Consolidated Financial Statements
December 31, 2018 and 2017

Horizon Bancorp, Inc. and Subsidiary

Independent Auditor's Report

To the Board of Directors
Horizon Bancorp, Inc. and Subsidiary
Lake Havasu City, Arizona

Report on the Financial Statements
We have audited the accompanying consolidated financial statements of Horizon Bancorp, Inc. and Subsidiary, 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.

Auditor's 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, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

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

Opinion

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

Eide Bailly LLP

Phoenix, Arizona
May 30, 2019

	2018	2017
Assets		
Cash and Due from Banks	$ 7,015,232	$ 5,856,526
Federal Funds Sold	17,727,000	14,288,000
Cash and cash equivalents	24,742,232	20,144,526
Interest-Bearing Deposits in Banks	17,224,063	15,212,690
Securities Available-for-Sale	22,685,769	21,023,392
Federal Home Loan Bank Stock	1,181,500	1,085,900
Loans Held-for-Sale	330,658	639,400
Loans, Net	214,763,263	189,408,635
Premises and Equipment, Net	5,700,815	4,894,781
Accrued Interest Receivable	759,644	591,607
Bank Owned Life Insurance	5,900,330	5,691,345
Foreclosed Real Estate	1,811,463	2,026,951
Deferred Tax Asset	1,476,000	1,282,000
Other Assets	585,599	616,925
Total assets	$ 297,161,336	$ 262,618,152
Liabilities and Stockholders' Equity		
Liabilities		
Deposits		
Noninterest-bearing	$ 71,886,890	$ 61,462,354
Interest-bearing	183,450,601	165,515,503
Total deposits	255,337,491	226,977,857
Repurchase agreements	3,881,694	4,083,680
Short and long-term borrowings	8,896,331	4,679,179
Accrued interest payable	142,725	101,697
Other liabilities	3,084,071	3,304,488
Total liabilities	271,342,312	239,146,901
Stockholders' Equity		
Common stock, par value $0, voting, authorized 20,000,000 shares; issued and outstanding, 4,125,182 as of December 31, 2018 and 2017	25,219,182	25,219,182
Retained earnings / (accumulated deficit)	1,039,833	(1,451,198)
Accumulated other comprehensive loss	(439,991)	(296,733)
Total stockholders' equity	25,819,024	23,471,251
Total liabilities and stockholders' equity	$ 297,161,336	$ 262,618,152

	2018	2017
Interest Income		
Loans	$ 12,181,751	$ 9,936,647
Securities available-for-sale	500,948	395,578
Interest-bearing deposits in banks	840,618	508,357
Total interest income	13,523,317	10,840,582
Interest Expense		
Deposits	1,664,974	1,080,747
Other	256,639	147,065
Total interest expense	1,921,613	1,227,812
Net interest income	11,601,704	9,612,770
Provision for Loan Losses	497,610	314,666
Net interest income after provision for loan losses	11,104,094	9,298,104
Noninterest Income		
Service charges and other fee income	1,224,120	1,065,946
Merchant processing income	213,556	305,023
Income from bank owned life insurance	164,236	159,851
Gain on loans sold on secondary market	1,878,415	2,013,682
Other income	802,580	580,421
Total noninterest income	4,282,907	4,124,923
Noninterest Expenses		
Salaries and employee benefits	7,413,546	6,174,912
Occupancy and equipment	1,262,422	1,136,933
Merchant processing fees	159,969	233,276
Other processing fees	1,008,337	880,474
Public relations	230,134	278,269
Professional services	312,293	351,457
FDIC assessment	113,870	128,215
Losses on sale and write down of foreclosed real estate	66,830	233,960
Foreclosed real estate expenses	83,368	77,322
General and administrative	1,524,063	1,385,688
Total noninterest expenses	12,174,832	10,880,506
Net income before income taxes	3,212,169	2,542,521
Income Tax (Benefit) Expense	721,138	(408,357)
Net Income	$ 2,491,031	$ 2,950,878
Earnings per Share		
Basic	$ 0.60	$ 0.75

	2018	2017
Net Income	$ 2,491,031	$ 2,950,878
Other Comprehensive Income (Loss)		
Unrealized income (loss) on securities		
Unrealized holding income (loss) arising during period, net of taxes	(143,258)	61,282
Other Comprehensive Income (Loss)	(143,258)	61,282
Comprehensive Income	$ 2,347,773	$ 3,012,160

	Common Stock Shares	Amount	Retained Earnings / (Accumulated Deficit)	Accumulated Other Comprehensive Income (Loss)	Total
Balance, December 31, 2016	3,750,126	$ 25,217,790	$ (4,402,076)	$ (358,015)	$ 20,457,699
Stock dividends	375,056	-	-	-	-
Stock option exercise	-	1,392	-	-	1,392
Net income	-	-	2,950,878	-	2,950,878
Other comprehensive income	-	-	-	61,282	61,282
Balance, December 31, 2017	4,125,182	25,219,182	(1,451,198)	(296,733)	23,471,251
Net income	-	-	2,491,031	-	2,491,031
Other comprehensive loss	-	-	-	(143,258)	(143,258)
Balance, December 31, 2018	4,125,182	$ 25,219,182	$ 1,039,833	$ (439,991)	$ 25,819,024

	2018	2017
Cash Flows from Operating Activities		
Net income	$ 2,491,031	$ 2,950,878
Adjustments to reconcile net income to net cash provided by operating activities		
Depreciation of premises and equipment	387,299	337,337
Gain on sale of loans	(1,878,415)	(2,013,682)
(Gain) loss on sale of foreclosed real estate	(21,170)	39,922
Net amortization of securities	205,191	130,449
Provision for loan losses	497,610	314,666
Provision for foreclosed real estate losses	88,000	199,253
Activity on bank owned life insurance	(208,985)	(204,599)
Stock option expense	-	1,392
Net change in		
Accrued interest receivable	(168,037)	(53,863)
Other assets	(64,274)	(638,344)
Accrued interest payable and other liabilities	(179,389)	904,066
Net Cash Provided by Operating Activities	1,148,861	1,967,475
Cash Flows from Investing Activities		
Net change in interest-bearing deposits in banks	(2,011,373)	(1,516,882)
Activity in available-for-sale securities		
Purchase of securities	(6,403,773)	(4,600,183)
Proceeds from maturities, calls and paydowns of securities	4,239,158	3,808,496
Loan principal advances, net	(23,871,728)	(17,185,883)
Proceeds from sale of foreclosed real estate	315,094	730,840
Purchases of premises and equipment	(1,193,333)	(177,967)
Net Cash Used in Investing Activities	(28,925,955)	(18,941,579)
Cash Flows from Financing Activities		
Net increase in deposits	28,359,634	23,369,707
Proceeds from short and long-term borrowings	5,000,000	2,000,000
Payments on short and long-term borrowings	(782,848)	(820,821)
Net change in repurchase agreements	(201,986)	(2,811,868)
Net Cash Provided by Financing Activities	32,374,800	21,737,018
Net Increase in Cash and Cash Equivalents	4,597,706	4,762,914
Cash and Cash Equivalents, Beginning of Year	20,144,526	15,381,612
Cash and Cash Equivalents, End of Year	$ 24,742,232	$ 20,144,526

	2018	2017
Supplemental Disclosures of Cash Flow Information		
Cash payments for interest	$ 1,880,585	$ 1,218,615
Supplemental Disclosures of Cash Flow Information		
Cash payments for taxes	$ 925,152	$ 314,245
Supplemental Disclosure of Non-Cash Investing Activities		
Loans transferred to foreclosed assets during the year	$ 204,647	$ -

Note 1 - Nature of Business and Significant Accounting Policies

Nature of Business

Horizon Bancorp, Inc. is a bank holding company that provides a full range of banking services to commercial and consumer customers through its wholly-owned subsidiary, Horizon Community Bank. The Company's business is concentrated in the Lake Havasu City area (Mohave and LaPaz counties in Arizona) and is subject to the general economic conditions of this area. The Company has a loan production office located in Kingman, Arizona to further support and promote lending activities in Mohave County. The Company also has a full-service branch in Mesa, Arizona and a loan production office in Goodyear, Arizona and another loan production office in the Biltmore area of Phoenix, Arizona to expand its market and growth opportunities into the greater Phoenix area. The Company's wholly-owned subsidiary, Horizon Community Bank (the Bank), opened for business on December 9, 2002.

