TriCity Bankshares Corporation

2017 Annual Report • Proxy • Financial Statements

The Tri City Story

Our founder, David A. Ulrich, was a small business owner (in addition to working a full-time manufacturing job) when his bank declined him for a small business loan. It became his mission to start a bank that cared about all customers, not just the large ones.

It took eight years to raise the capital to start Tri City National Bank in October of 1963. We are now located in four counties and have over 30 locations in Southeastern Wisconsin. Our mission is to be the community bank that defines our success by yours. In order to live this out each and every day, we value our employees, customers, and our community. We work hard to serve those who believed in us from the start and continue to support us today.

Strong past

TRI CITY
NATIONAL
BANK

Bright future

TriCity
National
Bank

We're proud to share our refreshed logo and brand, which will begin to rollout in 2018. It pays homage to our past, with the inward and outward arrows representing the flow of money through the bank. The inward facing arrows represent deposits from our customers – checking, savings and investment deposits. These make the outward arrows possible, which represent money flowing out of the bank in the form of loans – business loans, mortgage loans and consumers loans, as well as donations we make to the communities we serve. Taken as a whole, the logo represents Tri City National Bank's commitment to its hometown communities, lending money for business growth and consumer dreams, and helping customers reach their financial goals. The new colors symbolize our bright future after 55 years as your hometown bank.

Dear Shareholders,

It seems just like yesterday I was looking back at our performance of 2016 and composing my very first annual shareholder letter... how time flies when we are having fun! During 2017, the stock market hit record highs, the Federal Reserve Bank raised the fed funds rate three times after eight years of flat interest rates and we finished the year with passage of The Tax Cuts and Job Act. Unfortunately, the decision to sign this act into law on December 22, 2017 required us to re-evaluate our deferred tax assets and liabilities for year-end 2017 given the lower federal corporate tax rate beginning in 2018. As a result, 2017 income tax expense included a one-time expense of $1.5 million. Excluding this one-time expense, net income would have been $12.2 million, an increase of 13.5% compared to 2016.

We also faced market loan yields continuing to decrease during 2017 as competing banks raced to book new loans at any cost during the raising-rate environment. We chose not to follow that trend and continued with our conservative lending standards and were still able to grow the portfolio $26 million with an additional $42 million in undrawn construction loans that should disburse in 2018. Despite that growth, net interest margin was squeezed as we renewed and repriced existing loans. To compensate, we revamped our fee structure to add significant income to help offset the lower loan yields.

Over the past year we invested in our IT department with additional staff and long overdue hardware and software upgrades. Also, I'm proud to report we now have an in-house marketing department, a vital department we were without for decades. Both of these additions will serve us well in our future.

This summer we will open a new bank in the City of Waukesha, our first full-service branch in over a decade. This new location is projected to have one of the highest volume traffic counts in the area. As with any of our branch locations, "staffing, staffing, staffing" is equally as important as "location, location, location." Along with our existing six locations in Waukesha County, the new branch will better serve existing and new customers.

In addition, our branch located in the Village of Sturtevant, Racine County is the closest bank to the new Foxconn advanced manufacturing campus, the projected $10 billion facility will employee 13,000 new workers. We are positioned to take advantage of what may be the greatest opportunity for a generation in Southeastern Wisconsin. Our marketing department and lending staff are all diligently making plans to capitalize on the projected $51.5 billion this development could add to Wisconsin's economy.

Regardless of the talk of reducing regulated capital ratios in Washington, your bank will continue to grow its capital in line with our historically high ratios, that have and will protect us from the inevitable economic downturns. While maintaining our traditional high capital levels, I plan to simultaneously improve efficiency ratios and increase our return on assets ratio. That is a goal that few other banks could only dream of doing in this era. I like to refer to it as "polishing our jewel." Thank you Dave.

As we look forward to 2018 and beyond, I am confident that your bank can weather any storm and prosper. We should all be proud of the strong foundation that our dedicated bank officers, employees and directors worked so hard to accomplish. I appreciate your support and continued investment. Thank you all.

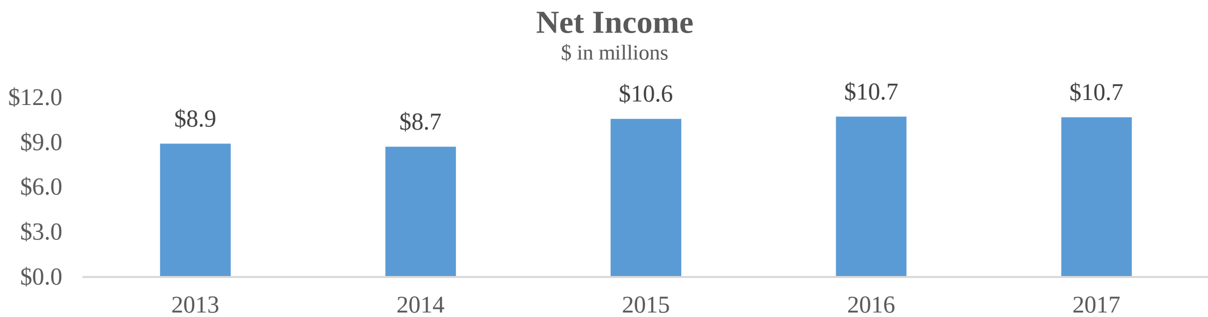
Sincerely,

Brian T. McGarry

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

2017 Financial Highlights

The Corporation posted net income of $10.7 million for both 2016 and 2017, which resulted in earnings per share of $1.20 for both years. Pre-tax earnings increased $2.0 million in 2017 compared to 2016 primarily due to an increase in interest income and a decrease in the provision for loan losses as asset quality continued to improve. This was partially offset by an increase in noninterest expense as management continued to make significant investments in both employees and technology. In addition, on December 22, 2017 the Tax Cuts and Jobs Act was signed into law, requiring us to re-evaluate our deferred tax assets and liabilities for year-end 2017 given the lower federal corporate income tax rate beginning in 2018. As a result, 2017 income tax expense included a one-time expense of $1.5 million. Not including this one-time expense, net income would have been $12.2 million and earnings per share would have been $1.37. The Corporation paid dividends of $0.48 per share in both 2016 and 2017.



Income Statement

Net interest income was $45.5 million during 2017, an increase of $2.7 million or 6.3% over the prior year. The increase was due to a $1.7 million increase in interest income on loans and a $1.3 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 2017. As a result, our interest income on earning assets increased to 3.57% in 2017 compared to 3.49% in 2016. The Bank's primary competitive advantage is that our entire funding base is made up of core deposits. As a result, our cost of funds remained remarkably low at 0.12% in 2017. Net interest margin was 3.45% in 2017 compared to 3.39% in 2016.

The Bank remains asset sensitive, meaning that if interest rates rise we would expect our net interest margin to increase resulting in additional net interest income. We fully expect our interest income on earning assets to increase in a rising rate environment, however the key to increased profitability will be controlling the Bank's cost of funds.

The provision for loan losses decreased $0.9 million to $0.0 during 2017 due to continued improvement in asset quality discussed in detail below.

Core noninterest income during 2017 was $15.3 million, an increase of $0.2 million or 1.1% from the prior year. The increase was due to an increase in service charges on deposits, which was offset by both a decrease in the loans sold into the secondary mortgage markets and a decrease in acquisition-related purchase accounting income. As a result, core noninterest income to total assets was 1.08% in 2017 compared to 1.06% in 2016.

Noninterest expense was $42.7 million in 2017, an increase $1.7 million or 4.1% compared to 2016. The increase was primarily due to an increase in salary and benefits, furniture and equipment expenses, and professional fees. The increase in salary and benefits was due to a full year of increased staffing in human resources and compliance as well as an increase in hourly wages. The increase in furniture and equipment expense was due to continued investment in technology infrastructure. The increase in professional fees was primarily due to the outsourcing of several projects in 2017. Noninterest expense to total assets increased to 3.02% in 2017 from 2.87% in 2016 due to the increase in noninterest expense. Management will continue to invest in both employees and technology during 2018 to ensure the long-term success of the Bank.

Operating earnings were supplemented by acquisition-related purchase accounting income of $1.0 million in 2017 compared to $1.9 million in 2016. While there is $8.9 million in purchase loan discount remaining on the acquired loan portfolio as of December 31, 2017, 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 $7.5 million in 2017 compared to $5.4 million in 2016. Income tax expense included a one-time expense of $1.5 million due to the Tax Cuts and Jobs Act, which resulted in a write-down of our deferred tax assets.

Balance Sheet

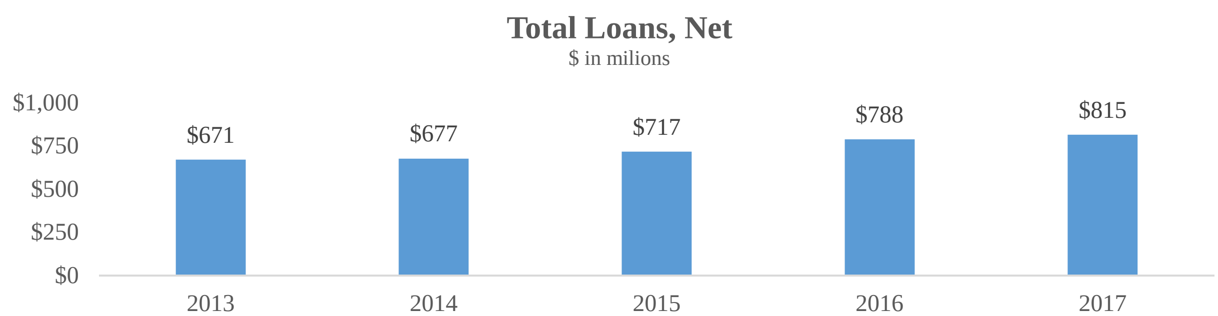
Total assets were $1.4 billion as of December 31, 2017, a decrease $12.6 million or 0.9% compared to December 31, 2016.

