Baker Boyer Bancorp and Subsidiary Consolidated Financial Report
December 31, 2018 and 2017

Contents

MOSSADAMS

Report of Independent Auditors

The Board of Directors
Baker Boyer Bancorp and Subsidiary

Report on the Financial Statements

We have audited the accompanying consolidated financial statements of Baker Boyer Bancorp and Subsidiary (Bank), which comprise the consolidated balance sheets as of December 31, 2018 and 2017, and the related consolidated statements of income, comprehensive income, changes in shareholders' equity, and cash flows for the years then ended, and the related notes to the consolidated financial statements.

Management's Responsibility for the Financial Statements

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

Auditor's Responsibility

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

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

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

Opinion

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

Moss Adams LLP

Spokane, Washington
February 22, 2019

Consolidated Balance Sheets

Dollars in Thousands, except per share amounts

December 31,	2018	2017
Assets		
Cash and cash equivalents	$4,877	$4,070
Interest-bearing deposits at other financial institutions	151,817	123,811
Securities available for sale, at fair value	140,479	175,407
Securities held to maturity, at cost (fair value $1,362 and $1,364)	1,306	1,298
Other investments, at cost	1,349	1,316
Loans	287,684	286,871
Allowance for credit losses	(6,260)	(6,225)
Net Loans	**281,424**	**280,646**
Premises and equipment, net	13,217	13,009
Accrued interest receivable	2,155	2,014
Deferred tax asset, net	1,316	1,169
Other assets	3,050	4,339
Total Assets	**$600,990**	**$607,079**
Liabilities and Shareholders' Equity		
Liabilities		
Deposits:		
Demand, non-interest-bearing	$188,108	$172,907
Savings and interest-bearing demand	304,903	318,869
Time	37,439	44,019
Total Deposits	**530,450**	**535,795**
Accrued interest payable	16	12
Securities sold under agreements to repurchase	14,257	17,652
Other liabilities	1,037	1,401
Total Liabilities	**545,760**	**554,860**
Commitments and Contingencies (Note 11)		
Shareholders' Equity		
Common stock (no par value, stated value $3.125 per share); Authorized 4,000,000 shares; 2018 -1,293,066 shares issued and 1,280,609 shares outstanding; 2017 -1,292,940 shares issued and 1,281,596 shares outstanding	4,041	4,040
Additional paid-in capital	348	364
Retained earnings	51,297	47,917
Accumulated other comprehensive losses	(456)	(102)
Total Shareholders' Equity	**55,230**	**52,219**
Total Liabilities and Shareholders' Equity	**$600,990**	**$607,079**

The accompanying notes are an integral part of these consolidated financial statements.

Consolidated Statements of Income

Dollars in Thousands, except per share amounts

Years Ended December 31,	2018	2017
Interest and Dividend Income		
Loans, including fees	$16,026	$14,972
Investment securities		
Taxable	857	757
Tax-exempt	2,221	2,471
Other investment income and dividends	60	50
Interest-bearing deposits at other financial institutions	2,250	1,031
Total Interest and Dividend Income	**21,414**	**19,281**
Interest Expense		
Deposits	349	238
Security repurchase agreements and other	14	36
Total Interest Expense	**363**	**274**
Net Interest Income	**21,051**	**19,007**
Provision for Credit Losses	0	2
Net interest income after provision for credit losses	**21,051**	**19,005**
Non-Interest Income		
Trust and investment management fees	8,772	8,382
Service charges on deposit accounts	722	833
Other service charges and fees	1,460	1,438
Non-deposit retail brokerage fees	1,325	1,182
Loss on securities available for sale	(127)	0
Net gain on sale of loans	206	444
Other operating income	235	301
Total Non-Interest Income	**12,593**	**12,580**
Non-Interest Expense		
Salaries and employee benefits	16,344	15,562
Occupancy	1,249	1,244
Furniture and equipment	537	535
Professional services	1,616	1,190
Training, meetings, and travel	543	381
Office supplies and printed forms	136	162
Information systems and data processing	2,184	2,135
Marketing & charitable contributions	390	390
Business & FDIC insurances	470	450
ATM and Debit Card	400	390
Other	1,176	1,155
Total Non-Interest Expense	**25,045**	**23,594**
Income Before Provision For Income Taxes	**8,599**	**7,991**
Provision For Income Taxes	**1,337**	**2,542**
Net Income	**$7,262**	**$5,449**
Basic Earnings Per Share	**$5.61**	**$4.19**
Diluted Earnings Per Share	**$5.59**	**$4.18**
Basic Weighted Average Number of Shares Outstanding	1,282,006	1,287,109
Diluted Weighted Average Number of Shares Outstanding	1,287,788	1,292,278

The accompanying notes are an integral part of these consolidated financial statements.

Consolidated Statement of Comprehensive Income

Dollars in thousands

Years ended December 31,	2018	2017
Net Income	$7,262	$5,449
Other comprehensive income (loss):		
Unrealized holding loss on securities available for sale net of tax of ($94) and ($70), respectively	(254)	(135)
Reclassification adjustment for loss on securities available for sale included in net income, net of tax of ($27) and $0, respectively	(100)	--
Total other comprehensive (loss) income	($354)	($135)
Comprehensive Income	**$6,908**	**$5,314**

The accompanying notes are an integral part of these consolidated financial statements.

Consolidated Statements of Shareholders' Equity

Dollars in Thousands, except share amounts

	Shares of Common Stock	Common Stock	Additional Paid-in Capital	Retained Earnings	Accumulated Other Compre-hensive Income (loss)	Total
Balance at December 31, 2016	**1,286,344**	**$4,059**	**$704**	**$46,452**	**$33**	**$51,248**
Net income	--	--	--	5,449	--	5,449
Other Comprehensive loss	--	--	--	--	(135)	(135)
Cash dividends paid ($3.07 per share)	--	--	--	(3,984)	--	(3,984)
Stock issued to directors in lieu of compensation	951	3	64	--	--	67
Restricted stock vested	3,006	--	--	--	--	--
Restricted stock issued to officers under stock incentive plan	--	8	(8)	--	--	--
Restricted stock compensation	--	--	199	--	--	199
Restricted stock forfeited		(2)	(21)			(23)
Repurchases of common stock	(8,705)	(28)	(574)	--	--	(602)
Balance at December 31, 2017	**1,281,596**	**$4,040**	**$364**	**$47,917**	**($102)**	**$52,219**
Net income	--	--	--	7,262	--	7,262
Other Comprehensive loss	--	--	--	--	(354)	(354)
Cash dividends paid ($3.00 per share)	--	--	--	(3,882)	--	(3,882)
Stock issued to directors in lieu of compensation	1,495	5	95	--	--	100
Restricted stock vested	1,892	--	--	--	--	--
Restricted stock issued to officers under stock incentive plan	--	9	(9)	--	--	--
Restricted stock compensation	--	--	170	--	--	170
Repurchases of common stock	(4,374)	(13)	(272)	--	--	(285)
Balance at December 31, 2018	**1,280,609**	**$4,041**	**$348**	**$51,297**	**($456)**	**$55,230**

The accompanying notes are an integral part of these consolidated financial statements.

Statements of Cash Flows

Dollars in Thousands

Years ended December 31,	2018	2017
Cash Flows from Operating Activities		
Net income	$7,262	$5,449
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for credit losses	--	2
Depreciation and amortization	908	961
Loss on disposal of assets	37	--
Restricted stock compensation expense	170	199
Directors stock issued in lieu of compensation	100	67
Accretion of net deferred loan fees	(125)	(181)
Net investment amortization	2,400	2,855
Deferred income tax (benefit) expense	(63)	445
Mortgage servicing rights amortization	226	235
Recovery mortgage servicing rights	(20)	--
Origination of loans held for sale	(12,577)	(24,082)
Proceeds from sale of loans held for sale	12,919	24,196
Net gain on sales of loans	(206)	(444)
Loss on securities available for sale	147	--
(Decrease) increase in interest receivable	(125)	29
Increase (decrease) in accrued interest payable	4	(5)
Other - net	(872)	712
Net cash provided by operating activities	**10,185**	**10,438**
Cash Flows from Investing Activities		
Activity in securities available for sale:		
Maturities, prepayments and calls	55,904	65,413
Purchases	(22,497)	(51,501)
Sales	--	6,473
Activity in securities held to maturity:		
Redemption of Federal Home Loan Bank stock	(5)	(43)
Increase in interest-bearing deposits at other financial institutions, net	(28,006)	(23,151)
Increase in loans made to customers, net of principal collections	(949)	(6,040)
Purchases of premises and equipment, net	(918)	(488)
Net cash used by investing activities	**3,529**	**(9,337)**

(continued)

The accompanying notes are an integral part of these consolidated financial statements.

Consolidated Statements of Cash Flows *(continued)*

Dollars in Thousands

	2018	2017
Cash Flows from Financing Activities		
Net (decrease) increase in deposits	($5,345)	$8,649
Net decrease in security repurchase agreements	(3,395)	(4,991)
Cash dividends paid	(3,882)	(3,984)
Repurchases of common stock	(285)	(625)
Net cash provided by financing activities	**(12,907)**	**(951)**
Net increase in cash and cash equivalents	**807**	**150**
Cash and Cash Equivalents		
Beginning of year	4,070	3,920
End of year	**$4,877**	**$4,070**
Supplemental Disclosures of Cash Flow Information		
Interest paid	$359	$300
Income taxes paid	$1,799	$1,796
Supplemental Disclosures of Non-Cash Investing and Financing Activities		
Fair value holding loss of securities available for sale	($430)	($205)
Retention of Mortgage Servicing Rights from loan sales	$160	$245

The accompanying notes are an integral part of these consolidated financial statements.

Note 1 - Summary of Significant Accounting Policies

Nature of Operations

Baker Boyer Bancorp (the Company) and its wholly owned subsidiary, Baker Boyer National Bank (the Bank), provide banking services primarily to the greater Walla Walla and Columbia Valley area of southeastern Washington and northeastern Oregon. Services are marketed primarily to individuals, small businesses, and the agricultural industry. The Company and its subsidiary are subject to competition from other financial institutions, as well as non-financial intermediaries. Primary sources of revenue are loans, investment securities, and wealth management services. The Company and its subsidiary are also subject to the regulations of certain federal and state agencies, and undergo periodic examinations by those regulatory agencies.

