Delmarva Bancshares, Inc.
and Subsidiaries

Annual Report 2017

Delmarva Bancshares, Inc. and Subsidiaries

Financial Report
December 31, 2017

DELMARVA BANCSHARES, INC.

To Our Shareholders:

I am pleased to report 2017 net income for Delmarva Bancshares, Inc., parent company for 1880 Bank, of $4.1 million or $0.69 per share. Delmarva's total assets grew to $355 million at December 31, 2017 compared to $325 million at December 31, 2016. Total deposits increased by $27 million, or 9.7%, to $300 million and total loans increased $7.2 million, or 3%, to $249 million at December 31, 2017. In comparison, total deposits and loans were $273 million and $241 million, respectively, at December 31, 2016. Fully diluted tangible book value grew by $0.67, or 11%, to $6.73 from year-end 2016 to 2017. Nonperforming assets ("NPAs") decreased by 4% to $5.8 million from year-end 2016 to 2017, and NPAs to total assets were 1.63% at December 31, 2017 compared to 1.84% at December 31, 2016. Return on average assets and return on average equity were 1.26% and 10.06%, respectively, for the year ended December 31, 2017.

Net income for 2017 included a deferred tax asset ("DTA") write down of $2.6 million, $0.43 per share, related to the Tax Cut and Jobs Act ("TCJA") signed into law in December 2017, and recapture of the remaining $4.4 million in DTA valuation allowance, $0.74 per share. Net income for 2016 was $7.9 million or $1.32 per share and included a DTA recapture of $5.8 million, $0.98 per share. Excluding the impact of the TCJA, recapture of the remaining DTA valuation allowance and nonrecurring items, core net income was $2.5 million, or $0.42 per share for year-end 2017 compared to $2.1 million, or $0.35 per share, for year-end 2016.

1880 Bank continues to focus on the communities we serve through unique partnerships. In 2017, we joined with Talbot County and Tilghman Island to offer banking services to this underserved community. We will open soon an Interactive Teller Machine ("ITM") in Tilghman Island. The ITM will give residents and visitors real time access to 1880 Bank services and professionals via interactive video. Dorchester County began the first phase of construction on a new high school to replace North Dorchester High School. 1880 Bank was selected by Dorchester County to support this endeavor and we readily made the investment to enhance the County's educational infrastructure. These are some of the activities representative of 1880 Bank's ongoing commitment to support worthwhile partnerships for the good of the community and shareholders.

Technology is important to all of us, and we remain committed to offering secure electronic solutions for our clients. Early 2017, we reissued chip enabled 1880 Bank Visa check cards to enhance safe and secure transactions for our customers. In March 2018, we will offer a free mobile app called SecurLock to help our customers manage their 1880 Bank Visa check cards. SecureLock will provide customers with immediate transaction alerts, spending controls, and fraud prevention tools, all from their mobile device. Technology will change; however, 1880 Bank will use it to better serve and stay connected through high touch, hometown service for the most valuable asset, our customer.

We, the Board and Management, thank you for your ongoing support, loyalty and investment in Delmarva Bancshares, Inc.

Kim C. Liddell
President and Chairman of the Board

INDEPENDENT AUDITOR'S REPORT

To the Board of Directors and Stockholders
Delmarva Bancshares, Inc.
Cambridge, Maryland

Report on the Financial Statements
We have audited the accompanying consolidated financial statements of Delmarva Bancshares, Inc. and its subsidiaries (the Company), which comprise the consolidated balance sheets as of December 31, 2017 and 2016, the related consolidated statements of income, comprehensive income, changes in stockholders' equity and cash flows for the years then ended, and the related notes to the consolidated financial statements (collectively, the financial statements).

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

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

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

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

Opinion
In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Delmarva Bancshares, Inc. and its subsidiaries as of December 31, 2017 and 2016, and the results of their operations and their cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Yount, Hyde & Barbour, P.C.

Winchester, Virginia
March 19, 2018

Delmarva Bancshares, Inc. and Subsidiaries
Consolidated Balance Sheets
December 31, 2017 and 2016

	2017	2016
Assets		
Cash and due from banks	$ 2,533,473	$ 4,531,309
Interest-bearing deposits in other banks	40,501,344	14,740,230
Federal funds sold	204,316	116,690
Total cash and cash equivalents	43,239,133	19,388,229
Investment securities available-for-sale, at fair value	33,818,170	36,068,361
Restricted stock, at cost	1,706,600	1,618,450
Total investment securities	35,524,770	37,686,811
Loans receivable, net of allowance for loan losses of $1,846,815 (2017) and $1,625,759 (2016)	246,735,506	239,787,156
Bank premises and equipment, net	5,141,751	5,443,228
Other real estate owned, net of valuation allowance of $284,295 (2017) and $147,590 (2016)	334,239	819,037
Accrued interest receivable	665,800	670,135
Goodwill	1,852,120	1,852,120
Core deposit intangible, net	596,993	921,562
Cash surrender value of life insurance	13,900,553	11,103,157
Deferred income taxes	6,257,465	5,543,126
Other assets	743,203	1,579,577
Total Assets	$ 354,991,533	$ 324,794,138
Liabilities and Stockholders' Equity		
Liabilities:		
Deposits:		
Non-interest-bearing	$ 80,360,996	$ 81,050,026
Interest-bearing	219,339,163	192,097,274
Total deposits	299,700,159	273,147,300
Accrued interest payable	95,366	626,257
Accrued benefit obligations	4,707,804	4,660,596
Junior subordinated debt	2,503,953	2,468,546
Senior subordinated debt	4,100,000	4,100,000
Other liabilities	994,560	1,106,353
Total Liabilities	312,101,842	286,109,052
Commitments and contingent liabilities		
Stockholders' Equity:		
Convertible Perpetual Preferred Stock, Series A, $.01 par value per share - 1,206,826 shares authorized, issued and outstanding	12,068	12,068
Convertible Perpetual Preferred Stock, Series B, $.01 par value per share - 852,887 shares authorized, issued and outstanding	8,529	8,529
Common Stock, $.01 par value per share - 7,940,287 shares authorized, 3,915,921 (including 21,547 nonvested restricted shares) and 3,872,168 shares issued and outstanding, respectively	38,944	38,721
Additional paid-in capital	43,621,548	43,508,713
Retained (deficit)	(575,117)	(4,741,775)
Accumulated other comprehensive loss	(216,281)	(141,170)
Total Stockholders' Equity	42,889,691	38,685,086
Total Liabilities and Stockholders' Equity	$ 354,991,533	$ 324,794,138

See Notes to Consolidated Financial Statements.

Delmarva Bancshares, Inc. and Subsidiaries
Consolidated Statements of Income
Years Ended December 31, 2017 and 2016

	2017	2016
Interest and Dividend Income:		
Loans, including fees	**$ 11,645,859**	$ 11,350,990
Investment securities	**660,843**	749,150
Dividends on restricted stock	**105,733**	85,350
Interest on deposits in other banks	**200,694**	42,684
Interest on federal funds sold	**780**	59
Total interest income	**12,613,909**	12,228,233
Interest Expense:		
Deposits	**673,379**	424,429
Junior subordinated debt	**163,847**	146,314
Senior subordinated debt	**290,986**	291,783
Borrowed funds	**2**	1,224
Total interest expense	**1,128,214**	863,750
Net interest income	**11,485,695**	11,364,483
Provision for Loan Losses	**320,813**	175,071
Net interest income after provision for loan losses	**11,164,882**	11,189,412
Noninterest Income:		
Service charges on deposit accounts	**779,186**	679,760
Other fees and commissions	**650,947**	615,381
Income on bank owned life insurance	**297,396**	271,901
Gains on sales of securities available for sale, net	**-**	150,033
Other income	**70,155**	102,836
Total noninterest income	**1,797,684**	1,819,911
Noninterest Expense:		
Salaries and employee benefits	**4,053,280**	3,968,919
Premises and equipment	**1,204,324**	1,427,606
Data processing	**1,514,519**	1,229,327
OREO write-downs, net losses on sales, and operating expenses	**211,648**	178,848
Professional fees	**782,154**	1,086,343
Director fees	**280,000**	209,996
Core deposit amortization	**324,570**	394,748
FDIC assessments	**108,170**	174,406
Regulatory examination assessments	**41,148**	41,148
Other insurance expense	**110,705**	111,243
Other expenses	**787,041**	810,020
Total noninterest expense	**9,417,559**	9,632,604
Net income before income taxes	**3,545,007**	3,376,719
Income tax benefit	**(586,058)**	(4,472,026)
Net income	**$ 4,131,065**	$ 7,848,745
Net Income per Common Share: Basic and Diluted	**$ 0.69**	$ 1.32

See Notes to Consolidated Financial Statements.

Delmarva Bancshares, Inc. and Subsidiaries
Consolidated Statements of Comprehensive Income
Years Ended December 31, 2017 and 2016

	2017	2016
Net income	**$ 4,131,065**	$ 7,848,745
Other comprehensive income (loss):		
Changes in net unrealized gains (losses) on securities available for sale net of tax of $45,001 and ($39,930), respectively	**(39,518)**	76,521
Reclassification adjustment for gain on sale of securities, net of tax of $0 and $51,011, respectively	**-**	(99,022)
Total other comprehensive income (loss)	**(39,518)**	(22,501)
Comprehensive income	**$ 4,091,547**	$ 7,826,244

See Notes to Consolidated Financial Statements.

Delmarva Bancshares, Inc. and Subsidiaries
Consolidated Statements of Changes in Stockholders' Equity
Years Ended December 31, 2017 and 2016

	Series A Preferred Stock	Series B Preferred Stock	Common Stock	Additional Paid-In Capital	Retained (Deficit)	Accumulated Other Comprehensive Income (Loss)	Total
Balances, December 31, 2015	12,068	8,529	38,721	43,433,877	(12,590,520)	(118,669)	30,784,006
Stock based compensation	-	-	-	74,836	-	-	74,836
Net income	-	-	-	-	7,848,745	-	7,848,745
Other comprehensive income (loss)	-	-	-	-	-	(22,501)	(22,501)
Balances, December 31, 2016	12,068	8,529	38,721	43,508,713	(4,741,775)	(141,170)	38,685,086
Stock based compensation	**-**	**-**	**223**	**112,835**	**-**	**-**	**113,058**
Net income	**-**	**-**	**-**	**-**	**4,131,065**	**-**	**4,131,065**
Reclassification of stranded tax effects from change in tax rate	**-**	**-**	**-**	**-**	**35,593**	**(35,593)**	**-**
Other comprehensive income (loss)	-	-	-	-	-	**(39,518)**	**(39,518)**
Balances, December 31, 2017	**$ 12,068**	**$ 8,529**	**$ 38,944**	**$ 43,621,548**	**$ (575,117)**	**$ (216,281)**	**$ 42,889,691**

See Notes to Consolidated Financial Statements.

Delmarva Bancshares, Inc. and Subsidiaries
Consolidated Statements of Cash Flows
Years Ended December 31, 2017 and 2016

	2017	2016
Cash Flows From Operating Activities:		
Net income	**$ 4,131,065**	$ 7,848,745
Adjustments to reconcile net income to net		
cash provided by operating activities:		
Depreciation, amortization and accretion, net	**555,516**	695,350
Net accretion of acquisition accounting adjustments	**(483,856)**	(255,478)
Stock based compensation	**161,186**	74,836
Deferred income tax expense	**3,722,287**	1,280,900
Change in deferred income tax	**(1,824,716)**	(5,812,983)
Deferred tax asset adjustment for enacted change in tax rate	**(2,566,908)**	-
Provision for loan losses	**320,813**	175,071
Income on investment in life insurance	**(297,396)**	(271,901)
Gain on sale of securities available for sale, net	**-**	(150,033)
Losses (gains) on other real estate owned write-downs and sales, net	**199,028**	114,075
Net change in:		
Accrued interest and other assets	**840,707**	(734,503)
Accrued interest and other liabilities	**(640,980)**	(1,475,548)
Net cash provided by operating activities	**4,116,746**	1,488,531
Cash Flows From Investing Activities:		
Proceeds from sales, maturities, calls and principal paydowns		
of available-for-sale securities	**6,909,499**	13,280,460
Purchases of available-for-sale securities	**(5,108,158)**	-
Purchase of restricted stock, net	**(88,150)**	(222,550)
Investment in life insurance	**(2,500,000)**	-
Increase in loans, net	**(6,462,402)**	(19,559,195)
Proceeds from sale of other real estate owned	**536,870**	1,312,371
Purchase of premises and equipment	**(135,270)**	(161,086)
Net cash (used in) investing activities	**(6,847,611)**	(5,350,000)
Cash Flows From Financing Activities:		
Increase (decrease) in demand, money markets, and savings deposits	**26,552,859**	(1,253,953)
Increase in time deposits	**28,910**	3,794,962
Net cash provided by financing activities	**26,581,769**	2,541,009
Increase (decrease) in cash and cash equivalents	**23,850,904**	(1,320,460)
Cash and Cash Equivalents, Beginning of Year	**19,388,229**	20,708,689
Cash and Cash Equivalents, End of Year	**$ 43,239,133**	$ 19,388,229
Supplemental Disclosures of Cash Flow Information		
Cash paid during the year for:		
Interest	**$ 1,665,602**	$ 852,770
Taxes	**$ -**	$ 987,635
Unrealized (loss) on securities available for sale	**$ (84,519)**	$ (11,591)
Loans transferred to other real estate owned	**$ 251,100**	$ 419,643

See Notes to Consolidated Financial Statements.

