Northumberland Bancorp

Consolidated Financial Statements

December 31, 2016 and 2015

Northumberland Bancorp

Contents

Northumberland Bancorp

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April 24, 2017

To our Shareholders:

I am happy to report that the operations of Northumberland Bancorp (the "Company") and its banking subsidiary The Northumberland National Bank (the "Bank") have improved significantly from the prior year as the organization continues to work through the regulatory requirements of the Consent Order issued in 2016. Net income improved to $2,866,000 an increase of 29.6% from the prior year. Assets continued to grow reaching $492,158,000, an increase of 3.3% from $476,258,000 in 2015.

From a balance sheet perspective, total loans increased $13,553,000 from December 31, 2015 or 4.7%, surpassing $300 million for the first time. This increase was primarily due to the growth in commercial loans. Deposits increased to $442,630,000 or 3.8% from 2015. Credit quality remained strong. Classified assets declined to $3,760,000 from $4,012,000 in the prior year. Past due loans declined from $3,779,000 or 1.3% of loans in 2015 to $3,222,000 or 1.1% of loans in 2016.

The Company and the Bank continue to be well capitalized. Tier One Capital of the Bank was 10.33% as of December 31, 2016 compared to 10.10% as of December 31, 2015. Common Equity Tier One Capital, Tier One Risk Based Capital and Total Risked based capital were 18.57%, 18.57% and 19.59% as of December 31, 2016 compared to the same ratios in 2015 of 19.09%, 19.05% and 20.15% as of December 31, 2015, respectively.

Organizationally, the Bank has taken certain actions to enhance its management structure. When completed, officers reporting to me will be a Chief Operating Officer (COO), a Chief Financial Officer (CFO), Senior Vice President of Wealth Management and Vice President of Compliance and Risk Management. This structure will strengthen the management of the Bank and enhance management continuity. J. Todd Troxell was appointed to fill the new position of COO. Mr. Troxell joined the Bank in 1998.

The Company continues to enhance its electronic services deliveries. In 2016, we updated our web site; introduced Apple Pay, Android Pay, Samsung Pay; and converted our debit cards to chip based technology. In 2017, we plan to implement a new internet banking product. In addition, we have implemented SecureLock Equip to provide additional security for our debit card holders.

I wish to recognize the service of John T. Fogarty as a Director of the Company and the Bank since 1988. John retired from the Board of Directors effective December 31, 2016 after 29 years of service. John's knowledge and input will be greatly missed. We wish him well as he continues to enjoy his retirement.

We thank you, our valued shareholders, directors, officers and employees for your dedication, support and contributions to the Company's growth and success during the year.

J. Donald Steele Jr.

J. Donald Steele, Jr.
Chairman and President

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Independent Auditor's Report

Board of Directors and Stockholders
Northumberland Bancorp
Northumberland, Pennsylvania

Report on the Financial Statements

We have audited the accompanying consolidated financial statements of Northumberland Bancorp and subsidiary, which comprise the consolidated balance sheets as of December 31, 2016 and 2015, and the related consolidated statements of income, comprehensive income, stockholders' equity, and cash flows for the years then ended, and the related notes to the consolidated financial statements.

Management's Responsibility for the Financial Statements

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

Auditor's Responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free of 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 Northumberland Bancorp and subsidiary as of December 31, 2016 and 2015, 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.

Emphasis of Matter Regarding Consent Order

As discussed in Note 2, The Northumberland National Bank, the wholly-owned subsidiary of Northumberland Bancorp, has entered into a Stipulation and Consent to Issuance of a Consent Order with the Comptroller of the Currency of the United States of America and Northumberland Bancorp adopted a resolution at the request of the Federal Reserve Bank of Philadelphia ("FRB"). Our opinion is not modified with respect to this matter.

BDO USA, LLP

Harrisburg, Pennsylvania
April 24, 2017

Consolidated Financial Statements

Northumberland Bancorp

Consolidated Balance Sheets

(amounts in thousands except share and per share data)

December 31,		**2016**		2015
Assets				
Cash and due from banks	**$**	**6,604**	$	7,087
Interest-bearing deposits in other banks		**7,644**		4,612
Total cash and cash equivalents		**14,248**		11,699
Investment securities available-for-sale		**149,666**		149,014
Investment securities held-to-maturity (fair value of $1,686 and $3,183)		**1,692**		3,191
Total investment securities		**151,358**		152,205
Restricted stock, at cost		**3,505**		3,300
Loans held for sale		**1,493**		1,293
Loans		**300,201**		286,648
Less allowance for loan losses		**2,778**		2,674
Net loans		**297,423**		283,974
Premises and equipment		**9,780**		10,172
Bank-owned life insurance		**9,525**		9,259
Accrued interest and other assets		**4,826**		4,356
Total Assets	**$**	**492,158**	$	476,258
Liabilities and Stockholders’ Equity				
Liabilities				
Deposits:				
Noninterest-bearing demand	**$**	**73,621**	$	64,874
Interest-bearing demand		**169,555**		164,888
Savings		**81,318**		77,582
Time deposits		**118,136**		118,993
Total deposits		**442,630**		426,337
Accrued interest and other liabilities		**1,677**		2,737
Total Liabilities		**444,307**		429,074
Stockholders' Equity				
Common stock, par value $0.10; 5,000,000 shares authorized, 1,502,500 shares issued and 1,328,358 shares outstanding		**150**		150
Capital surplus		**3,832**		3,832
Retained earnings		**48,778**		46,815
Accumulated other comprehensive loss		**(2,603)**		(1,293)
		50,157		49,504
Treasury stock, at cost (174,142 shares)		**(2,248)**		(2,248)
Total Northumberland Bancorp stockholders' equity		**47,909**		47,256
Noncontrolling interest		**(58)**		(72)
Total Stockholders' Equity		**47,851**		47,184
Total Liabilities and Stockholders' Equity	**$**	**492,158**	$	476,258

See accompanying notes to consolidated financial statements.

