and reasons for transfers between Level 1 and Level 2 of the fair value hierarchy, (2) the policy for timing of transfers between levels, (3) the valuation processes for Level 3 fair value measurements and (4) for nonpublic entities, the changes in unrealized gains and losses for the period included in earnings for recurring Level 3 fair value measurements held at the end of the reporting period. The following disclosure requirements were modified: (1) in lieu of a rollforward for Level 3 fair value measurements, a nonpublic entity is required to disclose transfers into and out of Level 3 of the fair value hierarchy and purchases and issues of Level 3 assets and liabilities, (2) for investments in certain entities that calculate net asset value, an entity is required to disclose the timing of liquidation of an investee's assets and the date when restrictions from redemption might lapse only if the investee has communicated the timing to the entity or announced the timing publicly, and (3) the amendments clarify that the measurement uncertainty disclosure is to communicate information about the uncertainty in measurement as of the reporting date. The Corporation must adopt this guidance in 2020. Management is currently evaluating the impact of adoption of the standard on the consolidated operations, financial position and cash flows of the Corporation.

In March 2017, the FASB issued ASU 2017-08, *Premium Amortization on Purchased Callable Debt Securities.* ASU 2017-08 shortens the amortization for premiums on purchased callable debt securities to the earliest call date (i.e. yield-to-earliest call amortization), rather than amortizing over the full contractual term. The ASU does not change the accounting for securities held at a discount. The amendments apply to callable debt securities with explicit, noncontingent call features that are callable at fixed prices and on preset dates. If a security may be prepaid based on prepayments of the underlying loans, not because the issuer has exercised a date specific call option, it is excluded from the scope of the new standard. However, for instruments with contingent call features, once the contingency is resolved and the security is callable at a fixed price and preset date, the security is within the scope of the amendment. Further, the amendments apply to all premiums on callable debt securities, regardless of how they were generated. The amendments require companies to reset the effective yield using the payment terms of the debt security if the call option is not exercised on the earliest call date. If the security has additional call dates, any excess of the amortized cost basis over the amount repayable by the issuer at the next call date should be amortized to the next call date. The Corporation must adopt this guidance in 2019. Management is currently evaluating the adoption of the new standard on the consolidated operations, financial position and cash flows of the Corporation.

NOTE 2 - Fair Value of Financial Instruments

The accounting guidance for fair value measurements and disclosures establishes a three-level valuation hierarchy for disclosure of fair value measurements. The valuation hierarchy favors the transparency of inputs to the valuation of an asset or liability as of the measurement date and thereby favors use of Level 1 if appropriate information is available, and otherwise Level 2 and finally Level 3 if a Level 2 input is not available. The three levels are defined as follows.

- Level 1 — Fair value is based upon quoted prices (unadjusted) for identical assets or liabilities in active markets in which the Corporation can participate.
- Level 2 — Fair value is based upon quoted prices for similar (i.e., not identical) assets and liabilities in active markets, and other inputs that are observable for the asset or liability, either directly or indirectly, for substantially the full term of the financial instrument.
- Level 3 — Fair value is based upon financial models using primarily unobservable inputs.

A financial instrument's categorization within the valuation hierarchy is based upon the lowest level of input within the valuation hierarchy that is significant to the fair value measurement.

Securities available for sale - The fair value of securities available for sale is determined by obtaining market price quotes from independent third parties wherever such quotes are available. Where such quotes are not available, management utilizes independent third party valuation analysis to support these estimates and judgments in determining fair value. The subsequent table presents, for the periods noted, the Corporation's fair value of securities available for sale in accordance with the fair value hierarchy described above.

Impaired loans - The Corporation does not record loans held for investment at fair value on a recurring basis. However, from time to time, a particular loan may be considered impaired and an allowance for loan losses established. Loans for which it is probable that payment of interest and principal will not be made in accordance with the contractual terms of the loan agreement are considered impaired. Once a loan is identified as individually impaired, management measures impairment in accordance with relevant accounting guidance. The fair value of impaired loans is estimated using either the fair value of collateral method or the present value of cash flows method. Those impaired loans requiring an allowance represent loans for which the fair value of the expected repayments or collateral does not exceed the recorded investments in such loans. For individually evaluated impaired loans, the significant unobservable inputs include the present value of expected future cash flows discounted at the loans effective interest rate, the underlying collateral for collateral-dependent loans, or the estimated liquidity of the note, resulting in an average discount of approximately 15%. The Corporation records these impaired loan as nonrecurring level 3 in the fair value hierarchy. At December 31, 2018 and 2017, substantially all of the impaired loans were evaluated based on the fair value of the collateral.

Mortgage servicing rights - The fair value of MSRs is estimated using third-party information for selected asset price tables for servicing cost and servicing fees applied to the Corporation's portfolio of serviced loans and is categorized as level 2 in the fair value hierarchy.

Other real estate owned - Loans on which the underlying collateral has been repossessed are recorded at fair value less estimated costs to sell upon transfer to OREO establishing a new cost basis. Fair value is based upon independent market prices or appraised values of the collateral less estimated selling costs of 10% and is categorized as level 3 in the fair value hierarchy.

Interest rate swaps – Values of these instruments are obtained through an independent pricing source utilizing information which may include market observed quotations for swaps, LIBOR rates, forward rates and rate volatility and are categorized as level 2 in the fair value hierarchy.

The methods described above may produce a fair value estimate that may not be indicative of net realizable value or reflective of future fair values. Further, while the Corporation believes its valuation methods are appropriate and consistent with other market participants, the use of different methodologies or assumptions to determine the fair value of certain financial instruments could result in different estimates of fair values of the same financial instruments at the reporting date.

NOTE 2 - Fair Value of Financial Instruments (cont.)