Note 1. Nature of Operations and Significant Accounting Policies

Principles of Consolidation: The accompanying consolidated financial statements include the accounts of Delmarva Bancshares, Inc. (the "Company"), 1880 Bank (formerly The National Bank of Cambridge), Idlewild Properties, LLC ("Idlewild") and Easton Capital Trust I, all wholly-owned subsidiaries of the Company. All material intercompany accounts and transactions have been eliminated in consolidation, with the exception of Easton Capital Trust, as detailed in Note 8.

Nature of Operations: On October 31, 2014, The National Bank of Cambridge converted from a federal to a state charter and was renamed 1880 Bank (the "Bank"). The 1880 Bank name was inspired by the institution's founding year and its 138 years of service to the Delmarva Peninsula community. The new name reflects the Company's heritage and provides flexibility to grow and expand geographically. The Bank provides full banking services to individuals and business customers located in Dorchester and Talbot Counties and surrounding areas of the Eastern Shore of Maryland and throughout the Delmarva Peninsula, and is subject to competition from other financial institutions. As a state bank, the Bank is subject to regulations of the Office of the Commissioner of Financial Regulation for the State of Maryland and the Federal Reserve Bank of Richmond. The accounting and reporting policies of the Company conform to accounting principles generally accepted in the United States of America and prevailing practices within the banking industry.

On July 15, 2015, the Company completed its acquisition of Easton Bancorp, Inc. ("Easton") pursuant to the terms and conditions of the Agreement and Plan of Merger, dated March 31, 2015 (the "Easton Merger Agreement"), between the Company and Easton. Easton was headquartered in Easton, Maryland, and engaged in banking operations through its subsidiaries bank, Easton Bank & Trust. The transaction expanded the Company's footprint in Maryland, adding three branches. Refer to Note 2 for further details on the merger. Idlewild was acquired as part of the acquisition. It was formed to hold the Bank's foreclosed real estate.

Use of Estimates: In preparing consolidated financial statements in conformity with accounting principles generally accepted in the United States of America, 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 goodwill, core deposit intangibles, allowance for loan losses, acquired loans with specific credit-related deterioration, valuation of other real estate owned, valuation of deferred tax assets, and other-than-temporary impairment of securities.

Cash and Cash Equivalents: For purposes of the consolidated statements of cash flows, cash and cash equivalents include cash and due from bank balances, interest-bearing deposits in other banks and federal funds sold, all of which have original maturities of ninety days or less. Included in cash and due from banks on the consolidated balance sheets were restricted funds on deposit with the Federal Reserve Bank totaling $1.1 million and $2.0 million at December 31, 2017 and 2016, respectively.

In addition, the Company maintains cash balances in other correspondent banks that may exceed federally insured limits. The Company has not experienced any losses in such accounts and does not believe it is exposed to any significant credit risk.

Investment Securities: Debt and equity securities are segregated into the following three categories: trading, held-to-maturity, and available-for-sale. Trading securities are purchased and held principally for the purpose of reselling them within a short period of time. Unrealized gains and losses on trading securities are included in earnings.

Securities classified as held-to-maturity are accounted for at amortized cost and require the Company to have both the positive intent and ability to hold these securities to maturity. Securities not classified as either trading or held-to-maturity are considered to be available-for-sale and are carried at fair value. Unrealized gains and losses on available-for-sale securities are reported, net of taxes, in accumulated other comprehensive income (loss) until realized.

Note 1. Nature of Banking Activities and Significant Accounting Policies (Continued)

Realized gains or losses on the sale of securities are reported in earnings and are determined using the adjusted cost of the specific security sold. Interest income is accrued on the investment's face value. Purchase premium and discounts are recognized in interest income using the interest method over the term of the securities. As of December 31, 2017 and 2016, the Company did not hold any trading or held-to-maturity securities.

Investment securities are impaired when fair value is less than cost. An impairment is considered "other than temporary" if any of the following conditions are met: the Company intends to sell the security, it is more likely than not that the Company will be required to sell the security before the recovery of its amortized cost basis, or the Company does not expect to recover the security's entire amortized cost basis (even if the Company does not intend to sell). The Company does not have any securities impairment that is considered "other-than-temporary" at December 31, 2017 and 2016.

Loans: Loans are reported at their recorded investment, which is the principal amount outstanding, as adjusted for partial charge-offs, payments received on nonaccrual loans, and net deferred fees or cost of loan originations. The balance of the allowance for loan losses is netted against the recorded investment in loans on the consolidated balance sheets. Interest income is accrued on the unpaid principal balance. Loan origination fees and certain direct origination costs are deferred and recognized as an adjustment of the yield on the related loans using the interest method. Loans on which the accrual of interest has been discontinued are designated as nonaccrual loans. Accrual of interest on all classes of loans is discontinued either when reasonable doubt exists as to the full, timely collection of interest or principal in accordance with the loan's contractual terms, or when a loan becomes contractually past due by ninety days or more with respect to principal or interest. All interest accrued, but not collected, for loans placed on non-accrual or charged-off is reversed against interest income.

Income on nonaccrual loans is recognized using the cost recovery method. Accruals are resumed on loans only when they are brought fully current with respect to interest and principal and when, in the judgment of management, the loan is estimated to be fully collectible as to both principal and interest. Loans are considered past due when the borrower is not current with their payments in accordance with the contractual terms of their loan agreement.

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

Allowance for Loan Losses: The allowance for loan losses is maintained at a level deemed appropriate by management to provide for known and inherent risks that are probable within the loan portfolio. The allowance is based upon management's continuing assessment of various factors affecting the collectibility of loans, including current economic conditions, past credit experience, the value of the underlying collateral, and such other factors as in management's judgment deserve current recognition in estimating probable credit losses. This evaluation is inherently subjective as it requires estimates that are susceptible to significant revision as more information becomes available. Loans deemed uncollectible are charged off and deducted from the allowance, while subsequent recoveries are credited to the allowance.

All classes of loans are charged off against the allowance for loan losses when the loan or a portion of the loan is deemed uncollectible. A loan or portion of the loan may be deemed uncollectible, when, for example, pending legal action such as foreclosure is expected to result in a collateral shortfall. Any loan or portion of a loan with an internally assigned grade of "loss" is charged off in the month such grade was assigned.

Note 1. Nature of Banking Activities and Significant Accounting Policies (Continued)

The allowance consists of specific, general and unallocated components. For loans that are classified as impaired, a specific allowance is established when the discounted cash flows (or collateral value or observable market price) of the impaired loan is lower than the carrying value of that loan. For collateral dependent loans, an updated appraisal will be ordered if a current one is not on file. Appraisals are performed by independent third-party appraisers with relevant industry experience. Adjustments to the appraised value may be made based on recent sales of like properties or general market conditions when appropriate. The general component covers non-classified, or performing, loans and those loans classified as substandard or special mention that are not impaired. The general component is based on historical loss experience adjusted for qualitative factors. Non-impaired classified loans are assigned a higher allowance factor than non-classified loans, which increases with the severity of classification. An unallocated component is maintained to cover uncertainties that could affect management's estimate of probable losses. The unallocated component of the allowance reflects the margin of imprecision inherent in the underlying assumptions used in the methodologies for estimating specific and general losses in the portfolio.

Management has an established internally developed methodology to determine the adequacy of the allowance for loan losses that assesses the risks inherent in the loan portfolio. For purposes of determining the allowance for loan losses, management has segmented certain loans in the portfolio by product type. Loans are grouped into the following segments: Residential Real Estate, Commercial Real Estate, Real Estate Development, Commercial and Consumer. As the first step in determining the general component of the allowance for loan losses, management uses the average of the last three years of net charge-off experience for each segment of the portfolio. The historical loss percentage calculated is applied to the quarter end balance of each portfolio segment. The historical component is further adjusted by management's evaluation of various conditions per segment including changes in loan policy and underwriting standards, changes in national and local economic conditions, changes in the nature or volume of the loan portfolio, changes in the ability of lending management and staff, changes in the levels of past dues, non-accruals and risk rated loans, changes in the quality of the loan review system, changes in the value of underlying collateral for secured loans, effects of concentrations and changes in their levels, changes in value and severity of past due loans and adversely classified loans, changes in collateral value of real estate loans and the effects of external factors including competition, legal and regulatory risks.

The evaluation also considers the following risk characteristics of each loan portfolio segment:

- Residential real estate loans, including equity lines of credit, carry risks associated with the continued creditworthiness of the borrower and the changes in the value of the underlying collateral.
- Commercial real estate loans are viewed primarily as cash flow loans and secondarily as loans secured by real estate. Commercial real estate lending typically involves higher loan principal amounts than residential lending and the repayment of these loans is generally largely dependent on the successful operation or sale of the income producing property securing the loan or the business conducted on the property securing the loan.
- Real estate development loans carry the same risks associated with real estate loans as described above. Construction loans also bear the risk that the general contractor, who may or may not be a loan customer, may not be able to finish the construction project as planned because of financial pressure unrelated to the project.
- Commercial loans carry risks associated with the successful operation of a business, in addition to other risks associated with ownership, because the repayment of these loans may be dependent upon the profitability and cash flows of the underlying business or project. In addition, there is risk associated with the value of collateral, if secured, other than real estate that may depreciate over time and cannot be appraised with as much precision.
- Consumer loans carry risks associated with the continued creditworthiness of the borrower and the value of the collateral (e.g., rapidly-depreciating assets such as automobiles), or lack thereof. Consumer loans are more likely than real estate loans to be immediately adversely affected by job loss, divorce, illness or personal bankruptcy.

Note 1. Nature of Banking Activities and Significant Accounting Policies (Continued)

Management further divides the commercial and consumer segments into secured and unsecured classes when analyzing the portfolio.

To determine the specific reserve component of the allowance for loan losses, management evaluates all impaired loans to determine the amount of anticipated loss. Management evaluates all segments of loans for impairment, except for smaller balance homogeneous loans. Accordingly, management does not separately identify consumer loans for impairment disclosures, unless such loans are the subject of a restructuring agreement. A loan is considered impaired when management determines it is probable the Company will be unable to collect all amounts due according to the original contractual terms of the loan agreement. Impaired loans are carried at the estimated present value of total expected future cash flows, discounted at the loan's effective rate, or the fair value of the collateral, if the loan is collateral-dependent.

In connection with the acquisition of Easton, certain loans were acquired which exhibited deteriorated credit quality since origination for which the Company does not expect to collect all contractual payments. These purchased credit impaired loans are recorded at fair value, such that there is no carryover of the seller's allowance for loan losses. After acquisition, losses are recognized by an increase in the provision for loan losses.

Such purchased credit impaired loans are accounted for individually or aggregated into pools of loans based on common risk characteristics such as, credit score, loan type, and date of origination. The Company estimates the amount and timing of expected cash flows for each loan pool, and the expected cash flows in excess of fair value is recorded as interest income over the remaining life of the loan pool (accretable yield). The excess of the loan pool's contractual principal and interest over expected cash flows is not recorded (nonaccretable difference).

Over the life of the loan or pool, expected cash flows continue to be estimated. If the present value of expected cash flows is less than the carrying amount, a loss is recorded as a provision for loan losses. If the present value of expected cash flows is greater than the carrying amount, it is recognized as part of future interest income.

There were no changes in the Company's allowance for loan loss methodology during 2017 or 2016.

Premises and Equipment: Land is carried at cost. Property and equipment are stated at cost, less accumulated depreciation, which is computed on the straight-line method over the estimated useful lives of the assets, which range between 5 and 40 years.

Maintenance and repairs of property and equipment are charged to operations, and major improvements are capitalized. Upon retirement, sale, or other disposition of premises and equipment, the cost and accumulated depreciation are eliminated from the accounts, and gain or loss is included in noninterest income and noninterest expenses, respectively.

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

Goodwill and Intangible Assets: Goodwill is subject to at least an annual assessment for impairment by applying a fair value based test. Additionally, acquired intangible assets (such as core deposit intangibles) are separately recognized if the benefit of the assets can be sold, transferred, licensed, rented, or exchanged, and amortized over their useful lives. The cost of purchased deposit relationships, based on independent valuation, is being amortized over the estimated life of 79 months.

Note 1. Nature of Banking Activities and Significant Accounting Policies (Continued)

The Company records as goodwill the excess of purchase price over the fair value of the identifiable net assets acquired. Impairment testing is being performed annually beginning with the first anniversary of the Easton acquisition, as well as when an event triggering impairment may have occurred. Accounting guidance permits preliminary assessment of qualitative factors to determine whether more substantial impairment testing is required. No indicators of impairment have occurred since the Easton acquisition in July, 2015. No impairment was identified during the Company's 2017 annual analysis of goodwill.

Bank Owned Life Insurance: Bank owned life insurance is reflected as the cash surrender value of the policies as provided by the insurer on a monthly basis.

Earnings Per Share of Common Stock: The Company applies the two-class method of computing basic and diluted net income per common share. Under the two-class method, net income per common share is determined for each class of common stock and participating security according to dividends declared and participation rights in undistributed earnings. Based on FASB guidance, the Company considers its Series A and B Preferred Stock to be participating securities. FASB guidance requires that all outstanding unvested share-based payment awards that contain rights to nonforfeitable dividends participate in undistributed earnings with common shareholders. Accordingly, the weighted average number of shares of the Company's common stock used in the calculation of basic and diluted net income per common share includes any unvested restricted stock of the Company's common stock outstanding. Potential common shares that may be issued by the Company relate to outstanding stock options and the Company's Series B Preferred Stock, and are determined using the treasury method. Earnings per share calculations are presented in Note 17.