Northumberland Bancorp

Consolidated Statements of Income

(amounts in thousands except share and per share data)

Years Ended December 31,		**2016**		2015
Interest and Dividend Income				
Interest and fees on loans:				
Taxable	**$**	**12,844**	$	12,212
Tax-exempt		**259**		171
Interest on interest-bearing deposits in other banks		**47**		21
Interest and dividends on investment securities:				
Taxable		**1,247**		1,017
Tax-exempt		**1,247**		1,484
Dividends		**176**		231
Total Interest and Dividend Income		**15,820**		15,136
Interest Expense				
Deposits		**2,409**		2,538
Total Interest Expense		**2,409**		2,538
Net interest income		**13,411**		12,598
Provision for Loan Losses		**208**		611
Net Interest Income After Provision for Loan Losses		**13,203**		11,987
Noninterest Income				
Service charges on deposit accounts		**1,044**		970
Trust services income		**611**		676
Investment securities gains, net		**163**		152
Gain on sale of loans		**797**		741
Earnings on bank-owned life insurance		**266**		538
Other income		**720**		690
Total Noninterest Income		**3,601**		3,767
Noninterest Expense				
Salaries and employee benefits		**6,738**		6,258
Occupancy expense, net		**757**		755
Equipment expense		**868**		818
Professional fees		**1,254**		761
Data processing		**845**		824
Shares tax		**377**		287
Federal deposit insurance expense		**376**		291
Reimbursements to customers		**36**		1,379
Other expense		**2,082**		2,176
Total Noninterest Expense		**13,333**		13,549
Income before income taxes		**3,471**		2,205
Income Taxes		**591**		(12)
Net Income		**2,880**		2,217
Net income attributable to noncontrolling interest		**14**		6
Net Income Attributable to Northumberland Bancorp	**$**	**2,866**	$	2,211
Earnings Per Share	**$**	**2.16**	$	1.66
Weighted-Average Shares Outstanding		**1,328,358**		1,328,872

See accompanying notes to consolidated financial statements.

Northumberland Bancorp

Consolidated Statements of Comprehensive Income

(amounts in thousands)

Years Ended December 31,		**2016**		2015
Net Income	**$**	**2,880**	$	2,217
Other Comprehensive (Loss) Income				
Change in unrealized holding losses on investment securities available-for-sale		**(1,678)**		(215)
Tax effect		**573**		107
Reclassification adjustment for investment securities gains recognized in net income		**(163)**		(152)
Tax effect		**55**		52
Change in unrecognized pension costs		**(147)**		798
Tax effect		**50**		(271)
Other Comprehensive (Loss) Income, Net of Tax		**(1,310)**		319
Comprehensive income before noncontrolling interest		**1,570**		2,536
Less: net income attributable to noncontrolling interest		**14**		6
Comprehensive Income	**$**	**1,556**	$	2,530

See accompanying notes to consolidated financial statements.

Northumberland Bancorp

Consolidated Statements of Stockholders' Equity

(amounts in thousands except share and per share data)

	Common Stock	Capital Surplus	Retained Earnings	Accumulated Other Comprehensive Loss	Treasury Stock	Noncontrolling Interest	Total
Balance, December 31, 2014	$ 150	$ 3,832	$ 45,534	$ (1,612)	$ (2,189)	$ (78)	$ 45,637
Net income	-	-	2,211	-	-	6	2,217
Other comprehensive income	-	-	-	319	-	-	319
Dividends declared ($0.70 per share)	-	-	(930)	-	-	-	(930)
Purchase of treasury stock (2,000 shares)	-	-	-	-	(59)	-	(59)
Balance, December 31, 2015	150	3,832	46,815	(1,293)	(2,248)	(72)	47,184
Net income	**-**	**-**	**2,866**	**-**	**-**	**14**	**2,880**
Other comprehensive loss	**-**	**-**	**-**	**(1,310)**	**-**	**-**	**(1,310)**
Dividends declared ($0.68 per share)	**-**	**-**	**(903)**	**-**	**-**	**-**	**(903)**
Balance, December 31, 2016	**$ 150**	**$ 3,832**	**$ 48,778**	**$ (2,603)**	**$ (2,248)**	**$ (58)**	**$ 47,851**

See accompanying notes to consolidated financial statements.

Northumberland Bancorp

Consolidated Statements of Cash Flows

(amounts in thousands)