Principles of Consolidation

The consolidated financial statements include the amounts of the parent company and its wholly owned subsidiary. All significant intercompany transactions and balances have been eliminated.

Segment Reporting

While the chief decision-makers monitor the revenue streams of the various products and services, operations are managed and financial performance is evaluated on a Company-wide basis. All services and products are considered but not evaluated separately. Accordingly, all of the financial service operations are considered by management to be aggregated in one reporting operating segment.

Use of Estimates

In preparing consolidated financial statements in conformity with accounting principles generally accepted in the United States (U.S. GAAP), management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities as the date of the consolidated balance sheets and reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. The material estimates that are particularly susceptible to significant change in the near term relate to the determination of the allowance for credit losses and fair value of financial instruments.

Subsequent Events

Subsequent events are events or transactions that occur after the date of the consolidated balance sheet but before the consolidated financial statements are issued. The Company recognizes in the consolidated financial statements the effects of all subsequent events that provide additional evidence about conditions that existed at the date of the consolidated balance sheet, including the estimates inherent in the process of preparing the consolidated financial statements. The Company's consolidated financial statements do not recognize subsequent events that provide evidence about conditions that did not exist at the date of the consolidated balance sheets but arose after the date of the consolidated balance sheets and before the financial statements are available to be issued.

The Company has evaluated subsequent events through February 22, 2019, the date on which the consolidated financial statements were available to be issued.

(continued)

Note 1 - Summary of Significant Accounting Policies *(continued)*

Cash and Cash Equivalents

Cash and cash equivalents include amounts due from banks and federal funds sold. The company maintains balances in depository institutions which at any time may exceed federally insured limits. Federal funds sold generally mature in one day.

Interest Bearing Deposits at Other Financial Institutions

Interest bearing deposits at other financial institutions mature within three years, are carried at cost, and may at times exceed federally insured limits.

Securities Available for Sale

Securities available for sale consist of debt securities that the Bank intends to hold for an indefinite period, but not necessarily to maturity, and certain equity securities. Such securities may be sold to implement the Bank's asset/liability management strategies and in response to changes in interest rates and similar factors. Securities available for sale are reported at fair value. Unrealized holding gains and losses, net of tax, are reported in other comprehensive income.

Realized gains and losses on securities available for sale are recorded on trade date, determined using the specific-identification method, are included in earnings. Amortization of premiums and accretion of discounts are recognized in interest income over the period to maturity. Interest income includes amortization of purchase premiums and discounts, premiums, and discounts on securities are amortized using the level yield method.

Securities Held to Maturity

Debt securities for which the Bank has the positive intent and ability to hold to maturity are reported at cost, adjusted for purchase premiums or discounts.

Declines in the fair value of individual securities held to maturity and available for sale below their cost that are other than temporary result in impairments of the individual securities to their fair value. Management, reviewing quarterly, considers the following factors when determining other than temporary impairment (OTTI) for a security: the length of time and the extent to which the market value has been less than amortized cost, the financial condition and near-term prospects of the issuer, terms and structure of the security, the underlying fundamentals of the relevant market and the outlook for such market for the near future. Management also makes an assessment of whether the Company has (1) the intent to sell the security, or (2) more likely than not will be required to sell the security before its anticipated market recovery. If the security is likely to be sold or if it is likely the security will be required to be sold before recovering its cost basis, the entire impairment loss would be recognized in earnings as OTTI. If the Company does not intend to sell the security and it is not likely the security will be required to be sold, but management does not expect to recover the entire amortized cost basis of the security, only the portion of the impairment loss representing credit losses would be recognized in earnings as OTTI. The credit loss on a security is measured as the difference between the amortized cost basis and the present value of the cash flows expected to be collected. Projected cash flows are discounted by the original interest rate when a security is analyzed for potential OTTI. The remaining impairment related to all other factors, the difference between the present value of the cash flows expected to be collected and fair value, is recognized as a charge to other comprehensive income (OCI).

(continued)

Note 1 - Summary of Significant Accounting Policies *(continued)*

Equity Securities

On January 1, 2018, the Company adopted Accounting Standard Update 2016-01. Equity securities are carried at fair value, with changes in fair value reported in net income.

Other Investments

The Bank is a member of the Federal Home Loan Bank of Des Moines ("FHLB") and as a member is required to maintain a minimum level of investment in FHLB stock based on its outstanding FHLB borrowings. The Bank's investment in FHLB stock has no quoted market value and is carried at par value ($100 per share). Management periodically evaluates FHLB stock for impairment. The securities were not considered to be impaired at December 31, 2018 or 2017.

The Bank also holds Pacific Coast Bankers' Bancshares ("PCBB") stock and Federal Reserve Bank (FRB) Stock. No ready market exists for PCBB and FRB stock, and it has no quoted market value. These securities are carried at cost.

Loans Held for Sale

Mortgage loans originated and intended for sale in the secondary market are carried at the lower of aggregate cost or estimated market value. Net unrealized losses, if any, are recognized through a charge to earnings. There were $0 and $296,000 loans held for sale December 31, 2018 and 2017, respectively.

Mortgage loans are generally sold with servicing rights retained. The carrying value of mortgage loans sold is reduced by the amount allocated to the servicing right. Gains or losses on sales of mortgage loans are based on the difference between the selling price and the carrying value of the related loans sold.

Loans and Allowance for Credit Losses

Loans receivable that management has the intent and ability to hold for the foreseeable future or until maturity or payoff are reported at their outstanding principal balances adjusted for any charge-offs, the allowance for credit losses, and any deferred fees or costs on originated loans, and unamortized premiums or discounts on purchased loans. Loan fees and certain direct loan origination costs are deferred, and the net fee or cost is recognized as an adjustment to interest income.

Interest income on loans is accrued over the term of the loans based upon the principal outstanding. The accrual of interest on loans is discontinued when, in management's opinion, the borrower may be unable to meet payments as they become due, generally once a loan becomes 90 days delinquent. Past due status is based on contractual terms of the loan. When interest accrual is discontinued, all unpaid accrued interest is reversed against interest income. Interest income is subsequently recognized only to the extent that cash payments are received until, in management's judgment, the borrower has the ability to make contractual interest and principal payments, in which case the loan is returned to accrual status.

Because some loans may not be repaid in full, an allowance for credit losses is recorded. An allowance for credit losses is a valuation allowance for probable incurred credit losses. The allowance for credit losses is increased by a provision for credit losses charged to expense and decreased by charge-offs (net of recoveries). The allowance is based on ongoing, quarterly assessments of the probable and estimable losses inherent in the loan portfolio. The Company's methodology for assessing the appropriateness of the allowance consists of several key elements, which include the formula allowance and specific allowances.

(continued)

Note 1 - Summary of Significant Accounting Policies *(continued)*

Loans and Allowance for Credit Losses *(concluded)*

The formula portion of the general credit loss allowance is established by applying a loss percentage factor to the different loan types. The allowances are provided based on management's continuing evaluation of the pertinent factors underlying the quality of the loan portfolio, including changes in the size and composition of the loan portfolio, actual loan loss experience, current economic conditions, geographic concentrations, seasoning of the loan portfolio, specific industry conditions, and the duration of the current business cycle. The recovery of the carrying value of loans is susceptible to future market conditions beyond the Company's control, which may result in losses or recoveries differing from those provided.

Specific allowances are established in cases where management has identified significant conditions or circumstances related to a loan that management believes indicate the probability that a loss has been incurred. Impaired loans consist of loans receivable where the Bank has determined it is probable they will be unable to collect all the contractual interest and principal payments. Factors considered by management in determining impairment include payment status, collateral value, and the probability of collecting scheduled principal and interest payments when due. Loans that experience insignificant delays and payment shortfalls generally are not classified as impaired. Management determines the significance of payment delays and payment shortfalls on a case-by-case, taking into consideration all of the circumstances surrounding the loan and borrower, including the length of delay, the reasons for delay, the borrower's prior payment record, and the amount of the shortfall in relation to the principal and interest owed. Impairment is measured on a loan by loan basis by either the present value of expected future cash flows discounted at the loans effective interest rate or the fair value of the collateral if the loan is collateral dependent. Large groups of smaller balance homogeneous loans are collectively evaluated for impairment.

The ultimate recovery of all loans is susceptible to future market factors beyond the Bank's control. These factors may result in losses or recoveries differing significantly from those provided in the consolidated financial statements. In addition, regulatory agencies, as an integral part of their examination process, periodically review the Bank's allowance for loan losses and may require the Bank to make additions to the allowance based on their judgment about information available to them at the time of their examinations.

Troubled Debt Restructuring

Loans may occasionally be restructured due to economic or legal reasons relating to the borrower's financial condition by granting a concession in order to protect the Bank's investment. Examples of such concessions include forgiving of principal or accrued interest, extending the maturity date(s), or providing a lower interest rate than would normally be available for a transaction of similar risk. This generally occurs when the financial condition of the borrower necessitates temporary or permanent relief from the original contractual terms of the loan. A loan restructured in a troubled debt restructuring ("TDR") is an impaired loan and is accounted for as such. If a borrower on a restructured accruing loan has demonstrated performance under the previous terms and shows the capacity to continue to perform under the restructured terms, the loan will remain on accrual status. Otherwise the loan will be placed on nonaccrual status until the borrower demonstrates repayment ability over a period of not less than six months. A TDR that has been in compliance with its modified terms and which yields a market rate will not be reported as a troubled debt restructuring in calendar years after the year in which the restructuring took place.

(continued)

Note 1 - Summary of Significant Accounting Policies *(continued)*

Premises and Equipment

Premises and equipment are recorded at cost. Depreciation is computed on the straight-line method over the following estimated useful lives: building and improvements - up to forty years; software, furniture and equipment - three to seven years; and automobiles - five years. Amortization of leasehold improvements is calculated on the straight-line method over the shorter of the estimated useful lives of the assets or corresponding contractual lease term, which does not generally include renewal options. These assets are reviewed for impairment when events indicate their carrying value may not be recoverable. If management determines impairment exists, the asset is reduced with an offsetting charge to expense. The cost of maintenance and repairs is charged to expense as incurred. Gains and losses on dispositions are reflected in earnings.