Income Taxes: 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 the currently enacted tax laws and rates applicable to periods in which the differences are expected to affect taxable income. Valuation allowances are established, when necessary, to reduce deferred tax assets to the amount expected to be realized. Income tax expense is the tax payable or refundable for the period adjusted for the change during the period in deferred tax assets and liabilities.

When tax returns are filed, it is highly certain that some positions taken would be sustained upon examination by the taxing authorities, while others are subject to uncertainty about the merits of the position taken or the amount of the position that would be ultimately sustained. The benefit of a tax position is recognized in the financial statements in the period during which, based on all available evidence, management believes it is more likely than not that the position will be sustained upon examination, including the resolution of appeals or litigation processes, if any. Tax positions taken are not offset or aggregated with other positions. Tax positions that meet the more-likely-than-not recognition threshold are measured as the largest amount of tax benefit that is more than 50 percent likely of being realized upon settlement with the applicable taxing authority. The portion of the benefits associated with tax positions taken that exceeds the amount measured as described above is reflected as a liability for unrecognized tax benefits in the accompanying consolidated balance sheets along with any associated interest and penalties that would be payable to the taxing authorities upon examination. Interest and penalties associated with unrecognized tax benefits, if any, are classified as additional income taxes in the consolidated statements of operations. As of December 31, 2017 and 2016, there was no liability recorded for unrecognized tax benefits.

Retirement Plans: The Company maintains a multiple employer defined benefit plan covering all full-time employees with more than one year of service as of October 31, 2010. This plan was frozen at October 31, 2010. The Company also maintains a 401k profit sharing plan covering substantially all employees. The Company will contribute a safe harbor contribution of 3% of participants' compensation and also provides a 50% match for employee contributions up to 6%.

Stock-Based Compensation: The Company has a stock-based compensation plan, which is more fully described in Note 22. Costs resulting from share-based payments to employees are recognized in the consolidated financial statements.

Note 1. Nature of Banking Activities and Significant Accounting Policies (Continued)

Advertising Costs: Advertising costs are expensed as incurred. Advertising costs were $42,924 and $118,748 for the years ended December 31, 2017 and 2016, respectively.

Transfers of Financial Assets: Transfers of financial assets are accounted for as sales, when control over the assets has been surrendered. Control over transferred assets is deemed to be surrendered when (1) the assets have been isolated from the Company – put presumptively beyond reach of the transferor and its creditors, even in bankruptcy or other receivership, (2) the transferee obtains the right (free of conditions that constrain it from taking advantage of that right) to pledge or exchange the transferred assets, and (3) the Company does not maintain effective control over the transferred assets through an agreement to repurchase them before their maturity or the ability to unilaterally cause the holder to return specific assets.

Off-Balance-Sheet Financial Instruments: In the ordinary course of business, the Company has entered into off-balance-sheet agreements consisting primarily of commitments to extend credit. Such financial instruments are recorded in the consolidated financial statements when they are funded.

Comprehensive Income: Accounting principles generally require that recognized revenue, expenses, gains, and losses be included in net income. Certain changes in assets and liabilities, such as unrealized gains and losses on available-for-sale securities are components of other comprehensive income (loss). These components, along with net income, are reported in separate Consolidated Statements of Comprehensive Income. All the Company's other comprehensive income (loss) is related to unrealized gains and losses on available-for-sale securities for the years ended December 31, 2017 and 2016.

In February 2018, the FASB issued ASU 2018-02, "Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income ("AOCI")". The Company early adopted this new standard in the current year. ASU 2018-08 requires reclassification from AOCI to retained earnings the stranded tax effects from the impact of a newly enacted federal corporate tax rate on items included in AOCI. The amount of this reclassification in 2017 was $35,593.

Mergers and Acquisitions: Business combinations are accounted for under ASC 805, "*Business Combinations*", using the acquisition method of accounting. The acquisition method of accounting requires an acquirer to recognize the assets acquired and the liabilities assumed at the acquisition date measured at their fair values as of that date. To determine the fair values, the Company relies on third party valuations, such as appraisals, and third party valuations based on discounted cash flow analyses or other valuation techniques. Under the acquisition method of accounting, the Company identifies the acquirer and the closing date and applies applicable recognition principles and conditions. Acquisition-related costs are costs the Company incurs to effect a business combination. Those costs include advisory, legal, accounting, valuation, and other professional or consulting costs. Some other examples of costs to the Company include systems conversions, integration planning consultants and advertising costs. The Company accounts for acquisition-related costs as expenses in the periods in which the costs are incurred and the services are received, with one exception. The costs to issue debt or equity securities are recognized in accordance with other applicable GAAP. These acquisition-related costs have been and will be included with the Consolidated Statements of Income classified as a merger expense within the noninterest expense caption.

Note 1. Nature of Banking Activities and Significant Accounting Policies (Continued)

Recent Accounting Pronouncements: In May 2014, the FASB issued ASU No. 2014-09, "*Revenue from Contracts with Customers: Topic 606*". This ASU revised guidance for the recognition, measurement, and disclosure of revenue from contracts with customers. The original guidance has been amended through subsequent accounting standard updates that resulted in technical corrections, improvements, and a one-year deferral of the effective date to January 1, 2018. The guidance, as amended, is applicable to all entities and, once effective, will replace significant portions of existing industry and transaction-specific revenue recognition rules with a more principles-based recognition model. Most revenue associated with financial instruments, including interest income, loan origination fees, and credit card fees, is outside the scope of the guidance. Gains and losses on investment securities, derivatives, and sales of financial instruments are similarly excluded from the scope. Entities can elect to adopt the guidance either on a full or modified retrospective basis. Full retrospective adoption will require a cumulative effect adjustment to retained earnings as of the beginning of the earliest comparative period presented. Modified retrospective adoption will require a cumulative effect adjustment to retained earnings as of the beginning of the reporting period in which the entity first applies the new guidance. The Company plans to adopt this guidance on the effective date, January 1, 2018 via the modified retrospective approach. The Company has completed its assessment of the adoption of this ASU, noting the standard will result in expanded disclosures related to non-interest income and enhance the qualitative disclosures on the revenues within the scope of the new guidance. The Company has concluded the adoption of ASU 2014-09 will not have a material impact on its consolidated financial statements.

In January 2016, the FASB issued ASU 2016-01, "Financial Instruments – Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities". The amendments in ASU 2016-01, among other things: 1) Requires equity investments (except those accounted for under the equity method of accounting, or those that result in consolidation of the investee) to be measured at fair value with changes in fair value recognized in net income; 2) Requires public business entities to use the exit price notion when measuring the fair value of financial instruments for disclosure purposes; 3) Requires separate presentation of financial assets and financial liabilities by measurement category and form of financial asset (i.e., securities or loans and receivables); and 4) Eliminates the requirement for public business entities to disclose the method(s) and significant assumptions used to estimate the fair value that is required to be disclosed for financial instruments measured at amortized cost. The amendments in this ASU are effective for public companies for fiscal years beginning after December 15, 2017, including interim periods within those fiscal years. The Company does not expect the adoption of ASU 2016-01 to have a material impact on its consolidated financial statements.

In February 2016, the FASB issued ASU No. 2016-02, "Leases (Topic 842)". Among other things, in the amendments in ASU 2016-02, lessees will be required to recognize the following for all leases (with the exception of short-term leases) at the commencement date: (1) A lease liability, which is a lessee's obligation to make lease payments arising from a lease, measured on a discounted basis; and (2) A right-of-use asset, which is an asset that represents the lessee's right to use, or control the use of, a specified asset for the lease term. Under the new guidance, lessor accounting is largely unchanged. Certain targeted improvements were made to align, where necessary, lessor accounting with the lessee accounting model and Topic 606, Revenue from Contracts with Customers. The amendments in this ASU are effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. Early application is permitted upon issuance. Lessees (for capital and operating leases) and lessors (for sales-type, direct financing, and operating leases) must apply a modified retrospective transition approach for leases existing at, or entered into after, the beginning of the earliest comparative period presented in the financial statements. The modified retrospective approach would not require any transition accounting for leases that expired before the earliest comparative period presented. Lessees and lessors may not apply a full retrospective transition approach. The Company does not expect the adoption of ASU 2016-02 to have a material impact on its consolidated financial statements due to the fact the Company only has two small real estate leases and leases on certain office equipment.

Note 1. Nature of Banking Activities and Significant Accounting Policies (Continued)

During June 2016, the FASB issued ASU No. 2016-13, "Financial Instruments – Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments". The amendments in this ASU, among other things, require the measurement of all expected credit losses for financial assets held at the reporting date based on historical experience, current conditions, and reasonable and supportable forecasts. Financial institutions and other organizations will now use forward-looking information to better inform their credit loss estimates. Many of the loss estimation techniques applied today will still be permitted, although the inputs to those techniques will change to reflect the full amount of expected credit losses. In addition, the ASU amends the accounting for credit losses on available-for-sale debt securities and purchased financial assets with credit deterioration. The amendments in this ASU are effective for SEC filers for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2019. For public companies that are not SEC filers, the amendments in this ASU are effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2020. The Company is currently assessing the impact that ASU 2016-13 will have on its consolidated financial statements. The Company formed a committee during mid-2016 to address the compliance requirements and engaged a third party during mid-2017 to generate a loan loss model that will measure projected credit losses under the ASU.

During August 2016, the FASB issued ASU No. 2016-15, "Statement of Cash Flows (Topic 230): Classification of Certain Cash Receipts and Cash Payments", to address diversity in how certain cash receipts and cash payments are presented and classified in the statement of cash flows. The amendments are effective for public business entities for fiscal years beginning after December 15, 2017, and interim periods within those fiscal years. The amendments should be applied using a retrospective transition method to each period presented. If retrospective application is impractical for some of the issues addressed by the update, the amendments for those issues would be applied prospectively as of the earliest date practicable. Early adoption is permitted, including adoption in an interim period. The Company does not expect the adoption of ASU 2016-15 to have a material impact on its consolidated financial statements.

During January 2017, the FASB issued ASU No. 2017-01, "Business Combinations (Topic 805): Clarifying the Definition of a Business". The amendments in this ASU clarify the definition of a business with the objective of adding guidance to assist entities with evaluating whether transactions should be accounted for as acquisitions (or disposals) of assets or businesses. Under the current implementation guidance in Topic 805, there are three elements of a business—inputs, processes, and outputs. While an integrated set of assets and activities (collectively referred to as a "set") that is a business usually has outputs, outputs are not required to be present. In addition, all the inputs and processes that a seller uses in operating a set are not required if market participants can acquire the set and continue to produce outputs. The amendments in this ASU provide a screen to determine when a set is not a business. If the screen is not met, the amendments (1) require that to be considered a business, a set must include, at a minimum, an input and a substantive process that together significantly contribute to the ability to create output and (2) remove the evaluation of whether a market participant could replace missing elements. The ASU provides a framework to assist entities in evaluating whether both an input and a substantive process are present. The amendments in this ASU are effective for annual periods beginning after December 15, 2017, including interim periods within those annual periods. The amendments in this ASU should be applied prospectively on or after the effective date. No disclosures are required at transition. The Company does not expect the adoption of ASU 2017-01 to have a material impact on its consolidated financial statements.

Note 1. Nature of Banking Activities and Significant Accounting Policies (Continued)

During January 2017, the FASB issued ASU No. 2017-04, "Intangibles – Goodwill and Other (Topic 350): Simplifying the Test for Goodwill Impairment". The amendments in this ASU simplify how an entity is required to test goodwill for impairment by eliminating Step 2 from the goodwill impairment test. Step 2 measures a goodwill impairment loss by comparing the implied fair value of a reporting unit's goodwill with the carrying amount of that goodwill. Instead, under the amendments in this ASU, an entity should perform its annual, or interim, goodwill impairment test by comparing the fair value of a reporting unit with its carrying amount. An entity still has the option to perform the qualitative assessment for a reporting unit to determine if the quantitative impairment test is necessary. Public business entities that are U.S. Securities and Exchange Commission (SEC) filers should adopt the amendments in this ASU for annual or interim goodwill impairment tests in fiscal years beginning after December 15, 2019. Public business entities that are not SEC filers should adopt the amendments in this ASU for annual or interim goodwill impairment tests in fiscal years beginning after December 15, 2020. Early adoption is permitted for interim or annual goodwill impairment tests performed on testing dates after January 1, 2017. The Company does not expect the adoption of ASU 2017-04 to have a material impact on its consolidated financial statements.

During March 2017, the FASB issued ASU 2017-07, "Compensation — Retirement Benefits (Topic 715): Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost". The amendments in this ASU require an employer that offers defined benefit pension plans, other postretirement benefit plans, or other types of benefits accounted for under Topic 715 to report the service cost component of net periodic benefit cost in the same line item(s) as other compensation costs arising from services rendered during the period. The other components of net periodic benefit cost are required to be presented in the income statement separately from the service cost component. If the other components of net periodic benefit cost are not presented on a separate line or lines, the line item(s) used in the income statement must be disclosed. In addition, only the service cost component will be eligible for capitalization as part of an asset, when applicable. The amendments are effective for annual periods beginning after December 15, 2017, including interim periods within those annual periods. Early adoption is permitted. The Company does not expect the adoption of ASU 2017-07 to have a material impact on its consolidated financial statements.

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

During May 2017, the FASB issued ASU 2017-09, "Compensation – Stock Compensation (Topic 718): Scope of Modification Accounting". The amendments provide guidance on determining which changes to the terms and conditions of share-based payment awards require an entity to apply modification accounting under Topic 718. The amendments are effective for annual periods, including interim periods within those annual periods, beginning after December 15, 2017. Early adoption is permitted, including adoption in any interim period, for reporting periods for which financial statements have not yet been issued. The Company is currently assessing the impact that ASU 2017-09 will have on its consolidated financial statements.