Years Ended December 31,	**2016**	2015
Cash Flows from Operating Activities		
Net income	**$ 2,880**	$ 2,217
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for loan losses	**208**	611
Depreciation, amortization, and accretion, net	**1,631**	1,823
Proceeds from sale of loans held for sale	**26,103**	23,926
Gain on sale of loans	**(797)**	(741)
Originations of residential loans held for sale	**(25,506)**	(23,229)
Investment securities gains, net	**(163)**	(152)
Deferred income tax (benefit) expense	**217**	(458)
Earnings on bank-owned life insurance	**(266)**	(260)
Write-down of other real estate owned	**14**	137
(Increase) decrease in accrued interest receivable	**(22)**	83
Decrease in accrued interest payable	**(2)**	(14)
Other, net	**(2,022)**	157
Net Cash Provided by Operating Activities	**2,275**	4,100
Cash Flows from Investing Activities		
Investment securities available-for-sale:		
Proceeds from sales	**29,294**	21,996
Proceeds from maturities or redemptions	**20,856**	19,194
Purchases	**(52,926)**	(30,510)
Investment securities held-to-maturity:		
Proceeds from maturities or redemptions	**1,446**	1,670
Purchases	**(4)**	(1,565)
Increase in loans, net	**(13,652)**	(9,118)
Purchases of premises and equipment, net	**(260)**	(1,818)
Purchases of restricted stock	**(470)**	(458)
Redemptions of restricted stock	**265**	145
Purchase of bank-owned life insurance	**-**	(1,010)
Proceeds from surrender of bank-owned life insurance	**-**	263
Proceeds from sale of real estate owned	**335**	19
Net Cash Used in Investing Activities	**(15,116)**	(1,192)
Cash Flows from Financing Activities		
Net increase (decrease) in deposits	**16,293**	(3,958)
Cash dividends paid	**(903)**	(930)
Purchase of treasury stock	**-**	(59)
Net Cash Provided by (Used in) Financing Activities	**15,390**	(4,947)
Increase (decrease) in cash and cash equivalents	**2,549**	(2,039)
Cash and Cash Equivalents, Beginning Of Year	**11,699**	13,738
Cash and Cash Equivalents, End Of Year	**$ 14,248**	$ 11,699

See accompanying notes to consolidated financial statements.

1. Summary of Significant Accounting Policies

A summary of significant accounting and reporting policies applied in the presentation of the accompanying consolidated financial statements follows:

Nature of Operations and Basis of Presentation

Northumberland Bancorp (the "Company") is a Pennsylvania corporation and is registered under the Bank Holding Company Act. The Company was organized as the holding company of its wholly owned subsidiary, The Northumberland National Bank (the "Bank"). The Bank is a nationally chartered commercial bank located in Northumberland, Pennsylvania. The Bank's service area includes portions of Northumberland, Snyder, Union, and Montour counties in Pennsylvania. The Company and the Bank derive substantially all of their income from banking and bank-related services, which include interest earnings on commercial, commercial mortgage, residential real estate, and consumer loan financing as well as interest earnings on investment securities and deposit and trust services to their customers. The Bank has a subsidiary, NNB Financial Services, that sells financial and insurance products. The Company is supervised by the Federal Reserve Board, while the Bank is subject to regulation and supervision by the Office of the Comptroller of the Currency.

The consolidated financial statements include the accounts of the Company and its wholly-owned subsidiary, the Bank. Intercompany activity has been eliminated in consolidation.

The consolidated financial statements have been prepared in conformity with U.S. generally accepted accounting principles and with general practice within the banking industry. In preparing the financial statements, management is required to make certain estimates and assumptions that affect the reported amounts of assets and liabilities as of the consolidated balance sheet date and revenues and expenses for the period. Actual results could differ significantly from those estimates.

Investment Securities

Investment securities are classified at the time of purchase, based on management's intention and ability, as securities held-to-maturity or securities available-for-sale. Debt securities acquired with the intent and ability to hold to maturity are stated at cost adjusted for amortization of premium and accretion of discount that are computed using the level yield method and recognized as adjustments of interest income. Certain other debt securities have been classified as available-for-sale to serve principally as a source of liquidity. Unrealized holding gains and losses for available-for-sale securities are reported as a separate component of stockholders' equity, net of tax, until realized. Realized securities gains and losses are computed using the specific identification method. Interest and dividends on investment securities are recognized as income when earned.

Securities are periodically reviewed for other-than-temporary impairment based upon a number of factors including, but not limited to, the length of time and extent to which the market value has been less than cost, the financial condition of the underlying issuer, the ability of the issuer to meet contractual obligations, the likelihood of the security's ability to recover any decline in its market value, and whether or not the Company intends to sell the security or whether it's more likely than not that the Company would be required to sell the security before its anticipated recovery in market value. A decline in value that is considered to be other than temporary is recorded as a loss within noninterest income in the consolidated statements of income.

Federal Home Loan Bank Stock

The Bank is a member of the Federal Home Loan Bank ("FHLB") of Pittsburgh and, as such, is required to maintain a minimum investment in stock of the FHLB that varies with the level of advances outstanding with the FHLB, as well as a minimum level of mortgages in the Mortgage Partnership Finance (“MPF”) program. The stock is bought from and sold to the FHLB based upon its $100 par value. The stock does not have a readily determinable fair value and as such is classified as restricted stock, carried at cost.

Loans Held for Sale and Loans Serviced

Loans held for sale are carried at the lower of cost or fair value, as determined on an aggregate basis. Gains and losses on sales of loans held for sale are recognized on settlement dates and are determined by the difference between the sale proceeds and the carrying value of loans. All sales are made with limited recourse. Loans held for sale were $1,493,000 and $1,293,000 at December 31, 2016 and 2015, respectively. At December 31, 2016 and 2015, the amounts of loans serviced by the Company for the benefit of others were $123,739,000 and $118,462,000, respectively. These loans are not included in the Company’s consolidated balance sheet.

Mortgage Servicing Rights ("MSRs")

The Company has agreements for the express purpose of selling loans in the secondary market. The Company maintains servicing rights for certain loans. Originated MSRs are recorded by allocating total costs incurred between the loan and servicing rights based on their relative fair values. MSRs are amortized in proportion to the estimated servicing income over the estimated life of the servicing portfolio. Annually, the Company performs an impairment review of the MSRs and recognizes impairment through a valuation account. No impairment was recognized in 2016 or 2015. MSRs are a component of other assets on the consolidated balance sheets. The balance of loan servicing assets was $893,000 and $959,000 at December 31, 2016 and 2015, respectively.