Foreclosed Real Estate

Real estate properties acquired through, or in lieu of, foreclosure are to be sold and are initially recorded at the fair value of the properties less estimated costs of disposal. Any write-down to fair value at the time of transfer to foreclosed real estate is charged to the allowance for credit losses. Properties are evaluated regularly to ensure that the recorded amounts are supported by their current fair values. Any subsequent reductions in carrying values and revenues and expenses from the operations of properties are charged to operations. The Company had $0 foreclosed real estate at December 31, 2018 and 2017.

Servicing

Servicing assets are recognized when rights are acquired through purchase or through sale of financial assets. Servicing rights resulting from the sale or securitization of loans originated by the Company are initially measured at fair value at the date of transfer. Fair value is based on a valuation model that calculates the present value of estimated future net servicing income. The valuation model incorporates assumptions that market participants would use in estimating future net servicing income, such as the cost to service, the discount rate, the custodial earnings rate, an inflation rate, ancillary income, prepayment speeds and default rates and losses. The Company has elected to subsequently measure the servicing rights using the amortization method. Under the amortization method, servicing rights are amortized in proportion to and over the period of estimated net servicing income.

Each class of servicing assets subsequently measured using the amortization method are evaluated and measured for impairment. Impairment is determined by stratifying rights into tranches based on predominant characteristics, such as interest rate, loan type and investor type. Impairment is recognized through a valuation allowance for an individual tranche, to the extent the fair value is less than the carrying amount of the servicing assets for that tranche. The valuation allowance is adjusted to reflect changes in the measurement of impairment after the initial recognition of impairment. Changes in valuation allowances are reported with other income on the consolidated statement of income. Fair value in excess of the carrying amount of servicing asset for that stratum is not recognized.

Servicing fee income is recorded for fees earned for servicing loans. The fees are based on a contractual percentage of the outstanding principal; or a fixed amount per loan and are recorded as income when earned. The amortization of mortgage servicing rights is netted against loan servicing fee income.

Trust Assets

Assets held by the Company in a fiduciary or agency capacity for trust department customers are not included in the consolidated financial statements because such items are not assets of the Company or its subsidiary. Assets totaling $1,064,107,000 and $1,115,453,000 were held in trust as of December 31, 2018 and 2017, respectively.

(continued)

Note 1 - Summary of Significant Accounting Policies *(continued)*

Transfers of Financial Assets

Transfers of an entire financial asset, a group of entire financial assets, or a participating interest in an entire financial asset are accounted for as sales when control over the assets has been surrendered. Control over transferred assets is deemed to be surrendered when: (1) the assets have been isolated from the Bank, (2) the transferee obtains the right (free of conditions that constrain it from taking advantage of that right) to pledge or exchange the transferred assets, and (3) the Bank does not maintain effective control over the transferred assets through an agreement to repurchase them before their maturity or the ability to unilaterally cause the holder to return specific assets.

Adoption of New Accounting Standards

On January 1, 2018, the Company adopted ASU 2014-09 Revenue from *Contracts with Customers* and all subsequent amendments to the ASU (collectively, "ASC 606"), which (i) creates a single framework for recognizing revenue from contracts with customers that fall within its scope and (ii) revises when it is appropriate to recognize a gain (loss) from the transfer of nonfinancial assets, such as OREO. To determine revenue recognition for arrangements that an entity determines are within the scope of Topic 606, the Company performs the following five steps: (i) identify the contract(s) with a customer; (ii) identify the performance obligations in the contract; (iii) determine the transaction price; (iv) allocate the transaction price to the performance obligations in the contract; and (v) recognize revenue when (or as) the Company satisfies a performance obligation. The majority of the Company's revenues come from interest income and other sources, including loans, leases, and securities that are outside the scope of ASC 606. The Company's services that fall within the scope of ASC 606 are presented within Non-Interest Income and are recognized as revenue as the Company satisfies its obligation to the customer. Services within the scope of ASC 606 include Deposit service charges, debit and ATM interchange income, brokerage revenue, and gain (loss) on other real estate owned, net. Refer to Note 17 Revenue from Contracts with Customers for further discussion on the Company's accounting policies for revenue sources within the scope of ASC 606.

The Company adopted ASC 606 using the modified retrospective method applied to all contracts not completed as of January 1, 2018. Results for reporting periods beginning after January 1, 2018 are presented under ASC 606 while prior period amounts continue to be reported in accordance with legacy GAAP. The adoption of ASC 606 did not result in a material change to the accounting for any of the in-scope revenue streams; as such, no cumulative effect adjustment was recorded.

Advertising Costs

Advertising costs are expensed as incurred. Advertising costs were $79,000 and $88,000 for the years ending December 31, 2018 and 2017, respectively.

Income Taxes

Deferred income taxes reflect the effect of temporary differences between the tax basis of assets and liabilities and the reported amounts of those assets and liabilities for financial reporting purposes. Deferred tax assets and liabilities are reflected at currently enacted income tax rates applicable to the period in which the deferred tax assets or liabilities are expected to be realized or settled. Deferred tax assets are reduced by a valuation allowance when, in the opinion of management, it is more likely than not that some portion or all of the deferred tax assets will not be realized. As changes in tax laws or rates are enacted, deferred tax assets and liabilities are adjusted through the provision for income taxes.

(continued)

Note 1 - Summary of Significant Accounting Policies *(concluded)*

Income Taxes *(concluded)*

Financial Accounting Standards Board (FASB) ASC 740-10, *Income Taxes*, requires recognition and measurement of uncertain tax positions using a “more-likely-than-not” approach. The Company’s approach to FASB ASC 740-10 consisted of an examination of its financial statements, its income tax provision, and its federal and state income tax returns. The Company analyzed its tax positions including the permanent and temporary differences as well as the major components of income and expense. As of December 31, 2018, the Company did not believe that it had any uncertain tax positions that would rise to the level of having a material effect on its financial statements. In addition, the Bank had no accrued interest or penalties as of December 31, 2018. It is the Bank’s policy to record interest and penalties as a component of income tax expense.

Earnings Per Common Share

Basic and diluted earnings per common share are calculated using a two-class method. Under the two-class method, basic earnings per common share is calculated by dividing net income available to common shareholders by the weighted average number of common shares outstanding during the period, excluding outstanding participating securities. Participating securities include non-vested restricted stock awards. Diluted earnings per common share is calculated by dividing net income available to common shareholders by the weighted average number of common shares outstanding determined for the basic earnings per share calculation plus the dilutive effect of unvested restricted shares and options of common stock using the treasury stock method.

Stock-Based Compensation

The Company records compensation expense in the accompanying consolidated statements of income related to restricted stock awards by recognizing the grant date fair value of such awards. Compensation cost is recognized over the required service period, generally defined as the vesting period.

Comprehensive Income

Accounting principles generally require that recognized revenue, expenses, gains and losses be included in net income. However, certain changes in assets and liabilities, such as unrealized gains and losses on available for sale securities, are components of comprehensive income and are reported in a separate statement following the statements of income, along with net income.

Fair Value of Financial Instruments

Fair values of financial instruments are estimated using relevant market information and other assumptions, as more fully disclosed in a separate note. Fair value estimates involve uncertainties and matters of significant judgment regarding interest rates, credit risk, prepayments, and other factors, especially in the absence of broad markets for particular items. Changes in assumptions or in market conditions could significantly affect these estimates.

Note 2 - Restricted Assets

Federal Reserve Board regulations often require that the Bank maintain reserves in the form of cash and deposit balances with the Federal Reserve Bank, based on a percentage of deposits. For years ended December 31, 2018 and 2017, no reserves were required.

Note 3 - Debt and Equity Securities

Debt and equity securities have been classified according to management's intent. The amortized cost of securities and their approximate fair values were as follows (*dollars in thousands*):

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Values
Securities Available for Sale				
December 31, 2018				
U.S. Government and agency securities	$32,902	$14	$157	$32,759
State and political debt securities	108,155	204	639	107,720
Total	**$141,057**	**$218**	**$796**	**$140,479**
December 31, 2017				
U.S. Government and agency securities	$26,478	$0	$116	$26,362
State and political debt securities	149,076	608	675	149,009
Equity securities	8	28	--	36
Total	**$175,562**	**$636**	**$791**	**$175,407**
Securities Held to Maturity				
December 31, 2018				
State and political debt securities	$1,306	$56	$ --	$1,362
December 31, 2017				
State and political debt securities	$1,298	$66	$ --	$1,364
Other Investments				
December 31, 2018				
Equity Securities	$8	$20	$ --	$28

(continued)

Note 3 - Debt and Equity Securities *(continued)*

The fair values of temporarily impaired debt and equity securities, the amount of unrealized losses, and the length of time these unrealized losses existed as of December 31 are as follows (*dollars in thousands*):

	Less Than 12 Months		More Than 12 Months		Total	
	Fair Values	Unrealized Losses	Fair Values	Unrealized Losses	Fair Values	Unrealized Losses
Securities Available for Sale						
December 31, 2018						
U.S. Government and agency	$12,421	$27	$17,350	$130	$29,771	$157
State and political debt securities	18,692	75	66,690	564	85,382	639
Total	**$31,113**	**$102**	**$84,040**	**$694**	**$115,153**	**$796**
December 31, 2017						
U.S. Government and agency	$21,907	$74	$4,456	$42	$26,363	$116
State and political debt securities	94,784	530	15,817	145	110,601	675
Total	**$116,691**	**$604**	**$20,273**	**$187**	**$136,964**	**$791**

As of December 31, 2018 and 2017, there were 358 and 430 securities available for sale, respectively, in an unrealized loss position. There were no securities held to maturity at December 31, 2018 and 2017, with unrealized losses. Management has concluded, as of December 31, 2018 and 2017 that these investments are not other-than-temporarily impaired, respectively. This assessment was based on the following factors: i) the length of time and the extent to which the market value has been less than cost; ii) the financial condition and near-term prospects of the issuer; iii) the intent and ability of the Company to retain its investment in a security for a period of time sufficient to allow for any anticipated recovery in market value; iv) general market conditions which reflect prospects for the economy as a whole, including interest rates and sector credit spreads; and v) whether it's more likely than not that it will be required to sell the security before its anticipated market recovery. Because the Bank does not intend to sell the securities in this class and it is not likely that the Bank will be required to sell these securities before recovery of their amortized cost basis, which may include holding each security until contractual maturity, the unrealized losses on these investments are not considered other-than-temporarily impaired.