Cash and due from banks was $84.0 million as of December 31, 2017 compared to $128.6 million as of December 31, 2016. The decrease was primarily due to an increase in loans and a decrease in deposits. Included in the cash and due from banks is $33.5 million invested at the Federal Reserve. The yield on those funds continued to increase as the Federal Reserve raised short-term interest rates. In addition, this liquidity will fund additional loan growth as well as help us manage our cost of funds on deposits as we anticipate that interest rates will continue to rise in 2018.

The investment portfolio was $444.5 million as of December 31, 2017 compared to $440.8 million as of December 31, 2016. The investment portfolio is made up of 49.91% collateralized mortgage obligations (“CMO”), 38.46% mortgage backed securities (“MBS”) and 11.63% in municipal bonds. The CMO and MBS investments provide the Bank with relatively stable cash flows over time that can be reinvested in either loans or investment securities enhancing our interest income in a rising rate environment or provide us with additional liquidity to manage our cost of funds. Total loans, net of the allowance for loan losses, increased $26.7 million or 3.4% to $815.1 million and represents the highest level of loans in our history. The increase does not include an additional $42.0 million of construction loans approved in 2017 that were still unfunded as of December 31,

2017. While our renewed focus on loan growth over the last four years has been successful, we continue to lag our peers in loan growth due to competitive pricing pressure and our continued 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 interest rates poised to rise, there has been significant pressure in the market to make longer term fixed-rate loans. Despite this market pressure, we are confident the loan portfolio is positioned to reprice higher as interest rates rise resulting in increased interest income.



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 portion of the portfolio due to evolving demographics as millennials are delaying single-family home ownership relative to previous generations.

Loan Portfolio Composition

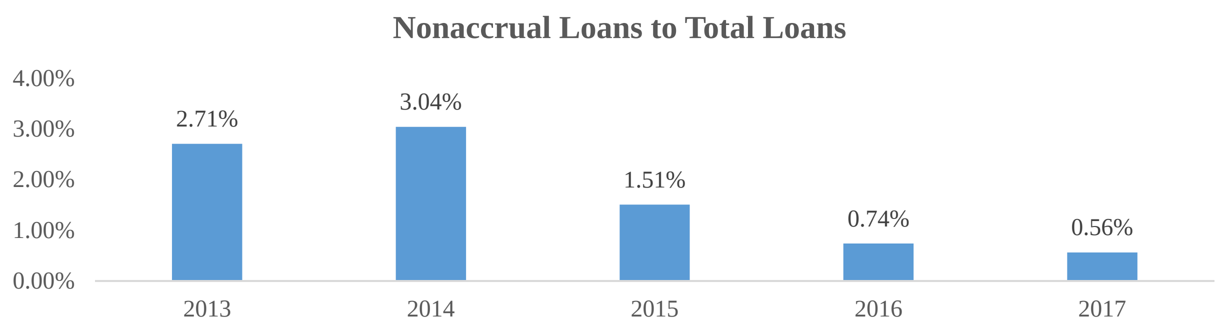
$ in thousands

	December 31, 2016		December 31, 2017	
	Loan Balance	Percent of Total Loans	Loan Balance	Percent of Total Loans
Commercial & Industrial	$48,417	6.05%	$43,444	5.26%
Real Estate:				
Commercial	439,356	54.95%	458,376	55.50%
Residential	201,148	25.16%	193,555	23.44%
Multifamily	56,641	7.08%	76,952	9.32%
Construction	46,540	5.82%	46,214	5.60%
Installment & Other	7,526	0.94%	7,301	0.88%
Total	$799,628	100.00%	$825,842	100.00%

The decline in liquidity during 2017 was partially due to a decrease in core deposits of $17.8 million or 1.38%. As interest rates continued to rise throughout 2017, we saw a modest decline in both money market accounts and certificates of deposit. This was offset by an increase in demand deposits due to continued loan growth. If interest rates continue to rise as expected, management is prepared with several strategies that are designed to maintain enough liquidity for continued loan growth while proactively managing our cost of funds.

Asset Quality

All of our asset quality measures continued to improve since we acquired the failed bank from the FDIC in 2009. Nonaccrual loans to total loans decreased to 0.56% in 2017 from 0.74% in 2016. Charge-offs net of recoveries to total loans also decreased to 0.06% in 2017 compared to 0.15% in 2016. The allowance for loan losses to total loans remained strong at 1.30% as of December 31, 2017 compared to 1.41% as of December 31, 2016. In addition, we only had one property totaling $122,670 in other real estate owned at the end of 2017.



Capital

Total stockholders' equity at December 31, 2017 increased $5.7 million to $143.9 million compared to $138.2 million at December 31, 2016. The increase in stockholders' equity during 2017 was due to increase of $6.9 million in retained earnings and a decrease in accumulated other comprehensive income of $1.2 million. Book value per share was $16.16 at December 31, 2017 compared with $15.52 December 31, 2016.

The Corporation's capital levels exceed all of our regulatory requirements. We are in full compliance with the BASEL III rules that became effective for the Corporation on January 1, 2015. The BASEL III requirements are being phased in over a multi-year schedule and will be fully phased in by January 1, 2019.

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

Tri City Bankshares Corporation
Selected Financial Data

	For the Year Ended December 31,				
	2013	2014	2015	2016	2017
Results of Operations					
Interest income	$ 40,260,922	$ 41,031,315	$ 40,830,614	$ 44,091,245	$ 47,094,056
Interest expense	1,914,793	1,285,720	1,146,131	1,241,042	1,562,534
Net interest income	38,346,129	39,745,595	39,684,483	42,850,203	45,531,522
Provision for loan losses ("PLL")	6,482,000	3,000,000	3,000,000	900,000	-
Net interest income after PLL	31,864,129	36,745,595	36,684,483	41,950,203	45,531,522
Core noninterest income	17,332,360	13,854,562	15,851,292	15,149,208	15,322,514
One-time income	2,152,957	1,001,628	3,167,791	-	-
Noninterest expense	37,993,007	39,122,018	39,802,394	40,988,691	42,668,461
Income before income taxes	13,356,439	12,479,767	15,901,172	16,110,720	18,185,575
Deferred tax adjustment	-	-	-	-	1,500,190
Income taxes	4,443,584	3,768,500	5,332,852	5,382,714	6,005,916
Net income	$ 8,912,855	$ 8,711,267	$ 10,568,320	$ 10,728,006	$ 10,679,469
Balance Sheet Data					
Total assets	$ 1,180,647,180	$ 1,251,880,603	$ 1,332,293,272	$ 1,427,301,200	$ 1,414,721,950
Securities	331,176,998	357,659,154	446,840,309	440,788,027	444,488,998
Total loans, net	670,639,122	676,541,152	717,106,439	788,371,693	815,109,422
Deposits	1,058,775,995	1,120,507,223	1,195,119,232	1,284,805,692	1,267,051,615
Borrowings	-	-	-	-	-
Total stockholders' equity	118,215,584	127,836,562	133,771,359	138,186,448	143,865,498
Loan to deposits	63.34%	60.38%	60.00%	61.36%	64.33%
Asset Quality Ratios					
Nonaccrual loans to total loans	2.71%	3.04%	1.51%	0.74%	0.56%
Past due loan >30 days to total loans	3.49%	3.07%	1.31%	1.01%	0.80%
Net charge-offs to total loans	0.92%	0.47%	0.48%	0.15%	0.06%
Other real estate owned to total assets	0.48%	0.38%	0.24%	0.03%	0.01%
Allowance for loan losses to total loans	1.81%	1.76%	1.59%	1.41%	1.30%
Capital Ratios					
Total equity to total assets	10.01%	10.21%	10.04%	9.68%	10.17%
Leverage capital ratio	9.98%	10.39%	10.28%	10.06%	10.50%
Tier 1 risk based capital ratio	15.93%	16.70%	16.64%	15.99%	15.97%
Total risk based capital ratio	17.18%	17.95%	17.89%	17.24%	17.21%
Per Share Data					
Earnings per share	$ 1.00	$ 0.98	$ 1.19	$ 1.20	$ 1.20
Cash dividend declared	$ -	$ -	$ 0.48	$ 0.48	$ 0.48
Book value per share	$ 13.28	$ 14.36	$ 15.02	$ 15.52	$ 16.16
Shares outstanding	8,904,915	8,904,915	8,904,915	8,904,915	8,904,915
Performance Ratios					
Return on assets	0.75%	0.70%	0.79%	0.75%	0.75%
Return on equity	7.54%	6.81%	7.90%	7.76%	7.42%
Interest on earning assets	3.65%	3.67%	3.48%	3.49%	3.57%
Cost of funds	0.17%	0.12%	0.10%	0.10%	0.12%
Net interest margin	3.48%	3.55%	3.38%	3.39%	3.45%
Core noninterest income to assets	1.47%	1.11%	1.19%	1.06%	1.08%
Noninterest expense to assets	3.22%	3.13%	2.99%	2.87%	3.02%

BAKER TILLY

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 its subsidiaries, which comprise the consolidated balance sheets as of December 31, 2017 and 2016, 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 Tri City Bankshares Corporation and its subsidiaries as of December 31, 2017 and 2016, 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, Tri City Bankshares Corporation and its subsidiaries internal control over financial reporting as of December 31, 2017, based on criteria established in *Internal Control-Integrated Framework (2013)*, issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) and our report dated March 7, 2018 expressed an unqualified opinion.