Loans

Loans originated with the intention to hold to maturity are reported at their principal amount, net of unearned income and the allowance for loan losses. Interest income on all loans is recognized on an accrual basis. Nonrefundable loan fees and certain direct costs are deferred and amortized over the life of the loans using the interest method. The amortization is reflected as an interest yield adjustment, and the deferred portion of the net fees and costs is reflected as part of the loan balance. Accrual of interest is discontinued when, in the opinion of management, reasonable doubt exists as to the collectability of additional interest. Loans are returned to accrual status when past-due interest is collected and the collection of principal is probable.

Allowance for Loan Losses

The allowance for loan losses represents the amount that management estimates is adequate to provide for probable losses inherent in its loan portfolio. The allowance method is used in providing for loan losses. Accordingly, all loan losses are charged to the allowance, and all recoveries are credited to it. The allowance for loan losses is established through a provision for loan losses charged to operations. The provision for loan losses is based on management's periodic evaluation of individual loans, economic factors, past loan loss experience, changes in the composition and volume of the portfolio, and other relevant factors. The estimates used in determining the adequacy of the allowance for loan losses, including the amounts and timing of future cash flows expected on impaired loans, are particularly susceptible to changes in the near term.

Impaired loans are commercial and commercial real estate loans for which it is probable the Company will not be able to collect all amounts due according to the contractual terms of the loan agreement. The Company individually evaluates such loans for impairment and does not aggregate loans by major risk classifications. The definition of "impaired loans" is not the same as the definition of "nonaccrual loans," although the two categories overlap. The Company may choose to place a loan on nonaccrual status due to payment delinquency or uncertain collectability, while not classifying the loan as impaired if the loan is not a commercial or commercial real estate loan. Factors considered by management in determining impairment include payment status and collateral value. The amount of impairment for these types of impaired loans is determined by the difference between the present value of the expected cash flows related to the loan, using the original interest rate, and its recorded value, or as a practical expedient in the case of collateralized loans, the difference between the fair value of the collateral and the recorded amount of the loans. When foreclosure is probable, impairment is measured based on the fair value of the collateral.

Mortgage loans on one-to-four family properties and all consumer loans are large groups of smaller-balance homogeneous loans and are measured for impairment collectively. Loans that experience insignificant payment delays, which are defined as 90 days or less, generally are not classified as impaired. Management determines the significance of payment delays on a case-by-case basis taking into consideration all circumstances surrounding the loan and the borrower including the length of the delay, the borrower's prior payment record, and the amount of shortfall in relation to the principal and interest owed.

Loans whose terms are modified are classified as troubled debt restructurings if the Bank grants such borrowers concessions and it is deemed that those borrowers are experiencing financial difficulty. Concessions granted under a troubled debt restructuring generally involve a temporary reduction in interest rate or an extension of a loan's stated maturity date. Nonaccrual troubled debt restructurings are restored to accrual status if principal and interest payments, under the modified terms, are current for six consecutive months after modification. Loans classified as troubled debt restructurings are designated as impaired.

Premises and Equipment

Land is carried at cost. Premises and equipment are stated at cost less accumulated depreciation. Depreciation is computed on the straight-line method over the estimated useful lives of the assets, which range from 3 to 20 years for furniture, fixtures, and equipment and 15 to 50 years for buildings and leasehold improvements. Expenditures for maintenance and repairs are charged against income as incurred. Costs of major additions and improvements are capitalized.

Real Estate Owned

Real estate owned acquired in settlement of foreclosed loans is carried as a component of other assets at fair value minus estimated cost to sell. Prior to foreclosure, the estimated collectible value of the collateral is evaluated to determine whether a partial charge-off of the loan balance is necessary. After transfer to real estate owned, any subsequent write-downs are charged against other operating expenses. Direct costs incurred in the foreclosure process and subsequent holding costs incurred on such properties are recorded as expenses of current operations. The balance of real estate owned included in accrued interest and other assets was $-0- and $299,000 at December 31, 2016 and 2015, respectively.

Bank Owned Life Insurance

The Company invests in bank owned life insurance (“BOLI”) as a source of funding for employee benefit expenses. BOLI involves the purchasing of life insurance by the bank on a select group of employees. The Company is the owner and beneficiary of the policies. This life insurance investment is carried at the cash surrender value of the underlying policies. Income from the increase in cash surrender value of the policies or from death benefits realized is included in other income on the consolidated statements of income.

Advertising Costs

Advertising costs are expensed as the costs are incurred. Advertising expenses amounted to $121,000 and $135,000 for 2016 and 2015, respectively.

Income Taxes

The Company and the Bank file a consolidated federal income tax return. Deferred tax assets or liabilities are computed based on the difference between the financial statement and income tax basis of assets and liabilities using the enacted marginal tax rates. Deferred income tax expenses or benefits are based on the changes in the deferred tax asset or liability from period to period.

Employee Benefit Plans

The Bank has a noncontributory defined benefit pension plan that covers all eligible employees. Benefits are based upon years of service, the employee’s compensation, and age at retirement. The Bank’s contribution is actuarially determined and is intended to meet the current and projected obligations of the plan. The Bank has a noncontributory defined contribution plan that covers all eligible employees.

(amounts in thousands except share data)

Trust Assets and Income

Assets held by the Bank in a fiduciary or agency capacity for its customers are not included in the accompanying financial statements, since such items are not assets of the Bank. The fair value of trust assets under administration were $128,902,000 and $162,082,000 as of December 31, 2016 and 2015, respectively. In accordance with banking industry practice, trust services income is recognized on the cash basis and is not materially different than if it was reported on the accrual basis.