Financial instruments measured at fair value on a recurring basis for 2018 and 2017 are summarized below:

Assets	Balance at 12/31/2018	Level 1	Level 2	Level 3
Securities available for sale				
Obligations of State and political subdivision	$ 43,809,127	$ -	$ 43,809,127	$ -
Collateralized mortgage obligations	182,826,120	-	182,826,120	-
Mortgage-backed securities	144,382,371	-	144,382,371	-
Total securities available for sale	$ 372,078,260	$ -	$ 372,078,260	$ -
Interest rate swaps - other assets	$ 530,321	$ -	$ 530,321	$ -
Liabilities				
Interest rate swaps - other liabilities	$ 530,321	$ -	$ 530,321	$ -

	Balance at 12/31/2017	Level 1	Level 2	Level 3
Securities available for sale				
Obligations of State and political subdivision	$ 51,695,504	$ -	$ 51,695,504	$ -
Collateralized mortgage obligations	221,833,100	-	221,833,100	-
Mortgage-backed securities	170,960,394	-	170,960,394	-
Total securities available for sale	$ 444,488,998	$ -	$ 444,488,998	$ -

Financial instrumants measured at fair value on a non-recurring basis for 2018 and 2017 are summarized below:

Assets measured on a nonrecurring basis

	Balance at 12/31/2018	Level 1	Level 2	Level 3
Impaired loans with a related allowance, net	$ 7,010,050	$ -	$ -	$ 7,010,050
Mortgage servicing rights	1,444,069	-	1,444,069	-
Other real estate owned, net	104,400	-	-	104,400
Totals	$ 8,558,519	$ -	$ 1,444,069	$ 7,114,450

	12/31/2017	Level 1	Level 2	Level 3
Impaired loans with a related allowance, net	$ 8,278,401	$ -	$ -	$ 8,278,401
Mortgage servicing rights	1,455,810	-	1,455,810	-
Other real estate owned, net	122,670	-	-	122,670
Totals	$ 9,856,881	$ -	$ 1,455,810	$ 8,401,071

NOTE 2 - Fair Value of Financial Instruments (cont.)

The estimated fair values of financial instruments as of December 31,

		2018		2017	
	Fair Value Hierarchy	Carrying Amount	Estimated Fair Value	Carrying Amount	Estimated Fair Value
FINANCIAL ASSETS					
Cash and due from banks	1	$ 64,379,595	$ 64,379,595	$ 84,043,266	$ 84,043,266
Federal funds sold	2	990,830	990,830	2,414,518	2,414,518
Available for sale securities	2	371,017,618	371,017,618	444,488,998	444,488,998
Federal reserve stock	2	322,100	322,100	322,100	322,100
Loans held for investment	3	896,469,697	881,063,000	815,109,422	814,879,493
Cash surrender value of life insurance	2	39,255,799	39,255,799	38,301,624	38,301,624
Mortgage servicing rights, net	2	1,444,069	1,444,069	1,455,810	1,455,810
Interest rate swaps	2	530,321	530,321	-	-
Accrued interest receivable	2	3,622,802	3,622,802	3,748,673	3,748,673
FINANCIAL LIABILITIES					
Deposits	2	$ 1,249,302,645	$ 1,247,750,645	$ 1,267,051,615	$ 1,265,965,221
Interest rate swaps	2	530,321	530,321	-	-
Accrued interest payable	2	82,744	82,744	84,763	84,763

The estimated fair value of fee income on letters of credit outstanding at December 31, 2018 and December 31, 2017 is insignificant. Loan commitments on which the committed interest rate is less than the current market rate are also insignificant at December 31, 2018 and December 31, 2017.

NOTE 3 - Cash and Due from Banks

The Bank is required to maintain vault cash and reserve balances with the FRB based upon a percentage of deposits. These requirements were $33,722,000 at December 31, 2018 and $29,539,000 at December 31, 2017.

NOTE 4 - Available for Sale Securities

The following table presents the amortized costs and fair values of available for sale securities as of December 31,

	2018			
	Amortized Cost	Unrealized Gains	Unrealized Losses	Fair Value
Obligations of states and political subdivisions	$ 44,026,349	$ 209,310	$ (426,532)	$ 43,809,127
Collateralized mortgage obligations	187,193,210	1,012	(4,368,102)	182,826,120
Mortgage-backed securities	148,494,339	-	(4,111,968)	144,382,371
Totals	$ 379,713,898	$ 210,322	$ (8,906,602)	$ 371,017,618

	2017			
	Amortized Cost	Unrealized Gains	Unrealized Losses	Fair Value
Obligations of states and political subdivisions	$ 51,424,229	$ 525,341	$ (254,066)	$ 51,695,504
Collateralized mortgage obligations	223,889,628	236,117	(2,292,645)	221,833,100
Mortgage-backed securities	173,009,777	262,605	(2,311,988)	170,960,394
Totals	$ 448,323,634	$ 1,024,063	$ (4,858,699)	$ 444,488,998

The amortized cost and fair value of available for sale securities as of December 31, 2018, by contractual maturity are shown below. Expected maturities will differ from contractual maturities for collateralized mortgage obligations and mortgage backed securities because borrowers or issuers may have the right to call or prepay obligations with or without call or prepayment penalties.

	2018	
	Amortized Cost	Fair Value
Due in one year or less	$ 4,467,818	$ 4,468,299
Due after one year less than 5 years	19,874,108	19,786,226
Due after 5 years less than 10 years	9,093,187	8,952,223
Due over 10 years	10,591,236	10,602,379
	44,026,349	43,809,127
Collateralized mortgage obligations	187,193,210	182,826,120
Mortgage backed securities	148,494,339	144,382,371
Totals	$ 379,713,898	$ 371,017,618

NOTE 4 - Available for Sale Securities (cont.)

Available for sale securities with an amortized cost of $124,539,635 and $113,336,085 at December 31, 2018 and December 31, 2017, respectively, were pledged as collateral on public deposits and for other purposes as required or permitted by law.

The following table presents the portion of the Bank's available for sale securities portfolio which has gross unrealized losses, reflecting the length of time that individual securities have been in a continuous unrealized loss position as of December 31:

2018	Continuous unrealized losses existing for 12 months or less		Continuous unrealized losses existing for greater than 12 months		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Obligations of states and political subdivisions	$ 4,981,904	$ (7,858)	$ 16,946,136	$ (418,674)	$ 21,928,040	$ (426,532)
Collateralized mortgage obligations	21,999,664	(185,879)	160,551,381	(4,182,223)	182,551,045	(4,368,102)
Mortgage-backed securities	19,808,934	(158,563)	124,573,437	(3,953,405)	144,382,371	(4,111,968)
Totals	$ 46,790,502	$ (352,300)	$ 302,070,954	$ (8,554,302)	$ 348,861,456	$ (8,906,602)

2017	Continuous unrealized losses existing for 12 months or less		Continuous unrealized losses existing for greater than 12 months		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Obligations of states and political subdivisions	$ 12,560,630	$ (123,247)	$ 5,135,765	$ (130,819)	$ 17,696,395	$ (254,066)
Collateralized mortgage obligations	105,308,756	(938,500)	69,049,533	(1,354,145)	174,358,289	(2,292,645)
Mortgage-backed securities	71,517,498	(1,011,494)	47,665,290	(1,300,494)	119,182,788	(2,311,988)
Totals	$ 189,386,884	$ (2,073,241)	$ 121,850,588	$ (2,785,458)	$ 311,237,472	$ (4,858,699)

Management does not believe any individual unrealized loss as of December 31, 2018 represents other than temporary impairment. The Bank held one hundred twenty-three investment securities as of December 31, 2018 that had unrealized losses existing for greater than 12 months, which consisted of fifty collateralized mortgage obligations, thirty-four mortgage-backed securities and thirty-nine obligations of states and political subdivisions. The Bank held thirty-three investment securities at December 31, 2017 that had unrealized losses existing for greater than 12 months, which consisted of fifteen collateralized mortgage obligations, eight mortgage-backed securities and ten obligations of states and political subdivisions. Management believes the temporary impairment in fair value was caused by market fluctuation in interest rates. Management does not believe that the Bank will experience any losses on these investments.