Baker Tilly Virchow Krause, LLP

Milwaukee, Wisconsin
March 7, 2018

TRI CITY BANKSHARES CORPORATION

CONSOLIDATED BALANCE SHEETS

As of December 31, 2017 and 2016

ASSETS

		2017		2016
Cash and due from banks	$	84,043,266	$	128,622,650
Federal funds sold		2,414,518		2,464,348
Total Cash and Cash Equivalents		86,457,784		131,086,998
Securities available for sale, at fair value		444,488,998		440,788,027
Loans, less allowance for loan losses of $10,732,652 and $11,256,774 as of 2017 and 2016, respectively		815,109,422		788,371,693
Premises and equipment - net		14,863,076		15,469,273
Bank owned life insurance		38,301,624		37,256,129
Mortgage servicing rights - net		1,455,810		1,602,769
Core deposit intangible		-		63,272
Other real estate owned - net		122,670		469,350
Accrued interest receivable and other assets		13,922,566		12,193,689
TOTAL ASSETS	$	1,414,721,950	$	1,427,301,200

LIABILITIES AND STOCKHOLDERS' EQUITY

		2017		2016
LIABILITIES				
Deposits				
Demand	$	293,775,453	$	267,485,080
Savings and NOW		886,571,718		922,714,221
Other time		86,704,444		94,606,391
Total Deposits		1,267,051,615		1,284,805,692
Accrued interest payable and other liabilities		3,804,837		4,309,060
Total Liabilities		1,270,856,452		1,289,114,752
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 2017 and 2016		8,904,915		8,904,915
Additional paid-in-capital		26,543,470		26,543,470
Accumulated other comprehensive (loss)		(2,790,043)		(1,569,545)
Retained earnings		111,207,156		104,307,608
Total Stockholders' Equity		143,865,498		138,186,448
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	$	1,414,721,950	$	1,427,301,200

See accompanying notes to consolidated financial statements.

TRI CITY BANKSHARES CORPORATION

CONSOLIDATED STATEMENTS OF INCOME

For the Years Ended December 31, 2017 and 2016

	2017	2016
INTEREST INCOME		
Loans	$ 36,977,923	$ 35,236,889
Investment securities		
Taxable	8,360,243	7,441,289
Tax exempt	990,432	1,037,756
Federal funds sold and due from banks	746,132	355,985
Other	19,326	19,326
Total Interest Income	47,094,056	44,091,245
INTEREST EXPENSE		
Deposits	1,562,397	1,240,941
Other borrowings	137	101
Total Interest Expense	1,562,534	1,241,042
Net Interest Income before Provision for Loan Losses	45,531,522	42,850,203
Provision for loan losses	-	900,000
Net Interest Income after Provision for Loan Losses	45,531,522	41,950,203
NONINTEREST INCOME		
Service charges on deposits	10,717,443	9,818,172
Loan servicing income	295,340	378,748
Net gain on sale of loans	592,511	905,554
Increase in bank owned life insurance	1,045,495	1,099,682
Non-accretable loan discount	329,920	769,702
Gain on sale of other real estate owned	49,960	181,537
Other income	2,291,845	1,995,813
Total Noninterest Income	15,322,514	15,149,208
NONINTEREST EXPENSES		
Salaries and employee benefits	23,992,590	23,276,276
Net occupancy costs	3,695,212	3,651,284
Furniture and equipment expenses	2,123,209	1,625,177
Data processing expense	4,412,296	4,240,365
Professional fees	1,453,794	1,046,573
Telecommunications expense	745,514	762,572
Advertising and promotional	771,054	783,874
FDIC and other regulatory assessments	762,946	906,321
Operation of other real estate owned	70,557	347,385
Office supplies	917,017	871,281
Postage	628,880	629,586
Other expense	3,095,392	2,847,997
Total Noninterest Expense	42,668,461	40,988,691
Total Income before Taxes	18,185,575	16,110,720
Less: Income tax expense	7,506,106	5,382,714
NET INCOME	$ 10,679,469	$ 10,728,006
Basic earnings per share	$ 1.20	$ 1.20
Dividends per share	$ 0.48	$ 0.48

See accompanying notes to consolidated financial statements.

TRI CITY BANKSHARES CORPORATION

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

For the Years Ended December 31, 2017 and 2016

	2017	2016
NET INCOME	$ 10,679,469	$ 10,728,006
Other comprehensive (loss) income, net of tax:		
Securities available for sale:		
Net changes in unrealized (losses)		
on securities available for sale	(1,212,829)	(3,405,251)
Tax effect	486,769	1,366,693
Total Other Comprehensive (Loss), net of tax:	(726,060)	(2,038,558)
COMPREHENSIVE INCOME	$ 9,953,409	$ 8,689,448

See accompanying notes to consolidated financial statements.

TRI CITY BANKSHARES CORPORATION

CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY

For the Years Ended December 31, 2017 and 2016

	Common Stock	Additional Paid-in Capital	Accumulated Other Comprehensive Income (Loss)	Retained Earnings	Total
BALANCES - January 1, 2016	$ 8,904,915	$ 26,543,470	$ 469,013	$ 97,853,961	$ 133,771,359
Net income	-	-	-	10,728,006	10,728,006
Net changes in unrealized (loss) on securities available for sale	-	-	(3,405,251)	-	(3,405,251)
Tax effect	-	-	1,366,693	-	1,366,693
Total Comprehensive Income					8,689,448
Cash dividends - ($0.48 per share)	-	-	-	(4,274,359)	(4,274,359)
BALANCES - December 31, 2016	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

See accompanying notes to consolidated financial statements

TRI CITY BANKSHARES CORPORATION

CONSOLIDATED STATEMENTS OF CASH FLOWS

For the Years Ended December 31, 2017 and 2016

	2017	2016
CASH FLOWS FROM OPERATING ACTIVITIES		
Net Income	$ 10,679,469	$ 10,728,006
Adjustments to reconcile net income to net cash flows from operating activities:		
Depreciation	1,638,018	1,615,436
Amortization and (accretion) of servicing rights, premiums and discounts	3,046,396	2,994,109
Net gain on sale of loans	(592,511)	(905,554)
Core deposit intangible amortization	63,272	98,275
Provision for loan losses	-	900,000
Benefit for deferred income taxes	1,774,319	11,428
Proceeds from sales of loans held for sale	24,486,095	36,883,547
Originations of loans held for sale	(24,065,284)	(36,244,902)
Increase in cash surrender value of life insurance	(1,045,495)	(1,099,682)
Gain on sale of other real estate owned	(49,960)	(181,537)
Net change in fair value of other real estate owned	2,330	18,900
Net change in fair value of mortgage servicing rights	98,943	-
(Gain) loss on disposal of premises and equipment	(1,022)	5,459
Net change in:		
Accrued interest receivable and other assets	(1,728,877)	(2,762,916)
Accrued interest payable and other liabilities	(1,791,773)	2,261,644
Net cash flows from operating activities	12,513,920	14,322,213
CASH FLOWS FROM INVESTING ACTIVITIES		
Activity in available for sale securities:		
Maturities, prepayments and calls	80,641,670	113,712,278
Purchases	(89,352,469)	(115,756,452)
Net increase in loans	(26,111,100)	(71,196,392)
Purchase of premises and equipment	(1,081,497)	(1,843,549)
Proceeds from sale of other real estate owned	738,000	3,864,900
Proceeds from sales of premises and equipment	50,698	46,843
Net cash used in investing activities	(35,114,698)	(71,172,372)
CASH FLOWS FROM FINANCING ACTIVITIES		
Net (decrease) increase in deposits	(17,754,077)	89,686,460
Dividends paid	(4,274,359)	(4,274,359)
Net cash flows (used in) from financing activities	(22,028,436)	85,412,101
Net change in cash and cash equivalents	(44,629,214)	28,561,942
CASH AND CASH EQUIVALENTS - BEGINNING OF YEAR	131,086,998	102,525,056
CASH AND CASH EQUIVALENTS - END OF YEAR	$ 86,457,784	$ 131,086,998

See accompanying notes to consolidated financial statements

TRI CITY BANKSHARES CORPORATION

CONSOLIDATED STATEMENTS OF CASH FLOWS

For the Years Ended December 31, 2017 and 2016

(continued)

	2017	2016
SUPPLEMENTAL CASH FLOW DISCLOSURES		
Cash paid for interest	$ 1,555,893	$ 1,234,266
Cash paid for income taxes	6,550,000	3,840,000
SUPPLEMENTAL CASH FLOW DISCLOSURES		
Loans receivable transferred to other real estate owned	$ 343,690	$ 980,710
Mortgage servicing rights resulting from sales of loans	171,700	266,909

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"). 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 and TCNB Aurora Investment Fund LLC, subsidiaries to facilitate tax credit investments. 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. All significant intercompany accounts and transactions have been eliminated in the consolidated financial statements. The Corporation has evaluated the consolidated financial statements for subsequent events through the report issue date.