The accounting and reporting policies of the Company conform to accounting principles generally accepted in the United States of America and general industry practices.

Principles of Consolidation

The consolidated financial statements include the accounts of Horizon Bancorp, Inc. and its wholly-owned subsidiary, Horizon Community Bank. These entities are collectively referred to herein as the Company. All significant intercompany accounts and transactions have been eliminated in consolidation.

Use of Estimates

To prepare consolidated financial statements in conformity with accounting principles generally accepted in the United States of America, management makes estimates and assumptions based on available information. These estimates and assumptions affect the amounts reported in the financial statements and the disclosures provided, and future results could differ. Material estimate that is particularly susceptible to significant change in the near term relate to the determination of the allowance for loan losses.

Significant Group Concentrations of Credit Risk

Most of the Company's loans are with customers within the state of Arizona. Concentrations of credit are present in commercial real estate and residential real estate. Loans for commercial real estate and residential real estate comprise approximately 57% and 23% of total loans for December 31, 2018, respectively. As of December 31, 2017, loans for commercial real estate and residential real estate comprise approximately 56% and 22% of total loans, respectively. The ability of the Company's debtors to honor their obligations is dependent on the real estate and general economic condition in Arizona. Management is monitoring these concentrations on an on-going basis.

Cash and Cash Equivalents

Cash and cash equivalents include cash, deposits with other financial institutions under 90 days, and federal funds sold. Net cash flows are reported for customer loan and deposit transactions, deferred tax asset valuation allowance, and repurchase agreements.

Balances in transaction accounts at other financial institutions may exceed amounts covered by federal deposit insurance. Management regularly evaluates the credit risk associated with other financial institutions and believes that the Company is not exposed to any significant credit risks on cash and cash equivalents.

Interest-Bearing Deposits in Banks

Interest-bearing deposits in banks mature in varying maturities over the next five years and are carried at cost.

Securities Available-for-Sale

The Company classifies its debt securities as available-for-sale and are recorded at fair value, with unrealized gains and losses excluded from earnings and reported in comprehensive income.

Purchase premiums and discounts are recognized in interest income using the interest method over the terms of the securities. Gains and losses on the sale of securities are recorded on the trade date and are determined using the specific identification method.

The Company follows the accounting guidance related to recognition and presentation of other-than-temporary impairment. This guidance specifies that (a) if a company does not have the intent to sell a debt security prior to recovery and (b) it is more likely than not that it will not have to sell the debt security prior to recovery, the security would not be considered other-than-temporarily impaired unless there is a credit loss. When an entity does not intend to sell the security, and it is more likely than not, the entity will not have to sell the security before recovery of its cost basis, it will recognize the credit component of an other-than-temporary impairment of a debt security in earnings and the remaining portion in other comprehensive income.

Federal Home Loan Bank Stock

The Company, as a member of the Federal Home Loan Bank (FHLB) system, is required to maintain an investment in capital stock of the FHLB. Based on redemption provisions of the FHLB, the stock has no quoted market value and is carried at cost. Management reviews for impairment based on the ultimate recoverability of the cost basis in the FHLB stock.

Loans Held-for-Sale

Loans originated and intended for sale in the secondary market are carried at lower of cost or fair value. For loans carried at the lower of cost or fair value, gains and losses on loan sales (sales proceeds minus carrying value) are recorded in noninterest income, and direct loan origination costs and fees are deferred at origination of the loan and are recognized in noninterest income upon sale of the loan.

Loans

Loans that management has the intent and ability to hold for the foreseeable future or until maturity or pay-off generally are reported at their outstanding unpaid principal balances adjusted for unearned income, the allowance for loan losses, and any unamortized deferred fees or costs on originated loans, and premiums or discounts on purchased loans.

For loans amortized at cost, interest income is accrued based on the unpaid principal balance. Loan origination fees, net of certain direct origination costs, are deferred and amortized as a level yield adjustment over the respective term of the loan.

Interest income is accrued on the unpaid principal balance. The accrual of interest on loans is discontinued at the time the loan is 90 days delinquent unless the credit is well secured and in process of collection. Past due status is based on contractual terms of the loan. Loans are placed on non-accrual or charged-off at an earlier date if collection of principal or interest is considered doubtful.

All interest accrued but not collected for loans that are placed on nonaccrual or charged off are reversed against interest income. The interest on these loans is accounted for on the cash-basis or cost-recovery method, until qualifying for return to accrual. Loans are returned to accrual status when all the principal and interest amounts contractually due are brought current and future payments are reasonably assured.

Allowance for Loan Losses

The allowance for loan losses is established as losses are estimated to have occurred through a provision for loan losses charged to earnings. Loan losses are charged against the allowance when management believes the uncollectability of a loan balance is confirmed. Subsequent recoveries, if any, are credited to the allowance.

The allowance for loan losses is evaluated on a regular basis by management and is based upon management's periodic review of the collectability of the loans in light of historical experience, the nature and volume of the loan portfolio, adverse situations that may affect the borrower's ability to repay, estimated value of any underlying collateral and prevailing economic conditions. This evaluation is inherently subjective as it requires estimates that are susceptible to significant revision as more information becomes available.

The allowance consists of allocated and general components. The allocated component relates to loans that are classified as impaired. For those loans that are classified as impaired, an allowance is established when the discounted cash flows (or collateral value or observable market price) of the impaired loan is lower than the carrying value of that loan. General components cover non-impaired loans and are based on historical loss rates for each portfolio segment, adjusted for the effects of qualitative or environmental factors that are likely to cause estimated credit losses as of the evaluation date to differ from the portfolio segment's historical loss experience. Qualitative factors include consideration of the following: changes in lending policies and procedures; changes in economic conditions, changes in the nature and volume of the portfolio; changes in the experience, ability and depth of lending management and other relevant staff; changes in the volume and severity of past due, nonaccrual and other adversely graded loans; changes in the loan review system; changes in the value of the underlying collateral for collateral-dependent loans; concentrations of credit and the effect of other external factors such as competition and legal and regulatory requirements.

A loan is considered impaired when, based on current information and events, it is probable that the Company will be unable to collect the scheduled payments of principal and interest when due according to the contractual terms of the loan agreement. Factors considered by management in determining impairment include payment status, collateral value, and the probability of collecting scheduled principal and interest payments when due. Loans that experience insignificant payment delays and payment shortfalls generally are not classified as impaired. Management determines the significance of payment delays and payment shortfalls on a case-by-case basis, taking into consideration all of the circumstances surrounding the loan and the borrower, including the length of the delay, the reasons for the delay, the borrower's prior payment record, and the amount of the shortfall in relation to the principal and interest owed. Impairment is measured on a loan by loan basis by either the present value of expected future cash flows discounted at the loan's effective interest rate, the loan's obtainable market price, or the fair value of the collateral if the loan is collateral dependent.

Major categories of loans are further defined by the Company into portfolio segments identified by the Company including commercial, commercial real estate, residential real estate, and consumer. Relevant risk characteristics for these portfolio segments generally include debt service coverage, loan-to-value ratios and financial performance on non-consumer loans and credit scores, debt-to-income, collateral type and loan-to-value ratios for consumer loans.