(continued)

Note 3 - Debt and Equity Securities *(concluded)*

The contractual maturities of debt securities available for sale and held to maturity at December 31, 2018, are as follows (*dollars in thousands*):

	Available for Sale		Held to Maturity	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
Due in one year or less	$55,758	$55,546	$0	$0
Due from one year to five years	61,332	60,902	830	859
Due from five to ten years	17,231	17,309	476	502
Due after ten years	6,735	6,722	--	--
Total	**$141,056**	**$140,479**	**$1,306**	**$1,361**

There were $0 gross realized gains and $147,273 gross realized losses of sales of securities in 2018, and there were $7,000 gross realized gains and $7,000, gross realized losses of sales of securities in 2017.

Securities, carried at approximately $47,371,000 at December 31, 2018 and $50,571,000 at December 31, 2017, were pledged to secure repurchase agreements, public and trust deposits, and for other purposes required or permitted by law.

Note 4 – Loans

Major classifications of loans at December 31 consist of the following (*dollars in thousands*):

	2018	2017
Commercial	$76,208	$72,993
Commercial Real Estate	145,681	148,062
Residential Real Estate	61,447	62,105
Consumer, Installment, and other	4,966	4,325
	288,302	**287,485**
Less net deferred loan origination fees	618	614
Total loans	**$287,684**	**$286,871**

(continued)

Note 4 - Loans *(continued)*

The following table summarizes activity related to the allowance for loan losses and the unpaid principal balance in loans by portfolio segment and based on impairment method as of (*dollars in thousands*):

	December 31, 2018					
	Commercial	Commercial Real Estate	Consumer, Installment, and other	Real Estate Residential	Unallocated	Total
Allowance for credit losses						
Beginning balance	$1,359	$2,092	$107	$998	$1,669	$6,225
Charge-offs	(50)	--	(29)	--		(79)
Recoveries	56	30	17	11		114
Provision	(187)	(292)	20	(176)	635	--
Ending balance	$1,178	$1,830	$115	$833	$2,304	$6,260
Ending balance: individually evaluated for impairment	$1	$43	$--	$3		$47
Ending balance: collectively evaluated for impairment	$1,177	$1,787	$115	$830	$2,304	$6,213
Loans:						
Ending Balance	$76,208	$145,681	$4,966	$61,447		$288,302
Ending balance: individually evaluated for impairment	$4	$1,376	$--	$70		$1,450
Ending balance: collectively evaluated for impairment	$76,204	$144,305	$4,966	$61,377		$286,852

	December 31, 2017					
	Commercial	Commercial Real Estate	Consumer, Installment, and other	Real Estate Residential	Unallocated	Total
Allowance for credit losses						
Beginning balance	$1,388	$2,438	$139	$1,125	$964	$6,054
Charge-offs	(24)	--	(23)	--		(47)
Recoveries	26	158	24	12		220
Provision	(31)	(504)	(33)	(139)	705	(2)
Ending balance	$1,359	$2,092	$107	$998	$1,669	$6,225
Ending balance: individually evaluated for impairment	$78	$3	$--	$21		$102
Ending balance: collectively evaluated for impairment	$1,281	$2,089	$107	$997	$1,669	$6,123
Loans:						
Ending Balance	$72,993	$148,062	$4,325	$62,105		$287,485
Ending balance: individually evaluated for impairment	$182	$583	$--	$83		$848
Ending balance: collectively evaluated for impairment	$72,811	$147,479	$4,325	$62,022		$286,637

(continued)

Note 4 - Loans *(continued)*

The following tables summarize impaired loans by class as of December 31, 2018 and 2017:

(dollars in thousands)

	December 31, 2018				
	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Interest Income Recognized
With no related allowance recorded					
Commercial – Business	--	--	--	--	--
Commercial – Agriculture	--	--	--	--	--
Commercial Real Estate - Owner Occupied	--	--	--	--	--
Commercial Real Estate - Non-Owner Occupied	--	--	--	--	--
Consumer - credit card	--	--	--	--	--
Consumer – other	--	--	--	--	--
Consumer – auto	--	--	--	--	--
Residential	--	--	--	--	--
With an allowance recorded					
Commercial – Business	$ --	$ --	$ --	$ 67	--
Commercial – Agriculture	4	34	1	234	--
Commercial Real Estate - Owner Occupied	121	279	4	137	--
Commercial Real Estate - Non-Owner Occupied	1,255	1,550	39	1,068	--
Consumer - credit card	--	--	--	--	--
Consumer – other	--	--	--	--	--
Consumer – auto	--	--	--	--	--
Residential	70	196	3	76	--
Total					
Commercial	**$ 4**	**$34**	**$ 1**	**$301**	**--**
Commercial Real Estate	**1,376**	**1,829**	**43**	**1,205**	**--**
Consumer, Installment and Other	**--**	**--**	**--**	**--**	**--**
Residential Real Estate	**70**	**196**	**3**	**76**	**--**
Total	**$1,450**	**$2,059**	**$47**	**$1,582**	**--**

(continued)

Note 4 - Loans *(continued)*

	December 31, 2017				
	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Interest Income Recognized
With no related allowance recorded					
Commercial – Business	--	--	--	--	--
Commercial – Agriculture	--	--	--	--	--
Commercial Real Estate - Owner Occupied	--	--	--	--	--
Commercial Real Estate - Non-Owner Occupied	--	--	--	--	--
Consumer - credit card	--	--	--	--	--
Consumer – other	--	--	--	--	--
Consumer – auto	--	--	--	--	--
Residential	--	--	--	--	--
With an allowance recorded					
Commercial – Business	$ 182	$184	$ 78	$ 36	--
Commercial – Agriculture	--	--	--	--	--
Commercial Real Estate - Owner Occupied	153	298	6	169	--
Commercial Real Estate - Non-Owner Occupied	430	801	15	454	--
Consumer - credit card	--	--	--	--	--
Consumer – other	--	--	--	--	--
Consumer – auto	--	--	--	--	--
Residential	83	200	3	91	--
Total					
Commercial	**$ 182**	**$184**	**$ 78**	**$36**	**--**
Commercial Real Estate	**583**	**1,099**	**21**	**623**	**--**
Consumer, Installment and Other	**--**	**--**	**--**	**--**	**--**
Residential Real Estate	**83**	**200**	**3**	**91**	**--**
Total	**$848**	**$1,483**	**$102**	**$750**	**--**

(continued)

Note 4 - Loans *(continued)*

Loans receivable identified as nonaccrual loans at December 31, are presented by loan class in the table below.

(dollars in thousands)

	2018	2017
Commercial		
Business	$--	$182
Agricultural	4	--
Commercial Real Estate		
Owner Occupied	121	153
Non-owner Occupied	1,255	430
Residential	70	83
Total	**$1,450**	**$848**

Credit Quality Indicators. The Bank utilizes internal risk ratings for its credit quality indicators. The internal risk ratings (1) provide a basis for evaluating, monitoring, and reporting the overall quality of the loan portfolio, (2) promptly identify deterioration of loan quality and the need for remedial action, and (3) emphasize areas requiring upgrading of policies, procedures, or documentation.
The internal risk ratings are as follows:

EXCEPTIONAL LOANS (A)
These are generally the Bank's best loans. The borrower is well established with the bank and is in excellent financial condition. The character and repayment ability of the borrower is without question. They have a long history of profits and their credit is impeccable. The loan is normally unsecured but security sometimes is taken. The repayment risk to the bank is negligible. Financial statements and tax returns are provided on a timely basis. In addition, the loan has low handling costs in relation to borrowings.

QUALITY LOANS (B)
These loans provide excellent primary and secondary sources of repayment with no identifiable risk of collection. They conform in all respects to Bank Policy and Federal Regulations. The operation has a minimum of two previous years of profitability and ample liquidity to withstand adversity. Probability of serious financial deterioration is unlikely. Financial statements and tax returns are acquired on a timely annual basis.

SATISFACTORY LOANS (C)
These loans have adequate sources of repayment with minimal identifiable risk of collection and conform to Bank policy and Federal Regulations. These loans may show some slight weaknesses such as vulnerability to changing economic conditions, weaker ratios, an unprofitable previous year or the original terms had to be altered. There may be a split vote for approval by the loan committee.

PASS-WATCHED LOANS (W)
These loans have acceptable credit but on which requires more than the normal level of supervision and warrants formal quarterly management reporting. Credits in this category are not yet criticized or classified, but due to adverse events or aspects of underwriting require closer than normal supervision. Generally, credits assigned this risk rating should not be in this category for longer than 18 months. A lack of any new information may result in a minimum downgrade to Special mention after the 18-month period expires.

(continued)

Note 4 - Loans *(continued)*

OTHER LOANS ESPECIALLY MENTIONED (O)

These loans have developed weaknesses and as a result deserve management's close attention. Special Mention loans are currently protected but are potentially weak assets. Potential weaknesses if left uncorrected could result in the borrower's inability to repay the loan or deterioration in the bank's credit position at some future date. Such weaknesses would include, but not be limited to:

- Prospect of or actual loan covenant violations.
- Ongoing negative financial trends (i.e. two or more concurrent years of losses).
- Negative or potentially negative company news.
- Negative industry trends, news or forecasts.
- Lack of current financial information.
- Weakened but still acceptable collateral positions.
- Failure to obtain proper documentation.
- Management problems, pending litigation, an ineffective loan agreement or other material structural weakness, or any other significant deviation from prudent lending practices.

This loan classification is generally transitory in nature. The weaknesses to be corrected should be identified and corrected within the time-frame of a specific action plan (generally no longer than one year). If the correction does not take place within the framework of the plan, further downgrade may be warranted. All Special Mention loans will be monitored for improvement or deterioration of the borrower's financial condition.