NOTE 5 – Loans

Major classifications of loans are as follows as of December 31:

	2018	2017
Commercial	$ 47,457,101	$ 43,443,761
Real Estate		
Construction	68,278,197	46,213,504
Commercial	487,664,412	458,376,164
Residential	196,612,774	193,555,109
Multifamily	99,445,469	76,952,505
Installment and other	8,006,129	7,301,031
	907,464,082	825,842,074
Less: Allowance for loan losses	(10,994,385)	(10,732,652)
Net loans	$ 896,469,697	$ 815,109,422

NOTE 5 – Loans (cont.)

The following table presents the contractual aging of the recorded investment in loans as of December 31:

2018	Current Loans	Days Past Due 30-59	Days Past Due 60-89	Days Past Due Over 90	Days Past Due Total	Total Loans
Commercial	$ 47,437,089	$ 10,052	$ 9,960	$ -	$ 20,012	$ 47,457,101
Real Estate						
Construction	68,278,197	-	-	-	-	68,278,197
Commercial	487,259,024	239,168	48,567	117,653	405,388	487,664,412
Residential	192,034,010	3,419,371	370,260	789,133	4,578,764	196,612,774
Multifamily	99,445,469	-	-	-	-	99,445,469
Installment and other	7,711,199	32,676	122,464	139,790	294,930	8,006,129
Total loans	902,164,988	3,701,267	551,251	1,046,576	5,299,094	907,464,082
Purchase credit-impaired loans	(4,703,235)	(158,829)	(189,865)	-	(348,694)	(5,051,929)
Total loans, excluding purchase credit-impaired Loans	$ 897,461,753	$ 3,542,438	$ 361,386	$ 1,046,576	$ 4,950,400	$ 902,412,153

2017	Current Loans	Days Past Due 30-59	Days Past Due 60-89	Days Past Due Over 90	Days Past Due Total	Total Loans
Commercial	$ 43,443,761	$ -	$ -	$ -	$ -	$ 43,443,761
Real Estate						
Construction	46,213,504	-	-	-	-	46,213,504
Commercial	456,049,339	958,635	116,465	1,251,725	2,326,825	458,376,164
Residential	189,481,526	3,558,268	205,904	309,411	4,073,583	193,555,109
Multifamily	76,952,505	-	-	-	-	76,952,505
Installment and other	7,089,518	15,814	94,993	100,706	211,513	7,301,031
Total loans	819,230,153	4,532,717	417,362	1,661,842	6,611,921	825,842,074
Purchase credit-impaired loans	(7,686,574)	(113,685)	(48,813)	-	(162,498)	(7,849,072)
Total loans, excluding purchase credit-impaired Loans	$ 811,543,579	$ 4,419,032	$ 368,549	$ 1,661,842	$ 6,449,423	$ 817,993,002

Commercial loans deemed to be inadequately collateralized and past due 90 days or more for principal or interest are placed in a non-accrual status. Residential real estate loans are not subject to these guidelines if well-secured, as deemed by the Senior Loan Committee, and in the process of collection.

NOTE 5 – Loans (cont.)

The following table presents the recorded investment in nonaccrual loans and loans past due ninety days or more and still accruing by class of loans as of December 31:

	2018	
	Nonaccrual	Past due 90 days or More and accruing
Commercial	$ 30,778	$ -
Real Estate		
Construction	-	-
Commercial	1,697,673	-
Residential	2,511,170	-
Multifamily	-	-
Installment and other	22,518	127,923
Total Loans	4,262,139	127,923
Purchase Credit Impaired Loans:		
Commercial	-	-
Real Estate		
Construction	-	-
Commercial	-	-
Residential	(38,297)	-
Multifamily	-	-
Installment and other	-	-
Total Purchased Credit-Impaired Loans	(38,297)	-
Total Loans, excluding Purchase Credit Impaired Loans	$ 4,223,842	$ 127,923

	2017	
	Nonaccrual	Past due 90 days or More and accruing
Commercial	$ -	$ -
Real Estate		
Construction	-	-
Commercial	2,961,715	299,824
Residential	1,676,806	-
Multifamily	-	-
Installment and other	18,233	100,706
Total Loans	4,656,754	400,530
Purchase Credit Impaired Loans:		
Commercial	-	-
Real Estate		
Construction	-	-
Commercial	(16,897)	-
Residential	(22,948)	-
Multifamily	-	-
Installment and other	-	-
Total Purchased Credit-Impaired Loans	(39,845)	-
Total Loans, excluding Purchase Credit Impaired Loans	$ 4,616,909	$ 400,530

NOTE 5 – Loans (cont.)

Management uses an internal asset classification system as a means of identifying problem and potential problem assets. A Special Mention loan has potential weaknesses that deserve management's close attention. If left uncorrected, these potential weaknesses may result in deterioration of the repayment prospects for the loan at a future date. An asset is classified Substandard if it is inadequately protected by the current net worth and paying capacity of the obligor or of the collateral pledged, if any. Substandard assets include those characterized by the distinct possibility that the Corporation will sustain some loss if the deficiencies are not corrected. Assets classified as Doubtful have all the weaknesses inherent in those classified Substandard with the added characteristic that the weaknesses make collection or liquidation in full, on the basis of currently existing facts, conditions and values, highly questionable and improbable. Assets that do not currently expose the Corporation to sufficient risk to warrant classification in one of the aforementioned categories, but possess weaknesses that may or may not be within the control of the customer are classified as "Pass." Loans not rated are included in groups of homogeneous loans with similar risk and loss characteristics and are not included in the table below. The following tables present the risk category of loans by class of loans based on the most recent analysis performed and the contractual aging as of December 31:

	2018				
	Pass	Special Mention	Substandard	Doubtful	Total
Commercial	$ 46,668,173	$ 137,683	$ 651,245	$ -	$ 47,457,101
Real Estate					
Construction	66,812,760	-	1,465,437	-	68,278,197
Commercial	470,429,348	9,867,808	7,367,256	-	487,664,412
Multifamily	99,320,620	-	124,849	-	99,445,469
Total	$ 683,230,901	$ 10,005,491	$ 9,608,787	$ -	$ 702,845,179
Current	$ 683,220,941	$ 10,005,491	$ 9,193,347	$ -	$ 702,419,779
30-59	-	-	249,220	-	249,220
60-89	9,960	-	48,567	-	58,527
Over 90	-	-	117,653	-	117,653
Total	$ 683,230,901	$ 10,005,491	$ 9,608,787	$ -	$ 702,845,179

	2017				
	Pass	Special Mention	Substandard	Doubtful	Total
Commercial	$ 40,588,450	$ 184,485	$ 2,670,826	$ -	$ 43,443,761
Real Estate					
Construction	44,644,630	-	1,568,874	-	46,213,504
Commercial	443,450,641	3,725,032	11,200,491	-	458,376,164
Multifamily	76,813,049	-	139,456	-	76,952,505
Total	$ 605,496,770	$ 3,909,517	$ 15,579,647	$ -	$ 624,985,934
Current	$ 604,849,534	$ 3,909,517	$ 13,900,058	$ -	$ 622,659,109
30-59	347,412	-	611,223	-	958,635
60-89	-	-	116,465	-	116,465
Over 90	299,824	-	951,901	-	1,251,725
Total	$ 605,496,770	$ 3,909,517	$ 15,579,647	$ -	$ 624,985,934

NOTE 5 – Loans (cont.)

The following table presents the recorded investment in residential real estate and installment and other loan classes based on payment activity as of December 31:

	2018		
	Performing	Nonperforming	Total
Residential Real Estate	$ 194,101,604	$ 2,511,170	$ 196,612,774
Installment & Other	7,855,688	150,441	8,006,129
Totals	$ 201,957,292	$ 2,661,611	$ 204,618,903

	2017		
	Performing	Nonperforming	Total
Residential Real Estate	$ 191,878,303	$ 1,676,806	$ 193,555,109
Installment & Other	7,182,092	118,939	7,301,031
Totals	$ 199,060,395	$ 1,795,745	$ 200,856,140

At December 31, 2018, the Corporation has identified $18.2 million of loans as impaired, including $13.9 million of performing TDRs. As of December 31, 2017, the Corporation has identified $19.3 million of loans as impaired, including $14.6 million of performing TDRs. The Corporation evaluates loans placed on the watch list for impairment. A loan is identified as impaired when, based on current information and events, it is probable that the Corporation will be unable to collect all amounts due according to the contractual terms of the loan agreement. A performing TDR consists of loans that have been modified and are performing in accordance with the modified terms for a sufficient length of time, generally six months, or loans that were modified on a proactive basis. A summary of the details regarding impaired loans as of December 31 follows:

	2018	2017
Loans for which there was a related allowance for loan loss	$ 8,533,363	$ 10,740,668
Impaired loans with no related allowance	9,704,802	8,562,106
Total Impaired Loans	$ 18,238,165	$ 19,302,774
Average quarterly balance of impaired loans	$ 19,272,225	$ 19,987,775
Related allowance for loan losses	1,523,313	2,462,267
Interest income recognized while impaired	652,632	661,608

At December 31, 2018 and 2017, the Corporation had residential real estate loans in foreclosure with a carrying value of $770,961 and $427,353, respectively.

NOTE 5 – Loans (cont.)

The following table presents loans individually evaluated for impairment by class of loans as of December 31:

	2018			
	Unpaid Principal Balance	Partial Charge-offs	Recorded Investment	Allowance For Loan Losses Allocation
Loans with no related allowance recorded:				
Commercial	$ 10,404	$ 351	$ 10,053	$ -
Real Estate				
Construction	23,221	-	23,221	-
Commercial	2,719,475	239,348	2,480,127	-
Residential	7,554,654	429,541	7,125,113	-
Multifamily	-	-	-	-
Installment and other	68,922	2,634	66,288	-
Total	10,376,676	671,874	9,704,802	-
Loans with a related allowance recorded:				
Commercial	51,006	475	50,531	45,532
Real Estate				
Construction	737,020	-	737,019	241,019
Commercial	1,082,503	-	1,082,503	478,503
Residential	6,664,218	34,964	6,629,256	757,205
Multifamily	-	-	-	-
Installment and other	34,055	-	34,054	1,054
Total	8,568,802	35,439	8,533,363	1,523,313
Total Impaired Loans	$ 18,945,478	$ 707,313	$ 18,238,165	$ 1,523,313

	2017			
	Unpaid Principal Balance	Partial Charge-offs	Recorded Investment	Allowance For Loan Losses Allocation
Loans with no related allowance recorded:				
Commercial	$ -	$ -	$ -	$ -
Real Estate				
Construction	78,917	-	78,917	-
Commercial	3,610,253	287,887	3,322,366	-
Residential	5,594,873	488,353	5,106,520	-
Multifamily	-	-	-	-
Installment and other	55,296	993	54,303	-
Total	9,339,339	777,233	8,562,106	-
Loans with a related allowance recorded:				
Commercial	35,219	-	35,219	30,219
Real Estate				
Construction	787,823	-	787,823	369,823
Commercial	1,798,364	41,092	1,757,271	549,271
Residential	8,209,215	96,836	8,112,380	1,508,979
Multifamily	-	-	-	-
Installment and other	47,975	-	47,975	3,975
Total	10,878,596	137,928	10,740,668	2,462,267
Total Impaired Loans	$ 20,217,935	$ 915,161	$ 19,302,774	$ 2,462,267

NOTE 5 – Loans (cont.)

The following table presents the balance in the allowance for loan losses and the recorded investment in loans by portfolio class and based on impairment method as of December 31:

2018	Commercial	Construction Real Estate	Commercial Real Estate	Residential Real Estate	Multifamily Real Estate	Installment & Other	Total
Allowance for loan losses:							
Beginning Balance	$ 316,485	$ 478,905	$ 3,302,951	$ 6,123,320	$ 383,966	$ 127,025	$ 10,732,652
Charge-offs	-	-	(200,418)	(103,226)	-	(43,559)	(347,203)
Recoveries	2,899	-	372,282	209,949	304	23,502	608,936
Provisions	-	-	-	-	-	-	-
Ending Balance	$ 319,384	$ 478,905	$ 3,474,815	$ 6,230,043	$ 384,270	$ 106,968	$ 10,994,385
Loans:							
Recorded Investment	$ 47,457,101	$ 68,278,197	$ 487,664,412	$ 196,612,774	$ 99,445,469	$ 8,006,129	$ 907,464,082
Allowance for loan losses:							
Individually evaluated for impairment	45,532	241,019	478,503	757,205	-	1,054	1,523,313
Collectively evaluated for impairment	273,852	237,886	2,996,312	5,472,838	384,270	105,914	9,471,072
Total allowance for loan losses	319,384	478,905	3,474,815	6,230,043	384,270	106,968	10,994,385
Ending Balance	$ 47,137,717	$ 67,799,292	$ 484,189,597	$ 190,382,731	$ 99,061,199	$ 7,899,161	$ 896,469,697
Ending Balance:							
Individually evaluated for impairment	$ 60,584	$ 760,240	$ 3,562,630	$ 11,622,868	$ -	$ 97,178	$ 16,103,500
Collectively evaluated for impairment	47,396,517	67,479,166	484,083,454	179,998,260	99,445,469	7,905,787	886,308,653
Purchase credit-impaired							
Individually evaluated for impairment	-	-	-	2,131,501	-	3,164	2,134,665
Collectively evaluated for impairment	-	38,791	18,328	2,860,145	-	-	2,917,264
Total ending balance	$ 47,457,101	$ 68,278,197	$ 487,664,412	$ 196,612,774	$ 99,445,469	$ 8,006,129	$ 907,464,082

2017	Commercial	Construction Real Estate	Commercial Real Estate	Residential Real Estate	Multifamily Real Estate	Installment & Other	Total
Allowance for loan losses:							
Beginning Balance	$ 348,541	$ 478,905	$ 3,531,551	$ 6,356,577	$ 383,966	$ 157,234	$ 11,256,774
Charge-offs	(32,357)	-	(424,862)	(422,424)	-	(37,050)	(916,693)
Recoveries	301	-	196,262	189,167	-	6,841	392,571
Provisions	-	-	-	-	-	-	-
Ending Balance	$ 316,485	$ 478,905	$ 3,302,951	$ 6,123,320	$ 383,966	$ 127,025	$ 10,732,652
Loans:							
Recorded Investment	$ 43,443,761	$ 46,213,504	$ 458,376,164	$ 193,555,109	$ 76,952,505	$ 7,301,031	$ 825,842,074
Allowance for loan losses:							
Individually evaluated for impairment	30,219	369,823	549,271	1,508,979	-	3,975	2,462,267
Collectively evaluated for impairment	286,266	109,082	2,753,680	4,614,341	383,966	123,050	8,270,385
Total allowance for loan losses	316,485	478,905	3,302,951	6,123,320	383,966	127,025	10,732,652
Ending Balance	$ 43,127,276	$ 45,734,599	$ 455,073,213	$ 187,431,789	$ 76,568,539	$ 7,174,006	$ 815,109,422
Ending Balance:							
Individually evaluated for impairment	$ 35,219	$ 866,740	$ 5,062,740	$ 10,399,053	$ -	$ 97,479	$ 16,461,231
Collectively evaluated for impairment	43,408,542	45,304,920	453,296,527	176,124,385	76,198,643	7,198,753	801,531,770
Purchase credit-impaired							
Individually evaluated for impairment	-	-	16,897	2,819,847	-	4,799	2,841,543
Collectively evaluated for impairment	-	41,844	-	4,211,824	753,862	-	5,007,530
Total ending balance	$ 43,443,761	$ 46,213,504	$ 458,376,164	$ 193,555,109	$ 76,952,505	$ 7,301,031	$ 825,842,074

NOTE 5 – Loans (cont.)

The Corporation continues to evaluate loans purchased for impairment in accordance with U.S. GAAP. The purchased loans were considered impaired at the acquisition date if there was evidence of deterioration since origination and if it was probable that not all contractually required principal and interest payments would be collected. The following table reflects the carrying value of all purchased loans as of December 31:

	2018		
	Contractually Required Payments Receivable		
	Credit Impaired	Non-Credit Impaired	Carrying Value of Purchased Loans
Loans with no related allowance recorded:			
Commercial	$ -	$ -	$ -
Real Estate			
Construction	73,729	-	38,791
Commercial	72,819	263,206	219,229
Residential	10,182,557	17,011,288	20,312,950
Multifamily	-	13,390	-
Installment and other	12,664	34,999	25,710
Total	$ 10,341,769	$ 17,322,883	$ 20,596,680

	2017		
	Contractually Required Payments Receivable		
	Credit Impaired	Non-Credit Impaired	Carrying Value of Purchased Loans
Loans with no related allowance recorded:			
Commercial	$ -	$ -	$ -
Real Estate			
Construction	76,782	-	41,844
Commercial	71,388	287,510	195,339
Residential	13,495,604	21,378,410	26,547,294
Multifamily	1,052,840	65,266	743,657
Installment and other	16,531	61,288	48,452
Total	$ 14,713,145	$ 21,792,474	$ 27,576,586

As of December 31, 2018, the estimated contractually-required payments receivable on credit impaired and non-credit impaired loans was $10.3 million and $17.3 million, respectively. The cash flows expected to be collected related to principal as of December 31, 2018 on all purchased loans is $20.6 million. As a result, there is $7.0 million of remaining discount on the purchased loans. These amounts are based upon the estimated fair values of the underlying collateral or discounted cash flows as of December 31, 2018. The difference between the contractually required payments at acquisition and the cash flow expected to be collected at acquisition is referred to as the non-accretable difference. Subsequent decreases to the expected cash flows will generally result in a provision for loan losses. Subsequent increases in cash flows will result in a reversal of the provision for loan losses charged to earnings to the extent of prior charges or a reclassification of the difference from non-accretable discount to accretable discount, with a positive impact on interest income. Further, any excess of cash flows expected over the estimated fair value is referred to as the accretable yield and is recognized in interest income over the remaining life of the loan when there is a reasonable expectation about the amount and timing of such cash flows.

NOTE 5 – Loans (cont.)

The change in the carrying amount of accretable yield for purchased loans was as follows for the years ended December 31:

	For Twelve Months Ended December 31, 2018	2017
Beginning Balance	$ 2,064,960	$ 2,256,068
Additions	273,115	449,291
Accretion(1)	(559,943)	(640,399)
Ending Balance	$ 1,778,132	$ 2,064,960

(1) Accretable yield is recognized in interest income as the purchased loans pay down, mature, renew or pay off.

Contractual maturities of loans with accretable yield range from 1 year to 30 years. Actual maturities may differ from contractual maturities because borrowers have the right to prepay or renew their loan prior to maturity or the loan may be charged off.