During August 2017, the FASB issued ASU 2017-12, "Derivatives and Hedging (Topic 815): Targeted Improvements to Accounting for Hedging Activities". The amendments in this ASU modify the designation and measurement guidance for hedge accounting as well as provide for increased transparency regarding the presentation of economic results on both the financial statements and related footnotes. Certain aspects of hedge effectiveness assessments will also be simplified upon implementation of this update. The amendments are effective for annual periods, including interim periods within those annual periods, beginning after December 15, 2018. Early adoption is permitted, including adoption in any interim period. The Company does not expect the adoption of ASU 2017-12 to have a material impact on its consolidated financial statements.

Note 1. Nature of Banking Activities and Significant Accounting Policies (Continued)

During February 2018, the FASB issued ASU 2018-02, "Income Statement – Reporting Comprehensive Income (Topic 220): Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income". The amendments provide financial statement preparers with an option to reclassify stranded tax effects within accumulated other comprehensive income to retained earnings in each period in which the effect of the change in the U.S. federal corporate income tax rate in the Tax Cuts and Jobs Act (or portion thereof) is recorded. The amendments are effective for all organizations for fiscal years beginning after December 15, 2018, and interim periods within those fiscal years. Early adoption is permitted. Organizations should apply the proposed amendments either in the period of adoption or retrospectively to each period (or periods) in which the effect of the change in the U.S. federal corporate income tax rate in the Tax Cuts and Jobs Act is recognized. The Company has elected to reclassify the stranded income tax effects from the Tax Cuts and Jobs Act in the consolidated financial statements for the period ending December 31, 2017. The amount of this reclassification in 2017 was $35,593.

Note 2. Acquisition of Easton Bancorp, Inc.

On July 15, 2015, the Company completed its acquisition of Easton. The merger of Easton with and into the Company was effected pursuant to the terms and conditions of the Easton Merger Agreement. Immediately after the merger, Easton Bank & Trust, Easton's wholly owned bank subsidiaries, merged with and into the Bank. Pursuant to the Easton Merger Agreement, Easton shareholders received cash of $9.60 for each share of Easton stock held immediately prior to the effective date of the merger. The cash portion of the merger consideration was funded through a private capital raise and no borrowing was incurred by the Company or the Bank in connection with the merger. There were no replacement stock awards awarded as part of the transaction.

The transaction was accounted for using the acquisition method of accounting and, accordingly, assets acquired, liabilities assumed, and consideration exchanged were recorded at fair value on the acquisition date.

A core deposit intangible of $1.5 million was recognized in connection with the acquisition of Easton. This intangible is being amortized over 79 months on an accelerated cost recovery basis.

Amortization expense of core deposit intangibles for the years ended December 31, 2017 and 2016 were $324,570 and $394,748, respectively. At December 31, 2017, the estimated future amortization expense of core deposit intangibles is as follows:

	Amount
2018	**$ 254,392**
2019	**184,215**
2020	**114,038**
2021	**43,861**
2022	**487**
	$ 596,993

Note 3. Investment Securities

Investment securities are summarized as follows at December 31, 2017 and 2016:

December 31, 2017	**Amortized Cost**	**Gross Unrealized Gains**	**Gross Unrealized Losses**	**Fair Value**
Available-for-Sale:				
Obligations of U.S. Government agencies and corporations	**$ 8,507,738**	**$ 4,903**	**$ (74,099)**	**$ 8,438,542**
Mortgage backed securities	**8,605,458**	**31,745**	**(49,332)**	**8,587,871**
Collateralized mortgage obligations	**17,003,386**	**2,954**	**(214,583)**	**16,791,757**
	$ 34,116,582	**$ 39,602**	**$ (338,014)**	**$ 33,818,170**

December 31, 2016	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Available-for-Sale:				
Obligations of U.S. Government agencies and corporations	$ 10,456,860	$ 141	$ (110,202)	$ 10,346,799
Mortgage backed securities	11,784,223	44,195	(39,354)	11,789,064
Collateralized mortgage obligations	14,041,171	18,186	(126,859)	13,932,498
	$ 36,282,254	$ 62,522	$ (276,415)	$ 36,068,361

The following table shows gross unrealized losses and fair value, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position, at December 31, 2017 and 2016:

	Less Than 12 Months		**12 Months or More**		**Total**	
December 31, 2017	**Fair Value**	**Unrealized Losses**	**Fair Value**	**Unrealized Losses**	**Fair Value**	**Unrealized Losses**
Obligations of U.S. Government agencies and corporations	**$ 4,210,279**	**$ (26,722)**	**$ 2,946,161**	**$ (47,377)**	**$ 7,156,440**	**$ (74,099)**
Mortgage backed securities	**5,055,127**	**(30,834)**	**1,727,082**	**(18,498)**	**6,782,209**	**(49,332)**
Collateralized mortgage obligations	**11,624,934**	**(96,017)**	**3,025,638**	**(118,566)**	**14,650,572**	**(214,583)**
	$ 20,890,340	**$ (153,573)**	**$ 7,698,881**	**$ (184,441)**	**$ 28,589,221**	**$ (338,014)**

	Less Than 12 Months		12 Months or More		Total	
December 31, 2016	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Obligations of U.S. Government agencies and corporations	$ 2,270,327	$ (9,292)	$ 7,675,863	$ (100,910)	$ 9,946,190	$ (110,202)
Mortgage backed securities	703,613	(11,428)	6,090,449	(27,926)	6,794,062	(39,354)
Collateralized mortgage obligations	1,354,254	(56,783)	7,087,474	(70,076)	8,441,728	(126,859)
	$ 4,328,194	$ (77,503)	$ 20,853,786	$ (198,912)	$ 25,181,980	$ (276,415)

At December 31, 2017, fifty-six securities with a fair value of $28.6 million had gross unrealized losses of $338,014. At December 31, 2016, fifty-two securities with a fair value of $25.2 million had gross unrealized losses of $276,415. As of December 31, 2017 and 2016, the Company's unrealized losses in investment securities are related to interest rate fluctuations and not credit deterioration. In addition, these securities are investment grade. Since the Company does not intend to sell any of the investments before recovery of their amortized cost basis and has the ability and intent to hold these investments to maturity, the Company does not consider these investments to be other-than-temporarily impaired.

Note 3. Investment Securities (Continued)

The amortized cost and estimated fair value of debt securities at December 31, 2017, by contractual maturity are shown in the table that follows. Maturities may differ from contractual maturities in mortgage-backed securities because the mortgages underlying the securities may be called or prepaid without any penalties.

	Available-for-Sale	
December 31, 2017	**Amortized Cost**	**Fair Value**
Due in one year or less	**$ 249,982**	**$ 249,910**
Due after one year through five years	**8,332,994**	**8,277,918**
Due after five years through ten years	**5,799,289**	**5,732,824**
Due after ten years	**19,734,317**	**19,557,518**
	$ 34,116,582	**$ 33,818,170**

During the year ended December 31, 2017, the Company did not sell any securities. During the year ended December 31, 2016, proceeds received from the sale of securities available for sale totaled $5.8 million with gross gains of $150,033 realized and $0 gross losses.

Investment securities with a carrying value of $13.7 million and $28.9 million were pledged as collateral of certain government agencies and municipalities as required or permitted by law at December 31, 2017 and 2016, respectively.

Note 4. Loans Receivable and Allowance for Loan Losses

The Company makes loans to customers primarily on the Eastern Shore of the State of Maryland in an economy closely tied to agriculture and the seafood industry. A substantial portion of its loan portfolio consists of residential and commercial real estate mortgages. The principal categories of the loan portfolio are as follows at December 31, 2017 and 2016:

	2017	2016
Real estate loans:		
Residential real estate	**$ 105,747,760**	$ 105,054,693
Commercial real estate	**103,684,331**	112,375,892
Real estate development	**7,352,361**	2,230,867
Commercial loans:		
Secured	**22,826,307**	17,932,713
Unsecured	**5,718,741**	973,124
Consumer loans:		
Secured	**2,127,192**	2,048,722
Unsecured	**543,389**	460,224
Gross loans	**248,000,081**	241,076,235
Unearned income on loans	**582,240**	336,680
Allowance for loan losses	**(1,846,815)**	(1,625,759)
Net loans	**$ 246,735,506**	$ 239,787,156

Note 4. Loans Receivable and Allowance for Loan Losses (Continued)

Acquired Loans

The outstanding principal balance and the carrying amount of acquired loans included in the consolidated balance sheet as of December 31, 2017 and 2016 are as follows:

	2017	2016
Outstanding principal balance	**$ 38,585,042**	$ 65,195,768
Carrying amount	**37,541,157**	59,751,343

The outstanding principal balance and related carrying amount of purchased credit impaired loans, for which the Company applies ASC 310-30, to account for interest earned, as of December 31, 2017 and 2016 are as follows:

	2017	2016
Outstanding principal balance	**$ 10,567,059**	$ 11,830,347
Carrying amount	**6,872,721**	7,746,483

The following table presents changes in the accretable yield on purchased credit impaired loans, for which the Company applies ASC 310-30, for the years ended December 31, 2017 and 2016:

	2017	2016
Balance, Beginning of Year	**$ 2,570,467**	$ 684,522
Accretion	**(1,043,838)**	(831,313)
Reclassification from nonaccretable difference, due to improvement in expected cash flows	**139,274**	1,143,697
Other changes, net (1)	**503,776**	1,573,561
Balance, End of Year	**$ 2,169,679**	$ 2,570,467

(1) Represents net increases (decreases) in expected cash flows resulting from other changes in the loan pools including, but not limited to, loan term and interest rate assumptions or the receipt of payments not originally forecasted.

An analysis of the allowance for loan losses follows for the years ended December 31, 2017 and 2016:

	2017	2016
Balance, beginning of year	**$ 1,625,759**	$ 1,491,149
Charge-offs	**(107,480)**	(101,205)
Recoveries	**7,723**	60,744
Provision for loan losses	**320,813**	175,071
Balance, end of year	**$ 1,846,815**	$ 1,625,759

Note 4. Loans Receivable and Allowance for Loan Losses (Continued)

A summary of the break down in the allowance for loan losses, by segment, follows for the years ended December 31, 2017 and 2016:

	Residential Real Estate	Commercial Real Estate	Real Estate Development	Commercial and Industrial	Consumer	Unallocated	Total
Allowance for Loan Losses:							
Balance, December 31, 2016	$ 523,153	$ 878,479	$ 38,571	$ 178,584	$ 5,955	$ 1,017	$ 1,625,759
Charge-offs	(70,527)	(2,806)	-	-	(34,147)		(107,480)
Recoveries	1,008	-			6,715		7,723
Provision for loan losses	102,361	(5,441)	89,300	103,509	31,935	(851)	320,813
Balance, December 31, 2017	$ 555,995	$ 870,232	$ 127,871	$ 282,093	$ 10,458	$ 166	$ 1,846,815
Ending balance: individually evaluated for impairment	$ -	$ -	$ -	$ -	$ -	$ -	$ -
Ending balance: collectively evaluated for impairment	$ 555,995	$ 870,232	$ 127,871	$ 282,093	$ 10,458	$ 166	$ 1,846,815
Ending balance: acquired impaired loans	$ -	$ 80,468	$ -	$ -	$ -	$ -	$ 80,468
Balance, December 31, 2017	$ 105,747,760	$ 103,684,331	$ 7,352,361	$ 28,545,048	$ 2,670,581	$ -	$ 248,000,081
Ending balance: individually evaluated for impairment	$ 388,635	$ 4,403,269	$ -	$ -	$ 34,587	$ -	$ 4,826,491
Ending balance: collectively evaluated for impairment	$ 101,836,650	$ 96,515,831	$ 7,270,103	$ 28,045,273	$ 2,633,012	$ -	$ 236,300,869
Ending balance: acquired impaired loans	$ 3,522,475	$ 2,765,231	$ 82,258	$ 499,775	$ 2,982	$ -	$ 6,872,721

	Residential Real Estate	Commercial Real Estate	Real Estate Development	Commercial and Industrial	Consumer	Unallocated	Total
Allowance for Loan Losses:							
Balance, December 31, 2015	$ 590,492	$ 645,845	$ 54,247	$ 81,464	$ 8,414	$ 110,687	$ 1,491,149
Charge-offs			(58,376)	(28,288)	(14,541)		(101,205)
Recoveries	950	57,830	-		1,964		60,744
Provision for loan losses	(68,289)	174,804	42,700	125,408	10,118	(109,670)	175,071
Balance, December 31, 2016	$ 523,153	$ 878,479	$ 38,571	$ 178,584	$ 5,955	$ 1,017	$ 1,625,759
Ending balance: individually evaluated for impairment	$ -	$ -	$ -	$ -	$ -	$ -	$ -
Ending balance: collectively evaluated for impairment	$ 523,153	$ 878,479	$ 38,571	$ 178,584	$ 5,955	$ 1,017	$ 1,625,759
Ending balance: acquired impaired loans	$ -	$ -	$ -	$ -	$ -	$ -	$ -
Balance, December 31, 2016	$ 105,054,693	$ 112,375,892	$ 2,230,867	$ 18,905,837	$ 2,508,946	$ -	$ 241,076,235
Ending balance: individually evaluated for impairment	$ 169,328	$ 4,597,122	$ -	$ -	$ -	$ -	$ 4,766,450
Ending balance: collectively evaluated for impairment	$ 101,257,935	$ 104,058,215	$ 2,131,752	$ 18,610,295	$ 2,505,105	$ -	$ 228,563,302
Ending balance: acquired impaired loans	$ 3,627,430	$ 3,720,555	$ 99,115	$ 295,542	$ 3,841	$ -	$ 7,746,483

Note 4. Loans Receivable and Allowance for Loan Losses (Continued)

Management evaluates the credit quality of all loans based on an internal grading system that estimates the capability of the borrower to repay the contractual terms of their loan agreement as scheduled or at all. The Company's internal risk grading is based on experiences with similarly graded loans. Management analyzes risk grades on an ongoing basis. In addition, risk grades are validated by an independent loan review performed at least annually.