Comprehensive Income

The Company is required to present comprehensive income and its components in a full set of general-purpose financial statements for all periods presented. Other comprehensive income (loss) is comprised of net unrealized holding gains or losses on its available-for-sale investment securities and mortgage-backed securities portfolio, as well as changes in unrecognized pension cost.

Earnings Per Share

The Company currently maintains a simple capital structure; therefore, there are no dilutive effects on earnings per share. As such, earnings per share are calculated using the weighted-average number of shares outstanding for the periods.

Cash Flow Information

The Company has defined cash and cash equivalents as those amounts included in the consolidated balance sheet captions "cash and due from banks," and "interest-bearing deposits in other banks," with original maturities of 90 days or less.

	2016	2015
Cash paid during the year for:		
Interest	**$ 2,411**	$ 2,552
Income taxes	**300**	1,190
Noncash investing transactions:		
Transfer of loans to real estate owned	**50**	455
Transfer of investment securities held-to-maturity to available-for-sale due to significant deterioration in the issuer's credit worthiness	**-**	260

Reclassification of Comparative Amounts

Certain comparative amounts for the prior year have been reclassified to conform to current-year classifications. Such reclassifications had no effect on stockholders' equity or net income.

2. OCC Consent Order and Federal Reserve Bank Resolution

On May 5, 2016, the Bank entered into a Stipulation and Consent to the Issuance of a Consent Order ("Order") with the Comptroller of the Currency of the United States of America, through its national bank examiners and other staff of the Office of the Comptroller of the Currency ("OCC"), which has supervisory authority over the Bank. In entering into the Order, the Bank did not concede to the findings or admit to any of the assertions therein. However, as a result of the Order, the Bank is considered under OCC regulations to be in a "troubled condition," meaning primarily that the Bank must seek the OCC's advance consent to hiring certain executive officers or adding directors, to entering into agreements with Bank officers which provide for "golden parachute" payments, and to making "golden parachute" payments, and that the Bank is not eligible to receive expedited consideration of certain actions for which it must seek the OCC's advance approval, such as opening a new branch office.

The provisions of the Order are summarized below. The full text of the Order has been published by the OCC on its website (www.occ.gov). The actions to be taken by the Bank's Board of Directors ("Board"), as a result of the Order, were required to be taken within time periods specified in the Order and, in some cases, must be taken periodically on an ongoing basis. The Bank's Board intends to fully comply with all the requirements of the Order.

Compliance Committee. The Board was required to appoint and maintain a Compliance Committee of at least three directors, whose main function is to monitor and report to the OCC on the Bank's compliance with the Order. The Compliance Committee was established on the day that the Order was issued and continues to meet at least monthly.

Board Supervision and Competent Management. The Order requires the Board to ensure that the Bank has competent and effective full-time management in place for all executive officer positions at the Bank. The Board is also required to evaluate corporate governance processes and management supervision in light of the Bank's condition, to establish, at least annually, the objectives it will use to measure the effectiveness of the Bank's executive officers, to perform an annual independent written performance appraisal for each of the Bank's executive officers, including the President, after identifying any deficiency in an officer's performance as a result of the annual performance appraisal to identify what corrective action is required to address the deficiency and ensure the Bank implements and adheres to such corrective action, and to develop and thereafter maintain and update a written Board and management succession program that identifies the Bank's future management requirements and promotes the retention and continuity of competent and experienced management and board members.

Cross Trading Remediation. The Order required the Board to adopt policies, procedures, and controls for the crossing of buy and sell orders for securities on a fair and equitable basis to the parties to the transaction, where permissible under applicable law. With respect to cross trades which the Trust Department conducted at par value between 2002 and 2014, the Bank was required to adhere to the cross-trade Reimbursement Plan previously submitted to the OCC and to not make any changes to the Reimbursement Plan without submitting a request to and receiving a written determination of no supervisory from the OCC. The Bank has substantially completed the Reimbursement Plan.

Forensic Investigation Findings. The Order requires the Board to periodically report on the Bank's progress in addressing the concerns identified in the Bank's forensic investigation of past Trust Department activities, and the Bank continues to do so.

Account Administration. The Order required the Board to submit to the OCC for a written determination of no supervisory objection written policies and procedures for the proper administration of fiduciary and custody accounts.

Investment Management Processes. The Order required the Board to submit a written investment management program to the OCC for a written determination of no supervisory objection. Additionally, the Board must ensure the Bank's engagement of any third party to assist the Bank with its investment management program is consistent with the OCC's guidance on third party engagements.

Asset Management Governance and Controls. The Order required the Board to adopt a program to ensure effective oversight and controls for trust department operations, after submitting the program to the OCC and obtaining an indication of no objection. Additionally, the Bank's internal audit function must periodically test and verify that the Bank is adhering to the program and that it remains effective and is functioning as designed.

Asset Management Fees and Earnings. The Order requires the Board to adopt fee schedules that cover all accounts administered by the Trust Department. The Bank must enter into account agreements implementing the new fee schedule by September 30, 2017. Additionally, the Board must adopt and ensure the Bank implements and thereafter adheres to a process for reviewing all accounts administered by the trust department to ensure such accounts are charged fees in accordance with the fee schedules developed pursuant to the Order.

Fiduciary Audit. The Order required the Board to adopt a revised Fiduciary Audit Program that complies with OCC regulations and to ensure that the Bank adheres to the new Program.