Certain directors and executive officers of the Corporation, and their related interests, had loans outstanding in the aggregate amounts of $6.9 million and $6.0 million as of December 31, 2018, and 2017, respectively. During 2018, there was one new loan for $1.6 million, one loan participation repurchased for $0.4 million and repayments totaled $1.2 million. Certain affiliated parties of the Corporation are investors in loan participations of the Corporation. The outstanding balance of loan participations with affiliated parties totaled $3.7 million and $4.1 million at December 31, 2018 and 2017, respectively. The participations represent investments by the affiliated parties in a portion of the affiliated party loans described in the paragraph above.

Residential and commercial real estate loans approximating $7.7 million and $41.7 million as of December 31, 2018 and 2017, respectively, were pledged as collateral on public deposits and for other purposes as required or permitted by law.

NOTE 5 – Loans (cont.)

A TDR includes a loan modification where a borrower is experiencing financial difficulty and the Corporation grants a concession to that borrower that it would not otherwise consider except for the borrower's financial difficulties. Modifications include below market interest rates, interest-only terms, forgiveness of principal, or an exceptionally long amortization period. Most of the Corporation's modifications are below market interest rate concessions. A TDR may be either on accrual or nonaccrual status based upon the performance of the borrower and management's assessment of collectability. If a TDR is placed on nonaccrual status, it remains there until it performs under the restructured terms for a sufficient period of time, generally six consecutive months at which time it is returned to accrual status.

The following is a summary of TDRs as of December 31:

	2018		
	Number of Modifications	Total Trouble Debt Restructurings	Allowance For Loan Losses Allocation
Commercial	1	$ 29,806	$ 24,806
Real Estate			
Construction	4	760,239	241,019
Commercial	11	2,363,030	478,503
Residential	128	12,432,857	757,205
Multifamily	-	-	-
Installment & Other	5	77,824	1,054
Total Loans	149	$ 15,663,756	$ 1,502,587

	2017		
	Number of Modifications	Total Trouble Debt Restructurings	Allowance For Loan Losses Allocation
Commercial	1	$ 35,219	$ 30,219
Real Estate			
Construction	5	866,740	369,823
Commercial	15	3,404,641	549,271
Residential	122	12,561,943	1,501,771
Multifamily	-	-	-
Installment & Other	4	84,045	3,975
Total Loans	147	$ 16,952,588	$ 2,455,059

There were no TDR's as of December 31, 2018 and 2017 that defaulted during the period and were modified within the previous 12 months. TDR's in default are past due 90 days or more at the end of the period.

NOTE 5 - Loans (cont.)

A summary of the type of modifications made on TDR's that occurred during 2018 and 2017 are noted in the table below.

For the Twelve Months Ended December 31, 2018

	Modification of Terms	Reduction of Interest Rate	Modification to Interest-only Payments	Forgiveness of Debt	Bankruptcy	Total
	Balance	Balance	Balance	Balance	Balance	Balance
Commercial	$ -	$ -	$ -	$ -	$ -	$ -
Real Estate						
Construction	-	-	-	-	-	-
Commercial	-	-	-	-	117,653	117,653
Residential	1,010,646	67,914	241,793	-	14,323	1,334,676
Multifamily	-	-	-	-	-	-
Installment & Other	-	4,630	-	-	-	4,630
Total Loans	$ 1,010,646	$ 72,544	$ 241,793	$ -	$ 131,976	$ 1,456,959
	Count	Count	Count	Count	Count	Count
Commercial	-	-	-	-	-	-
Real Estate						
Construction	-	-	-	-	-	-
Commercial	-	-	-	-	1	1
Residential	12	2	3	-	1	18
Multifamily	-	-	-	-	-	-
Installment & Other	-	1	-	-	-	1
Total Loans	12	3	3	-	2	20

For the Twelve Months Ended December 31, 2017

	Modification of Terms	Reduction of Interest Rate	Modification to Interest-only Payments	Forgiveness of Debt	Bankruptcy	Total
	Balance	Balance	Balance	Balance	Balance	Balance
Commercial	$ -	$ -	$ -	$ -	$ -	$ -
Real Estate						
Construction	-	-	-	-	-	-
Commercial	-	-	312,769	-	-	312,769
Residential	149,025	83,229	135,661	-	127,231	495,146
Multifamily	-	-	-	-	-	-
Installment & Other	-	-	-	-	-	-
Total Loans	$ 149,025	$ 83,229	$ 448,430	$ -	$ 127,231	$ 807,915
	Count	Count	Count	Count	Count	Count
Commercial	-	-	-	-	-	-
Real Estate						
Construction	-	-	-	-	-	-
Commercial	-	-	2	-	-	2
Residential	3	1	1	-	1	6
Multifamily	-	-	-	-	-	-
Installment & Other	-	-	-	-	-	-
Total Loans	3	1	3	-	1	8

NOTE 6 - Premises and Equipment

Premises and equipment are stated at cost less accumulated depreciation as of December 31 and are summarized as follows:

	2018	2017
Land	$ 6,663,629	$ 6,587,501
Buildings and leasehold improvements	30,767,746	29,801,147
Furniture and equipment	15,634,642	14,509,204
Total	53,066,017	50,897,852
Less: Accumulated depreciation	(37,315,310)	(36,034,776)
Net Premises and Equipment	$ 15,750,707	$ 14,863,076

NOTE 7 – New Market Tax Credits - Variable Interest Entities

The Corporation invests in CDEs that are designed to generate a return primarily through the realization of New Market Tax Credits. The CDEs are formed as limited partnerships and limited liability companies in which the Corporation invests as a limited partner/investor member through equity contributions. The economic performance of the CDEs, which are variable interest entities ("VIEs"), is subject to the performance of their underlying loans. The Corporation has determined that it is not the primary beneficiary of any CDE as it lacks the power to direct the activities that most significantly impact the economic performance of the underlying loans or to affect their ability to operate in compliance with the rules and regulations necessary for the qualification of tax credits generated by equity investments. This power is held by the general partners and managing members who exercise full and exclusive control of the operations of the VIEs.

As of December 31, 2018 and 2017, the carrying amounts of these investments in CDEs that generate the tax credits, included in accrued interest receivable and other assets in the consolidated balance sheets, totaled $6.5 million and $4.4 million, respectively. The risk of loss in these investments is tied to the ability of the CDE to operate in compliance with the rules and regulations necessary for the qualification of the tax credits generated by equity investments. As of December 31, 2018 and 2017 there are no compliance issues associated with these entities.