The consolidated income of the Corporation is principally from the income of the Bank. The Bank grants commercial, real estate and installment loans and accepts deposits primarily in Southeastern Wisconsin. The Corporation and the Bank are subject to competition from other financial institutions and nonfinancial institutions providing financial products. Additionally, the Corporation and the Bank are 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, valuation of other real estate owned, 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 Bank maintained amounts due from banks that exceeded federally insured limits as of December 31, 2017. The Bank has not experienced any losses in such accounts.

Securities

Securities are classified as available for sale when the Bank 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 income (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 Bank grants a concession to that borrower that the Bank 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 Bank’s policy is to promptly charge these loans off in the period the uncollectible loss amount is reasonably determined. The Bank 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 Bank 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 Bank 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 Bank'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 Bank’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 Bank’s carrying value of the loan, no loss is anticipated and no specific reserve is established. However, if the Bank’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 Bank'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 Bank, (2) the transferee obtains the right (free of conditions that constrain it from taking advantage of that right) to pledge or exchange the transferred assets, and (3) the Bank does not maintain effective control over the transferred assets through an agreement to repurchase them before their maturity.

Mortgage Servicing Rights

The Bank records a mortgage servicing right (“MSR”) asset when it continues to service borrower payments and perform maintenance activities on loans in which the loan has been sold to secondary market investors. The servicing rights are initially capitalized at 75 basis points on an individual loan level basis. 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. Amortization of MSRs is calculated based on actual payment activity on a per loan basis and is included in loan servicing income on the consolidated statements of income.

Quarterly impairment testing is performed by the Bank to determine if an impairment on the MSRs exits. Quarterly the Bank engages a third party specialist to calculate the fair value using significant inputs/assumptions such as prepayment speed, default rates, cost to service and discount rates. A valuation allowance is recorded when the fair value of the MSRs is less than its amortized cost. Changes in the valuation allowance are recorded as loan servicing income on the consolidated statements of income.

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

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 Bank ultimately recovers on repossessed assets may differ substantially from the net carrying value of these assets because of future market factors beyond the Bank'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.

Intangible Assets

The Bank's intangible assets include the value of ongoing customer relationships (core deposit intangible) arising from the purchase of certain assets and the assumption of certain liabilities from unrelated entities. Core deposit intangibles are amortized over an eight year period. Any impairment in the intangibles would be recorded against income in the period of impairment. No impairment was recorded during the years ended December 31, 2017 and 2016.

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. The Corporation generates its returns on tax credit motivated projects through the receipt of federal tax credits. The federal tax credits are recorded as an offset to the income tax provision in the year that they are earned under federal income tax law – over 7 years for Federal NMTC upon the investment of funds into the qualifying project. These credits, if not used in the tax return for the year of origination, can be carried forward for 20 years.

The Corporation invested in one tax credit during each of the years ended December 31, 2017 and 2016, totaling $3.0 million and $2.4 million, respectively. As of December 31, 2017 and 2016 the Corporation had total tax credits of $4.4 million and $2.0 million, respectively.

Federal Reserve Bank Stock

The Bank'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 Bank 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.

Derivative Financial Instruments

The Bank utilizes derivative financial instruments to meet the ongoing credit needs of its customers and in order to manage the market exposure of its residential loans held for sale and its commitments to extend credit for residential loans. Derivative financial instruments include commitments to extend credit. The Bank does not use interest rate contracts (e.g. swaps, caps, floors) or other derivatives to manage interest rate risk and has none of these instruments outstanding at December 31, 2017 or 2016.

Advertising Costs

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

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

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, 2017 and 2016.

Segment Reporting

The Corporation has determined that it has one reportable segment - community banking. The Bank 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 Bank has established a defined contribution 401(k) profit-sharing plan for qualified employees. The Bank's policy is to fund contributions as accrued.

Bank Owned Life Insurance

The Bank has purchased life insurance policies on certain key employees. Bank owned life insurance is recorded at the amount that can be realized under the insurance contract at the balance sheet date, which is net cash surrender value. Appreciation in value of the insurance policies is classified as noninterest income.

Reclassifications

Certain 2017 and 2016 amounts have been reclassified to conform to the 2017 presentation. The reclassifications have no effect on previously reported consolidated net income, basic earnings per share, and consolidated stockholders' equity.

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

Recent Accounting Pronouncements

The Financial Accounting Standards Board (“FASB”) issues Accounting Standards Updates (“ASU”s) to the FASB Accounting Standards Codification (“ASC”). This section provides a summary description of recent ASUs that management expects may have an impact on the consolidated financial statements issued in the near future.

In May 2014, FASB issued ASU No. 2014-09, *Revenue from Contracts with Customers*. This ASU establishes a comprehensive revenue recognition standard for virtually all industries following U.S. GAAP, including those that previously followed industry-specific guidance such as the real estate and construction industries. The revenue standard’s core principal is built on the contract between a vendor and a customer for the provision of goods and services. It attempts to depict the exchange of rights and obligations between the parties in the pattern of revenue recognition based on the consideration to which the vendor is entitled. To accomplish this, the standard requires five basic steps: (i) identify the contract with the customer, (ii) identify the performance obligations in the contract, (iii) identify the transaction price, (iv) allocate the transaction price to the performance obligations in the contract, and (v) recognize revenue when (or as) the entity satisfies the performance obligation. Three basic transition methods are available - full retrospective, retrospective with certain practical expedients, and a cumulative effect approach. Under the cumulative effect alternative, an entity would apply the new revenue standard only to contracts that are incomplete under legacy U.S. GAAP at the date of initial application and recognize the cumulative effect of the new standard as an adjustment to the opening balance of retained earnings. In August 2015, the FASB issued ASU No. 2015-14, Revenue from Contracts with Customers: Deferral of the Effective Date. The guidance in this ASU is now effective for annual reporting periods beginning after December 15, 2017. All entities may apply the guidance as early as reporting periods beginning after December 15, 2016. In March 2016, the FASB issued ASU No. 2016-08, Revenue from Contracts with Customers: Principal versus Agent Considerations (Reporting Revenue Gross versus Net). While the ASU does not change the core provisions of Topic 606, it clarifies the implementation guidance on principal versus agent considerations. Namely, the ASU clarifies and offers guidance to help determine when the reporting entity is providing goods or services to a customer itself (i.e., the entity is a principal), or merely arranging for that good or service to be provided by the other party (i.e., the reporting entity is an agent). If the entity is a principal, it recognizes revenue in the gross amount of consideration to which it expects to be entitled in exchange for the specified good or service transferred to the customer. When the reporting entity is an agent, it recognizes revenue in the amount of any fee or commission to which it expects to be entitled in exchange for arranging for the specified good or service to be provided by the other party. An entity is a principal if it controls the specified good or service before that good or service is transferred to a customer. The guidance includes indicators to assist in determining whether the control criteria are met. If a contract with a customer includes more than one specified good or service, an entity could be a principal for some specified goods or services and an agent for others. In April 2016, the FASB issued ASU No. 2016-10, Revenue from Contracts with Customers: Identifying Performance Obligations and Licensing.

This ASU clarifies guidance related to identifying performance obligations and licensing implementation guidance contained in the new revenue recognition standard. The ASU includes targeted improvements based on input the FASB received from the Transition Resource Group for Revenue Recognition and other stakeholders. The ASU seeks to proactively address areas in which diversity in practice potentially could arise, as well as to reduce the cost and complexity of applying certain aspects of the guidance both at implementation and on an ongoing basis. The amendments in this ASU affect the guidance in ASU 2014-09, Revenue from Contracts with Customers, which will be effective for fiscal years beginning after December 31, 2017. In May 2016, the FASB issued ASU No. 2016-12, Revenue from Contracts with Customers: Narrow-Scope Improvements and Practical Expedients. This ASU clarifies certain aspects of Topic 606 guidance as follows:

•The objective of the collectability assessment is to determine whether the contract is valid and represents a substantive transaction on the basis of whether a customer has the ability and intention to pay the promised consideration in exchange for the goods or services transferred.

•An entity can recognize revenue in the amount of consideration received when it has transferred control of the goods or services, has no additional obligation to transfer goods or services, and the consideration received is nonrefundable.

•A reporting entity is permitted to make the accounting policy election to exclude amounts collected from customers for all sales taxes from the transaction price.

•The measurement date is specified as being the contract inception, and variable consideration guidance applies only to variability resulting from reasons other than the form of the consideration.

•As a practical expedient, a reporting entity is permitted to reflect the aggregate effect of all modifications that occur before the beginning of the earliest period presented in accordance with Topic 606 when identifying the satisfied and unsatisfied performance obligations, determining the transaction price, and allocating the transaction price to the satisfied and unsatisfied performance obligations.