Bank Secrecy Act/Anti-Money Laundering Internal Controls. The Order required the Board to adopt and ensure that the Bank implements and thereafter adheres to a revised Bank Secrecy Act/Anti-Money Laundering ("BSA/AML") written compliance program that covers the Bank's Trust Department. Additionally, the Board must ensure the Bank's ongoing compliance with the Bank Secrecy Act, that the Bank reviews and updates its BSA/AML customer risk rating process and methodology for Trust Department customers and accounts in accordance with the Federal Financial Institutions Examination Council ("FFIEC") BSA/AML Examination Manual and other applicable regulatory guidance, that the Bank reviews and updates, in accordance with the FFIEC BSA/AML Examination Manual and other applicable regulatory guidance, its risk-based processes to obtain and analyze appropriate customer due diligence information for Trust Department customers and accounts at the time of account opening and on an ongoing basis, and effectively use the information in monitoring account activity, and investigating suspicious or unusual activity, that the Bank develops, implements, and thereafter adheres to suspicious activity monitoring policies, procedures and processes to ensure the Bank's timely and effective identification and review of potential suspicious activity involving customer relationships and accounts administered by the trust department, and the Bank's compliance with reporting requirements, and that the Bank has an effective risk-based BSA/AML independent testing function to ensure the Bank's adherence to effective BSA/AML internal controls for trust department customers and accounts, including evaluation of the Bank's BSA/AML risk assessment, and customer due diligence, enhanced due diligence and suspicious activity monitoring processes for trust customers and accounts.

(amounts in thousands except share data)

Violations of Law. The Order requires the Board to immediately take all necessary steps to ensure that Bank management corrects each violation of law, rule or regulation recently cited by the OCC and to adopt, implement, and thereafter ensure Bank adherence to specific procedures to which incorporate internal control systems and education of employees regarding laws, rules and regulations applicable to their areas of responsibility.

On December 6, 2016, the directors of the Company adopted a resolution at the request of the Federal Reserve Bank of Philadelphia ("FRB"). In the resolution, the directors committed to addressing concerns raised by the FRB with respect to the same issues which were the subject of the OCC's Consent Order and to providing regular progress reports to the FRB on the Company's progress. The Company intends to fully comply with all the requirements of the resolution.

In connection with the OCC Consent Order and the resolution adopted at the request of the FRB, including the related investigation, the Company incurred professional fees of $562,000 and $278,000 for 2016 and 2015, respectively, and made or accrued reimbursements to customers of $1,379,000 through December 31, 2015 and an additional $36,000 in 2016.

3. Investment Securities

The amortized cost and fair values of investment securities are as follows:

December 31, 2016	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Available-for-sale:				
Obligations of states and political subdivisions	**$ 58,619**	**$ 266**	**$ (759)**	**$ 58,126**
Mortgage-backed securities in government sponsored entities	**92,330**	**124**	**(1,119)**	**91,335**
	150,949	**390**	**(1,878)**	**149,461**
Equity securities in financial institutions	**167**	**38**	**-**	**205**
Total	**$ 151,116**	**$ 428**	**$ (1,878)**	**$ 149,666**

(amounts in thousands except share data)

December 31, 2015	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Available-for-sale:				
Obligations of states and political subdivisions	$ 64,694	$ 878	$ (77)	$ 65,495
Mortgage-backed securities in government sponsored entities	83,264	181	(602)	82,843
Corporate debt securities	500	1	(3)	498
	148,458	1,060	(682)	148,836
Equity securities in financial institutions	165	13	-	178
Total	$ 148,623	$ 1,073	$ (682)	$ 149,014

December 31, 2016	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Held-to-maturity:				
Obligations of states and political subdivisions	**$ 1,692**	**$ -**	**$ (6)**	**$ 1,686**
Total	**$ 1,692**	**$ -**	**$ (6)**	**$ 1,686**

December 31, 2015	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Held-to-maturity:				
Obligations of states and political subdivisions	$ 3,191	$ 6	$ (14)	$ 3,183
Total	$ 3,191	$ 6	$ (14)	$ 3,183

(amounts in thousands except share data)

The following tables show the Company's gross unrealized losses and fair value, aggregated by investment category and length of time that the individual securities have been in a continuous unrealized loss position, at December 31, 2016 and 2015.

December 31, 2016	Less than 12 Months		12 Months or Longer		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Available-for-sale:						
Obligations of states and political subdivisions	**$ 29,352**	**$ (759)**	**$ -**	**$ -**	**$ 29,352**	**$ (759)**
Mortgage-backed securities in government sponsored entities	**35,616**	**(681)**	**39,393**	**(438)**	**75,009**	**(1,119)**
Total	**$ 64,968**	**$ (1,440)**	**$ 39,393**	**$ (438)**	**$ 104,361**	**$ (1,878)**
Held-to-maturity:						
Obligations of states and political subdivisions	**$ 647**	**$ (2)**	**$ 784**	**$ (4)**	**$ 1,431**	**$ (6)**
	$ 647	**$ (2)**	**$ 784**	**$ (4)**	**$ 1,431**	**$ (6)**

December 31, 2015	Less than 12 Months		12 Months or Longer		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Available-for-sale:						
Obligations of states and political subdivisions	$ 7,743	$ (38)	$ 4,120	$ (39)	$ 11,863	$ (77)
Mortgage-backed securities in government sponsored entities	25,081	(196)	40,138	(406)	65,219	(602)
Corporate debt securities	-	-	247	(3)	247	(3)
Total	$ 32,824	$ (234)	$ 44,505	$ (448)	$ 77,329	$ (682)
Held-to-maturity:						
Obligations of states and political subdivisions	$ 1,073	$ (14)	$ -	$ -	$ 1,073	$ (14)
	$ 1,073	$ (14)	$ -	$ -	$ 1,073	$ (14)

(amounts in thousands except share data)

The Company reviews its unrealized loss positions quarterly and has asserted that at December 31, 2016 and 2015, the declines outlined in the above tables represent temporary declines and the Company does not intend to sell and does not believe it will be required to sell these securities before recovery of their cost basis, which may be at maturity. There were 198 and 142 positions that were temporarily impaired at December 31, 2016 and 2015, respectively. The Company has concluded that the unrealized losses disclosed above are not other than temporary but are the result of interest rate changes, sector credit ratings changes, or issuer-specific ratings changes that are not expected to result in the noncollection of principal and interest during the period.