SUBSTANDARD (D)

Loans graded D may be inadequately protected by current net worth, paying capacity or pledged collateral, if any. Loans are graded D when they have unsatisfactory characteristics causing more than acceptable levels of risk. D loans typically have one or more well-defined and uncorrected weaknesses indicating inability for repayment of the debt or the borrower's financial information indicates an unacceptable level of risk. These loans are characterized by the distinct possibility the bank will sustain some loss if the deficiencies are not corrected. A potential loss does not have to be recognizable in an individual credit for that credit to be rated substandard; therefore, a loan can be fully and adequately secured and still be considered a substandard credit. Situations that suggest a D classification include the following:

- Cash flow deficiencies exist that jeopardize future loan payments.
- Past due principal or interest.
- The sale of non-collateral assets has become a primary source of repayment for the loan.
- The relationship has deteriorated to the point that the sale of collateral is now the bank's primary source of repayment (unless it was the original source of repayment). If the collateral is in the bank's control and is cash or is highly marketable, a C or O classification may be appropriate.
- Loans that will not be repaid within the normal time frame associated with the type of loan or original loan terms.
- Loans rated D require a high level of management supervision.

DOUBTFUL (E)

All loans with weaknesses inherent in the D classification and for which collection or liquidation in full is questionable are graded doubtful (E). An E classification causes the loan to be placed immediately on non-accrual.

LOSS (F)

An F rating is assigned to loans considered uncollectible and of such little value that their continuance as an active bank asset is not warranted. This rating does not mean that the asset has no recovery value or salvage value, but rather the asset should be charged off now, even though partial or full recovery may be possible in the future.

(continued)

Note 4 - Loans *(continued)*

The following credit quality indicators are based on management's most recent analysis, and vary by loan type. At December 31, they were as follows:
(dollars in thousands)

	Commercial Business		Agriculture		Commercial Real Estate Owner Occupied		Commercial Real Estate Non-Owner Occupied	
	2018	2017	2018	2017	2018	2017	2018	2017
A	$6,095	$5,808	$--	$--	$--	$--	$158	$174
B	1,754	4,229	2,254	2,226	1,406	944	1,918	3,770
C	36,631	37,881	12,039	9,071	36,337	23,124	77,631	101,607
W	10,580	5,679	1,749	363	3,940	3,011	14,253	3,971
Special Mention	--	--	--	--	--	44	1,380	1,507
Substandard	3,627	2,079	1,479	5,475	4,264	6,095	4,394	3,815
Doubtful	--	182	--	--	--	--	--	--
Total	**$58,687**	**$55,858**	**$17,521**	**$17,135**	**$45,947**	**$33,218**	**$99,734**	**$114,844**

	Residential Real Estate	
	2018	2017
Grade:		
Pass (A-C)	$60,220	$61,569
Special Mention	--	267
Substandard	1,227	269
Total	**$61,447**	**$62,105**

	Consumer – Other		Consumer – Auto	
	2018	2017	2018	2017
Performing	$4,842	$4,110	$124	$215
Nonperforming	--	--	--	--
Total	**$4,842**	**$4,110**	**$124**	**$215**

(continued)

Note 4 - Loans *(continued)*

The following table is an aging analysis of the recorded investment in loans receivable by loan class at December 31 *(dollars in thousands):*

	2018						
	30-59 Past Due	60-89 Past Due	90 Days or greater	Total Past Due	Current	Total Loans	Recorded Investment >90 Days and Accruing
Commercial							
Business	--	$--	$--	$--	$58,687	$58,687	$--
Agriculture	--	--	--	--	17,521	17,521	--
Commercial Real Estate							
Owner Occupied	--	--	115	115	45,832	45,947	--
Non-owner Occupied	--	--	--	--	99,734	99,734	--
Consumer							
Consumer - other	--	--	--	--	4,842	4,842	--
Consumer – auto	--	--	--	--	124	124	--
Residential	--	343	--	343	61,104	61,447	--
Total	**--**	**$343**	**$115**	**$458**	**$287,844**	**$288,302**	**$--**

	2017						
	30-59 Past Due	60-89 Past Due	90 Days or greater	Total Past Due	Current	Total Loans	Recorded Investment >90 Days and Accruing
Commercial							
Business	$185	$--	$--	$185	$55,673	$55,858	$--
Agriculture	--	--	--	--	17,135	17,135	--
Commercial Real Estate							
Owner Occupied	--	--	134	134	33,084	33,218	--
Non-owner Occupied	52	--	--	52	114,792	114,844	--
Consumer							
Consumer - other	--	8	--	8	4,102	4,110	--
Consumer – auto	--	--	--	--	215	215	--
Residential	385	12	--	397	61,708	62,105	--
Total	**$622**	**$20**	**$134**	**$776**	**$286,709**	**$287,485**	**$--**

(continued)

Note 4 - Loans *(concluded)*

Loans may be occasionally restructured due to economic or legal reasons relating to the borrower's financial condition by granting a concession in an attempt to protect the Bank's investment. A modification of a loan's terms constitutes a troubled debt restructure if the bank grants a concession to the borrower that it would not otherwise consider. Not all modifications of loan terms automatically result in a troubled debt restructure. For example, if the modified terms are consistent with market conditions and representative of terms the borrower could obtain in the open market, the restructured loan is not categorized as a troubled debt restructure. However, if a concession (e.g., below market interest rate, forgiving principal or previously accrued interest) is granted based on the borrower's financial difficulty, the troubled debt restructure (TDR) designation is appropriate.

The Bank offers a variety of modifications to borrowers. The modification categories offered can generally be described in the following categories:

Rate Modification - A modification in which the interest rate is changed.

Term Modification - A modification in which the maturity date, timing of payments or frequency of payments is changed.

Interest Only Modification – A modification in which the loan is converted to interest only payments for a period of time.

Payment Modification – A modification in which the dollar amount of the payment is changed, other than an interest only modification described above.

Combination Modification – Any other type of modification, including the use of multiple categories above.

There were no loans that were restructured in a troubled debt restructuring during the years ended December 31, 2018 and 2017. There were no loans that were modified in a troubled debt restructuring that subsequently defaulted during the years ended December 31, 2018 and 2017. At December 31, 2018 and 2017, there were no commitments to lend additional funds to borrowers whose loans have been modified.

Certain related parties of the Bank, principally Bank directors and their associates, were loan customers of the Bank in the ordinary course of business during 2018 and 2017. Total loans outstanding at December 31, 2018 and 2018, to key officers and directors were $2,625,000 and $1,630,000 respectively. During 2018 loan advances totaled $3,653,000 and loan repayments totaled $2,618,000 on these loans. During 2017 loan advances totaled $4,312,000 and loan repayments totaled $4,408,000 on these loans.

Note 5 – Servicing

Mortgage loans serviced for others are not included on the accompanying consolidated balance sheets. The unpaid principal balances of mortgage and other loans serviced for others were $141,961,000 and $150,705,000 at December 31, 2018 and 2017, respectively.

Custodial escrow balances maintained in connection with the foregoing loan servicing, and included in deposits, were approximately $839,000 and $805,000 at December 31, 2018 and 2017 respectively.

The activity pertaining to mortgage servicing rights and the related valuation allowance for the years ended December 31, is as follows (*dollars in thousands*):

	2018	2017
Balance, beginning of year	$644	$634
Additions	160	245
Impairments	--	--
Recovery	20	--
Amortization of servicing rights	(226)	(235)
Balance, end of year	**$598**	**$644**
Fair Value	**$1,447**	**$1,373**

Valuation Allowance:	2018	2017
Balance, at beginning of year	($84)	($84)
Additions	--	--
Reductions	20	--
Balance, end of year	**($64)**	**($84)**

The fair value of servicing rights was determined using a discount rate of 9.0% and 9.0% at December 31, 2018 and 2017, respectively. Prepayment speeds ranging from 6.69% to 13.77% and 8.47% to 17.17% December 31, 2018 and 2017, respectively, constant prepayment rate (CPR), depending on the specific characteristics of each loan. The most significant assumption in valuing the servicing rights is the change in prepayment speed that results from shifts in mortgage interest rates. The Bank assumed weighted-average years to payoff to range from 3.0 to 9.0 years and 3.0 to 7.9 years at December 31, 2018 and 2017, respectively, depending on loan type and interest rates.

Servicing rights are included in other assets on the consolidated balance sheet.

Note 6 - Premises and Equipment

The components of premises and equipment at December 31 are as follows (*dollars in thousands*):

	2018	2017
Land	$2,196	$2,196
Buildings	17,758	17,268
Furniture and equipment	4,593	4,281
	24,547	**23,745**
Less accumulated depreciation	11,330	10,736
Total premises and equipment	**$13,217**	**$13,009**

The total depreciation expense for years ending December 31, 2018 and 2017 was $673,000 and $647,000, respectively.

Rental expense of month to month leased premises and equipment totaled $10,000 and $9,000 in 2018 and 2017, respectively, which are included in occupancy and furniture and equipment expense.

Note 7 – Deposits

The aggregate amount of certificates of deposit with balances of $250,000 or more was approximately $2,648,000 and $3,423,000 at December 31, 2018 and 2017, respectively.

Scheduled maturities of certificates of deposit for future years ending December 31 are as follows *(dollars in thousands)*:

2019	$25,169
2020	4,905
2021	2,849
2022	2,342
2023	2,174
Thereafter	0
Total	**$37,439**

Certain related parties of the bank, principally Bank directors and their associates, have deposit accounts with the Bank. Total related party bank deposits were $5,176,000 and $4,798,000 at December 31, 2018 and 2017, respectively.

Note 8 - Security Repurchase Agreements

The following table presents information regarding securities sold under agreements to repurchase for the years ended December 31 *(dollars in thousands)*:

	2018	2017
Average balance during the year	$14,609	$21,585
Average interest rate during the year	0.10%	0.10%
Maximum month-end balance during the year	$19,517	$25,827
Balance outstanding at year-end	$14,257	$17,652
Average interest rate at year-end	0.07%	0.11%

Investment securities are pledged as collateral in an amount equal to or greater than the repurchase agreements. The carrying amount of securities pledged as collateral for repurchase agreements at December 31, 2018 and 2017, were $20,967,000 and $22,890,000, respectively.