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

Recent Accounting Pronouncements (continued)

•The ASU clarifies that a completed contract for purposes of transition is a contract for which all (or substantially all) of the revenue was recognized under legacy U.S. GAAP before the date of initial application. Accounting for elements of a contract that do not affect revenue under legacy U.S. GAAP are irrelevant to the assessment of whether a contract is complete. In addition, the amendments in this ASU permit an entity to apply the modified retrospective transition method either to all contracts or only to contracts that are not completed contracts.

The amendments in this ASU clarify that an entity that retrospectively applies the guidance in Topic 606 to each prior reporting period is not required to disclose the effect of the accounting change for the period of adoption. However, an entity is still required to disclose the effect of the changes on any prior periods retrospectively adjusted.

The guidance in the revenue recognition ASUs listed above is effective for annual reporting periods beginning after December 15, 2017, including interim reporting periods within that reporting period. The Bank is currently evaluating the impact of the various revenue recognition ASUs. The guidance does not apply to revenue associated with financial instruments, including loans and securities. The Bank is currently evaluating its non-interest revenue sources and does not anticipate the adoption of these ASUs to have a material impact on its consolidated operations, financial position and cash flows.

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.

The amendments are effective for fiscal years beginning after December 15, 2017. The new guidance permits early adoption of the own credit provision. In addition, the new guidance permits early adoption of the provision that exempts private companies and not-for-profit organizations from having to disclose fair value information about financial instruments measured at amortized cost. The Bank does not expect the adoption of the new standard to have a material impact on the consolidated operations, financial position and cash flows of the Bank.

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 lessee's 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 amendments are effective for fiscal years beginning after December 15, 2018. Early adoption is permitted. The Bank's leases are operating leases and ASU 2016-02 will require us to add them to our consolidated balance sheet. The Bank's operating leases are predominantly related to real estate. Management is currently evaluating other impacts this guidance will have on the consolidated operations, financial position and cash flows of the Bank.

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

Recent Accounting Pronouncements (continued)

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 (CECL) 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 Update is effective for fiscal years beginning after December 15, 2020, and interim periods within those fiscal years. 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 Bank.

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 amendments are effective for fiscal years beginning after December 15, 2018, and interim periods within those years. Early adoption is permitted. Management is currently evaluating the adoption of the new standard on the consolidated operations, financial position and cash flows of the Bank.

The Tax Cuts and Jobs Act (the Act) was enacted on December 22, 2017. The Act reduces the US federal corporate tax rate from 35% to 21%. At December 31, 2017, we have completed our accounting for the tax effects of enactment of the Act.

As described below, we have made a reasonable estimate of the effects on our existing deferred tax balances as of December 31, 2017. We re-measured all of our deferred tax assets and liabilities based on the rates at which they are expected to reverse in the future. We recognized a tax expense of $1,522,034 in our tax provision for the year ended December 31, 2017 related to adjusting our deferred tax balance to reflect the new corporate tax rate.

Deferred tax asset (DTA) related to available for sale (AFS) securities losses that were revalued as of December 31, 2017 noted above created a "stranded tax effects" in Accumulated Other Comprehensive Income (AOCI) 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 AOCI 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 Consolidated Statements of Changes in Stockholders' Equity for details of the reclassification.

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.

The Corporation has an established process for determining fair value of assets on both a recurring and nonrecurring basis. Fair value is based upon quoted market prices, where available. If listed prices or quotes are not available, fair value is based upon internally developed models that use primarily market-based or independently-sourced market parameters, including interest rate yield curves and option volatilities. Valuation adjustments may be made to ensure that financial instruments are recorded at fair value. These adjustments include amounts to reflect counterparty credit quality, creditworthiness, liquidity and unobservable parameters that are applied consistently over time. Any changes to the valuation methodology are reviewed by management to determine appropriateness of the changes.

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.

Loans held for investment - The Bank 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 Bank records these impaired loan as nonrecurring level 3 in the fair value hierarchy. At December 31, 2017 and 2016, substantially all of the impaired loans were evaluated based on the fair value of the collateral.

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, appraised values of the collateral or management's estimation of the value of the collateral and recorded as nonrecurring level 3 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.)

Assets measured at fair value on a recurring basis for 2017and 2016 are summarized below:

Assets measured on a recurring basis

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

	Balance at 12/31/2016	Level 1	Level 2	Level 3
Securities available for sale				
Collateralized mortgage obligations	$ 239,145,034	$ -	$ 239,145,034	$ -
Mortgage-backed securities	149,140,510	-	149,140,510	-
Obligations of State and political subdivision	52,502,483	-	52,502,483	-
Total securities available for sale	$ 440,788,027	$ -	$ 440,788,027	$ -

Assets measured at fair value on a non-recurring basis for 2017 and 2016 are summarized below:

Assets measured on a nonrecurring basis

	Balance at 12/31/2017	Level 1	Level 2	Level 3
Impaired loans with a related allowance, net	$ 8,278,401	$ -	$ -	$ 8,278,401
Other real estate owned, net	122,670	-	-	122,670
Totals	$ 8,401,071	$ -	$ -	$ 8,401,071

	Balance at 12/31/2016	Level 1	Level 2	Level 3
Impaired loans with a related allowance, net	$ 8,969,800	$ -	$ -	$ 8,969,800
Other real estate owned, net	469,350	-	-	469,350
Totals	$ 9,439,150	$ -	$ -	$ 9,439,150

Disclosure of fair value information about financial instruments, for which it is practicable to estimate that value, is required whether or not recognized in the consolidated balance sheets. In cases where quoted market prices are not available, fair values are based on estimates using present value or other valuation techniques. Those techniques are significantly affected by the assumptions used, including the discount rate and estimates of future cash flows. In that regard, the derived fair value estimates cannot be substantiated by comparison to independent markets and, in many cases, could not be realized in immediate settlement of the instruments. Certain financial instruments with a fair value that is not practicable to estimate and all non-financial instruments are excluded from the disclosure requirements. Accordingly, the aggregate fair value amounts presented do not necessarily represent the underlying value of the Corporation.

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

The following is a description of the valuation methodologies used by the Corporation to estimate fair value, as well as the general classification of financial instruments pursuant to the valuation hierarchy:

Cash and due from banks – Due to their short-term nature, the carrying amount of cash and due from banks approximates fair value and is categorized as a level 1 in the fair value hierarchy.

Fed funds sold – Due to their short-term nature, the carrying amount of Fed funds sold approximates fair value and is categorized as a level 1 in the fair value hierarchy.

Available for sale securities – The fair value is estimated using quoted market prices and is categorized as a level 2 in the fair value hierarchy.

Federal Reserve Bank Stock – It is not practical to determine the fair value of FRB stock due to restrictions placed on its transferability. No secondary market exists for FRB stock. The stock is bought and sold at par by the FRB. Management believes the recorded value is the fair value and is categorized as a level 2 in the fair value hierarchy.

Loans held for investment – The fair value of loans held for investment is estimated using the rates currently offered for loans held for investment segregated by loan purpose and term and is categorized as a level 3 in the fair value hierarchy.

Cash surrender value of life insurance – Fair value is based on the cash surrender value of the individual policies as provided by the insurance agency and is categorized as a level 2 in the fair value hierarchy.

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 Bank's portfolio of serviced loans and is categorized as a level 2 in the fair value hierarchy.

Accrued interest receivable – The carrying amount of accrued interest receivable approximates fair value and is categorized as a level 1 in the fair value hierarchy.

Deposits - The fair value of demand deposits and savings accounts approximates the carrying amount. The fair value of fixed maturity certificates of deposit is estimated using the rates currently offered for certificates of deposit with similar remaining maturities and is categorized as a level 3 in the fair value hierarchy.

Accrued interest payable – The carrying amount of accrued interest payable approximates fair value and is categorized as a level 1 in the fair value hierarchy.

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

	2017		2016	
	Carrying Amount	Estimated Fair Value	Carrying Amount	Estimated Fair Value
FINANCIAL ASSETS				
Cash and due from banks	$ 84,043,266	$ 84,043,266	$ 128,622,650	$ 128,622,650
Federal funds sold	2,414,518	2,414,518	2,464,348	2,464,348
Available for sale securities	444,488,998	444,488,998	440,788,027	440,788,027
Federal reserve stock	322,100	322,100	322,100	322,100
Loans held for investment	815,109,422	814,879,493	788,371,693	789,186,409
Cash surrender value of life insurance	38,301,624	38,301,624	37,256,129	37,256,129
Mortgage servicing rights, net	1,455,810	1,455,810	1,602,769	1,632,421
Accrued interest receivable	3,748,673	3,748,673	3,803,031	3,803,031
FINANCIAL LIABILITIES				
Deposits	$ 1,267,051,615	$ 1,265,965,221	$ 1,284,805,692	$ 1,283,721,533
Accrued interest payable	84,763	84,763	78,122	78,122

The estimated fair value of fee income on letters of credit outstanding at December 31, 2017 and December 31, 2016 is insignificant. Loan commitments on which the committed interest rate is less than the current market rate are also insignificant at December 31, 2017 and December 31, 2016.

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 $29,539,000 at December 31, 2017 and $18,210,000 at December 31, 2016.

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,

	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

	2016			
	Amortized Cost	Unrealized Gains	Unrealized Losses	Fair Value
Obligations of:				
States and political subdivisions	$ 52,426,886	$ 333,947	$ (258,350)	$ 52,502,483
Collateralized mortgage obligations	240,549,237	603,721	(2,007,924)	239,145,034
Mortgage-backed securities	150,433,711	645,481	(1,938,682)	149,140,510
Totals	$ 443,409,834	$ 1,583,149	$ (4,204,956)	$ 440,788,027

The amortized cost and fair value of available for sale securities as of December 31, 2017, 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.