NOTE 8 – Accrued Interest Receivable and Other Assets

A summary of accrued interest receivable and other assets as of December 31 is as follows:

	2018	2017
Accrued interest receivable	$ 3,622,802	$ 3,748,673
Federal reserve bank stock	322,100	322,100
Mortgage servicing rights	1,444,069	1,455,810
Other real estate owned	104,400	122,670
Investment in community development entities	6,501,109	4,407,459
Prepaid expenses and other assets	6,573,078	5,444,334
Total	$ 18,567,558	$ 15,501,046

NOTE 9 - Deposits

The distribution of deposits at December 31 is as follows:

	2018	2017
Noninterest bearing demand	$ 300,283,663	$ 293,775,453
Interest bearing NOW accounts	420,682,938	403,886,845
Money Market	219,818,792	256,000,163
Savings	235,545,020	226,684,710
Other time	72,972,232	86,704,444
Total	$ 1,249,302,645	$ 1,267,051,615

The aggregate amount of time deposits, each with a minimum denomination of $250,000, was $12,054,131 and $14,276,095 as of December 31, 2018 and 2017, respectively.

Scheduled maturities of time deposits at December 31 are:

	2018	2017
Due within one year	$ 44,975,997	$ 53,960,875
After one year but within two years	13,697,913	15,058,449
After two years but within three years	6,039,374	7,609,579
After three years but within four years	4,343,535	4,475,587
After four years but within five years	3,915,413	5,599,954
Total	$ 72,972,232	$ 86,704,444

Deposits from the Corporation's related parties at December 31, 2018 and December 31, 2017 amounted to $6,710,567 and $10,576,767, respectively.

NOTE 10 - Other Borrowings

The Corporation has the ability to borrow (purchase) Federal funds of up to $70,000,000 under a revolving line-of-credit. Such borrowings bear interest at the lender bank's announced daily Federal funds rate and mature daily. There were no federal funds purchased outstanding as of December 31, 2018 or 2017.

The Corporation may also borrow through the Federal Reserve Bank Discount Window short term funds up to the amount of $7,241,374 and $12,138,622 as of December 31, 2018 and 2017, respectively. These funds are secured by U.S. government sponsored entity securities or qualified municipal securities totaling $8,045,971 and $13,487,358 as of December 31, 2018 and 2017, respectively.

NOTE 11 - Income Taxes

Income tax expense (benefit) consists of the following components for the year ending December 31:

	2018	2017
Current income taxes		
Federal	$ 2,629,459	$ 4,345,175
State	1,721,669	1,386,612
Total current income taxes	4,351,128	5,731,787
Deferred income taxes		
Federal	229,819	1,781,109
State	(28,447)	(6,790)
Total deferred income taxes	201,372	1,774,319
Total income taxes	$ 4,552,500	$ 7,506,106

The net deferred income tax assets in the accompanying consolidated balance sheets include the following amounts of deferred income tax assets and liabilities at December 31:

	2018	2017
Deferred income tax assets:		
Allowance for loan losses	$ 3,083,811	$ 2,923,682
Reserve for health plan	257,646	276,800
Depreciation	129,717	372,336
Non-accrual interest	54,323	16,500
Loss carryforwards	34,203	36,834
Unrealized losses on securities available for sale	2,368,956	1,044,593
Other	6,808	141,484
Total deferred income tax assets	5,935,464	4,812,229
Deferred income tax liabilities:		
Loan acquisition fair market valuation	(465,692)	(587,480)
Mortgage servicing rights	(393,379)	(396,577)
Tax Credits	(268,990)	(158,078)
Other	(129,721)	(115,403)
Total deferred income tax liabilities	(1,257,782)	(1,257,538)
Net deferred income tax asset	$ 4,677,682	$ 3,554,691

The Corporation has state net operating loss carryforwards of approximately $548,000 and $590,000 as of December 31, 2018 and 2017, respectively. The net operating loss carryforwards expire in 2032.

Realization of the deferred income tax asset over time is dependent upon the Corporation generating sufficient taxable income in future periods. In determining that realization of the deferred income tax asset recorded was more likely than not, the Corporation gave consideration to a number of factors including its recent earnings history, its expectations for earnings in the future, and where applicable, the expiration dates associated with tax carryforwards.

NOTE 11 - Income Taxes (cont.)

A reconciliation of statutory Federal income taxes based upon income before taxes to the provision for Federal and state income taxes is as follows:

	2018		2017	
	Amount	% of Pretax Income	Amount	% of Pretax Income
Federal income taxes at statutory rate	$ 4,517,847	21.00%	$ 6,364,972	35.00%
Adjustments for:				
Tax exempt interest on municipal obligations	(196,816)	-0.91%	(346,652)	-1.91%
Increase in taxes resulting from state income taxes, net of federal tax benefit	1,335,958	6.21%	896,884	4.93%
Increase in cash surrender value of life insurance	(200,377)	-0.93%	(365,923)	-2.01%
Tax credits	(885,951)	-4.12%	(451,750)	-2.48%
Change in tax rate	-	0.00%	1,522,034	8.37%
Other - net	(18,161)	-0.08%	(113,459)	-0.63%
Income tax expense	$ 4,552,500	21.17%	$ 7,506,106	41.27%

As of December 31, 2018 and 2017, the Corporation had no uncertain tax positions. The Corporation's policy is to record interest and penalties related to income tax liabilities in income tax expense. The Corporation, along with its subsidiaries, files U.S. federal and Wisconsin income tax returns. The Corporation's federal tax returns for 2015 and prior and its 2014 and prior year Wisconsin tax returns are no longer subject to examination by tax authorities.

On December 22, 2017, the U.S. government enacted comprehensive tax legislation commonly referred to as the Tax Cuts and Jobs Act (the "Tax Act"). The Tax Act makes broad and complex changes to the U.S. tax code, including, but not limited to, (1) reducing the U.S. federal corporate tax rate from 35 percent to 21 percent, (2) eliminating the corporate alternative minimum tax ("AMT") and changing how existing AMT credits can be realized, and (3) bonus depreciation that will allow for full expensing of qualified property.

The Act reduces the corporate tax rate to 21 percent, effective January 1, 2018. Consequently, the Corporation has recorded a decrease related to net deferred tax assets of $1,522,034, with a corresponding net adjustment to deferred income tax expense of $1,522,034 for the year ended December 31, 2017.

NOTE 12 - Employee Benefit Plans

The Corporation has a contributory defined-contribution 401(k) retirement plan. This plan covers substantially all employees who have attained the age of 21. Participants may contribute a portion of their compensation (up to IRS limits) to the plan. The Corporation may make regular and matching contributions to the plan each year. In 2018 and 2017, the Corporation provided a dollar-for-dollar match of employee contributions up to 5% of their compensation. The Corporation recorded contribution expense of $762,057 and $709,096 in 2018 and 2017, respectively.