The Company's internally assigned grades are as follows:

- Pass – Loans classified as pass are supported by adequate financial statements, adequately secured by collateral and borrower demonstrates the ability to repay from normal business operations.
- Special Mention – Loans classified as special mention have a potential weakness that deserves management's close attention and include loans with characteristics such as significant guideline or policy exceptions that are not offset by appropriate mitigating factors, extending loans that are currently performing satisfactorily but with potential weaknesses that may, if not corrected, weaken the asset or inadequately protect the Company's position at some future date and loans where the development of adverse economic conditions subsequent to origination would substantially increase the level of risk, but may not jeopardize liquidation of the collateral.
- Substandard – Loans classified as substandard are inadequately protected by the current net worth and paying capacity of the obligor or of the collateral pledged, if any. Loans are classified substandard that have a well-defined weakness or weaknesses that jeopardize the liquidation of the debt. They are characterized by the distinct possibility that the institution will sustain some loss if the deficiencies are not corrected. Loans in the category are characterized by deterioration in quality exhibited by any number of well-defined weaknesses requiring corrective action. The repayment ability of the borrower is marginal or weak and the loan may have exhibited excessive overdue status or extensions and/or renewals.
- Doubtful – Loans classified as doubtful have all the weaknesses inherent in one classified substandard with the added characteristic that the weaknesses make collection or liquidation in full, on the basis of currently existing facts, conditions, and values, highly questionable and therefore improbable. However, the loans are not yet rated loss because events may occur that could salvage the debt.
- Loss – Loans classified as loss are considered uncollectible and of such little value that their continuance as bankable assets is not warranted.

Note 4. Loans Receivable and Allowance for Loan Losses (Continued)

The following table represents the credit quality of loans, by class, as of December 31, 2017 and 2016:

Balance, December 31, 2017	**Pass**	**Special Mention**	**Substandard**	**Doubtful**	**Loss**
Real estate loans:					
Residential real estate	**$ 104,501,034**	**$ 27,114**	**$ 1,219,612**	**$ -**	**$ -**
Commercial real estate	**96,423,018**	**567,211**	**6,694,102**	**-**	**-**
Real estate development	**7,255,729**	**-**	**96,632**	**-**	**-**
Commercial loans:					
Secured	**22,826,307**	**-**	**-**	**-**	**-**
Unsecured	**5,718,741**	**-**	**-**	**-**	**-**
Consumer loans:					
Secured	**2,127,192**	**-**	**-**	**-**	**-**
Unsecured	**543,389**	**-**	**-**	**-**	**-**
Total	**$ 239,395,410**	**$ 594,325**	**$ 8,010,346**	**$ -**	**$ -**

Balance, December 31, 2016	Pass	Special Mention	Substandard	Doubtful	Loss
Real estate loans:					
Residential real estate	$ 103,215,474	$ 41,108	$ 1,798,111	$ -	$ -
Commercial real estate	104,900,240	678,031	6,797,621	-	-
Real estate development	2,130,885	867	99,115	-	-
Commercial loans:					
Secured	17,932,713	-	-	-	-
Unsecured	973,124	-	-	-	-
Consumer loans:					
Secured	2,018,007	-	30,715	-	-
Unsecured	460,224	-	-	-	-
Total	$ 231,630,667	$ 720,006	$ 8,725,562	$ -	$ -

Note 4. Loans Receivable and Allowance for Loan Losses (Continued)

Past due loans based on contractual payment status, including loans on nonaccrual status, presented by class before unearned fees were as follows as of December 31, 2017 and 2016:

December 31, 2017	30 - 59 Days Past Due	60-89 Days Past Due	Greater Than 90 Days	Total Past Due	Current	Total Loans	Recorded Investments >90 Days Accruing	Non-Accrual Loans
Real estate loans:								
Residential real estate	**$ 703,378**	**$ 414,216**	**$ 254,632**	**$ 1,372,226**	**$ 104,375,534**	**$ 105,747,760**	**$ 64,668**	**$ 592,290**
Commercial real estate	**101,188**	**-**	**3,179,211**	**3,280,399**	**100,403,932**	**103,684,331**	**-**	**4,833,091**
Real estate development	**-**	**14,374**	**-**	**14,374**	**7,337,987**	**7,352,361**	**-**	**14,411**
Commercial loans:								
Secured	**-**	**-**	**-**	**-**	**22,826,307**	**22,826,307**	**-**	**-**
Unsecured	**515**	**-**	**-**	**515**	**5,718,226**	**5,718,741**	**-**	**-**
Consumer loans:								
Secured	**39,587**	**-**	**50,554**	**90,141**	**2,037,051**	**2,127,192**	**23,705**	**-**
Unsecured	**515**	**-**	**-**	**515**	**542,874**	**543,389**	**-**	**-**
Total	**$ 845,183**	**$ 428,590**	**$ 3,484,397**	**$ 4,758,170**	**$ 243,241,911**	**$ 248,000,081**	**$ 88,373**	**$ 5,439,792**

December 31, 2016	30 - 59 Days Past Due	60-89 Days Past Due	Greater Than 90 Days	Total Past Due	Current	Total Loans	Recorded Investments >90 Days Accruing	Non-Accrual Loans
Real estate loans:								
Residential real estate	$ 112,744	$ 107,247	$ 500,238	$ 720,229	**$ 104,334,464**	$ 105,054,693	$ 21,032	$ 575,113
Commercial real estate	-	-	2,912,756	2,912,756	**109,463,136**	112,375,892	-	4,596,730
Real estate development	-	18,656	197,177	215,833	**2,015,034**	2,230,867	197,178	-
Commercial loans:								
Secured	-	-	-	-	**17,932,713**	17,932,713	-	-
Unsecured	-	-	-	-	**973,124**	973,124	-	-
Consumer loans:								
Secured	-	6,042	-	6,042	**2,042,680**	2,048,722	-	-
Unsecured	1,029	191	-	1,220	**459,004**	460,224	-	-
Total	$ 113,773	$ 132,136	$ 3,610,171	$ 3,856,080	$ 237,220,155	$ 241,076,235	$ 218,210	$ 5,171,843

Note 4. Loans Receivable and Allowance for Loan Losses (Continued)

Information relating to individually impaired loans, excluding acquired impaired loans, by class of loans, was as follows as of December 31, 2017:

December 31, 2017	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Interest Income Recognized
With no related allowance:					
Real estate loans:					
Residential real estate	$ 388,635	$ 441,020	$ -	$ 338,756	$ 32,697
Commercial real estate	4,403,269	4,403,269	-	4,516,216	23,019
Real estate development	-	-	-	-	-
Commercial loans:					
Secured	-	-	-	-	-
Unsecured	-	-	-	-	-
Consumer loans:					
Secured	34,587	34,587	-	38,980	1,454
Unsecured	-	-	-	-	-
With an allowance recorded:					
Real estate loans:					
Residential real estate	$ -	$ -	$ -	$ -	$ -
Commercial real estate	-	-	-	-	-
Real estate development	-	-	-	-	-
Commercial loans:					
Secured	-	-	-	-	-
Unsecured	-	-	-	-	-
Consumer loans:					
Secured	-	-	-	-	-
Unsecured	-	-	-	-	-
Total:					
Real estate loans:					
Residential real estate	$ 388,635	$ 441,020	$ -	$ 338,756	$ 32,697
Commercial real estate	4,403,269	4,403,269	-	4,516,216	23,019
Real estate development	-	-	-	-	-
Commercial loans:					
Secured	-	-	-	-	-
Unsecured	-	-	-	-	-
Consumer loans:					
Secured	34,587	34,587	-	38,980	1,454
Unsecured	-	-	-	-	-

Note 4. Loans Receivable and Allowance for Loan Losses (Continued)

Information relating to individually impaired loans, by class of loans, was as follows as of December 31, 2016:

December 31, 2016	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Interest Income Recognized
With no related allowance:					
Real estate loans:					
Residential real estate	$ 169,328	$ 202,380	$ -	$ 585,010	$ 43,412
Commercial real estate	4,597,122	4,597,122	-	5,097,149	31,172
Real estate development	-	-	-	-	-
Commercial loans:					
Secured	-	-	-	-	-
Unsecured	-	-	-	-	-
Consumer loans:					
Secured	-	-	-	15,466	-
Unsecured	-	-	-	-	-
With an allowance recorded:					
Real estate loans:					
Residential real estate	$ -	$ -	$ -	$ 126,207	$ -
Commercial real estate	-	-	-	68,059	-
Real estate development	-	-	-	-	-
Commercial loans:					
Secured	-	-	-	-	-
Unsecured	-	-	-	-	-
Consumer loans:					
Secured	-	-	-	-	-
Unsecured	-	-	-	-	-
Total:					
Real estate loans:					
Residential real estate	$ 169,328	$ 202,380	$ -	$ 711,217	$ 43,412
Commercial real estate	4,597,122	4,597,122	-	5,165,208	31,172
Real estate development	-	-	-	-	-
Commercial loans:					
Secured	-	-	-	-	-
Unsecured	-	-	-	-	-
Consumer loans:					
Secured	-	-	-	15,466	-
Unsecured	-	-	-	-	-

Note 4. Loans Receivable and Allowance for Loan Losses (Continued)

A summary of loans modified as TDRs is presented, by loan class, as follows for the years ended December 31, 2017 and 2016:

December 31, 2017	**Number of Contracts**	**Pre-Modification Investment**	**Post-Modification Investment**
Commercial real estate	**0**	**$ -**	**$ -**
Residential real estate	**1**	**26,241**	**26,241**
Consumer - Secured	**0**	**-**	**-**
		$ 26,241	**$ 26,241**

December 31, 2016	Number of Contracts	Pre-Modification Investment	Post-Modification Investment
Commercial real estate	0	$ -	$ -
Residential real estate	4	364,352	370,011
Consumer - Secured	0	-	-
		$ 364,352	$ 370,011

For the purposes of this disclosure, the Company defines default as any payment that occurs more than 90 days past the due date, charge-off or foreclosure subsequent to modification. No troubled debt restructurings defaulted within twelve months of modification during the years ended December 31, 2017 and 2016.

Note 5. Premises and Equipment

Premises and equipment are comprised of the following at December 31, 2017 and 2016:

	2017	2016
Land	**$ 1,101,521**	$ 1,101,521
Buildings and land improvements	**6,297,755**	6,287,787
Furniture, fixtures and equipment	**2,216,098**	2,094,588
	9,615,374	9,483,896
Accumulated depreciation	**(4,473,623)**	(4,040,668)
Premises and equipment, net	**$ 5,141,751**	$ 5,443,228
Depreciation expense	**$ 436,747**	$ 462,001

The Company leases property for two branches acquired from Easton. The Glebe Road lease became effective October 17, 2008. It is a 5 year lease with four 5 year renewal options. Easton executed an extension of the lease for an additional 5 year period through October 2018. In July 2014, Easton executed a two year lease agreement for property in which the Oxford Branch is located. The lease became effective July 31, 2014 and ended on August 1, 2016. The Company executed a new two year lease effective January 1, 2017 through December 31, 2018. The Company is responsible for all real estate taxes.

Note 5. Premises and Equipment (Continued)

Minimum lease obligations as of December 31, 2017 are as follows:

Year	Amount
2018	**$ 52,527**

Rent expense for 2017 and 2016 totaled $54,148 and $55,560, respectively.

Note 6. Other Real Estate Owned

As of December 31, 2017, there were three residential real estate properties totaling $170,100 included in other real estate owned. There were no residential real estate loans in process of foreclosure as of December 31, 2017.

The table below reflects changes in OREO for the years ended December 31, 2017 and 2016:

	2017	2016
Balance, beginning of year	**$ 819,037**	$ 1,825,840
Properties acquired at foreclosure	**251,100**	419,642
Properties acquired in acquisition	**-**	-
Sale of foreclosed properties	**(553,466)**	(1,363,800)
Valuation adjustments	**(182,432)**	(62,645)
Balance, end of year	**$ 334,239**	$ 819,037

Expenses applicable to other real estate owned include the following for the years ended December 31, 2017 and 2016:

	2017	2016
Net loss on sales of real estate	**$ 85,865**	$ 53,593
Gain on foreclosure	**(69,269)**	(2,163)
Valuation adjustments	**182,432**	62,645
Operating expenses, net of rental income	**12,620**	64,773
	$ 211,648	$ 178,848

Note 7. Deposits

The aggregate amount of time deposits in denominations of $250,000 or greater was $17.1 million and $14.4 million at December 31, 2017 and 2016, respectively.

The scheduled maturities of time deposits are as follows:

2018	**$ 40,494,089**
2019	**13,071,611**
2020	**5,090,629**
2021	**12,441,101**
2022	**7,684,413**
Thereafter	**491,705**
	$ 79,273,548

Note 7. Deposits (Continued)

At December 31, 2017 and December 31, 2016, there was one customer relationship, where the balances on deposit exceeded 5% of outstanding deposits. This customer relationship comprised 7.64% and 5.04% of the outstanding deposits at December 31, 2017 and 2016, respectively.