Brokered Residential Real Estate Loan Fees

The Company receives fee income from other companies for the completion of applications and loan documents and to perform pre-underwriting activities for long-term residential mortgages. These fees are recognized as income when earned (upon loan closing) and reflected in gains on loans sold on secondary market in the accompanying statement of income. The Company issues various representations and warranties associated with the brokering of these loans. The Company has not experienced any losses as a result of these representations and warranties.

Premises and Equipment

Premises and equipment are stated at cost less accumulated depreciation and amortization using the straight-line method over the estimated useful lives of the assets, generally 3 to 40 years. Leasehold improvements are amortized over the lesser of the useful life of the improvements or the life of the lease, generally 5 years. Amortization of leasehold improvements is included in depreciation expense.

Income Taxes

Income taxes are provided for the tax effects of transactions reported in the consolidated financial statements and consist of taxes currently due plus deferred taxes related primarily to differences between the basis of receivables, other real estate owned, property and equipment, intangible assets, and accrued expenses for financial and income tax reporting. The deferred tax assets and liabilities represent the future tax return consequences of those differences, which will either be taxable or deductible when the assets and liabilities are recovered or settled. Deferred tax assets are reduced by a valuation allowance when, in the opinion of management, it is more likely than not that some portion or all of the deferred tax assets will not be realized.

The Company evaluates its tax positions that have been taken or are expected to be taken on income tax returns to determine if an accrual is necessary for uncertain tax positions. As of December 31, 2018 and 2017, the unrecognized tax benefit accrual was zero. The Company will recognize future accrued interest and penalties related to unrecognized tax benefits in income tax expense, if incurred.

Bank Owned Life Insurance

Bank owned life insurance is stated at its cash surrender value. The cash surrender value of the underlying policies was $5,900,330 and $5,691,345 as of December 31, 2018 and 2017, respectively.

Foreclosed Real Estate

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

Employee Stock Options

The Company recognizes compensation cost relating to share-based payment transactions (stock options), in the consolidated financial statements. That cost will be measured based on the grant date fair value of the equity instrument issued.

The Company calculates and recognizes compensation cost for all stock awards over the employees' service period, generally defined as the vesting period. The Company uses a Black-Scholes model, which incorporates assumptions as to stock price volatility, the expected life of the options, risk free rate and dividend yield to estimate the fair value of stock options.

Off-Balance-Sheet Instruments

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

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 Company – put presumptively beyond the reach of the transferor and its creditors, even in bankruptcy or other receivership, (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 Company does not maintain effective control over the transferred assets through an agreement to repurchase them before their maturity or the ability to unilaterally cause the holder to return specific assets.

Comprehensive Income

Comprehensive income consists of net income and other comprehensive income. Other comprehensive income includes unrealized gains on securities available-for-sale and unrealized losses related to factors other than credit on debt securities, which are also recognized as separate components of equity.

Loss Contingencies

Loss contingencies, including claims and legal actions arising in the ordinary course of business, are recorded as liabilities when the likelihood of loss is probable, and an amount or range of loss can be reasonably estimated. Management does not believe there now are such matters that will have a material effect on the consolidated financial statements.

Fair Value of Financial Instruments

Fair values of financial instruments are estimated using relevant market information and other assumptions, as more fully disclosed in Note 13. Fair value estimates involve uncertainties and matters of significant judgment. Changes in assumptions or in market conditions could significantly affect the estimates.

Advertising Costs

Advertising costs are expensed as incurred. Such costs totaled $230,134 and $278,269 for the years ended December 31, 2018 and 2017, respectively.

Recent Accounting Guidance

Accounting Standards Update (ASU) 2016- 02, *Leases (Topic 842)*:

In February 2016, the Financial Accounting Standards Board (FASB) amended existing guidance that requires lessees recognize the following for all leases (with the exception of short-term leases) at the commencement date (1) A lease liability, which is a lessee's obligation to make lease payments arising from a lease, measured on a discounted basis; and (2) A right-of-use-asset, which is an asset that represents the lessee's right to use or control the use of, a specified asset for the lease term.

Nonpublic business entities should apply the amendments for fiscal years beginning after December 15, 2018. Early adoption is permitted for all entities upon issuance.

Lessees must apply a modified retrospective transition approach for leases existing at, or entered into after, the beginning of the earliest comparative period presented in the financial statements. The modified retrospective approach would not require any transition accounting for leases that expired before the earliest comparative period presented.

The Company is currently evaluating the impact of the adoption of ASU 2016-02 on its consolidated financial statements.

ASU 2016-13, *Financial Instruments – Credit Losses (Topic 326)*:

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

The standard will be effective for fiscal years beginning after December 15, 2019.

The Company is currently evaluating the impact of the adoption of ASU 2016-13 on its consolidated financial statements.

Adoption of New Accounting Standards

On January 1, 2018, the Company adopted ASU 2014-09, *Revenue from Contracts with Customers*, and all subsequent amendments to the ASU (collectively, "ASC 606"), which (i) creates a single framework for recognizing revenue from contracts with customers that all within its scope and (ii) revises when it is appropriate to recognize a gain (loss) from the transfer of nonfinancial assets, such as OREO. The majority of the Company's revenues come from interest income and other sources, including loans, leases, securities, that are outside the scope of ASC 606. The Company's services that fall within the scope of ASC 606 are presented within non-interest income and are recognized as revenue as the Company satisfies its obligation to the customer. Services within the scope of ASC 606 include deposit service charges on deposits, interchange income, and the sale of OREO. The effects of this implementation were not material to the consolidated financial statements.

Subsequent Events

The Company has evaluated subsequent events through May 30, 2019, the date which the consolidated financial statements were available to be issued.

Note 2 - Restrictions on Cash and Due from Banks

The Company is required to maintain reserve balances in cash or on deposit with the Federal Reserve Bank. The total of those reserve balances was approximately $1,114,000 and $685,000 at December 31, 2018 and 2017, respectively.

Note 3 - Securities Available-for-Sale

Debt and equity securities have been classified in the consolidated balance sheets according to management's intent. Securities are classified as available-for-sale. The amortized cost and fair value of securities, with gross unrealized gains and losses at December 31 are as follows:

	2018			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Municipal bonds	$ 2,155,163	$ 2,132	$ (40,704)	$ 2,116,591
SBA guaranteed loan pools	1,882,172	347	(38,204)	1,844,315
GSE residential mortgage-backed	19,242,214	22,422	(539,773)	18,724,863
	$ 23,279,549	$ 24,901	$ (618,681)	$ 22,685,769

	2017			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Municipal bonds	$ 2,176,967	$ 2,705	$ (20,715)	$ 2,158,957
SBA guaranteed loan pools	2,854,322	758	(36,738)	2,818,342
GSE residential mortgage-backed	16,288,837	24,908	(267,652)	16,046,093
	$ 21,320,126	$ 28,371	$ (325,105)	$ 21,023,392

Securities pledged to secure public deposits and repurchase agreements totaled approximately $7,216,380 and $4,943,000 as of December 31, 2018 and 2017, respectively.

The amortized cost and fair value of securities available-for-sale as of December 31, 2018, by contractual maturity are shown below:

	Amortized Cost	Fair Value
Due within one year	$ -	$ -
Due after five years through ten years	2,155,163	2,116,591
	2,155,163	2,116,591
SBA guaranteed loan pools	1,882,172	1,844,315
GSE residential mortgage-backed	19,242,214	18,724,863
	$ 23,279,549	$ 22,685,769

GSE residential mortgage-backed securities and SBA guaranteed loan pools are not included in the maturity categories in the above summary because these securities may mature earlier than contractual maturities because borrowers have the right to call or prepay their obligations with or without penalties.