	2017	
	Amortized Cost	Fair Value
Due in one year or less	$ 4,104,553	$ 4,111,523
Due after one year less than 5 years	24,445,233	24,455,750
Due after 5 years less than 10 years	8,731,874	8,694,971
Due over 10 years	14,142,569	14,433,260
	51,424,229	51,695,504
Collateralized mortgage obligations	223,889,628	221,833,100
Mortgage backed securities	173,009,777	170,960,394
Totals	$ 448,323,634	$ 444,488,998

NOTE 4 - Available for Sale Securities (cont.)

Available for sale securities with an amortized cost of $113,336,085 and $126,816,123 at December 31, 2017 and December 31, 2016, 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:

	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)

	2016					
	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	$ 14,239,276	$ (249,005)	$ 206,525	$ (9,345)	$ 14,445,801	$ (258,350)
Collateralized mortgage obligations	146,137,131	(1,938,724)	5,677,797	(69,200)	151,814,928	(2,007,924)
Mortgage-backed securities	103,309,886	(1,938,682)	-	-	103,309,886	(1,938,682)
Totals	$ 263,686,293	$ (4,126,411)	$ 5,884,322	$ (78,545)	$ 269,570,615	$ (4,204,956)

Management does not believe any individual unrealized loss as of December 31, 2017 and 2016 represents other than temporary impairment. The Bank held thirty-four investment securities as of 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 eleven obligations of states and political subdivisions. The Bank held three investment securities at December 31, 2016 that had unrealized losses existing for greater than 12 months, which consisted of two obligations of states and political subdivisions and one collateralized mortgage obligation. 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:

	2017	2016
Commercial	$ 43,443,761	$ 48,416,976
Real Estate		
Construction	46,213,504	46,539,706
Commercial	458,376,164	439,356,010
Residential	193,555,109	201,148,919
Multifamily	76,952,505	56,641,334
Installment and other	7,301,031	7,525,522
	825,842,074	799,628,467
Less: Allowance for loan losses	(10,732,652)	(11,256,774)
Net loans	$ 815,109,422	$ 788,371,693

NOTE 5 – Loans (cont.)

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

2017	Current Loans	Days Past Due 30-59	60-89	Over 90	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

2016	Current Loans	Days Past Due 30-59	60-89	Over 90	Total	Total Loans
Commercial	$ 48,382,070	$ 2,174	$ -	$ 32,732	$ 34,906	$ 48,416,976
Real Estate						
Consttuction	46,539,706	-	-	-	-	46,539,706
Commercial	436,967,930	1,259,359	78,593	1,050,128	2,388,080	439,356,010
Residential	195,757,888	3,234,954	401,788	1,754,289	5,391,031	201,148,919
Multifamily	56,641,334	-	-	-	-	56,641,334
Installment and other	7,257,471	34,618	11,205	222,228	268,051	7,525,522
Total loans	791,546,399	4,531,105	491,586	3,059,377	8,082,068	799,628,467
Purchase credit-impaired loans	(7,902,415)	(654,156)	(97,006)	(83,715)	(834,877)	(8,737,292)
Total loans, excluding purchase credit-impaired Loans	$ 783,643,984	$ 3,876,949	$ 394,580	$ 2,975,662	$ 7,247,191	$ 790,891,175

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:

	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

	2016	
	Nonaccrual	Past due 90 days or More and accruing
Commercial	$ 35,125	$ -
Real Estate		
Construction	-	-
Commercial	2,672,418	-
Residential	3,196,990	-
Multifamily	-	-
Installment and other	-	222,228
Total Loans	5,904,533	222,228
Purchase Credit Impaired Loans:		
Commercial	-	-
Real Estate		
Construction	-	-
Commercial	(22,806)	-
Residential	(131,562)	-
Multifamily	-	-
Installment and other	-	-
Total Purchased Credit-Impaired Loans	(154,368)	-
Total Loans, excluding Purchase Credit Impaired Loans	$ 5,750,165	$ 222,228

NOTE 5 – Loans (cont.)

Management uses an internal asset classification system as a means of identifying problem and potential problem assets. At the quarterly meetings, the Board of Directors of the Bank reviews trends for loans classified as "Special Mention," "Substandard" and "Doubtful" for the previous twelve months both as a total dollar volume in each classified category and as the percent of capital each classified category represents. 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 Bank 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 Bank 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:

	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

	2016				
	Pass	Special Mention	Substandard	Doubtful	Total
Commercial	$ 47,662,827	$ -	$ 754,149	$ -	$ 48,416,976
Real Estate					
Construction	44,963,004	-	1,576,702	-	46,539,706
Commercial	423,424,963	7,559,993	8,371,054	-	439,356,010
Multifamily	55,669,710	815,396	156,228	-	56,641,334
Total	$ 571,720,504	$ 8,375,389	$ 10,858,133	$ -	$ 590,954,026
Current	$ 570,458,184	$ 8,375,389	$ 9,697,467	$ -	$ 588,531,040
30-59	1,183,727	-	77,806	-	1,261,533
60-89	78,593	-	-	-	78,593
Over 90	-	-	1,082,860	-	1,082,860
Total	$ 571,720,504	$ 8,375,389	$ 10,858,133	$ -	$ 590,954,026

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:

	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

	2016		
	Performing	Nonperforming	Total
Residential Real Estate	$ 197,951,929	$ 3,196,990	$ 201,148,919
Installment & Other	7,303,294	222,228	7,525,522
Totals	$ 205,255,223	$ 3,419,218	$ 208,674,441

At December 31, 2017, the Bank has identified $19.3 million of loans as impaired, including $14.6 million of performing TDRs. As of December 31, 2016, the Bank has identified $21.6 million of loans as impaired, including $15.5 million of performing TDRs. The Bank 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 Bank 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:

	2017	2016
Loans for which there was a related allowance for loan loss	$ 10,740,668	$ 12,356,717
Impaired loans with no related allowance	8,562,106	9,196,384
Total Impaired Loans	$ 19,302,774	$ 21,553,101
Average quarterly balance of impaired loans	$ 19,987,775	$ 25,314,903
Related allowance for loan losses	2,462,267	3,386,917
Interest income recognized while impaired	661,608	640,981

At December 31, 2017 and 2016 respectively, the Bank had residential real estate loans in foreclosure with an unpaid principal balance of $494,696 and $1,703,810, partial charge-offs of $67,616 and $342,307 and an allowance for loan loss allocation of $0 and $2,878 resulting in a recorded investment of $427,353 and $1,358,625.

NOTE 5 – Loans (cont.)

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

	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

	2016			
	Unpaid Principal Balance	Partial Charge-offs	Recorded Investment	Allowance For Loan Losses Allocation
Loans with no related allowance recorded:				
Commercial	$ 5,090	$ 2,322	$ 2,768	$ -
Real Estate				
Construction	88,896	-	88,896	-
Commercial	2,255,837	449,376	1,806,461	-
Residential	8,359,293	1,102,559	7,256,734	-
Multifamily	-	-	-	-
Installment and other	41,525	-	41,525	-
Total	10,750,641	1,554,257	9,196,384	-
Loans with a related allowance recorded:				
Commercial	72,443	-	72,443	35,548
Real Estate				
Construction	834,885	-	834,885	409,885
Commercial	2,573,888	46,462	2,527,426	877,526
Residential	8,896,483	64,002	8,832,481	2,043,476
Multifamily	-	-	-	-
Installment and other	89,482	-	89,482	20,482
Total	12,467,181	110,464	12,356,717	3,386,917
Total Impaired Loans	$ 23,217,822	$ 1,664,721	$ 21,553,101	$ 3,386,917

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:

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

2016	Commercial	Construction Real Estate	Commercial Real Estate	Residential Real Estate	Multifamily Real Estate	Installment & Other	Total
Allowance for loan losses:							
Beginning Balance	$ 361,309	$ 478,905	$ 3,650,333	$ 6,560,758	$ 383,966	$ 155,629	$ 11,590,900
Charge-offs	(51,273)	-	(743,867)	(1,006,257)	(273,764)	(16,874)	(2,092,035)
Recoveries	4,113	-	305,135	252,093	273,764	22,804	857,909
Provisions	34,392	-	319,950	549,983	-	(4,325)	900,000
Ending Balance	$ 348,541	$ 478,905	$ 3,531,551	$ 6,356,577	$ 383,966	$ 157,234	$ 11,256,774
Loans:							
Recorded Investment	$ 48,416,976	$ 46,539,706	$ 439,356,010	$ 201,148,919	$ 56,641,334	$ 7,525,522	$ 799,628,467
Allowance for loan losses:							
Individually evaluated for impairment	35,548	409,885	877,526	2,043,476	-	20,482	3,386,917
Collectively evaluated for impairment	312,993	69,020	2,654,025	4,313,101	383,966	136,752	7,869,857
Total allowance for loan losses	348,541	478,905	3,531,551	6,356,577	383,966	157,234	11,256,774
Ending Balance	$ 48,068,435	$ 46,060,801	$ 435,824,459	$ 194,792,342	$ 56,257,368	$ 7,368,288	$ 788,371,693
Ending Balance:							
Individually evaluated for impairment	$ 75,211	$ 923,781	$ 4,311,081	$ 13,015,667	$ -	$ 124,521	$ 18,450,261
Collectively evaluated for impairment	48,341,765	45,615,925	434,955,132	180,289,880	55,845,652	7,392,560	772,440,914
Purchase credit-impaired							
Individually evaluated for impairment	-	-	22,806	3,073,548	-	6,486	3,102,840
Collectively evaluated for impairment	-	-	66,991	4,769,824	795,682	1,955	5,634,452
Total ending balance	$ 48,416,976	$ 46,539,706	$ 439,356,010	$ 201,148,919	$ 56,641,334	$ 7,525,522	$ 799,628,467