Note 9 - Employee Benefits

401(k) Profit Sharing Plan

The Company has a profit-sharing 401(k) plan, with cash or deferred arrangements permitted by Internal Revenue Code subsection 401(k). Eligibility requirements are six months of service and attainment of age 21, with plan entry the following January 1 or July 1. The Company's profit-sharing contribution is 6 percent of eligible compensation. The Company's safe-harbor matching contribution is 100 percent of the first 6 percent of a participant's eligible compensation per payroll period deferred as 401(k) contributions. Under the 401(k) savings aspect of the plan, employees may contribute up to the regulatory or statutory dollar limitation for deferrals, plus the catch-up dollar limitation. The safe harbor matching contribution does not have an hour of service or employment on the last day of the plan year accrual requirement. The profit sharing contribution has a greater than 500 hours of service accrual requirement if not employed on the last day of the plan year. There is no hour of service accrual requirement if employed on the last day of the plan year, the employee dies, becomes disabled, or attains the plan's normal retirement age. Total employer contribution expenses were $1,325,000 and $1,268,000 for 2018 and 2017, respectively.

Outside Directors' Nonqualified Deferred Compensation Plan

The Company has an outside directors' nonqualified deferred compensation plan. Under the terms of the plan, an outside director (a non-employee director) may participate in the plan. The participant may elect to defer a portion of his or her directors' fees as designated at the beginning of each plan year. The Company does not make nonelective contributions to the plan. Payments begin after termination of service for any reason. Payments may begin prior to termination of service for an unforeseeable emergency. There are currently four participants in the plan. Balances include total deferrals plus earnings and were $736,000 and $723,000 at December 31, 2018 and 2017, respectively. There were no expenses incurred related to the administration of the plan for 2018 and 2017, respectively.

Stock Incentive Plan

Effective January 1, 2005, the Company adopted a restricted stock purchase/bonus incentive plan for the benefit of key employees. The objective of the plan is to retain personnel of experience and ability in key positions by providing them with a proprietary interest in the Company. The plan is also expected to enhance the ability of the Company to attract and retain key employees. The Company's plan is administered by its board of directors' Executive Compensation Committee. Members of this committee consist only of non-officer, outside directors.

(continued)

Note 9 - Employee Benefits *(concluded)*

Stock Incentive Plan *(concluded)*

The plan allows for the issuance to participants of up to 240,800 shares of the Company's common stock. As of December 31, 2018, shares remaining in reserve for issuance under the plan were 45,567.

The restricted stock is awarded to employees at the end of a five year vesting period. During the vesting period the employees have voting and dividend rights. Compensation expense in the amount of the fair value of the common stock at the date of the grant to the plan participants will be recognized straight line over the five-year vesting period. Compensation expense related to the plan was $170,000 and $176,000 for the years ended December 31, 2018 and 2017, respectively. The tax benefit recognized on this compensation was $36,000 and $57,000 for the years ending December 31, 2018 and 2017, respectively. At December 31, 2018, unrecognized compensation expense related to nonvested restricted stock awards was $385,000 and is expected to be recognized as follows:

	Stock-Based Compensation Expense
2019	141
2020	111
2021	80
2022	46
2023	7
Total	**$385**

The following summarizes activity under the restricted stock plan for the years ended December 31:

	Shares	Aggregate Intrinsic Value	Weighted Average Grant Date Fair Value
Restricted stock grants unvested at December 31, 2016	**12,386**	**$--**	**$72.17**
Granted	2,635		$69.56
Forfeited	(671)		70.37
Vested	(3,006)		75.39
Restricted stock grants unvested at December 31, 2017	**11,344**	**$--**	**$70.52**
Granted	3,005		$66.81
Vested	(1,892)		73.00
Restricted stock grants unvested at December 31, 2018	**12,457**	**$--**	**$69.28**

Note 10 - Income Taxes

Income taxes are comprised of the following for the years ended December 31 *(dollars in thousands)*:

	2018	2017
Current tax expense		
Federal	$1,379	$2,068
State	21	29
Total Current Tax Expense	1,400	2,097
Deferred tax		
Deferred tax expense -Tax Reform	--	719
Deferred tax (benefit) Federal	(62)	(272)
Deferred tax (benefit)-State	(1)	(2)
Total Deferred expense (benefit)	(63)	445
Provision for Income Taxes	**$1,337**	**$2,542**

The following is reconciliation between the statutory and the effective federal income tax rate for the years ended December 31 *(dollars in thousands)*:

	2018		2017	
	Amount	**Percent of Pretax Income**	**Amount**	**Percent of Pretax Income**
Income tax at statutory rates	$1,806	21.0%	$2,717	34.0%
Increase (decrease) resulting from:				
Tax-exempt income	(494)	(6.2)	(920)	(11.5)
Impact of Tax Reform – federal rate Change	--	--	719	9.0
Other	25	0.3	26	0.3
Total Tax Expense	**$1,337**	**15.1%**	**$2,542**	**31.8%**

Tax effects of temporary differences that give rise to significant portions of deferred tax assets (liabilities) at December 31 are as follows *(dollars in thousands)*:

	2018	2017
Deferred Tax Assets		
Allowance for credit losses	$1,330	$1,324
Deferred compensation	186	181
Nonaccrual interest	93	63
Stock-based compensation	94	86
Unrealized gain/loss on securities available for sale	117	33
Other	63	33
Total deferred tax assets	**1,883**	**1,720**
Deferred Tax Liabilities		
Accumulated depreciation and amortization	(343)	(314)
Prepaid expenses	(87)	(90)
Mortgage servicing rights	(127)	(137)
Other	(10)	(10)
Total deferred tax liabilities	**(567)**	**(551)**
Net deferred tax assets	**$1,316**	**$1,169**

(continued)

Note 10 - Income Taxes *(concluded)*

The "Tax Reform Act" was enacted December 22, 2017. The law includes significant changes to the U.S. corporate system, including a Federal corporate rate reduction from 34% to 21%. As a result of when the Act was signed into law, the Bank's deferred tax assets and liabilities were required to be remeasured using the lower 21% federal rate as of December 31, 2017. This resulted in a one-time unfavorable charge to tax expense of approximately $719,000. This was based on certain estimates of deferred tax balances and as such, additional adjustments may arise during 2018 as these calculations are finalized. Management does not anticipate that these adjustments will be material to the financial statements.

The Bank files income tax returns in the U.S. federal jurisdiction and Oregon. The Company does not have any uncertain tax positions. As of December 31, 2018, there is no accrued interest or penalties recorded in the financial statements.

Note 11 - Commitments and Contingencies

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

The Bank's exposure to credit loss in the event of nonperformance by the other party to the financial instrument for commitments to extend credit and standby letters of credit is represented by the contractual amount of those instruments. The Bank uses the same credit policies in making commitments and conditional obligations as it does for on-balance-sheet instruments. A summary of the Bank's commitments at December 31 is as follows *(dollars in thousands)*:

	2018	2017
Commitments to extend credit	$92,799	$76,241
Standby letters of credit	$189	$522

Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Since many of the commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. The Bank's experience has been that approximately 42 percent of loan commitments are drawn upon by customers. The Bank evaluates each customer's creditworthiness on a case-by-case basis. The amount of collateral obtained, if deemed necessary by the Bank upon extension of credit, is based on management's credit evaluation of the party. Collateral held varies, but may include accounts receivable, inventory, property and equipment, residential real estate, and income-producing commercial properties.

Standby letters of credit are conditional commitments issued by the Bank to guarantee the performance of a customer to a third party. Those guarantees are primarily issued to support public and private borrowing arrangements. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loan facilities to customers. Collateral held varies as specified above, and is required in instances where the Bank deems necessary.

The Bank has agreements with commercial banks for lines of credit totaling $10,000,000, none of which were used at December 31, 2018, and 2017. The Bank has a credit line with the Federal Reserve Bank Discount Window. Currently the Bank has $3,000,000 of securities pledged with the Discount Window with the same borrowing capacity, of which $0 was drawn on at December 31, 2018. In addition, the Bank has a credit line with the Federal Home Loan Bank (FHLB) of Des Moines. Currently the Bank has $61,342,000 of loans pledged with FHLB with a borrowing capacity of $42,689,000, of which $0 was drawn on at December 31, 2018.

(continued)

Note 11 - Commitments and Contingencies *(concluded)*

Because of the nature of its activities, the Company is subject to various pending and threatened legal actions which arise in the ordinary course of business. In the opinion of management, liabilities arising from these claims, if any, will not have a material effect on the financial position of the Company.

Note 12 - Significant Concentrations of Credit Risk

Most of the Bank's loans, commitments, and standby letters of credit have been granted to customers and/or are secured by collateral located in the Bank's market areas, which include Washington and northeastern Oregon. As such, significant changes in economic conditions in these areas or with its primary industries could adversely affect the Bank's ability to collect loans. The concentrations of credit by type of loan are set forth in Note 4. The distribution of commitments to extend credit approximates the distribution of loans outstanding. Loans are generally limited, by federal banking regulations, to 15 percent of the Bank's shareholders' equity, excluding accumulated other comprehensive income.

Investments in state and political debt securities involve governmental entities primarily in the state of Washington. Significant changes in economic conditions in these municipalities could adversely affect the issuers of these securities to repay their debt. The Bank primarily focuses on municipality debt that is guaranteed by the taxing base of the issuer. Furthermore the Bank performs detailed reviews of the majority of bonds which it purchases from issuers in Washington, Oregon, and Idaho.

The Bank places its cash with well capitalized financial institutions. The amount on deposit fluctuates and typically exceeds the insured limits of the Federal Deposit Insurance Corporation, and the Bank is therefore exposed to credit risk.

Note 13 - Regulatory Matters

The Company and the Bank are 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 Bank's and Company's financial statements. Under capital adequacy guidelines of the regulatory framework for prompt corrective action, the Bank must meet specific capital adequacy guidelines that involve quantitative measures of the Company's assets, liabilities and certain off-balance-sheet items, as calculated under regulatory accounting practices. The Bank's capital classification is also subject to qualitative judgments by the regulators about components, risk weightings and other factors.

Quantitative measures established by regulation to ensure capital adequacy require the Company and the Bank to maintain minimum amounts and ratios (set forth in the table below) of Tier 1 capital (as defined in the regulations) to total average assets (as defined), and minimum ratios of Tier 1 and total capital (as defined) to risk-weighted assets (as defined).