There were no sales of securities available-for-sale for the years ended December 31, 2018 and 2017.

The following table shows the gross unrealized losses and fair value of the Company's investments with unrealized losses that are not deemed to be other-than temporarily impaired, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position at December 31, 2018 and 2017:

	Less than Twelve Months		Over Twelve Months		
	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value	Total Unrealized Losses
December 31, 2018					
Municipal bonds	$ -	$ -	$ (40,704)	$ 1,605,106	$ (40,704)
SBA guaranteed loan pools	(3,502)	111,851	(34,702)	1,628,766	(38,204)
GSE residential mortgage-backed	(69,724)	4,488,055	(470,049)	12,016,949	(539,773)
	$ (73,226)	$ 4,599,906	$ (545,455)	$ 15,250,821	$ (618,681)
December 31, 2017					
Municipal bonds	$ (16,532)	$ 1,517,284	$ (4,183)	$ 255,885	$ (20,715)
SBA guaranteed loan pools	(12,852)	1,293,280	(23,886)	1,448,341	(36,738)
GSE residential mortgage-backed	(57,564)	6,085,705	(210,088)	7,439,404	(267,652)
	$ (86,948)	$ 8,896,269	$ (238,157)	$ 9,143,630	$ (325,105)

The unrealized loss on investments in municipal bonds, SBA loans pools, and GSE residential mortgage-backed securities investments were caused by interest rate changes. The contractual terms of the securities do not permit to issuer to settle the securities at a price less than the amortized cost bases of the investment. Because the Company does not intend to sell the securities and it is not more likely than not that the Company will be required to sell the securities before recovery of their amortized cost bases, which may be maturity, the Company does not consider the securities to be other-than-temporarily impaired at December 31, 2018.

Note 4 - Loans

A summary of loans by major category follows as of December 31:

	2018	2017
Commercial real estate	$ 125,768,267	$ 108,018,618
Residential real estate	42,659,340	42,385,082
Commercial	49,224,244	41,424,251
Consumer	1,000,080	1,078,695
	218,651,931	192,906,646
Deduct		
Deferred loan fees, net of costs	838,024	721,060
Allowance for loan losses	3,050,644	2,776,951
	$ 214,763,263	$ 189,408,635

Overdraft deposits of $109,669 and $57,813 as of December 31, 2018 and 2017, respectively, have been reclassified from deposits and included in consumer loans.

The following table presents the activity in the allowance for loan losses for the years ended 2018 and 2017 and the recorded investment in loans and impairment method as of December 31, 2018 and 2017 by portfolio segment:

	2018				
	Commercial	Commercial Real Estate	Residential Real Estate	Consumer	Total
Allowance for Loan Losses					
Balance at beginning of period	$ 227,546	$ 1,700,042	$ 820,653	$ 28,710	$ 2,776,951
Charge-offs	(128,821)	(145,075)	-	(3,707)	(277,603)
Recoveries	2,800	26,942	16,380	7,564	53,686
Provisions	109,474	9,953	14,928	363,255	497,610
Balance at end of period	$ 210,999	$ 1,591,862	$ 851,961	$ 395,822	$ 3,050,644
Individually evaluated for impairment	$ 70,953	$ 183,009	$ 39,367	$ -	$ 293,329
Collectively evaluated for impairment	140,046	1,408,853	812,594	395,822	2,757,315
Balance at end of period	$ 210,999	$ 1,591,862	$ 851,961	$ 395,822	$ 3,050,644
Loans					
Individually evaluated for impairment	$ 1,102,332	$ 1,971,908	$ 507,029	$ -	$ 3,581,269
Collectively evaluated for impairment	48,121,912	123,796,359	42,152,311	1,000,080	215,070,662
Balance at end of period	$ 49,224,244	$ 125,768,267	$ 42,659,340	$ 1,000,080	$ 218,651,931

	2017				
	Commercial	Commercial Real Estate	Residential Real Estate	Consumer	Total
Allowance for Loan Losses					
Balance at beginning of period	$ 282,783	$ 1,403,367	$ 731,649	$ 16,216	$ 2,434,015
Charge-offs	(164,994)	(28,014)	-	(3,817)	(196,825)
Recoveries	42,410	149,073	19,055	14,557	225,095
Provisions	67,347	175,616	69,949	1,754	314,666
Balance at end of period	$ 227,546	$ 1,700,042	$ 820,653	$ 28,710	$ 2,776,951
Individually evaluated for impairment	$ 113,125	$ 360,765	$ 52,491	$ -	$ 526,381
Collectively evaluated for impairment	114,421	1,339,277	768,162	28,710	2,250,570
Balance at end of period	$ 227,546	$ 1,700,042	$ 820,653	$ 28,710	$ 2,776,951
Loans					
Individually evaluated for impairment	$ 1,052,656	$ 1,837,818	$ 470,215	$ -	$ 3,360,689
Collectively evaluated for impairment	40,371,595	106,180,800	41,914,867	1,078,695	189,545,957
Balance at end of period	$ 41,424,251	$ 108,018,618	$ 42,385,082	$ 1,078,695	$ 192,906,646

Credit Quality Indicators

The Company categorizes loans into risk categories based on relevant information about the ability of borrowers to service their debt such as: current financial information, historical payment experience, collateral adequacy, credit documentation, public information and current economic trends, among other factors. The Company analyzes loans individually by classifying the loans as to credit risk. This analysis is performed on an ongoing basis as new information is obtained. The Company uses the following definitions for risk ratings:

Pass – Loans classified as pass represent loans that are evaluated and are performing under the stated terms. Pass rated assets are analyzed by the paying capacity, the current net worth, and the value of the loan collateral of the obligor.

Watch – Loans classified as watch are pass grade loans, which for one reason or another may require the attention of management. Reasons may include, but are not limited to, weakening repayment sources, adverse industry trends, concerns regarding concentrations of credit, or weakened evaluations by account officers. While the status of a loan put on this list may not technically trigger their classification as Substandard, it is considered a proactive way to identify potential issues and address them before the situation deteriorates further and does result in a loss for the Company.

Special Mention – Loans classified as special mention exhibit deficiencies that may be enough to constitute a credit risk, but are protected to the degree that no loss is anticipated. Assets in this category are currently protected, but are potentially weak. While the status of a loan put on this list may not technically trigger their classification as Substandard, it is considered a proactive way to identify potential issues and address them before the situation deteriorates further and does result in a loss for the Company.

Substandard – Loans classified as substandard are inadequately protected by the current net worth, paying capacity of the obligor, or by the collateral pledged. Substandard loans must have a well-defined weakness or weaknesses that jeopardize the repayment of the debt as originally contracted. They are characterized by the distinct possibility that the Company will sustain a loss if the deficiencies are not corrected.