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:

	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

	2016		
	Contractually Required Payments Receivable		
	Credit Impaired	Non-Credit Impaired	Carrying Value of Purchased Loans
Loans with no related allowance recorded:			
Commercial	$ 4,962	$ -	$ -
Real Estate			
Construction	-	31,306	30,517
Commercial	194,111	463,955	391,626
Residential	15,166,243	25,125,364	30,981,362
Multifamily	1,094,660	114,608	827,260
Installment and other	20,966	75,675	61,367
Total	$ 16,480,942	$ 25,810,908	$ 32,292,132

As of December 31, 2017, the estimated contractually-required payments receivable on credit impaired and non-credit impaired loans was $14.7 million and $21.8 million, respectively. The cash flows expected to be collected related to principal as of December 31, 2017 on all purchased loans is $27.6 million. As a result, there is $8.9 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, 2017. 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, 2017	For Twelve Months Ended December 31, 2016
Beginning Balance	$ 2,256,068	$ 3,074,120
Additions	449,291	361,818
Accretion (1)	(640,399)	(1,179,870)
Ending Balance	$ 2,064,960	$ 2,256,068

(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 $6.0 million and $9.3 million as of December 31, 2017, and 2016, respectively. During 2017, no new loans were made and repayments totaled $3.3 million. Management believes these loans were made on substantially the same terms, including interest rates and collateral, as those prevailing at the same time for comparable transactions with other persons and did not involve more than normal risks of collectability or present other unfavorable features. Certain affiliated parties of the Corporation are investors in loan participations of the Bank. The outstanding balance of loan participations with affiliated parties totaled $4.1 million and $6.4 million at December 31, 2017 and 2016, 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 $41.7 million and $53.2 million as of December 31, 2017 and 2016, respectively, were pledged as collateral on public deposits and for other purposes as required or permitted by law.

NOTE 6 – Allowance for Loan Losses

The allowance for loan losses reflected in the accompanying consolidated financial statements represents the allowance available to absorb loan losses that are probable and inherent in the portfolio. An analysis of changes in the allowance is presented in the following tabulation as of December 31:

	For Twelve Months Ended December 31, 2017	2016
Balance at beginning of year	$ 11,256,774	$ 11,590,900
Charge-offs	(916,693)	(2,092,035)
Recoveries	392,571	857,909
Net loans charged-off	(524,122)	(1,234,126)
Provision charged to operations	-	900,000
Balance at end of year	$ 10,732,652	$ 11,256,774

NOTE 7 - Other Real Estate Owned

The following is a summary of the activity in OREO for the years ended December 31:

	2017	2016
Beginning Balance	$ 469,350	$ 3,190,903
Additions	343,690	980,710
Sales	(688,040)	(3,683,363)
Total OREO	125,000	488,250
Valuation allowance for losses	(2,330)	(18,900)
Total OREO, net	$ 122,670	$ 469,350

The following is a summary of the changes in the valuation allowance for losses on other real estate owned as of December 31:

	2017	2016
Beginning Balance	$ 18,900	$ 134,500
Net change in fair value of other real estate owned	2,330	18,900
Amounts related to properties disposed	(18,900)	(134,500)
Ending Balance	$ 2,330	$ 18,900

NOTE 8 - Troubled Debt Restructuring

A TDR includes a loan modification where a borrower is experiencing financial difficulty and the Bank grants a concession to that borrower that the Bank 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 Bank'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:

	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

	2016		
	Number of Modifications	Total Trouble Debt Restructurings	Allowance For Loan Losses Allocation
Commercial	3	$ 72,818	$ 35,548
Real Estate			
Construction	5	923,781	409,885
Commercial	19	3,637,085	756,618
Residential	145	14,403,344	2,041,996
Multifamily	-	-	-
Installment & Other	6	131,007	20,482
Total Loans	178	$ 19,168,035	$ 3,264,529

The following is a summary of TDR's as of December 31, 2017 and 2016 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.

	December 31,			
	2017		2016	
	Number of Modifications	Total in Default	Number of Modifications	Total in Default
Commercial	-	$ -	-	$ -
Real Estate				
Construction	-	-	-	-
Commercial	-	-	-	-
Residential	-	-	1	97,500
Multifamily	-	-	-	-
Installment and other	-	-	-	-
Total Loans	-	$ -	1	$ 97,500

NOTE 8 - Troubled Debt Restructuring (cont.)

A summary of the type of modifications made on TDR's that occurred during 2017 and 2016 are noted in the table below.

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

For the Twelve Months Ended December 31, 2016

	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	-	258,726	-	-	775,842	1,034,568
Residential	380,903	1,275,089	113,859	232,357	237,399	2,239,607
Multifamily	-	-	-	-	-	-
Installment & Other	-	-	-	-	-	-
Total Loans	$ 380,903	$ 1,533,815	$ 113,859	$ 232,357	$ 1,013,241	$ 3,274,175
	Count	Count	Count	Count	Count	Count
Commercial	-	-	-	-	-	-
Real Estate						
Construction	-	-	-	-	-	-
Commercial	-	3	-	-	2	5
Residential	5	9	2	2	3	21
Multifamily	-	-	-	-	-	-
Installment & Other	-	-	-	-	-	-
Total Loans	5	12	2	2	5	26

NOTE 9 - Mortgage Servicing Rights

The following is an analysis of the mortgage servicing rights activity for the years ended December 31:

	2017	2016
Balance at beginning of year	$ 1,602,769	$ 1,588,336
Additions of mortgage servicing rights	171,700	266,909
Amortization	(219,716)	(252,476)
Change in valuation allowance	(98,943)	-
Balance at end of year	$ 1,455,810	$ 1,602,769

The following is a summary of the changes in the valuation allowance for mortgage servicing rights as of December 31:

	2017
Balance at beginning of year	$ -
Balance at end of year	$ 98,943

The carrying value of MSRs is determined in accordance with relevant accounting guidance. This guidance permits capitalized MSRs to be amortized in proportion to and over the period of estimated net servicing income and to be assessed for impairment. The Bank relies on industry data to estimate the initial fair value of MSRs to be capitalized as a percentage of the principal balance of the loans sold. The Bank adjusts the carrying value monthly for reductions due to normal amortization and actual prepayments, including defaults. The Bank assesses its MSRs for impairment each reporting period by using the most recent statistical data published by a third party source. At December 31, 2017 and 2016, the weighted average coupon rates of mortgage loans underlying the MSRs were 3.72% and 3.48%, respectively, and the weighted average remaining maturity of the mortgage loans underlying the MSRs were 200 months and 200 months, respectively. The estimated fair values of MSRs were $1,455,810 and $1,632,421 at December 31, 2017 and 2016, respectively.

The carrying value of MSRs was $1,455,810 or 0.61% of loans serviced for others at December 31, 2017 compared with $1,602,769, or 0.64% of loans serviced at December 31, 2017.

The projections of amortization expense shown below for mortgage servicing rights are based on existing asset balances and the existing interest rate environment as of December 31, 2016. Future amortization may be significantly different depending upon changes in the mortgage servicing portfolio, mortgage interest rates and market conditions.

Estimated future amortization by year is as follows:

	2017
2018	$ 178,263
2019	67,712
2020	67,797
2021	67,971
2022	68,242
Thereafter	1,005,825
	$ 1,455,810

The unpaid principal balance of mortgage loans serviced for others, which is not included in the accompanying consolidated balance sheets, was $238,297,636 and $251,649,335 at December 31, 2017 and 2016, respectively.

Custodial escrow balances maintained in connection with the foregoing loan servicing and included in demand deposits were $767,624 and $735,857 at December 31, 2017 and 2016, respectively.

NOTE 10 - Premises and Equipment

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

	2017	2016
Land	$ 6,587,501	$ 6,522,197
Buildings and leasehold improvements	29,801,147	29,562,652
Furniture and equipment	14,509,204	13,849,201
Total	50,897,852	49,934,050
Less: Accumulated depreciation	(36,034,776)	(34,464,777)
Net Premises and Equipment	$ 14,863,076	$ 15,469,273

Depreciation expense amounted to $1,638,018 and $1,615,436, in 2017 and 2016, respectively.

NOTE 11 – Accrued Interest Receivable and Other Assets

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

	2017	2016
Accrued interest receivable	$ 3,748,673	$ 3,803,031
Fererdal reserve bank stock	322,100	322,100
Tax credits	4,407,459	2,018,322
Prepaid expenses and other assets	5,444,334	6,050,236
Total	$ 13,922,566	$ 12,193,689

NOTE 12 - Deposits

The aggregate amount of time deposits, each with a minimum denomination of $250,000, was $14,276,095 and $17,749,183 as of December 31, 2017 and 2016, respectively.