NOTE 13 - Operating Leases

The Corporation leases various banking facilities under operating lease agreements from various companies. Three of these facilities are leased from companies held by a director and major shareholder of the Corporation. All of the agreements include renewal options and one agreement requires the payment of insurance, real estate taxes and maintenance costs associated with the lease. Rental amounts are subject to annual escalation based upon increases in the Consumer Price Index. Aggregate rental expense under all leases amounted to $1,470,766 and $1,074,380 in 2018 and 2017 respectively, including $797,815 and $480,326 respectively, on facilities leased from companies held by a director and major shareholder of the Corporation. Included in 2018 rental expense is $130,000 in lease buyout payments.

As of December 31, 2018, the future minimum lease payments for each of the five succeeding years and in the aggregate are as follows:

2019	$ 1,277,038
2020	988,418
2021	743,869
2022	663,288
2023	57,589
Thereafter	87,395
	$ 3,817,597

Office space at certain facilities is leased to outside parties. Rental income included in net occupancy costs was $884,408 and $937,881 for the years ended December 31, 2018 and 2017, respectively.

NOTE 14 - Commitments and Contingencies

The Corporation 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, financial guarantees and standby letters of credit. They involve, to varying degrees, elements of credit and interest rate risk in excess of amounts recognized on the consolidated balance sheets.

The Corporation's exposure to credit loss in the event of nonperformance by the other party to the financial instrument for commitments to extend credit and standby letters of credit is represented by the contractual notional amount of those instruments. The Corporation uses the same credit policies in making commitments and issuing letters of credit as they do for on-balance-sheet instruments.

A summary of the contract or notional amount of the Corporation's exposure to off-balance sheet risk as of December 31, are as follows:

	2018	2017
Fiancial instruments whose contract amounts represent credit risk:		
Commitments to extend credit	$ 138,586,127	$ 147,320,885
Standby letters of credit	11,906,723	8,551,773
Forward commitment to sell mortgage loans	-	368,253
	$ 150,492,850	$ 156,240,911

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. Standby letters of credit are conditional commitments issued to guarantee the performance of a customer to a third party. Those guarantees are primarily issued to support public and private borrowing arrangements. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loan facilities to customers. The Corporation evaluates each customer's credit worthiness on a case-by-case basis. The amount of collateral obtained, if deemed necessary by the Corporation upon extension of credit, is based on management's credit evaluation of the counterparty. Collateral held varies but may include accounts receivable, inventory, property and equipment, and income-producing commercial properties.

NOTE 15 - Stockholders' Equity

Dividends declared by the Bank that exceed the retained net income for the most current year plus retained net income for the preceding two years must be approved by federal regulatory agencies.

Under Federal Reserve regulations, the Bank is limited as to the amount it may lend to its affiliates, including the Corporation. Such loans are required to be collateralized by investments defined in the regulations. In addition, the maximum amount available for transfer from the Bank to the Corporation in the form of loans is limited to 10% of the Bank's stockholders' equity in the case of any one affiliate or 20% in the case of all affiliates.

NOTE 16 - Regulatory Capital Requirements

The Bank is subject to various regulatory capital requirements administered by the Federal banking agencies. The final rules implementing BASEL Committee on Banking Supervisor's Capital Guidance for U.S. banks ("BASEL III rules") became effective for the Bank on January 1, 2015, with full compliance with all of the requirements being phased in over a multi-year schedule and fully phased in by January 1, 2019. Beginning in 2016, an additional capital conservation buffer was added to the minimum requirements for capital adequacy purposes. The capital conservation buffer is required to ensure that the Bank conserves capital when it is most needed, to better handle periods of economic activity. The capital conservation buffer comprises common equity Tier 1 capital above its minimum capital requirements. The buffer is determined relative to risk-weighted assets. A depository and lending institution with a buffer of less than 2.5% (or the required phase-in amount in years prior to 2019) will be subject to limitations on capital distributions, including dividend payments and certain discretionary bonus payments to executive officers. The Bank's capital is sufficient to meet the fully phased-in conservation buffer as of December 31, 2018.

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 Corporation's financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, the Bank must meet specific capital guidelines that involve quantitative measures of its assets, liabilities, and certain off-balance sheet items calculated under regulatory accounting practices. The 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 maintenance of minimum amounts and ratios (set forth in the table below) of total and Tier 1 capital (as defined in the regulations) to risk-weighted assets, and of Tier 1 capital to average assets. Management believes, as of December 31, 2018, that the Bank meets all capital adequacy requirements to which it is subject.

The Federal Reserve Bank has established capital guidelines for bank holding companies. These guidelines allow small bank holding companies, as defined, an exemption from regulatory capital requirements. The Corporation meets the eligibility criteria and is exempt from regulatory capital requirements.

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

NOTE 16 - Regulatory Capital Requirements (cont.)

The Bank's actual capital amounts and ratios as of December 31 are as follows:

	Actual		For Capital Adequacy Purposes		To Be Well Capitalized Under Prompt Corrective Action Provision	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
As of December 31, 2018						
Total capital (to risk-weighted assets)	$ 168,375,000	17.1%	$ 78,654,960	8.0%	$ 98,318,700	10.0%
Tier 1 capital (to risk-weighted assets)	$ 157,381,000	16.0%	$ 58,991,220	6.0%	$ 78,654,960	8.0%
Common Equity Tier 1 (to risk-weighted assets)	$ 157,381,000	16.0%	$ 44,243,415	4.5%	$ 63,907,155	6.5%
Tier 1 capital (to average assets)	$ 157,381,000	11.2%	$ 56,033,640	4.0%	$ 70,042,050	5.0%
As of December 31, 2017						
Total capital (to risk-weighted assets)	$ 155,021,000	17.0%	$ 73,035,840	8.0%	$ 91,294,800	10.0%
Tier 1 capital (to risk-weighted assets)	$ 144,288,000	15.8%	$ 54,776,880	6.0%	$ 73,035,840	8.0%
Common Equity Tier 1 (to risk-weighted assets)	$ 144,288,000	15.8%	$ 41,082,660	4.5%	$ 59,341,620	6.5%
Tier 1 capital (to average assets)	$ 144,288,000	10.4%	$ 55,643,160	4.0%	$ 69,553,950	5.0%

NOTE 17 - Concentration of Credit Risk

Practically all of the Corporation's loans, commitments, and commercial and standby letters of credit have been granted to customers in the Bank's market area of Southeastern Wisconsin. Although the Corporation has a diversified loan portfolio, the ability of its debtors to honor its contracts is dependent on the economic conditions of this market area. The concentration of credit by type of loan is set forth in Note 5.