Credit Risk Profile by Internally Assigned Grade – Commercial, Commercial Real Estate, Residential Real Estate, and Consumer

Based on the most recent analysis performed, the risk category of loans by portfolio segment was as follows as of December 31, 2018 and 2017:

	2018				
	Pass	Watch	Special Mention	Substandard	Total
Commercial	$ 45,396,169	$ 1,844,824	$ 1,263,233	$ 720,018	$ 49,224,244
Commercial Real Estate					
Commercial real estate	108,858,044	4,183,309	451,949	1,006,326	114,499,628
Construction, land development and other land loans	9,365,328	1,644,723	-	258,588	11,268,639
Residential Real Estate	40,385,642	1,813,692	155,099	304,907	42,659,340
Consumer	996,701	-	3,379	-	1,000,080
	$ 205,001,884	$ 9,486,548	$ 1,873,660	$ 2,289,839	$ 218,651,931

	2017				
	Pass	Watch	Special Mention	Substandard	Total
Commercial	$ 38,863,973	$ 878,626	$ 933,711	$ 747,941	$ 41,424,251
Commercial Real Estate					
Commercial real estate	97,670,913	2,000,340	2,449,921	1,463,973	103,585,147
Construction, land development and other land loans	3,987,109	131,988	44,601	269,773	4,433,471
Residential Real Estate	40,609,931	1,309,865	-	465,286	42,385,082
Consumer	1,078,695	-	-	-	1,078,695
	$ 182,210,621	$ 4,320,819	$ 3,428,233	$ 2,946,973	$ 192,906,646

The following table summarizes the aging of the past due loans by loan class within the portfolio segments at December 31, 2018 and 2017:

	2018		
	Still Accruing		
	30-89 Days Past Due	Over 90 Days Past Due	Nonaccrual Balance
Commercial	$ 172,404	$ -	$ -
Commercial Real Estate			
Commercial real estate	70,776	-	130,476
Construction, land development and other land loans	890,925	-	258,588
Residential Real Estate	-	-	133,779
Total	$ 1,134,105	$ -	$ 522,843

	2017		
	Still Accruing		
	30-89 Days Past Due	Over 90 Days Past Due	Nonaccrual Balance
Commercial	$ 244,065	$ -	$ 79,920
Commercial Real Estate			
Commercial real estate	-	-	1,013,512
Construction, land development and other land loans	5,653	-	269,773
Residential Real Estate	-	-	240,035
Total	$ 249,718	$ -	$ 1,603,240

The following table summarizes individually impaired loans by class of loans as of December 31, 2018:

	Recorded Investment	Unpaid Principal Balance (1)	Average Recorded Investment	Interest Income Recognized
With no related allowance recorded				
Commercial	$ 83,501	$ 83,501	$ 1,127,682	$ 129,624
Commercial Real Estate				
Commercial real estate	1,696,070	1,696,070	948,513	31,577
Residential Real Estate	227,960	227,960	227,277	16,356
	$ 2,007,531	$ 2,007,531	$ 2,303,472	$ 177,557

	Recorded Investment	Unpaid Principal Balance (1)	Related Allowance	Average Recorded Investment	Interest Income Recognized
With an allowance recorded					
Commercial	$ 1,018,831	$ 1,018,831	$ 70,953	$ 973,312	$ 102,041
Commercial Real Estate					
Commercial real estate	275,838	275,838	183,009	20,315	2,547
Residential Real Estate	279,069	279,069	39,367	281,184	14,633
	$ 1,573,738	$ 1,573,738	$ 293,329	$ 1,274,811	$ 119,221

(1) Represents the borrower's loan obligation, gross of any previously charged-off amounts.

The following table summarizes individually impaired loans by class of loans as of December 31, 2017:

	Recorded Investment	Unpaid Principal Balance (1)	Average Recorded Investment	Interest Income Recognized
With no related allowance recorded				
Commercial Real Estate				
Commercial real estate	$ 171,090	$ 171,090	$ 163,484	$ 17,316
Residential Real Estate	31,357	31,357	34,357	3,884
	$ 202,447	$ 202,447	$ 197,841	$ 21,200

	Recorded Investment	Unpaid Principal Balance (1)	Related Allowance	Average Recorded Investment	Interest Income Recognized
With an allowance recorded					
Commercial	$ 1,052,656	$ 1,052,656	$ 113,125	$ 1,300,619	$ 173,181
Commercial Real Estate					
Commercial real estate	1,412,065	1,412,065	189,995	1,504,402	33,719
Construction, land development and other land loans	254,663	254,663	170,770	259,063	-
Residential Real Estate	438,858	438,858	52,491	456,814	13,401
	$ 3,158,242	$ 3,158,242	$ 526,381	$ 3,520,898	$ 220,301

(1) Represents the borrower's loan obligation, gross of any previously charged-off amounts.

Impaired loans also include loans modified in a trouble debt restructuring (TDR) where concessions have been granted to borrowers experiencing financial difficulties. These concessions could include a reduction in interest rate on the loan, payment extensions, forgiveness of principal, forbearance or other actions intended to maximize collections. Loans modified in a TDR that were fully paid down, charged off or foreclosed upon by period end are not reported in the below tables. The unpaid balance is inclusive of all partial paydowns and charge-offs since the loan modification. The balance in the ALLL represents any specific component of the allowance for loan losses associated with these loans. One loan during the years ended December 31, 2018 and 2017 was modified in a TDR as a result of a payment modification.

The following is a summary of the Bank's loans modified in a TDR, by class, during the years ended December 31, 2018 and 2017:

	2018			
		Unpaid Principal	Balance in ALLL	
	Number of Contracts	Balance (at Year-End)	Prior to Modification	At Year-End
Troubled debt restructurings				
Commercial real estate	1	$ 559,788	$ 154,165	$ -
	1	$ 559,788	$ 154,165	$ -

	2017			
		Unpaid Principal	Balance in ALLL	
	Number of Contracts	Balance (at Year-End)	Prior to Modification	At Year-End
Troubled debt restructurings				
Commercial real estate	1	$ 23,659	$ -	$ 23,659
	1	$ 23,659	$ -	$ 23,659

The troubled debt restructurings that occurred during 2018 and 2017 resulted in $0 and $23,659, respectively, of specific reserves to the allowance for loan losses and did not result in any charge-offs.

No additional funds are committed to be advanced in connection with troubled debt restructurings.

Note 5 - Premises and Equipment

A summary of the cost and accumulated depreciation of premises and equipment follows at December 31:

	2018	2017
Land	$ 2,265,000	$ 2,265,000
Buildings	3,282,436	2,873,297
Leasehold improvements	90,639	90,639
Furniture, fixtures and office equipment	4,577,221	3,793,027
	10,215,296	9,021,963
Less accumulated depreciation	4,514,481	4,127,182
	$ 5,700,815	$ 4,894,781

Depreciation expense totaled $387,299 and $337,337 for the years ended December 31, 2018 and 2017, respectively.

Note 6 - Deposits

Deposits consisted of the following at December 31:

	2018	2017
Non-interest bearing demand	$ 71,886,897	$ 61,462,354
NOW	44,153,102	41,459,728
Money market	60,719,107	52,435,279
Savings	14,410,608	12,793,503
Time deposits, $250,000 and over	12,024,349	10,129,834
Time deposits under $250,000	52,143,428	48,697,159
	$ 255,337,491	$ 226,977,857

At December 31, 2018, scheduled maturities of time deposits are as follows:

2019	$ 41,010,776
2020	12,771,692
2021	5,396,501
2022	3,515,335
2023	1,473,473
	$ 64,167,777

Six customers held deposits of approximately $21,246,000 with the Company at December 31, 2018, which represents approximately 12% of total deposits. Eight customers held deposits of approximately $27,606,000 with the Company at December 31, 2017, which represents approximately 12% of total deposits.

Deposit balances with related parties were $5,972,209 and $4,168,636 at December 31, 2018 and 2017, respectively.

The Company has obtained $5,823,258 and $5,730,101 in time deposits through third-party brokers at December 31, 2018 and 2017, respectively.

Note 7 - Repurchase Agreements

Securities sold under agreements to repurchase amounted to $3,881,694 and $4,083,680 at December 31, 2018 and 2017, respectively, matured on a daily basis and are secured by U.S. Government-sponsored enterprises with a fair value of approximately $3,882,000 and $4,084,000, with weighted-average interest rate of 0.34% and 0.30%, respectively.

Note 8 - Income Tax Matters

The recorded income tax expense (benefit) for the years ended December 31, 2018 and 2017 was approximately $721,000 and $(408,000), respectively.