Scheduled maturities of time deposits at December 31 are:

	2017	2016
Due within one year	$ 53,960,875	$ 61,157,050
After one year but within two years	15,058,449	18,383,307
After two years but within three years	7,609,579	3,849,664
After three years but within four years	4,475,587	6,070,635
After four years but within five years	5,599,954	5,145,735
Total	$ 86,704,444	$ 94,606,391

Deposits from the Company's related parties and Directors held by the Bank at December 31, 2017 and December 31, 2016 amounted to $10,576,767 and $9,376,009, respectively.

NOTE 13 - Other Borrowings

The Bank 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, 2017 or 2016.

The Bank may also borrow through the Federal Reserve Bank Discount Window short term funds up to the amount of $12,138,622 and $14,771,562 as of December 31, 2017 and 2016, respectively. These funds are secured by U.S. government sponsored entity securities or qualified municipal securities totaling $13,487,358 and $16,412,847 as of December 31, 2017 and 2016, respectively.

NOTE 14 - Income Taxes

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

	2017	2016
Current income taxes		
Federal	$ 4,345,175	$ 4,157,132
State	1,386,612	1,214,152
Total current income taxes	5,731,787	5,371,284
Deferred income taxes		
Federal	1,781,109	13,723
State	(6,790)	(2,293)
Total deferred income taxes	1,774,319	11,430
Total income taxes	$ 7,506,106	$ 5,382,714

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:

	2017	2016
Deferred income tax assets:		
Allowance for loan losses	$ 2,923,682	$ 4,517,906
Reserve for health plan	276,800	458,964
Depreciation	372,336	457,999
Non-accrual interest	16,500	72,284
Loss carryforwards	36,834	32,471
Unrealized losses on securities available for sale	1,044,593	1,052,262
Other real estate owned	-	7,586
Other	141,484	181,580
Total deferred income tax assets	4,812,229	6,781,052
Deferred income tax liabilities:		
Loan acquisition fair market valuation	(587,480)	(968,616)
Core deposit intangible asset	-	(25,395)
Mortgage servicing rights	(396,577)	(643,272)
Tax Credits	(158,078)	(108,500)
Other	(115,403)	(193,028)
Total deferred income tax liabilities	(1,257,538)	(1,938,811)
Net deferred income tax asset	$ 3,554,691	$ 4,842,241

The Corporation has state net business loss carryforwards of approximately $590,000 and $632,000 as of December 31, 2017 and 2016, respectively. The net business loss carryforwards expire in 2032.

Realization of the deferred income tax asset over time is dependent upon the existence of taxable income in carryback periods or 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 14 - 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:

	2017		2016	
	Amount	% of Pretax Income	Amount	% of Pretax Income
Federal income taxes at statutory rate	$ 6,364,972	35.00%	$ 5,638,752	35.00%
Adjustments for:				
Tax exempt interest on municipal obligations	(346,652)	-1.91%	(363,215)	-2.25%
Increase in taxes resulting from state income taxes, net of federal tax benefit	896,884	4.93%	787,708	4.89%
Increase in cash surrender vaule of life insurance	(365,923)	-2.01%	(384,888)	-2.39%
Tax credits	(451,750)	-2.48%	-	0.00%
Change in tax rate	1,522,034	8.37%	-	0.00%
Other - net	(113,459)	-0.63%	(295,643)	-1.84%
Income tax expense	$ 7,506,106	41.27%	$ 5,382,714	33.41%

As of December 31, 2017 and 2016, 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 2013 and prior and its 2012 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 15 - 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 2017 and 2016, the Corporation provided a dollar-for-dollar match of employee contributions up to 5% of their compensation. Participants direct the investment of their contributions into one or more investment options. The Corporation recorded contribution expense of $709,096 and $688,965, in 2017 and 2016, respectively.

The Corporation purchased paid-up life insurance as owner and beneficiary on certain officers and executives to provide the Corporation with funds in the event of the death of such individuals and to help recover the cost of employee benefits. Included in the consolidated financial statements is $38,301,624 and $37,256,129 of related cash surrender value as of December 31, 2017 and 2016, respectively.

NOTE 16 - 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 subsidiary Bank to pay 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 $1,074,380 and $1,125,544 in 2017 and 2016 respectively, including $480,326 and $476,976 respectively, on facilities leased from companies held by a director and major shareholder of the Corporation.

As of December 31, 2017, the future minimum lease payments for each of the five succeeding years and in the aggregate are as follows:

2018	$	765,438
2019		763,045
2020		437,287
2021		141,093
2022		60,511
Thereafter		132,056
	$	2,299,430

Office space at certain facilities is leased to outside parties. Rental income included in net occupancy costs was $937,881 and $916,238 for the years ended December 31, 2017 and 2016, respectively.

NOTE 17 - Commitments and Contingencies

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

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

	2017	2016
Fiancial instruments whose contract amounts represent credit risk:		
Commitments to extend credit	$ 147,320,885	$ 116,806,074
Standby letters of credit	8,551,773	7,551,803
Forward commitment to sell mortgage loans	368,253	707,150
	$ 156,240,911	$ 125,065,027

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 Bank evaluates each customer's credit worthiness on a case-by-case basis. The amount of collateral obtained, if deemed necessary by the Bank upon extension of credit, is based on management's credit evaluation of the counterparty. Collateral held varies but may include accounts receivable, inventory, property and equipment, and income-producing commercial properties. The Bank also enters into forward commitments to sell mortgage loans to a secondary market agency.

NOTE 18 - Stockholders' Equity

Cumulative Preferred Stock

The Corporation's articles of incorporation authorize the issuance of up to 200,000 shares of $1 par value cumulative preferred stock. The Board of Directors is authorized to divide the stock into series and fix and determine the relative rights and preferences of each series. No shares have been issued.

Retained Earnings

The principal source of income and funds of the Corporation are dividends from the Bank. 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.

The Corporation paid total dividends of $0.48 per share in both 2017 and 2016.

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 19 - Regulatory Capital Requirements

The Corporation and its Bank subsidiary are 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 Corporation 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 Corporation and 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 Corporation and Bank capital are sufficient to meet the fully phased-in conservation buffer as of December 31, 2017.

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 Corporation and its Bank subsidiary 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, 2017, that the Corporation and its Bank subsidiary meet all capital adequacy requirements to which they are subject.

As of December 31, 2017, 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 19 - Regulatory Capital Requirements (cont.)

The Corporation's ratios do not differ significantly from the Bank's ratios presented below. 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, 2017						
Total capital (to risk-weighted assets)						
Tri City Bankshares Corporation	$ 157,596,000	17.2%	$ 73,238,800	8.0%	n/a	n/a
Tri City National Bank	$ 155,021,000	17.0%	$ 73,035,840	8.0%	$ 91,294,800	10.0%
Tier 1 capital (to risk-weighted assets)						
Tri City Bankshares Corporation	$ 146,161,000	16.0%	$ 54,929,100	6.0%	n/a	n/a
Tri City National Bank	$ 144,288,000	15.8%	$ 54,776,880	6.0%	$ 73,035,840	8.0%
Common Equity Tier 1 (to risk-weighted assets)						
Tri City Bankshares Corporation	$ 146,161,000	16.0%	$ 41,196,825	4.5%	n/a	n/a
Tri City National Bank	$ 144,288,000	15.8%	$ 41,082,660	4.5%	$ 59,341,620	6.5%
Tier 1 capital (to average assets)						
Tri City Bankshares Corporation	$ 146,161,000	10.5%	$ 55,654,240	4.0%	n/a	n/a
Tri City National Bank	$ 144,288,000	10.4%	$ 55,643,160	4.0%	$ 69,553,950	5.0%
As of December 31, 2016						
Total capital (to risk-weighted assets)						
Tri City Bankshares Corporation	$ 150,686,000	17.2%	$ 69,928,400	8.0%	n/a	n/a
Tri City National Bank	$ 148,789,000	17.0%	$ 69,818,480	8.0%	$ 87,273,100	10.0%
Tier 1 capital (to risk-weighted assets)						
Tri City Bankshares Corporation	$ 139,755,000	16.0%	$ 52,446,300	6.0%	n/a	n/a
Tri City National Bank	$ 137,876,000	15.8%	$ 52,363,860	6.0%	$ 69,818,480	8.0%
Common Equity Tier 1 (to risk-weighted assets)						
Tri City Bankshares Corporation	$ 139,755,000	16.0%	$ 39,334,725	4.5%	n/a	n/a
Tri City National Bank	$ 137,876,000	15.8%	$ 39,272,895	4.5%	$ 56,727,515	6.5%
Tier 1 capital (to average assets)						
Tri City Bankshares Corporation	$ 139,755,000	10.1%	$ 55,577,200	4.0%	$ n/a	n/a
Tri City National Bank	$ 137,876,000	9.9%	$ 55,521,880	4.0%	$ 69,402,350	5.0%

NOTE 20 - Concentration of Credit Risk

Practically all of the Bank'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 Bank has a diversified loan portfolio, the ability of its debtors to honor its contracts is dependent on the economic conditions of the counties surrounding the Bank. The concentration of credit by type of loan is set forth in Note 5.