Overdrafts reclassified from deposits to loans totaled $30,516 and $41,619 at December 31, 2017 and 2016, respectively.

Note 8. Junior Subordinated Debt

On July 15, 2015, in connection with the Easton acquisition, the Company assumed $3,000,000 in junior subordinated debt to the Easton Capital Trust I, to fully and unconditionally guarantee the preferred securities issued by the Easton Trust. These long-term obligations, which qualify as Tier 1 capital, constitute a full and unconditional guarantee by the Company of the Easton Capital Trust obligations. The junior subordinated debt will mature on February 8, 2034, which may be shortened to a date not earlier than February 8, 2009, if certain conditions, including regulatory approvals, are met. The junior subordinated debentures, which are the only assets of the trust, are subordinate to all present and future senior indebtedness of the Company. The junior subordinated debt accrues interest at a floating rate equal to the 3-month LIBOR plus 2.85%, payable quarterly. The quarterly interest rate on the debentures was 4.238% at December 31, 2017. The quarterly distributions on the preferred securities will be paid at the same rate that interest is paid on the junior subordinated debentures. The accrued interest on these obligations totaled $19,247 at December 31, 2017. In accordance with ASC 810-10-15-14 "Consolidation-Overall-Scope and Scope Exceptions," the Company did not eliminate through consolidation the Company's $93,000 equity investment in Easton Capital Trust I. Instead, the Company reflected this equity investment in the other assets line item in the consolidated balance sheet.

In conjunction with the acquisition of Easton, the junior subordinated debt was recorded at fair value. The original fair value discount was $679,615 and is being amortized into interest expense over the remaining life of the borrowing. The balance of the junior subordinated debt appearing on the Company's balance sheet as of December 31, 2017 totaled $2.5 million, which is net of the unamortized fair value discount of $589,047.

Note 9. Senior Subordinated Debt

At December 31, 2017 and 2016, total outstanding noncumulative subordinated notes of the Company totaled $4.1 million. The notes outstanding at December 31, 2017 have a fixed rate of interest of 7%, payable quarterly, are callable at par upon origination and mature on July 1, 2025. The Company has the right to redeem the notes, in whole or in part, on any interest payment date on or after July 1, 2020.

Note 10. Available Borrowings and Contingency Funding Lines

The Company has credit availability of approximately $7.8 million with various correspondent banks for short-term liquidity needs, if necessary. As of December 31, 2017 and 2016, there were no outstanding balances on these credit facilities.

The Company maintains a $44.9 million line of credit with the Federal Home Loan Bank of Atlanta (FHLB). The interest rate and term of each advance from the line is dependent upon the advance and commitment type. Advances on the line are secured by the Company's qualifying loans. As of December 31, 2017, the book value of these qualifying loans totaled $53.0 million. Advances on the line in excess of this amount require pledging of additional assets, including other types of loans and investment securities. As of December 31, 2017, there were $38.5 million in unfunded letters of credit outstanding against the FHLB line of credit. There were no outstanding balances with FHLB at December 31, 2016.

Note 11. Retirement Plans

The Company participates in a multiple employer defined benefit pension plan covering all full-time employees with more than one year of service. This plan was frozen at October 31, 2010. No additional cash payments are expected to be contributed to the plan for the period ended June 30, 2018. Pension plan expense was $42,507 and $41,195 for the years ended December 31, 2017 and 2016, respectively.

The Company has a 401k profit sharing plan covering substantially all employees. The Company will contribute a safe harbor contribution of 3% of participants' compensation and also provide a 50% match for employee contributions up to 6%. Related expenses were $159,550 and $156,463 for the years ended December 31, 2017 and 2016, respectively.

Note 12. Deferred Compensation Arrangements

The Company had a voluntary deferred compensation plan that permitted directors and certain officers to defer receipt of directors' fees or a portion of compensation until a later time. The Company purchased life insurance contracts on the participants with the premiums being paid from the deferred fees and compensation. The Company is the owner and sole beneficiary of all life insurance. The cash surrender value of the life insurance totaled $2.0 million and $1.9 million at December 31, 2017 and 2016, respectively. Accrued benefit obligations utilizing a 7% interest factor totaled $496,773 and $572,767 at December 31, 2017 and 2016, respectively. Income, net of expenses, related to this plan was $34,709 and $32,863, respectively, for the year ended December 31, 2017 and 2016.

The Company has an executive supplemental retirement and life insurance plan for the benefit of its former Chairman and President. The Company has purchased life insurance on the participant and is the owner of the policies. Split dollar death benefits are also provided to the Company and this participant. The Company's portion of the cash surrender value of the life insurance policy totaled $6.1 million and $6.0 million at December 31, 2017 and 2016, respectively. The accrued benefit obligation utilizing a 6% interest factor totaled $925,608 at December 31, 2017 and 2016. Total expense, net of income, related to this plan was $28,502 for the year ended December 31, 2017. Income, net of expenses, related to this plan was $41,977 for the year ended December 31, 2016.

In 2011, the Company began an executive supplemental retirement and life insurance plan for the benefit of its current Chairman and President. The Company purchased life insurance on the participant in February 2012 and is the owner of the policy. In 2017, the Company increased the executive supplemental retirement and life insurance plan for the benefit of the current Chairman and President. The Company's portion of the cash surrender value of the life insurance policy totaled $3.7 and $1.1 million at December 31, 2017 and 2016, respectively. The accrued benefit obligation utilizing a 6% interest factor totaled $765,033 and $560,896 at December 31, 2017 and 2016, respectively. Expenses, net of income, related to this plan were $137,804 and $88,141 for December 31, 2017 and 2016, respectively.

The split dollar death benefit agreement with the former Chairman and President provides for death benefits to be paid to his beneficiaries. This arrangement constitutes post-retirement benefits under ASC Topic 715 – "Retirement Benefits." This pronouncement required the recording of expense and liability for these post-retirement benefits prior to retirement, based on the present value of the future benefits, calculated on life expectancy, post retirement term insurance costs, and the related amounts of death benefits being provided. Ultimately, at the time of the former Chairman and President's death, the Company will record income equal to cumulative accrued expense. The accrued obligation was $1.7 million at December 31, 2017 and 2016.

In conjunction with the Easton acquisition, the Company assumed a supplemental retirement benefit for an Easton executive officer. The benefits vest at the rate of 10% per year and is funded by Bank Owned Life Insurance policy. As of December 31, 2017 and 2016, the liability totaled $865,016 and $903,811, respectively. The balance of the Bank Owned Life Insurance totaled $2.2 million and $2.1 million at December 31, 2017 and 2016, respectively. Income, net of expenses, related to this plan was $18,418 and $18,670, respectively, for the years ended December 31, 2017 and 2016.

Note 13. Restriction on Dividends

The Company is subject to certain restrictions on the amount of dividends that it may pay without regulatory approval. The Company normally restricts dividends to a lesser amount. The ability of the Company to pay dividends is largely dependent on the ability of the Bank to pay dividends to the Company. In general, under Maryland law, the Bank may declare a cash dividend, after providing for due or accrued expenses, losses, interest, and taxes, from its undivided profits, or with the prior approval of the Maryland Commissioner of Financial Regulation, from its surplus in excess of 100% of its required stock. However, because the Bank had a retained deficit as of December 31, 2017, until the Bank's surplus equals 100% of its required capital stock, cash dividends may not be paid in excess of 90% of the Bank's net earnings.

Note 14. Regulatory Matters

As of December 31, 2017, the most recent notification from the Federal Reserve Bank categorized the Bank as well capitalized under the regulatory framework for prompt corrective action. To be categorized as well capitalized, the Bank must maintain minimum total risk-based, Common Equity Tier 1 risk-based, Tier 1 risk-based, and Tier 1 leverage ratios as set forth in the table below. There are no conditions or events since that notification that management believes have changed the Bank's well capitalized category.

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

Quantitative measures established by regulation to ensure capital adequacy require the Bank to maintain minimum amounts and ratios of Total, Common Equity Tier 1, and Tier 1 Capital (as defined in the regulations) to risk-weighted assets (as defined) and Tier 1 Capital (as defined) to average assets (as defined). Management believes, as of December 31, 2017 and 2016, the Company and the Bank met all capital adequacy requirements to which they were subject.

Because total assets on a consolidated basis are less than $1 Billion, the Company is not subject to the consolidated capital requirements imposed by the Bank Holding Company Act. Consequently, the Company does not calculate its financial ratios on a consolidated basis.

On January 1, 2015, the Bank applied changes to the regulatory capital framework that were approved on July 9, 2013 by the federal banking regulators (the Basel III Final Rule). The regulatory risk-based capital amounts presented below for December 31, 2017 and 2016 include: (1) common equity tier 1 capital (CET1) which consists principally of common stock (including surplus) and retained earnings with adjustments for goodwill, intangible assets and deferred taxes; (2) Tier 1 capital which consists principally of CET1 plus the Bank's "grandfathered" trust preferred securities; and (3) Tier 2 capital which consists principally of Tier 1 capital plus a limited amount of the allowance for loan losses. In addition, the Bank has made the one-time irrevocable election to continue treating accumulated other comprehensive income (AOCI) under regulatory standards that were in place prior to the Basel III Final Rule in order to eliminate volatility of regulatory capital that can result from fluctuations in AOCI and the inclusion of AOCI in regulatory capital, as would otherwise be required under the Basel III Capital Rule. The capital conservation buffer is being phased in from 0.00% for 2015 to 2.50% by 2019. The capital conservation buffer for 2017 was 1.25% and for 2016 was 0.625%. The table below also reflects the minimum regulatory and certain prompt corrective action capital ratio requirements that began on January 1, 2015.

Note 14. Regulatory Matters (Continued)

The Bank's actual and required capital amounts and ratios are presented as follows as of December 31, 2017 and 2016:

	Actual		Minimum Capital Requirement		Minimum To Be Well Capitalized Under Prompt Corrective Active Provisions	
	Amount	**Ratio**	**Amount**	**Ratio**	**Amount**	**Ratio**
As of December 31, 2017:						
Total Capital [to Risk Weighted Assets]	**$ 45,372,000**	**18.61%**	**$ 19,506,720**	**8.000%**	**$ 24,383,400**	**10.000%**
Common Equity Tier 1 Capital [to Risk Weighted Assets]	**43,268,000**	**17.74%**	**10,972,530**	**4.500%**	**15,849,210**	**6.500%**
Tier 1 Capital [to Risk Weighted Assets]	**43,268,000**	**17.74%**	**14,630,040**	**6.000%**	**19,506,720**	**8.000%**
Tier 1 Capital [to Average Assets]	**43,268,000**	**12.63%**	**13,703,720**	**4.000%**	**17,129,650**	**5.000%**

	Actual		Minimum Capital Requirement		Minimum To Be Well Capitalized Under Prompt Corrective Active Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
As of December 31, 2016:						
Total Capital [to Risk Weighted Assets]	$ 41,607,000	17.63%	$ 18,880,960	8.000%	$ 23,601,200	10.000%
Common Equity Tier 1 Capital [to Risk Weighted Assets]	39,723,000	16.83%	10,620,540	4.500%	15,340,780	6.500%
Tier 1 Capital [to Risk Weighted Assets]	39,723,000	16.83%	14,160,720	6.000%	18,880,960	8.000%
Tier 1 Capital [to Average Assets]	39,723,000	12.77%	12,444,600	4.000%	15,555,750	5.000%

Note 15. Income Taxes

The Company files income tax returns in the U.S. federal jurisdiction and the State of Maryland. With few exceptions, the Company is no longer subject to U.S. federal and state income tax examinations by tax authorities for years prior to 2014.

On December 22, 2017, the President of the United States signed into law the Tax Cuts and Jobs Act (the "2017 Tax Act"). The 2017 Tax Act includes a number of changes to existing U.S. tax laws that impact the Company, most notably a reduction of the U.S. corporate income tax rate from a maximum of 35 percent to 21 percent for tax years beginning after December 31, 2017.

Note 15. Income Taxes (Continued)

The Company recognized the income tax effects of the 2017 Tax Act in its 2017 financial statements in accordance with Staff Accounting Bulletin No. 118, which provides SEC staff guidance for the application of ASC Topic 740, Income Taxes, in the reporting period in which the 2017 Tax Act was signed into law. As such, the Company's financial results reflect the income tax effects of the 2017 Tax Act for which the accounting under ASC Topic 740 is complete and provisional amounts for those specific income tax effects of the 2017 Tax Act for which the accounting under ASC Topic 740 is incomplete but a reasonable estimate could be determined. The Company did not identify items for which the income tax effects of the 2017 Tax Act have not been completed and a reasonable estimate could not be determined as of December 31, 2017.