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

The Company's and the Bank's actual capital amounts and ratios are also presented in the following table. Management believes, as of December 31, 2018, that the Company and the Bank meet all capital requirements to which they are subject (*dollars in thousands*):

(continued)

Note 13 - Regulatory Matters *(continued)*

	Actual Amount	Ratio	Capital Adequacy Purposes Amount	Ratio	To be Well Capitalized Under Prompt Corrective Action Provisions Amount	Ratio
December 31, 2018						
Tier 1 capital (to average assets):						
Company	$55,686	9.3%	$23,891	4.0%	N/A	N/A
Bank	54,835	9.2	$23,891	4.0	$29,863	5.0%
Common equity tier 1 capital ratio:						
Company	$55,686	16.8	$14,894	4.5%	N/A	N/A
Bank	54,835	16.6	$14,894	4.5	21,514	6.5%
Tier 1 capital ratio:						
Company	$55,686	16.8	$19,859	6.0%	N/A	N/A
Bank	54,835	16.6	$19,859	6.0	26,479	8.0%
Total capital ratio:						
Company	$59,849	18.1	$26,479	8.0	N/A	N/A
Bank	58,998	17.8	$26,479	8.0	33,098	10.0%
December 31, 2017						
Tier 1 capital (to average assets):						
Company	$52,321	8.6%	$24,298	4.0%	N/A	N/A
Bank	51,608	8.5	24,298	4.0	$30,372	5.0%
Common equity tier 1 capital ratio:						
Company	$52,321	15.6	15,075	4.5	N/A	N/A
Bank	51,608	15.4	15,075	4.5	21,775	6.5
Tier 1 capital ratio:						
Company	$52,321	15.6	20,100	6.0	N/A	N/A
Bank	51,608	15.4	20,100	6.0	26,801	8.0
Total capital ratio:						
Company	$56,546	16.9	26,801	8.0	N/A	N/A
Bank	55,832	16.7	26,801	8.0	33,501	10.0

The Federal Reserve and the Federal Deposit Insurance Corporation approved final capital rules in July 2013 that substantially amend the existing capital rules for banks. These new rules reflect, in part, certain standards initially adopted by the Basel Committee on Banking Supervision in December 2010 (which standards are commonly referred to as "Basel III") as well as requirements contemplated by the Dodd-Frank Act.

Under the new capital rules, the Bank is required to meet certain minimum capital requirements that differ from current capital requirements. The rules implement a new capital ratio of common equity Tier 1 capital to risk-weighted assets. Common equity Tier 1 capital generally consists of retained earnings and common stock (subject to certain adjustments) as well as accumulated other comprehensive income ("AOCI"), except to the extent that the Bank elected to make a one-time irrevocable option to exclude certain components of AOCI as of March 31, 2016. The Bank will also be required to establish a "conservation buffer," consisting of a common equity Tier 1 capital amount equal to 2.5% of risk-weighted assets to be phased in by 2019. An institution that does not meet the conservation buffer will be subject to restrictions on certain activities including payment of dividends, stock repurchases, and discretionary bonuses to executive officers.

The prompt corrective action rules are modified to include the common equity Tier 1 capital ratio and to increase the Tier 1 capital ratio requirements for the various thresholds. For example, the requirements for the Bank to be considered well-capitalized under the rules are a 5.0% leverage ratio, a 6.5% common equity Tier 1 capital ratio, an 8.0% Tier 1 capital ratio, and a 10.0% total capital ratio. To be adequately capitalized, those ratios are 4.0%, 4.5%, 6.0%, and 8.0%, respectively.

(continued)

Note 13 - Regulatory Matters *(concluded)*

The rules modify the manner in which certain capital elements are determined. The rules make changes to the methods of calculating the risk-weighting of certain assets, which in turn affects the calculation of the risk-weighted capital ratios. Higher risk weights are assigned to various categories of assets, including commercial real estate loans, credit facilities that finance the acquisition, development or construction of real property, certain exposures or credit that are 90 days past due or are nonaccrual, securitization exposures, and in certain cases mortgage servicing rights and deferred tax assets.

The Bank was required to comply with the new capital rules on January 1, 2015, with a measurement date of March 31, 2015. The conservation buffer will be phased-in beginning in 2016, and will take full effect on January 1, 2019. Certain calculations under the rules will also have phase-in periods.

Note 14 - Condensed Financial Information - Parent Company Only

Condensed Balance Sheets
Dollars in Thousands

Year ended December 31,	2018	2017
Assets		
Cash	$187	$66
Investment in Bank	54,379	51,504
Other assets	1,205	1,653
Total Assets	**$55,771**	**$53,223**
Liabilities	541	1,004
Shareholders' Equity	55,230	52,219
Total Liabilities and Shareholders' Equity	**$55,771**	**$53,223**

Condensed Statements of Income
Dollars in Thousands

Year ended December 31,	2018	2017
Revenue		
Dividend Income from the Bank	$4,092	$4,443
Misc Income	--	3
Total Revenue	**4,092**	**4,446**
Expenses	75	78
Income before income taxes and equity in undistributed income of the Bank	**4,017**	**4,368**
Income Tax Benefit	16	26
Income before undistributed income of the Bank	**4,033**	**4,394**
Equity in Undistributed Income of the Bank	3,229	1,055
Net Income	**$7,262**	**$5,449**

(continued)

Note 14 - Condensed Financial Information - Parent Company Only *(concluded)*

Condensed Statements of Cash Flows
Dollars in Thousands

December 31,	2018	2017
Cash Flows from Operating Activities		
Net income	$7,262	$5,449
Adjustments to reconcile net income to net cash provided by operating activities:		
Equity in undistributed income of the Bank	(3,229)	(1,055)
Restricted stock compensation expense	170	199
Restricted stock forfeited	-	(23)
Stock issued to directors in lieu of compensation	100	67
Other - net	(16)	(26)
Net cash provided by operating activities	**4,287**	**4,611**
Cash Flows from Financing Activities		
Cash dividends paid	(3,882)	(3,984)
Repurchase of common stock	(284)	(602)
Net cash used in financing activities	**(4,166)**	**(4,586)**
Increase (decrease) in cash	**121**	**25**
Cash		
Beginning of year	66	41
End of year	**$187**	**$66**

Note 15 - Fair Value of Financial Instruments

The fair value estimates that follow are subjective in nature and involve uncertainties and matters of significant judgment; therefore, they are not necessarily indicative of the amounts the Company could realize in current market exchange. The Company has not included certain material items in its disclosure, such as the value of the long-term relationships with the Company’s lending and deposit clients, since this is an intangible and not a financial instrument. Additionally, the estimates do not include any tax ramifications. There may be inherent weaknesses in any calculation technique, and changes in the underlying assumptions used, including discount rates and estimates of future cash flows that could materially affect the results. For all the reasons, the aggregation of the fair value calculations presented herein do not represent, and should not be construed to represent the underlying value of the Company.

The following methods and assumptions were used in estimating its fair value disclosures for each class of financial instruments:

Cash and Cash Equivalents, interest bearing deposits at other financial institutions, and accrued interest
The recorded amount is a reasonable estimate of fair value.

(continued)

Note 15 - Fair Value of Financial Instruments *(continued)*

Securities Available for Sale and Held to Maturity

The Company's investment securities consist primarily of securities issued by U.S. Government sponsored enterprises and state and political debt securities that trade in active markets. These securities are included under Level 2 because there may or may not be daily trades in each of the individual securities and because the valuation of these securities may be based on instruments that are not exactly identical to those owned by the Company.

Other Investments

The carrying value of stock holdings approximates fair value.

Loans receivable

Prior to the adoption of ASU 2016-01, Financial Instruments – Overall, Recognition and Measurement of Financial Assets and Financial Liabilities in 2018, the Bank was allowed to measure fair value of loans under an entry price notion using a discounted cash flow technique to calculate the present value of expected future cash flows. Under ASU 2016-01, the Bank is required to disclose the fair value of its loans using the exit price notion. The exit price notion uses the same approach, but also incorporates other factors, such as credit risk and illiquidity risk. As a result of the change in methodology, the fair values disclosed for the years ended December 31, 2017 and December 31, 2018, are not determined in a manner consistent with the current year fair values disclosed. For both years, loans with maturities of less than one year are estimated to have a fair value equal to the carrying value. Fair values for impaired loans are estimated using discounted cash flow analyses or underlying collateral values, where applicable.

Mortgage Servicing Rights

Mortgage servicing rights fair value is based on a valuation model that calculates the present value of estimated future net servicing income.

Deposits

The fair value of deposits with no stated maturity date is included at the amount payable on demand. The fair value of fixed maturity certificates of deposit is estimated by discounting future cash flows using the rates currently offered by the Bank for deposits of similar remaining maturities.

Other Borrowed Funds, and Security Repurchase Agreements

Carrying amounts of security repurchase agreements approximate their fair value. Fair value of other borrowings is estimated using discounted cash flow analyses based on the Bank's current incremental borrowing rates for similar types of borrowing arrangements. The fair value of the companies long term borrowings are estimated using discounted cash flow analysis based on the company's current incremental borrowing rates for similar instruments.

Off-Balance-Sheet Instruments

The fair value of commitments to extend credit and standby letters of credit was estimated using the fees currently charged to enter into similar agreements, taking into account the remaining terms of the agreements and the present creditworthiness of the customers. Since the majority of the Bank's off-balance-sheet instruments consist of non-fee producing, variable-rate commitments, the Bank has determined they do not have a distinguishable fair value.

(continued)

Note 15 - Fair Value of Financial Instruments *(continued)*

The following presents the carrying amount, estimated fair value, and placement in the fair value hierarchy of the company's financial instruments at December 31, 2018 and 2017 *(dollars in thousands):*

	2018				
	Carrying Amounts	Fair Value	Level 1	Level 2	Level 3
Financial Assets					
Cash and cash equivalents	$4,877	$4,877	$4,877	$ --	$ --
Interest bearing deposits at other financial institutions	151,817	151,817	151,817	--	--
Securities available for sale	140,479	140,479	26,787	113,692	--
Securities held to maturity	1,306	1,362	--	1,362	--
Other investments	1,349	1,349	28	1,321	--
Loans receivable	287,684	286,233	--	--	286,233
Accrued interest receivable	2,155	2,155	--	--	2,155
Mortgage servicing rights	598	1,447	--	--	1,447
Financial Liabilities					
Deposits	$530,450	$531,037	$493,011	$ --	$38,026
Securities sold under agreements to repurchase	14,257	14,257	14,257	--	--
Accrued interest payable	16	16	--	--	16

	2017				
	Carrying Amounts	Fair Value	Level 1	Level 2	Level 3
Financial Assets					
Cash and cash equivalents	$4,070	$4,070	$4,070	$ --	$ --
Interest bearing deposits at other financial institutions	123,811	123,811	123,811	--	--
Securities available for sale	175,407	175,407	21,429	153,978	--
Securities held to maturity	1,298	1,364	--	1,364	--
Other investments	1,316	1,316	--	1,316	--
Loans receivable	286,871	286,296	--	--	286,296
Accrued interest receivable	2,014	2,014	--	--	2,014
Mortgage servicing rights	644	1,373	--	--	1,373
Financial Liabilities					
Deposits	$535,795	$536,036	$491,776	$ --	$44,260
Securities sold under agreements to repurchase	17,652	17,652	17,652	--	--
Accrued interest payable	12	12	--	--	12

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

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

(continued)

Note 15 - Fair Value of Financial Instruments *(continued)*

ASC 820-10, *Fair Value Measurements and Disclosures,* provides enhanced guidance for measuring assets and liabilities using fair value and applies to situations where other standards require or permit assets or liabilities to be measured at fair value. It also requires expanded disclosure of items that are measured at fair value, the information used to measure fair value, and the effect of fair value measurements on earnings.