The provision (benefit) for income taxes recorded in income for the years ended December 31, 2018 and 2017 consists of the following:

	2018	2017
Currently payable	$ 915,138	$ 342,000
Deferred	(194,000)	(750,000)
	$ 721,138	$ (408,357)

The cumulative tax effects of the primary temporary differences which created deferred tax assets and liabilities at December 31 are as follows:

	2018	2017
Deferred tax assets		
Allowance for loan losses	$ 319,000	$ 195,000
Deferred compensation	310,000	263,000
Other real estate	599,000	589,000
Accrued compensation	140,000	125,000
Unrealized gain on available-for-sale securities	154,000	74,000
Deferred loan costs	208,000	179,000
Other	61,000	62,000
Total deferred tax assets	1,791,000	1,487,000
Deferred tax liabilities		
Prepaid expense	46,000	54,000
Premises and equipment	269,000	151,000
Total deferred tax liabilities	315,000	205,000
Net deferred tax assets	$ 1,476,000	$ 1,282,000

At December 31, 2018 and 2017, the Company had no operating loss carryforwards for federal tax purposes.

The Company's effective income tax rate is higher than what would be expected if the federal statutory rate were applied to income from continuing operations primarily because of expenses deductible for financial reporting purposes that are not deductible for tax purposes, tax-exempt income, and the dividends-received-deduction.

Note 9 - Commitments and Contingencies

Lease Commitments

The Company leases its Lake Havasu branch from companies that are related through common ownership with related parties. The lease expires June of 2019 and require monthly payments of approximately $21,000 for the years ended December 31, 2018 and 2017, respectively. The leases require the Company to pay all taxes, maintenance, utility costs, and certain types of insurance.

The Company entered into a sublease for a branch in Mesa, Arizona during 2015. The lease expires February 28, 2021 and requires monthly payments of approximately $11,000 per month.

At December 31, 2018, the future annual minimum lease payments under these operating leases are as follows:

2019	$ 358,014
2020	197,453
2021	50,220
	$ 605,687

Rent expense for these leases totaled approximately $487,000 and $454,000 for the years ended December 31, 2018 and 2017, respectively.

Financial Instruments with Off-Balance-Sheet Risk

The Company is party to financial instruments with off-balance-sheet risk in the normal course of business to meet the financing needs of its customers. These financial instruments include commitments to extend credit and standby letters of credit. Those instruments involve, to varying degrees, elements of credit and interest-rate risk in excess of the amount recognized in the balance sheet.

The Company's exposure to credit loss in the event of nonperformance by the other party to the financial instrument for commitments to extend credit and standby letters of credit is represented by the contractual amount of those instruments. The Company uses the same credit policies in making commitments and conditional obligations as it does for on-balance-sheet instruments.

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

	2018	2017
Commitments to extend credit, including unsecured commitments of approximately $100,000 at both December 31, 2018 and 2017, respectively	$ 28,767,402	$ 25,621,904
Credit card commitments, unsecured	2,302,698	1,991,338
	$ 31,070,100	$ 27,613,242

Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. Since many of the commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. The Company evaluates each customer's creditworthiness on a case-by-case basis. The amount of collateral obtained, if it is deemed necessary by the Company upon extension of credit, is based on management's credit evaluation of the counterparty. Collateral held varies, but may include accounts receivable, inventory, property, plant and equipment, and income-producing commercial properties.

Interest Rate Risk

The Company assumes interest rate risk (the risk that general interest rate levels will change) as a result of its normal operations. As a result, the fair values of the Company's financial instruments will change when interest rate levels change, and that change may be either favorable or unfavorable to the Company. Management attempts to match maturities of assets and liabilities to the extent believed necessary to minimize interest rate risk.

However, borrowers with fixed rate obligations are less likely to prepay in a rising rate environment and more likely to prepay in a falling rate environment. Also, depositors who are receiving fixed rates are more likely to withdraw funds before maturity in a rising rate environment and less likely to do so in a falling rate environment. Management monitors rates and maturities of assets and liabilities and attempts to minimize interest rate risk by adjusting terms of new loans and deposits and by investing in securities with terms that mitigate the Company's overall interest rate risk.

Employment Agreements

The Company has employment agreements with some of the senior officers. These agreements provide the senior officers with certain payments upon termination of employment, disability, death, or change in control of the Company pursuant to these agreements.

Legal Matters

From time to time, the Company is involved in various legal actions occurring in the normal course of business. Management believes that there will be no adverse effect on its financial position, results of operations, or cash flows as a result of these matters.

Note 10 - Borrowings and Borrowing Facilities

The Company has an approved federal funds borrowing arrangement with two unrelated financial institutions totaling $5,000,000 as of December 31, 2018 and 2017. There were no federal funds purchased as of December 31, 2018 and 2017. This borrowing arrangement is unsecured.

The Company has a borrowing arrangement with an unrelated financial institution which allows for borrowings up to 98% of the Company's portfolio of U.S. government-sponsored enterprise securities. The maximum borrowing capacity at December 31, 2018 and 2017 was approximately $22,121,000 and $21,859,000, respectively. There were no borrowings under this arrangement at both December 31, 2018 and 2017.

The Company has a borrowing arrangement with an unrelated financial institution which allows for borrowings up to 25% of the Company's total assets as of December 31, 2018 and 2017. The maximum borrowing capacity at December 31, 2018 and 2017 was approximately $74,290,000 and $65,655,000, respectively. There were no borrowings under this arrangement at December 31, 2018. The borrowing arrangement will be secured by securities and qualifying loans if advances are made.

The FHLB advances outstanding at December 31, 2018 have $1,000,000 maturing in 2020, $4,500,000 maturing in 2021, and $1,000,000 maturing in 2023. Advances have fixed rate interest, ranging from 1.42% to 3.13%. The Company maintains a collateral pledge agreement with the Federal Home Loan Bank of San Francisco covering secured advances whereby the Company has agreed to retain, free of all other pledges, liens, encumbrances, their securities available-for-sale. Long-term borrowings consisted of advances from the Federal Home Loan Bank (FHLB) of $1,500,000 as of December 31, 2017.

At December 31, 2018, the Company had an outstanding term loan in the amount of $2,396,331 with The Independent Bankers Bank. The loan matures on December 29, 2020 and was modified to become a promissory note with a variable interest rate of "prime rate" plus .50% (6.00 % at December 31, 2018).

As of December 31, 2018, the Company has a letter of credit with the Federal Home Loan Bank for $7,000,000. The letter of credit is used to cover uninsured public deposits.

Future maturities of long-term debt are as follows:

Years Ending December 31,	Amount
2019	$ 319,997
2020	2,076,334
	$ 2,396,331

Note 11 - Transactions with Related Parties

The Company has had, and may be expected to have in the future, banking transactions in the ordinary course of business with directors, principal officers, their immediate families and affiliated companies in which they are principal stockholders (commonly referred to as related parties), all of which have been, in the opinion of management, on the same terms, including interest rates and collateral, as those prevailing at the time for comparable transactions with others.

Aggregate loan transactions with related parties for the years ended December 31, 2018 and 2017 were approximately $3,614,000 and $5,354,000, respectively.

None of these loans are past due, on nonaccrual or have been restructured to provide a reduction or deferral of interest or principal because of deterioration in the financial position of the borrower. There were no loans to a related party that were considered classified loans at December 31, 2018 and 2017.

At December 31, 2018 and 2017, there were approximately $481,500 and $333,000, respectively, of unused commitments to extend credit to related parties.

Note 12 - Regulatory Matters

In July 2013, the federal banking agencies published final rules (the "Basel III Capital Rules") that revised their risk-based and leverage capital requirements and their method for calculating risk-weighted assets to implement, in part, agreements reached by the Basel Committee and certain provisions of the Dodd-Frank Act. The Basel III Capital Rules apply to banking organizations.