The provision for income taxes consists of the following for the years ended December 31, 2017 and 2016:

	2017	2016
Current tax expense	**$ 83,279**	$ 60,057
Deferred tax expense	**1,155,379**	1,280,900
Deferred tax asset adjustment for enacted change in tax rate	**2,566,908**	- -
Change in valuation allowance, excluding goodwill adjustment	**(4,391,624)**	(5,812,983)
Total income tax benefit	**$ (586,058)**	$ (4,472,026)

The income tax provision differs from the amount of income tax determined by applying the U.S. federal income tax rate to pretax income due to the following:

	2017	2016
Expense at Federal statutory rate	**$ 1,205,302**	$ 1,148,084
Differences resulting from:		
State income tax expense (benefit), net of federal tax effect	**142,595**	133,373
Tax exempt income	**(109,068)**	(98,539)
Other	**(171)**	158,039
Adjustments to DTA resulting from changes in federal tax law	**2,566,908**	-
Change in valuation allowance, excluding goodwill adjustment	**(4,391,624)**	(5,812,983)
Provision for income taxes	**$ (586,058)**	$ (4,472,026)

Note 15. Income Taxes (Continued)

The tax effects of temporary differences that give rise to significant portions of deferred tax assets and deferred tax liabilities are summarized below as of December 31, 2017 and 2016:

	2017	2016
Deferred tax assets:		
Other real estate owned	**$ 78,974**	$ 40,180
Allowance for loan losses	**410,191**	500,793
Accrued expenses	**601,923**	812,280
Net operating loss carryforward, federal and state	**4,239,829**	7,595,185
Nonaccrual interest	**321,357**	152,381
Other	**392,191**	340,760
Acquisition accounting adjustments	**452,887**	816,210
Unrealized loss on securities available-for-sale	**82,131**	72,724
Deferred tax assets	**6,579,483**	10,330,513
Deferred tax liabilities:		
Accumulated depreciation	**(156,200)**	(242,725)
Deferred costs and fees on loans, net	**(160,218)**	(132,803)
Other	**(5,600)**	(20,235)
Deferred tax liabilities	**(322,018)**	(395,763)
	6,257,465	9,934,750
Valuation allowance	**-**	(4,391,624)
Net deferred tax assets	**$ 6,257,465**	$ 5,543,126

The Company measures deferred tax assets and liabilities using enacted tax rates that will apply in the years in which the temporary differences are expected to be recovered or paid. Accordingly, the Company's deferred tax assets and liabilities were remeasured to reflect the reduction in the U.S. corporate income tax rate from 35 percent to 21 percent, resulting in a $2.6 million increase in income tax expense for the year ended December 31, 2017 and a corresponding $2.6 million decrease in net deferred tax assets as of December 31, 2017.

Under the provisions of the Internal Revenue Code, the Company has $15.4 million of net operating loss carryforwards which can be offset against future taxable income. The carryforwards expire through December 31, 2033. The full realization of tax benefits associated with carryforwards depends predominately upon the recognition of ordinary income during the carryforward period. Beginning in 2019, the federal portion of net operating loss carryforwards available to offset taxable income is limited to $833,717 annually under IRS code section 382. The Company believes it will generate sufficient future taxable income to fully utilize the remaining deferred tax assets. The Company has generated taxable income for three continuous years, resulting in a significant utilization of its net operating loss carryforwards, and it has no reason to believe this trend will not continue.

Note 16. Fair Value Measurements

The Company follows authoritative accounting guidance to record fair value adjustments to certain assets and liabilities and to determine fair value disclosures. The guidance clarifies that fair value of certain assets and liabilities is an exit price, representing the amount that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants. The guidance provides key considerations in determining the fair value of a financial asset when the market for that financial asset is not active.

Note 16. Fair Value Measurements (Continued)

Authoritative accounting guidance specifies a hierarchy of valuation techniques based on whether the inputs to those valuation techniques are observable or unobservable. Observable inputs reflect market data obtained from independent sources, while unobservable inputs reflect the Company's market assumptions. The three levels of the fair value hierarchy based on these two types of inputs are as follows:

Level 1 - Valuation is based on quoted prices in active markets for identical assets and liabilities.
Level 2 - Valuation is based on observable inputs including quoted prices in active markets for similar assets and liabilities, quoted prices for identical or similar assets and liabilities in less active markets, and model-based valuation techniques for which significant assumptions can be derived primarily from or corroborated by observable data in the market.
Level 3 - Valuation is based on model-based techniques that use one or more significant inputs or assumptions that are unobservable in the market.

The following describes the valuation techniques used by the Company to measure certain assets and liabilities recorded at fair value on a recurring basis in the financial statements:

Securities Available-for-Sale: Securities available-for-sale are recorded at fair value on a recurring basis. Fair value measurement is based upon quoted market prices, when available (Level 1). If quoted market prices are not available, fair values are measured utilizing independent valuation techniques of identical or similar securities for which significant assumptions are derived primarily from or corroborated by observable market data. Third party vendors compile prices from various sources and may determine the fair value of identical or similar securities by using pricing models that consider observable market data (Level 2).

The following table presents the balances of financial assets measured at fair value on a recurring basis as of December 31, 2017 and 2016:

		Fair Value Measurements at December 31, 2017 Using		
Description	**Fair Value as of December 31, 2017**	**Quoted Prices in Active Markets (Level 1)**	**Significant Other Observable Inputs (Level 2)**	**Significant Other Unobservable Inputs (Level 3)**
Assets:				
Available for sale securities:				
Obligations of U.S. Government agencies and corporations	**$ 8,438,542**	**$ -**	**$ 8,438,542**	**$ -**
Mortgage backed securities	**8,587,871**	**-**	**8,587,871**	**-**
Collateralized mortgage obligations	**16,791,757**	**-**	**16,791,757**	**-**
Total available for sale securities	**$ 33,818,170**	**$ -**	**$ 33,818,170**	**$ -**

		Fair Value Measurements at December 31, 2016 Using		
Description	Fair Value as of December 31, 2016	Quoted Prices in Active Markets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Other Unobservable Inputs (Level 3)
Assets:				
Available for sale securities:				
Obligations of U.S. Government agencies and corporations	$ 10,346,799	$ -	$ 10,346,799	$ -
Mortgage backed securities	11,789,064	-	11,789,064	-
Collateralized mortgage obligations	13,932,498	-	13,932,498	-
Total available for sale securities	$ 36,068,361	$ -	$ 36,068,361	$ -

Note 16. Fair Value Measurements (Continued)

Certain assets are measured at fair value on a nonrecurring basis in accordance with GAAP. Adjustments to the fair value of these assets usually result from the application of lower-of-cost-or-market accounting or write-downs of individual assets.

The following describes the valuation techniques used by the Company to measure certain assets recorded at fair value on a nonrecurring basis in the financial statements:

Impaired Loans: Loans are designated as impaired when, in the judgment of management based on current information and events, it is probable that all amounts due according to the contractual terms of the loan agreements will not be collected. The measurement of loss associated with impaired loans can be based on either the observable market price of the loan or the fair value of the collateral. Collateral may be in the form of real estate or business assets including equipment, inventory, and accounts receivable. The vast majority of the Company's collateral is real estate. The value of real estate collateral is determined utilizing a market valuation approach based on an appraisal, of one year or less, conducted by an independent, licensed appraiser using observable market data (Level 2). However, if the collateral is a house or building in the process of construction or if an appraisal of the property is more than one year old and not solely based on observable market comparables or management determines the fair value of the collateral is further impaired below the appraised value, then a Level 3 valuation is considered to measure the fair value. The value of business equipment is based upon an outside appraisal, of one year or less, if deemed significant, or the net book value on the applicable business's financial statements if not considered significant using observable market data. Likewise, values for inventory and accounts receivables collateral are based on financial statement balances or aging reports (Level 3). Impaired loans allocated to the allowance for loan losses are measured at fair value on a nonrecurring basis. Any fair value adjustments are recorded in the period incurred as provision for loan losses on the Consolidated Statements of Income. There were no impaired loans carried at fair value as of December 31, 2017 and 2016.

Other Real Estate Owned (OREO): OREO sold subsequent to year-end is determined using the subsequent sales price (Level 1). Other OREO is measured at fair value in the same manner as described above for impaired loans. Any subsequent write-downs are recorded as OREO write-downs on the Consolidated Statements of Income.

The following table presents the balances of assets measured at fair value on a nonrecurring basis as of December 31, 2017 and 2016:

		Fair Value Measurements at December 31, 2017 Using		
Description	**Fair Value as of December 31, 2017**	**Quoted Prices in Active Markets (Level 1)**	**Significant Other Observable Inputs (Level 2)**	**Significant Other Unobservable Inputs (Level 3)**
Assets:				
Other real estate owned, net	**$ 334,239**	**$ -**	**$ -**	**$ 334,239**

		Fair Value Measurements at December 31, 2016 Using		
Description	Fair Value as of December 31, 2016	Quoted Prices in Active Markets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Other Unobservable Inputs (Level 3)
Assets:				
Other real estate owned, net	$ 819,037	$ -	$ -	$ 819,037

Note 16. Fair Value Measurements (Continued)

The following table presents information about Level 3 fair value measurements for December 31 2017 and 2016:

December 31, 2017

Description	**Valuation Technique**	**Unobservable Input**	**Range (Weighted Average)**
Other real estate owned, net	**Discounted appraised value**	**Selling expenses**	**10.00% (10.00%)**
	Discounted appraised value	**Discount for lack of marketability and age of appraisal**	**0.00% - 88.24% (42.28%)**

December 31, 2016

Description	Valuation Technique	Unobservable Input	Range (Weighted Average)
Other real estate owned, net	Discounted appraised value	Selling expenses	10.00% (10.00%)
	Discounted appraised value	Discount for lack of marketability and age of appraisal	0.00% - 37.48% (18.46%)

Authoritative accounting guidance requires disclosures of the estimated fair values of financial instruments, which is defined as the amount at which the instrument could be exchanged in a current transaction between willing parties other than in a forced or liquidation sale. The assumptions used by management are more fully detailed below. It should be noted that different assumptions could significantly affect these estimates and the net realizable values could be materially different from the estimates presented below.

The Company has determined the fair value of its financial instruments using the following assumptions:

Cash and Cash Equivalents, Accrued Interest Receivable and Payable – The fair value of cash and cash equivalents, accrued interest receivable and payable was estimated to equal the carrying value due to the short-term nature of these financial instruments.

Investment Securities – The fair value of securities was estimated based on quoted market prices, dealer quotes, and prices obtained from independent pricing services. The carrying value of restricted stock approximates fair value based on the redemption provisions of the respective entity.

Loans – The fair value of loans receivable was estimated by discounting estimated future cash flows using current rates on loans with similar credit risks and terms.

Cash Surrender Value of Life Insurance – Bank owned life insurance represents insurance policies on officers, directors, and past directors of the Company. The cash value of these policies represents estimates using information provided by insurance carriers. These policies are carried at their cash surrender value, which approximates the fair value.

Deposits – The fair value of demand and savings deposits was estimated to equal the carrying value due to the short-term nature of the financial instruments. The fair value of time deposits was estimated by discounting estimated future cash flows using current rates on time deposits with similar maturities.

Noncumulative Subordinated Notes – The fair value of the junior subordinated debt was estimated by discounting estimated future cash flows using current rates on instruments with similar credit risks and maturities. The fair value of the senior subordinated debt was estimated by calculating the premium required to swap the Company's fixed rate debt for floating rate debt using current rates on instruments with similar credit risks and maturities.

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

Note 16. Fair Value Measurements (Continued)

The fair value estimates presented are based on pertinent information available as of December 31, 2017 and 2016. However, considerable judgment is required to interpret market data to develop the estimates of fair value. Accordingly, the estimates presented are not necessarily indicative of the amounts that the Company could realize in a current market transaction. The use of different market assumptions and/or estimation methodologies may have a material effect on the estimated fair value amounts.

		Fair Value Measurements Using			
December 31, 2017	**Carrying Value**	**Quoted Prices in Active Markets (Level 1)**	**Significant Other Observable Inputs (Level 2)**	**Significant Other Unobservable Inputs (Level 3)**	**Total Fair Value**
Financial Assets:					
Cash and due from banks	**$ 43,034,817**	**$ 43,034,817**	**$ -**	**$ -**	**$ 43,034,817**
Federal funds sold	**204,316**	**204,316**	**-**	**-**	**204,316**
Investment securities	**33,818,170**	**-**	**33,818,170**	**-**	**33,818,170**
Restricted securities	**1,706,600**	**-**	**1,706,600**	**-**	**1,706,600**
Loans, net	**246,735,506**	**-**	**-**	**241,935,000**	**241,935,000**
Cash surrender value of life insurance	**13,900,553**	**-**	**13,900,553**	**-**	**13,900,553**
Accrued interest receivable	**665,800**	**665,800**	**-**	**-**	**665,800**
Financial Liabilities:					
Deposits	**299,700,159**	**-**	**-**	**298,116,329**	**298,116,329**
Junior subordinated debt	**2,503,953**	**-**	**-**	**3,306,132**	**3,306,132**
Senior subordinated debt	**4,100,000**	**-**	**-**	**4,202,966**	**4,202,966**
Accrued interest payable	**95,366**	**95,366**	**-**	**-**	**95,366**

		Fair Value Measurements Using			
December 31, 2016	Carrying Value	Quoted Prices in Active Markets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Other Unobservable Inputs (Level 3)	Total Fair Value
Financial Assets:					
Cash and due from banks	$ 19,271,539	$ 19,271,539	$ -	$ -	$ 19,271,539
Federal funds sold	116,690	116,690	-	-	116,690
Investment securities	36,068,361	-	36,068,361	-	36,068,361
Restricted securities	1,618,450	-	1,618,450	-	1,618,450
Loans, net	239,787,156	-	-	237,592,000	237,592,000
Cash surrender value of life insurance	11,103,157	-	11,103,157	-	11,103,157
Accrued interest receivable	670,135	670,135	-	-	670,135
Financial Liabilities:					
Deposits	273,147,300	-	-	271,605,000	271,605,000
Junior subordinated debt	2,468,546	-	-	2,468,546	2,468,546
Senior subordinated debt	4,100,000	-	-	4,100,000	4,100,000
Accrued interest payable	626,257	626,257	-	-	626,257

Note 17. Income Per Share

The Company applies the two-class method of computing basic and diluted net income per common share. Under the two-class method, net income per common share is determined for each class of common stock and participating security according to dividends declared and participation rights in undistributed earnings. Based on FASB guidance, the Company considers its nonvested restricted stock, Series A and Series B Preferred stock to be participating securities. The following table shows the computation of basic and diluted net income per common share for the periods presented. Potential dilutive common stock had no effect on income per common share otherwise available to common shareholders for the years ended December 31, 2017 and 2016.