Valuation techniques are based upon observable and unobservable inputs. Observable inputs reflect market data obtained from independent sources, while unobservable inputs reflect the Company's assumptions about market value. These two types of inputs create the following fair value hierarchy:

Level 1 – Quoted prices for identical instruments in active markets.
Level 2 – Quoted prices for similar instruments in active markets; quoted prices for identical or similar instruments in markets that are not active; and model-derived valuations whose inputs are observable.
Level 3 – Instruments whose significant value drivers are unobservable.

The following table summarizes the Company's financial instruments that were measured at fair value at December 31:

	Fair Value Measurements Using			
	Fair Value (dollars in thousands)	**Quoted Prices in Active Markets for Identical Assets (Level 1)**	**Significant Other Observable Inputs (Level 2)**	**Significant Unobservable Inputs (Level 3)**
December 31, 2018				
Assets Measured at Fair Value on a Recurring Basis				
Securities available-for-sale				
U.S. Government and agency securities	$32,759	$26,787	$5,972	$--
State and political debt securities	107,720	--	107,720	--
Total	**$140,479**	**$26,787**	**$113,692**	**$--**
Other Investments				
Equity securities	28	28	--	--
Total	$28	$28	$--	$--
Assets Measured at Fair Value on a Nonrecurring Basis				
Impaired Loans	$197	$--	$--	$197
Total	**$197**	**$--**	**$--**	**$197**

(continued)

Note 15 - Fair Value of Financial Instruments *(continued)*

December 31, 2017				
Assets Measured at Fair Value on a Recurring Basis				
Securities available-for-sale				
U.S. Government and agency securities	$26,362	$21,393	$4,969	$--
State and political debt securities	149,009	--	149,009	--
Equity securities	36	36	--	--
Total	**$175,407**	**$21,429**	**$153,978**	**$--**
Assets Measured at Fair Value on a Nonrecurring Basis				
Impaired Loans	$233	$--	$--	$233
Total	**$233**	**$--**	**$--**	**$233**

The bank uses the following methods and significant assumptions to estimate fair value. The Bank's U.S. equity securities trade in a very active market of identical instruments and their valuation is therefore included under Level 1. The Bank's securities available-for-sale at December 31, 2018 primarily consisted of U.S. Government and Agency obligations and state and political debt securities that trade in active markets. U.S. Treasuries trade in a very active market and their valuation is therefore included under Level 1. Other U.S. Government and Agency obligations securities are included under Level 2 because there may or may not be daily trades in each of the individual securities and because the valuation of these securities may be based on instruments that are not exactly identical to those owned by the Bank. If quoted market prices are not available, the fair values are estimated using pricing models from investment service based upon the securities relationship to other bench mark quoted securities. Temporary changes in the valuation of securities available-for-sale do not affect current income; instead, unrealized gains or losses on available-for-sale securities are reported as a net amount in accumulated comprehensive income. Declines in the fair value of individual available-for-sale securities below their cost that are other than temporary result in write-downs of the individual securities to their fair value. No such write-downs have occurred during the periods presented.

Impaired loans in the table represent impaired, collateral dependent impaired loans that have been adjusted to fair value. The loss represents charge offs or impairments on collateral dependent loans for fair value adjustments based on the fair value of collateral. Impaired loans are individually reviewed to determine the amount of each loan considered to be at risk of non-collection. In determining the amount of each loan at risk, the Bank reviews real property appraisals, equipment valuations, accounts receivable and payable listings and other financial information.

The following table presents qualitative information about Level 3 fair value instruments measured at fair value on a non-recurring basis during December 31, 2018 and 2017 *(dollars in thousands):*

	December 31, 2018			
	Fair Value	Valuation Technique(s)	Unobservable Input(s)	Average Discount
Impaired Loans	$197	Sales Comparison Approach	Adjusted for differences in comparable sales	16%

(continued)

Note 15 - Fair Value of Financial Instruments *(concluded)*

	December 31, 2017			
	Fair Value	Valuation Technique(s)	Unobservable Input(s)	Average Discount
Impaired Loans	$233	Sales Comparison Approach	Adjusted for differences in comparable sales	15%

Note 16 – Earnings Per Share

Nonvested share-based payment awards that contain non forfeitable rights to dividends or dividend equivalents are participating securities and are included in the computation of EPS pursuant to the two-class method. The two-class method is an earnings allocation formula that determines earnings per share for each class of common stock and participating security according to dividends declared (or accumulated) and participation rights in undistributed earnings. Certain of the Company's nonvested restricted stock awards qualify as participating securities.

Net income is allocated between the common stock and participating securities pursuant to the two-class method, based on their rights to receive dividends, participate in earnings or absorb losses. Basic earnings per common share is computed by dividing net earnings available to common shareholders by the weighted average number of common shares outstanding during the period, excluding participating nonvested restricted shares.

Diluted earnings per share is calculated by dividing net income available to common shareholders by the weighted average number of common shares outstanding determined for the basic earnings per share calculation plus the dilutive effect of stock compensation using the treasury stock method.

The following table presents the computation of basic and diluted earnings per share for the periods indicated (in thousands, except share and per share data):

Dollars in Thousands, except per share amounts

December 31,	2018	2017
Net Income	$7,262	$5,449
Allocated to participating securities	(67)	(50)
Net income available to common shareholders	$7,195	$5,399
Weighted average common shares outstanding	1,282,006	1,287,109
Net effect of dilutive shares	5,782	5,169
Diluted weighted average shares outstanding	1,287,788	1,292,278
Earnings per common share		
Basic	$ 5.61	$ 4.19
Diluted	$ 5.59	$ 4.18

Note 17 – Revenue from Contracts with Customers

As noted in Note 1, the Bank adopted the provisions of ASU No. 2014-09, Revenue from Contracts with Customers (Topic 606), on January 1, 2018 and all subsequent ASUs that modified Topic 606. Results for reporting periods beginning after December 31, 2017 are presented under Topic 606, while prior period amounts have not been adjusted and continue to be reported in accordance with Topic 605.

All of the Bank's revenue from contracts with customers in the scope of ASC 606 is recognized in Non-Interest Income. Gains/losses on the sale of other real estate owned are included in non-interest expense and are generally recognized when the performance obligation is complete. This is typically at delivery of control over the property to the buyer at time of each real estate closing.

The following table presents the Bank's sources of Non-Interest Income for the twelve months ended December 31:

	2018	2017
Non-interest income:		
Service charges on deposits	$785	$900
Debit/ATM interchange	866	808
Trust and investment management fees	8,772	8,382
Brokerage revenue	1,325	1,182
Mortgage banking revenue (1)	556	868
Loss on investment securities, net (1)	(127)	--
Other Remaining Income (1)	416	440
Total non-interest income	$12,593	$12,580

(1) Not within the scope of ASC 606

Deposit service charges

The Bank earns fees from its deposit customers for account maintenance, transaction-based activity and overdraft services. Account maintenance fees consist primarily of account fees and analyzed account fees charged on deposit accounts on a monthly basis. The performance obligation is satisfied and the fees are recognized on a monthly basis as the service period is completed. Transaction-based fees on deposit accounts are charged to deposit customers for specific services provided to the customer, such as non-sufficient funds fees, overdraft fees, and wire fees. The performance obligation is completed as the transaction occurs and the fees are recognized at the time each specific service is provided to the customer.

Debit and ATM interchange fee income and expenses

Debit and ATM interchange income represent fees earned when a debit card issued by the Bank is used. The Bank earns interchange fees from debit cardholder transactions through the Visa payment network. Interchange fees from cardholder transactions represent a percentage of the underlying transaction value and are recognized daily, concurrently with the transaction processing services provided to the cardholder. The performance obligation is satisfied and the fees are earned when the cost of the transaction is charged to the cardholders' debit card. Certain expenses directly associated with the credit and debit card are recorded on a net basis with the interchange income.

(continued)

Note 17 – Revenue from Contracts with Customers *(concluded)*

Trust and Investment Management Fees and Brokerage revenue

Trust and Investment Management and Brokerage fees consist of transaction fees earned from asset management, trade execution and administrative fees from investments. Asset Management fees are variable, since they are based on the underlying portfolio value, which is subject to market conditions and amounts invested by clients. Asset management fees are recognized over the period that services are provided, and when the portfolio values are known or can be estimated at the end of each quarter. Brokerage transaction fees are fixed and determinable, based on security type and trade volume, and are recognized upon trade execution. In addition, revenues are earned from selling insurance and annuity policies. The amount of revenue earned is determined by the value and type of each instrument sold and is recognized when the policy is in force.

Gain on other real estate owned, net

The Bank records a gain or loss from the sale of other real estate owned when control of the property transfers to the buyer, which generally occurs at the time of an executed deed of trust. When the Bank finances the sale of other real estate owned to the buyer, the Bank assesses whether the buyer is committed to perform their obligations under the contract and whether collectability of the transaction price is probable. Once these criteria are met, the other real estate owned asset is derecognized and the gain or loss on sale is recorded upon the transfer of control of the property to the buyer. In determining the gain or loss on sale, The Bank adjusts the transaction price and related gain or loss on sale if a significant financing component is present.