In connection with the effective date of Capital Rules, most banks are required to decide whether to elect to opt-out of the inclusion of Accumulated Other Comprehensive Income ("AOCI") in their Common Equity Tier 1 Capital. This is a one-time election and generally irrevocable. If electing to opt-out, most AOCI items will be treated, for regulatory capital purposes, in the same manner in which they were prior to Basel III. The Bank has elected to opt-out of the inclusion.

Among other things, the Basel III Capital Rules: (i) introduce a new capital measure entitled "Common Equity Tier 1" ("CET1"); (ii) specify that tier 1 capital consist of CET1 and additional financial instruments satisfying specified requirements that permit inclusion in tier 1 capital; (iii) define CET1 narrowly by requiring that most deductions or adjustments to regulatory capital measures be made to CET1 and not to the other components of capital; and (iv) expand the scope of the deductions or adjustments from capital as compared to the existing regulations.

A minimum leverage ratio (tier 1 capital as a percentage of total assets) of 4.0% is also required under the Basel III Capital Rules (even for highly rated institutions). The Basel III Capital Rules additionally require institutions to retain a capital conservation buffer of 2.5% above these required minimum capital ratio levels. Banking organizations that fail to maintain the minimum 2.5% capital conservation buffer could face restrictions on capital distributions or discretionary bonus payments to executive officers.

The Basel III Capital Rules became effective as applied to the Bank on January 1, 2015, with a phase in period that generally extends from January 1, 2015 through January 1, 2019.

The Bank is subject to various regulatory capital requirements administered by the federal and state banking agencies. Failure to meet minimum capital requirements can initiate certain mandatory and possibly additional discretionary actions by regulators that, if undertaken, could have a direct material effect on the Bank's financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, the Bank must meet specific capital guidelines that involve quantitative measures of their assets, liabilities, and certain off-balance-sheet items as 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. Prompt corrective action provisions are not applicable to bank holding companies.

Quantitative measures established by regulation to ensure capital adequacy require the Bank to maintain minimum amounts and ratios of Common Equity Tier 1 Capital ("CET1"), Tier 1 Capital, Total Capital and leverage ratio of Tier 1 Capital. The requirements are:

- 4.5% based upon CET1
- 6.0% based upon tier 1 capital
- 8.0% based on total regulatory capital
- Leverage ratio of Tier 1 Capital assets equal to 4%

As of December 31, 2018 and 2017, management believes the Bank met all capital adequacy requirements to which they are subject. As of December 31, 2018, the most recent notification from the FDIC categorized the Bank as well capitalized under the regulatory framework for prompt corrective action. There are no conditions or events since the notification that management believes have changed the Bank's category.

The Bank's actual capital amounts and ratios are presented in the following table (dollars in thousands):

	Actual		For Capital Adequacy Purposes		To be Well Capitalized	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
December 31, 2018						
Common Equity Tier I Ratio	$ 28,255	12.3%	$ 10,371	4.5%	$ 14,980	6.5%
Tier I Capital to Risk Weighted Assets	28,255	12.3%	13,828	6.0%	18,437	8.0%
Total Risk Based Capital to Risk Weighted Assets	31,138	13.5%	18,436	8.0%	23,046	10.0%
Tier I Capital to Risk Average Assets	28,255	9.7%	11,679	4.0%	14,599	5.0%
December 31, 2017						
Common Equity Tier I Ratio	$ 26,056	13.0%	$ 9,019	4.5%	$ 13,028	6.5%
Tier I Capital to Risk Weighted Assets	26,056	13.0%	12,026	6.0%	16,034	8.0%
Total Risk Based Capital to Risk Weighted Assets	28,565	14.3%	16,036	8.0%	20,046	10.0%
Tier I Capital to Risk Average Assets	26,056	9.9%	10,485	4.0%	13,106	5.0%

Note 13 - Fair Value of Assets and Liabilities

The Company uses fair value measurements to record fair value adjustments to certain assets and to determine fair value disclosures. The fair value of a financial instrument is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. Fair value is best determined based upon quoted market prices. However, in many instances, there are no quoted market prices for the Company's various financial instruments. In cases where quoted market prices are not available, fair values are based on estimates using present value or other valuation techniques. These techniques are significantly affected by the assumptions used, including the discount rate and estimate of future cash flows. Accordingly, the fair value estimates may not be realized in an immediate settlement of the instrument.

Fair value accounting guidance provides a consistent definition of fair value, which focuses on exit price in an orderly transaction (that is, not a forced liquidation or distressed sale) between market participants at the measurement date under current market conditions. If there has been a significant decrease in the volume and level of activity for the asset, a change in valuation technique or the use of multiple valuation techniques may be appropriate. In such instances, determining the price at which willing market participants would transact at the measurement date under current market conditions depends on the facts and circumstances and requires the use of significant judgment. The fair value is a reasonable point within the range that is most representative of fair value under current market conditions.

In accordance with this guidance, the Company groups its financial assets and financial liabilities generally measured at fair value in three levels, based on the markets in which the assets are traded, and the reliability of the assumptions used to determine fair value.

Level 1: Valuation is based on quoted prices in active markets for identical assets and liabilities that the reporting entity has the ability to access at the measurement date. Level 1 assets and liabilities generally include debt and equity securities that are traded in an active exchange market. Valuations are obtained from readily available pricing sources for market transactions involving identical assets or liabilities.

Level 2: Valuation is based on inputs other than quoted prices included within level 1 that are observable for the asset or liability, either directly or indirectly. The valuation may be based on quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the asset or liability.

Level 3: Valuation is based on unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the asset or liability. Level 3 assets and liabilities include financial instruments whose value is determined by pricing models, discounted cash flow methodologies, or similar techniques, as well as instruments for which determination of fair value requires significant management judgment or estimation.

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

The following table sets forth assets measured at fair value on a recurring basis at December 31, 2018 and 2017:

		Fair Market Measurements Using		
	Total	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
December 31, 2018				
Securities available-for-sale				
SBA guaranteed loan pools	$ 1,844,315	$ -	$ 1,844,315	$ -
GSE residential mortgage-backed	18,724,863	-	18,724,863	-
Municipal bonds	2,116,591	-	2,116,591	-
	$ 22,685,769	$ -	$ 22,685,769	$ -
December 31, 2017				
Securities available-for-sale				
SBA guaranteed loan pools	$ 2,818,342	$ -	$ 2,818,342	$ -
GSE residential mortgage-backed	16,046,093	-	16,046,093	-
Municipal bonds	2,158,957	-	2,158,957	-
	$ 21,023,392	$ -	$ 21,023,392	$ -

Securities available-for-sale consist of U.S. government sponsored enterprises, municipal bonds, SBA guaranteed loan pools and GSE residential mortgage-backed securities. The fair value of all of the Company's securities available-for-sale are determined using Level 2 inputs, which are derived from readily available pricing sources and third-party pricing services of identical or comparable instruments.

Certain assets are measured at fair value on a nonrecurring basis; that is, the instruments are not measured at fair value on an ongoing basis, but are subject to fair value adjustments in certain circumstances (for example, when there is evidence of impairment). The following table presents such assets carried on the balance sheet by caption and by level within the fair value measurement hierarchy as of December 31, 2018 and 2017.