	Years Ended	
	December 31, 2017	**December 31, 2016**
Basic Net Income Per Common Share		
Net income available to common shareholders	**$ 4,131,065**	$ 7,848,745
Less: Net income allocated to participating securities	**1,426,387**	2,725,301
Net income allocated to common shareholders	**2,704,678**	5,123,444
Weighted average common shares outstanding for basic net income per common share	**3,905,575**	3,872,168
Basic net income per common share	**$ 0.69**	$ 1.32
Diluted Net Income Per Common Share		
Net income available to common shareholders	**$ 4,131,065**	$ 7,848,745
Weighted average common shares outstanding for basic net income per common share	**3,905,575**	3,872,168
Effect of dilutive securities, equity compensation	**24,981**	6,751
Effect of dilutive securities, participating securities	**2,059,713**	2,059,713
Weighted average common shares outstanding for diluted net income per common share	**5,990,269**	5,938,632
Diluted net income per common share	**$ 0.69**	$ 1.32

Options to acquire 10,000 shares of common stock were not included in computing diluted income per common share for the year ended December 31, 2016 because their effects were anti-dilutive. There were no anti-dilutive shares during the year ended December 31, 2017.

Note 18. Financial Instruments with Off-Balance Sheet Risk

The Company is a party to financial instruments with off-balance sheet risk in the normal course of business to meet the financial needs of its customers. These financial instruments include commitments to extend credit, commitments under credit card arrangements, and commercial and standby letters of credit. Those instruments involve, to varying degrees, elements of credit and interest rate risk in excess of amounts recognized in the consolidated balance sheets. The contract amounts of those instruments reflect the extent of involvement the Company has in particular classes of financial instruments.

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

Note 18. Financial Instruments with Off-Balance Sheet Risk (Continued)

The contract amounts of these financial instruments at December 31 2017 and 2016 are as follows:

		2017		2016
Commitments to extend credit	**$**	**35,847,287**	$	35,633,195
Standby letters of credit		**1,461,276**		854,630
	$	**37,308,563**	$	36,487,825

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

Standby letters of credit are conditional commitments issued by the Company to guarantee the performance of a customer to a third party. Those guarantees are primarily issued to support public and private borrowing arrangements and, generally, have terms of one year or less. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loan facilities to customers. The Company generally holds collateral supporting these commitments. In the event the customer does not perform in accordance with the terms of the agreement with the third-party, the Company would be required to fund the commitment. The maximum potential amount of future payments the Company could be required to make is represented by the contractual amount of the commitment. If the commitment is funded, the Company would be entitled to seek recovery from the customer.

Note 19. Commitments and Contingencies

In the ordinary course of business, the Company has various outstanding commitments and contingent liabilities that are not reflected in the accompanying consolidated financial statements. In the opinion of management, after consultation with legal counsel, the ultimate disposition of these matters is not expected to have a material adverse effect on the financial condition of the Company.

Note 20. Related Party Transactions

In the normal course of banking business, loans are made to officers, directors and their affiliated interests. In the opinion of management, 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 collectibility or present other unfavorable features. At December 31, 2017 and 2016, these loans totaled approximately $2.9 million and $10.2 million, respectively. Additions during 2017 totaled approximately $3.4 million and principal repayments totaled approximately $4.4 million. During 2017, there was a change in related party relationships which resulted in a $6.3 million decrease in related party loans outstanding.

In addition, the Company held deposits of $8.2 million and $8.6 million from officers and directors at December 31, 2017 and 2016, respectively.

Note 21. Concentrations of Credit

All of the Company's loans, commitments, and commercial and standby letters of credit have been granted to customers in the Company's market area. The concentrations of credit by type of loan are set forth in Note 4. Commercial and standby letters of credit were granted primarily to commercial borrowers.

Note 22. Equity Plans

Stock Option Plan

The Company adopted the 2010 Delmarva Bancshares, Inc. Stock Option Plan (the "Plan) to provide a means for selected key employees and directors to increase their personal financial interest in the Company, thereby stimulating their efforts and strengthening their desire to remain with the Company. Under the plan up to 100,000 shares of common stock are reserved for issuance. Options granted under the plan will have a ten year life with a five year vesting period that begins on the date of the grant, and are exercisable at a price equal to the fair value of the Company's common stock on the date of the grant. There were no options granted in 2017 and 5,000 options were granted in 2016.

Accounting standards require companies to recognize the cost of employee services rendered in exchange for awards of equity instruments, such as stock options, based on the fair value of those awards at the date of grant. The fair value of each award is estimated on the date of grant using the Black-Scholes option pricing model that uses the assumptions noted in the table below. Expected volatilities are based on historical volatilities of the Company's common stock. The Company uses the simplified method to estimate the expected life of the options by average the vesting period and the ten year life of the option. The risk-free interest rate is estimated based on the U.S. Treasury yield curve in effect at the time of the grant.

The fair value of the options granted during the year ended December 31, 2016 was $2.19 and was determined using the following weighted average assumptions as of the grant date:

	2016
Dividend yield	0.00%
Expected term	7.5 years
Expected volatility	31.64%
Risk-free interest rate	1.20%

Note 22. Equity Plans (Continued)

Stock Option Plan (Continued)

A summary of the activity in the stock option plan for 2017 follows:

	Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term	Aggregate Intrinsic Value (1)
Outstanding at beginning of year	80,000	$ 4.47	7	
Granted	-	-	-	
Exercised	-	-	-	
Expired and Forfeited	-	-	-	
Outstanding at end of year	80,000	$ 4.47	6	$ 245,700
Options exercisable, end of year	45,000			

(1) Intrinsic value is the amount by which the fair value of the underlying common stock exceeds the exercise price of a stock option as of December 31, 2017.

As of December 31, 2017, there was $35,976 of unrecognized stock option expense related to nonvested stock options under the Plan. The cost is expected to be recognized over the weighted-average remaining life of four years. Stock based compensation expense recognized in 2017 and 2016 totaled 26,829 and $22,488, respectively, for stock options granted.

Equity Incentive Plan

During 2015, the shareholders of the Company approved the Delmarva Bancshares, Inc. 2015 Equity Incentive Plan (the “Incentive Plan") that provides for the grant of stock options, restricted stock, restricted stock units and other stock-based awards to the Company’s officers, employees, directors, advisors and consultants. A total of 342,500 shares of common stock have been reserved for the issuance of awards under the Incentive Plan. Unless otherwise provided in the applicable equity award agreement, restricted stock recipients will have the right to receive dividends, if any, with respect to such shares of restricted stock, to vote such shares and to receive all other shareholder rights, except that the participant may not sell, transfer, pledge or otherwise dispose of the restricted stock until the restrictions have expired.

There were 45,699 shares in equity awards granted under the Incentive Plan during 2017 and no equity awards were issued under the Incentive Plan during 2016. During the year ended December 31, 2017, the Company recorded $134,317 of expense related to vesting of 2017 restricted stock grants. There were no restricted stock grants prior to 2017.

Note 22. Equity Plans (Continued)

Equity Incentive Plan (Continued)

	Shares	Weighted Average Grant Price
Nonvested, January 1, 2017	-	$ -
Granted	45,699	6.05
Forfeited	(1,946)	6.05
Vested	(22,206)	6.05
Nonvested, December 31, 2017	21,547	$ 6.05

At December 31, 2017, there was $130,390 of total unrecognized compensation expense related to nonvested restricted stock grants that is expected to be recognized over the next two years.

Note 23. Parent Company Only Condensed Financial Information

Delmarva Bancshares, Inc.
(Parent Corporation Only)

Condensed Balance Sheets
December 31, 2017 and 2016

	2017	2016
Assets:		
Cash and due from banks	$ 82,671	$ 645,910
Investment in bank subsidiary	49,128,643	44,930,802
Other assets	414,628	256,955
Total assets	$ 49,625,942	$ 45,833,667
Liabilities:		
Senior subordinated debt	$ 4,100,000	$ 4,100,000
Junior subordinated debt	2,503,953	2,468,546
Due to subsidiary	12,927	13,488
Accrued interest payable	19,247	566,547
Other liabilities	100,124	-
Total liabilities	6,736,251	7,148,581
Stockholders' Equity:		
Preferred stock	20,597	20,597
Common stock	38,944	38,721
Additional paid in capital	43,621,548	43,508,713
Retained (deficit)	(575,117)	(4,741,775)
Accumulated other comprehensive (loss)	(216,281)	(141,170)
Total stockholders' equity	42,889,691	38,685,086
Total liabilities and stockholders' equity	$ 49,625,942	$ 45,833,667

Delmarva Bancshares, Inc.
(Parent Corporation Only)

Condensed Statements of Income
Years Ended December 31, 2017 and 2016

	2017	2016
Dividend from subsidiary	$ 435,000	$ 691,940
Interest expense on subordinated notes	446,259	438,097
Other expenses	273,797	253,257
Total expenses	720,056	691,354
Income (loss) before income taxes and equity in undistributed income of subsidiary	(285,056)	586
Income tax benefit	178,763	262,866
Equity in undistributed income of subsidiary	4,237,358	7,585,293
Net income	$ 4,131,065	$ 7,848,745

Note 23. Parent Company Only Condensed Financial Information (Continued)

Delmarva Bancshares, Inc.
(Parent Corporation Only)

Condensed Statements of Cash Flows
Years Ended December 31, 2017 and 2016

	2017	2016
Cash Flows from Operating Activities:		
Net income	**$ 4,131,065**	$ 7,848,745
Adjustments to reconcile net income to net cash provided by (used in) operating activities:		
Net accretion of acquisition accounting adjustments	**35,407**	35,039
Undistributed income of subsidiary	**(4,237,358)**	(7,585,293)
Stock based compensation	**161,186**	74,836
Changes in assets and liabilities:		
Increase in other assets	**(157,674)**	(150,840)
Increase in other liabilities	**(495,865)**	(514,570)
Net cash (used in) provided by operating activities	**(563,239)**	(292,083)
Cash Flows from Investing Activities:		
Net cash used in investing activities	**-**	-
Cash Flows from Financing Activities:		
Net cash provided by financing activities	**-**	-
(Decrease) increase in cash and cash equivalents	**(563,239)**	(292,083)
Cash and Cash Equivalents, Beginning of Year	**645,910**	937,993
Cash and Cash Equivalents, End of Year	**$ 82,671**	$ 645,910

Note 24. Subsequent Events

The Company evaluated subsequent events that have occurred after the balance sheet date, but before the financial statements are issued. There are two types of subsequent events (1) recognized, or those that provide additional evidence about conditions that existed at the date of the balance sheet, including the estimates inherent in the process of preparing financial statements, and (2) nonrecognized, or those that provide evidence about conditions that did not exist at the date of the balance sheet but arose after that date.

Subsequent events have been considered through March 19, 2018, the date financial statements were available to be issued. Based on the evaluation, the Company did not identify any recognized or unrecognized subsequent events that would have required adjustment to and disclosure in the audited financial statements.

DELMARVA BANCSHARES, INC. AND 1880 BANK

DIRECTORS OF DELMARVA BANCSHARES, INC. AND 1880 BANK

Kim C. Liddell – President and Chairman of the Board
William W. Brooks – Chairman of Audit and Compliance Committees
John F. Luthy, III
E. Thomas Merryweather – Vice Chairman of the Board
Tom E. Powley
William L. Wise, III – Assistant Secretary

DIRECTORS EMERITUS

F. Levi Ruark
Allen L. Tyler

EXECUTIVE OFFICERS

Kim C. Liddell – President, Chief Executive Officer
Steven M. Belote – Executive Vice President, Chief Financial Officer
Judann Culver – Executive Vice President, Chief Operations Officer, Secretary
Kevin W. Moran – Executive Vice President, Chief Credit Officer, CRA Officer
Gregory J. Olinde – Executive Vice President, Chief Loan Officer

BANKING OFFICERS

Scott R. Bisker – Senior Vice President, Director of Information Technology/Information Security Officer
Elizabeth K. Casselbury – Branch Manager, Hurlock Office
Deborah M. Fitzhugh – Vice President, Branch Manager, Woods Road Office
Brenda L. Forbes-Butler – Consumer Loan Officer
Peggy A. Hall – Senior Vice President, Senior Credit Officer
Timothy A. McCarter – Vice President, Loan Officer
Karean “KC” Morris – Vice President, Deposit Operations and Customer Service Manager
Lisa A. Neild – Vice President, Compliance/BSA/Security Officer
Lawson Newcomb – Commercial Banking Officer
Jennifer Patrick – Branch Manager, Idlewild Office
Marianne S. Pepper – Assistant Branch Manager, Assistant Cashier
Kimberly D. Rada – Assistant Vice President, Branch Manager, Glebe Road Office
Crystal Rodgers – Loan Officer
Donna J. Schnoor – Assistant Vice President, Branch Manager, High Street Office
Dane C. Schriver – Senior Vice President, Senior Loan Officer
Kevin P. Schwaninger – Credit Analyst
David A. VanDerveer – Commercial Banking Officer
Katelyn Wilcoxon – Assistant Vice President, Controller
Milly L. Wroten – Senior Vice President, Loan Operations Manager

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