The amortized cost and fair value of debt securities at December 31, 2016, by contractual maturity, are shown below. Expected maturities will differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

	Available-for-Sale		Held-to-Maturity	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
Due in one year or less	$ **7,137**	$ **7,167**	$ **451**	$ **450**
Due after one year through five years	**76,085**	**75,474**	**1,236**	**1,231**
Due after five years through ten years	**50,786**	**49,965**	**-**	**-**
Due after ten years	**16,941**	**16,855**	**5**	**5**
Total	$ **150,949**	$ **149,461**	$ **1,692**	$ **1,686**

Proceeds from the sales of available-for-sale securities during 2016 amounted to $29,294,000 resulting in gross gains and gross losses of $187,000 and $(24,000), respectively. Proceeds from the sales of available-for-sale securities during 2015 amounted to $21,996,000 resulting in gross gains and gross losses of $192,000 and $(40,000), respectively.

Investment securities with fair values of $66,577,000 and $73,216,000 at December 31, 2016 and 2015, respectively, were pledged to secure public deposits and other purposes as required by law.

4. Loans

Major classifications of loans are summarized as follows:

	2016	2015
Commercial	$ **64,646**	$ 58,521
Commercial real estate	**53,699**	47,296
Residential real estate	**177,376**	176,495
Consumer	**4,480**	4,336
	300,201	286,648
Less allowance for loan losses	**2,778**	2,674
Net Loans	$ **297,423**	$ 283,974

(amounts in thousands except share data)

The Company grants residential, commercial, and consumer loans to customers throughout its trade area, which is concentrated in North Central Pennsylvania. Although the Company has a diversified loan portfolio at December 31, 2016 and 2015, a substantial portion of its debtors' ability to honor their loan agreements is dependent upon the economic stability of its immediate trade area.

5. Allowance for Loan Losses

Changes in the allowance for loan losses by portfolio segment are as follows:

December 31, 2016	Commercial	Commercial Real Estate	Residential Real Estate	Consumer	Unallocated	Total
Beginning Balance	**$ 722**	**$ 331**	**$ 1,382**	**$ 39**	**$ 200**	**$ 2,674**
Charge-offs	**(3)**	**-**	**(86)**	**(18)**	**-**	**(107)**
Recoveries	**-**	**-**	**2**	**1**	**-**	**3**
Provision	**(48)**	**(47)**	**185**	**18**	**100**	**208**
Ending Balance	**$ 671**	**$ 284**	**$ 1,483**	**$ 40**	**$ 300**	**$ 2,778**

December 31, 2015	Commercial	Commercial Real Estate	Residential Real Estate	Consumer	Unallocated	Total
Beginning Balance	$ 619	$ 302	$ 1,327	$ 45	$ 260	$ 2,553
Charge-offs	(350)	(29)	(135)	(15)	-	(529)
Recoveries	13	-	26	-	-	39
Provision	440	58	164	9	(60)	611
Ending Balance	$ 722	$ 331	$ 1,382	$ 39	$ 200	$ 2,674

Management has an established methodology to determine the adequacy of the allowance for loan losses that assesses the risks and losses inherent in the loan portfolio. For purposes of determining the allowance for loan losses, the Company has segmented certain loans in the portfolio by product type. Loans are segmented into the following pools: commercial, commercial real estate loans, residential real estate loans, and consumer loans. Historical loss percentages for each risk category are calculated and used as the basis for calculating allowance allocations. These historical loss percentages are calculated over a two-year period during 2016 and a three-year period during 2015 for all portfolio segments. Certain qualitative factors are then added to the historical allocation percentage to apply the adjusted factor to nonclassified loans. The following qualitative factors are analyzed for each portfolio segment and are adjusted based upon relevant changes within the portfolio:

- Levels of and trends in delinquencies
- Trends in volume and terms
- Trends in credit quality ratings
- Changes in management and lending staff
- Economic trends
- Concentrations of credit

(amounts in thousands except share data)

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 recognize additions to the allowance based on their judgments about information available to them at the time of their examination, which may not be currently available to management. Based on management's comprehensive analysis of the loan portfolio, management believes the current level of the allowance for loan losses is adequate.

The total allowance reflects management's estimate of loan losses inherent in the loan portfolio at the consolidated balance sheet date. The Company considers the allowance for loan losses of $2,778,000 and $2,674,000 adequate to cover loan losses inherent in the loan portfolio at December 31, 2016 and 2015, respectively. The following tables present the balance in the allowance for loan losses and the recorded investment in loans by portfolio segment and based on impairment evaluation method as of December 31, 2016 and 2015:

December 31, 2016	Commercial	Commercial Real Estate	Residential Real Estate	Consumer	Unallocated	Total
Allowance for loan losses:						
Individually evaluated for impairment	$ -	$ -	$ -	$ -	$ -	$ -
Collectively evaluated for impairment	671	284	1,483	40	300	2,778
Total	**$ 671**	**$ 284**	**$ 1,483**	**$ 40**	**$ 300**	**$ 2,778**
Loans:						
Individually evaluated for impairment	$ 1,391	$ -	$ -	$ -	$ -	$ 1,391
Collectively evaluated for impairment	63,255	53,699	177,376	4,480	-	298,810
Total	**$ 64,646**	**$ 53,699**	**$ 177,376**	**$ 4,480**	**$ -**	**$ 300,201**