		Fair Market Measurements Using		
	Total	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
December 31, 2018				
Impaired loans with specific valuation allowance	$ 3,287,940	$ -	$ -	$ 3,287,940
Foreclosed real estate	$ 1,811,463	$ -	$ -	$ 1,811,463
December 31, 2017				
Impaired loans with specific valuation allowance	$ 2,834,308	$ -	$ -	$ 2,834,308
Foreclosed real estate	$ 2,026,951	$ -	$ -	$ 2,026,951

The specific reserves for collateral dependent impaired loans are based on the fair value of the collateral less estimated costs to sell. The fair value of collateral was determined based on appraisals. In some cases, adjustments were made to the appraised values due to various factors including age of the appraisal, age of comparables included in the appraisal, and known changes in the market and in the collateral. When significant adjustments were based on unobservable inputs, such as when a current appraised value is not available, or management determines the fair value of the collateral is further impaired below appraised value and there is no observable market price, the resulting fair value measurement has been categorized as a Level 3 measurement.

The fair value of the foreclosed real estate was determined based on appraisals with further adjustments made to the appraised values due to various factors, including the age of the appraisal, age of comparables included in the appraisal, and known changes in the market.

Under certain circumstances the Company may make adjustments to fair value for assets and liabilities although they are not measured at fair value on an ongoing basis. The Company only had Level 3 financial assets measured at fair value on a nonrecurring basis, which is summarized below:

	2018	2017	Valuation Technique(s)	Unobservable Inputs	Average
Impaired loans	$ 3,287,940	$ 2,834,308	Sales comparison approach	Adjustment for differences between the comparable sales of valuations	10%
Foreclosed real estate	$ 1,811,463	$ 2,026,951	Sales comparison approach	Adjustment for comparable sales differences and bank-owned discount	10%

The estimated fair values, and related carrying amounts of the Company's financial instruments are as follows:

	Carrying Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
December 31, 2018				
Financial assets				
Cash and cash equivalents	$ 24,742,232	$ 24,742,232	$ -	$ -
Interest bearing deposits in banks	17,224,063	17,224,063	-	-
Securities available-for-sale	22,685,769	-	22,685,769	-
Loans held-for-sale	330,658	-	-	330,658
Loans, net	214,763,263	-	-	214,068,161
Interest receivable	759,644	-	-	759,644
Financial liabilities				
Deposits	255,337,491	-	-	244,854,639
Federal funds purchased and repurchase agreements	3,881,694	-	-	3,881,694
Short and long-term borrowings	8,896,331	-	-	8,896,331
Interest payable	142,725	-	-	142,725

	Carrying Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
December 31, 2017				
Financial assets				
Cash and cash equivalents	$ 20,144,526	$ 20,144,526	$ -	$ -
Interest bearing deposits in banks	15,212,690	15,212,690	-	-
Securities available-for-sale	21,023,392	-	21,023,392	-
Loans held-for-sale	639,400	-	-	639,400
Loans, net	189,408,635	-	-	189,735,828
Interest receivable	591,607	-	-	591,607
Financial liabilities				
Deposits	226,977,857	-	-	218,582,177
Federal funds purchased and repurchase agreements	4,083,680	-	-	4,083,680
Short and long-term borrowings	4,679,179	-	-	4,679,179
Interest payable	101,697	-	-	101,697

Note 14 - Deferred Compensation Plans

401(k) Plans

On January 1, 2003, the Company established a 401(k) plan for all employees. Employer matching contributions are made at the discretion of the Company. The Company paid $79,863 and $63,075 in matching contributions during the years ended December 31, 2018 and 2017, respectively.

Salary Continuation Plan

On January 1, 2005, the Company entered into salary continuation agreements with certain key employees. Under the terms of these agreements, these key employees are entitled to receive benefits equal to 40% of the employee's final average compensation plus 2% from the previous year's benefit amount. This benefit shall be paid in equal monthly installments starting at retirement until death of the key employee. If, however, less than eleven annual payments have been made prior to the death of the key employee, then the Company shall continue such annual payments to the beneficiary of the key employee until the full number of eleven annual payments have been made. Accrued benefits due to these key employees are based on the present value (using a discount rate of 6.25%) of benefits and will be recognized as expense over the future years of service until retirement. At December 31, 2018 and 2017, the Company has accrued approximately $1,245,000 and $1,057,000, respectively, for these agreements. In addition, these key employees are provided certain rights upon termination of employment, disability, death, or change in control of the Company pursuant to the agreements.

In connection with these plans, the Company has purchased whole life insurance policies totaling $4,350,000 as a funding vehicle for the retirement plans. The Company owns the cash surrender value relating to these policies. The Company entered into split dollar arrangements in 2006, whereby the Company shares a portion of the death benefits with the beneficiaries of the key employees. Effective January 1, 2008, the Company adopted Emerging Issues Task Force ("EITF") issue No. 06-4, *Accounting for Deferred Compensation and Postretirement Benefit Aspects of Endorsement Split Dollar Life Insurance Arrangements (EITF 06-4)*. Under the provisions of this statement, a liability should be accrued equal to the actuarial present value of the future death benefit over the service period. At December 31, 2018 and 2017, the Company has accrued approximately $39,000 and $36,000 for these agreements, and has recorded a related expense of approximately $4,000 and $4,000 for the years ended December 31, 2018 and 2017, respectively.

Note 15 - Stock Option Plan

The Company has issued nonqualified stock options as outlined in their August 8, 2002 offering memorandum to organizers of the Company and employees of the Company. The options granted provide for the exercise price and term of each option to be determined by the Board at the date of grant, provided that no options have a term greater than 10 years and an option price not less than the fair value on the date of grant. All of the stock options available under the offering memorandum have been granted. On April 30, 2016, the Board of Directors approved the 2016 Stock Option Plan, which allowed for 150,878 shares available for grant. At December 31, 2018 and 2017, 119,887 and 355,187 options, respectively, are available to be granted pursuant to these plans.

Compensation cost charged to operations for the plan was $0 and $1,392 for the years ended December 31, 2018 and 2017, respectively.

The fair value of each option award is estimated on the date of grant using a Black-Scholes option-pricing model. The Company uses historical option exercise and termination data to estimate the expected term the options are expected to be outstanding. The risk-free rate is based on the U.S. Treasury yield curve in effect at the time of grant. The expected dividend yield is calculated using historical dividend amounts and the stock price at the option issue date.

	2018
Expected volatility	1%
Expected dividends	$ -
Expected term (in years)	4.12
Risk-free rate	1.82%
Fair value of stock option grant	$ 5.83

A summary of stock option activity during the year ended December 31, 2018 is as follows:

	Shares	Weighted-Average Exercise Price	Weighted-Average Remaining Contractual Life (in Years)
Options outstanding and expected to vest, December 31, 2017	279,266	$ 9.05	4.1
Options granted	248,500	9.35	4.5
Options exercised	-	-	-
Options forfeited	13,200	9.21	
December 31, 2018	514,566	$ 9.19	3.7
Options exercisable, December 31, 2018	259,466	$ 9.07	3.4
Options available to be granted, December 31, 2018	119,887		

All options are generally granted with vesting terms ranging from immediate to three years and expire five years after the date of grant.

As of December 31, 2018, there was total unrecognized compensation costs associated with the stock option grants of approximately $9,000.

Note 16 - Earnings per Share

The factors used in the earnings per share computation are as follow as of December 31:

	2018	2017
Basic		
Net income	$ 2,491,031	$ 2,950,878
Weighted-average common shares outstanding	4,125,182	3,937,654
Basic earnings per common share	$ 0.60	$ 0.75
Diluted		
Net income	$ 2,491,031	$ 2,950,878
Weighted-average common shares outstanding for basic earnings per common share	4,125,182	3,937,654
Add: Dilutive effects of assumed exercises of stock options	33,000	33,000
Average shares and dilutive potential common shares	4,158,182	3,970,654
Diluted earnings per common share	$ 0.60	$ 0.74

Stock options for 481,566 and 246,266 shares of common stock were not considered in computing diluted earnings per common share for 2018 and 2017, respectively, because they were antidilutive.