(amounts in thousands except share data)

December 31, 2015	Commercial	Commercial Real Estate	Residential Real Estate	Consumer	Unallocated	Total
Allowance for loan losses:						
Individually evaluated for impairment	$ 286	$ -	$ -	$ -	$ -	$ 286
Collectively evaluated for impairment	436	331	1,382	39	200	2,388
Total	$ 722	$ 331	$ 1,382	$ 39	$ 200	$ 2,674
Loans:						
Individually evaluated for impairment	$ 1,766	$ -	$ -	$ -	$ -	$ 1,766
Collectively evaluated for impairment	56,755	47,296	176,495	4,336	-	284,882
Total	$ 58,521	$ 47,296	$ 176,495	$ 4,336	$ -	$ 286,648

Credit Quality Information

The Company's internally assigned grades are as follows:

Pass loans are protected by the current net worth and paying capacity of the obligor or by the value of the underlying collateral. There are five sub-grades within the pass category to further distinguish the loan.

Special Mention loans are loans for which a potential weakness or risk exists, which could cause a more serious problem if not corrected.

Substandard loans have a well-defined weakness based on objective evidence and are characterized by the distinct possibility that the bank will sustain some loss if the deficiencies are not corrected.

Doubtful loans have all the weaknesses inherent in a substandard asset. In addition, these weaknesses make collection or liquidation in full highly questionable and improbable, based on existing circumstances.

Loss loans are considered uncollectible, or of such value that continuance as an asset is not warranted.

(amounts in thousands except share data)

The following tables represent credit exposures by internally assigned grades for the years ended December 31, 2016 and 2015. The grading analysis estimates the capability of the borrower to repay the contractual obligations of the loan agreements as scheduled or at all. The Company's internal credit risk grading system is based on experiences with similarly graded loans.

December 31, 2016	Obligations of States and Political Subdivisions	Other Commercial Loans	Loans for Investment Properties	Other Commercial Real Estate Loans	Total
Pass	**$ 17,247**	**$ 44,867**	**$ 24,383**	**$ 29,276**	**$ 115,773**
Special Mention	**-**	**-**	**-**	**-**	**-**
Substandard	**-**	**2,532**	**40**	**-**	**2,572**
Doubtful	**-**	**-**	**-**	**-**	**-**
Loss	**-**	**-**	**-**	**-**	**-**
Ending Balance	**$ 17,247**	**$ 47,399**	**$ 24,423**	**$ 29,276**	**$ 118,345**

December 31, 2015	Obligations of States and Political Subdivisions	Other Commercial Loans	Loans for Investment Properties	Other Commercial Real Estate Loans	Total
Pass	$ 18,246	$ 37,455	$ 22,979	$ 21,931	$ 100,611
Special Mention	-	542	-	1,359	1,901
Substandard	-	1,828	42	985	2,855
Doubtful	-	450	-	-	450
Loss	-	-	-	-	-
Ending Balance	$ 18,246	$ 40,275	$ 23,021	$ 24,275	$ 105,817

The following tables present performing and nonperforming residential real estate and consumer loans based on payment activity for the years ended December 31, 2016 and 2015. Payment activity is reviewed by management on a monthly basis to determine how loans are performing. Loans are considered to be nonperforming when they become 90 days past due or are placed on nonaccrual.

December 31, 2016	First Mortgages	Home Equity Loans	Consumer	Total
Performing	**$ 135,529**	**$ 40,983**	**$ 4,479**	**$ 180,991**
Nonperforming	**840**	**24**	**1**	**865**
Total	**$ 136,369**	**$ 41,007**	**$ 4,480**	**$ 181,856**

December 31, 2015	First Mortgages	Home Equity Loans	Consumer	Total
Performing	$ 137,242	$ 38,659	$ 4,334	$ 180,235
Nonperforming	569	25	2	596
Total	$ 137,811	$ 38,684	$ 4,336	$ 180,831

(amounts in thousands except share data)

Following are tables which include an aging analysis of the recorded investment of past-due loans as of December 31, 2016 and 2015:

December 31, 2016	30-59 Days Past Due	60-89 Days Past Due	90 Days or Greater	Total Past Due	Current	Total
Commercial:						
Obligations of states and political subdivisions	**$ -**	**$ -**	**$ -**	**$ -**	**$ 17,247**	**$ 17,247**
Other commercial loans	**129**	**-**	**189**	**318**	**47,081**	**47,399**
Commercial real estate:						
Loans for investment property	**-**	**-**	**40**	**40**	**24,383**	**24,423**
Other commercial real estate loans	**37**	**-**	**-**	**37**	**29,239**	**29,276**
Residential mortgage loans:						
First mortgages	**1,446**	**204**	**935**	**2,585**	**133,784**	**136,369**
Home equity loans	**75**	**82**	**51**	**208**	**40,799**	**41,007**
Consumer	**30**	**3**	**1**	**34**	**4,446**	**4,480**
Total	**$ 1,717**	**$ 289**	**$ 1,216**	**$ 3,222**	**$ 296,979**	**$ 300,201**

December 31, 2015	30-59 Days Past Due	60-89 Days Past Due	90 Days or Greater	Total Past Due	Current	Total
Commercial:						
Obligations of states and political subdivisions	$ -	$ -	$ -	$ -	$ 18,246	$ 18,246
Other commercial loans	-	-	543	543	39,732	40,275
Commercial real estate:						
Loans for investment property	-	-	-	-	23,021	23,021
Other commercial real estate loans	-	-	-	-	24,275	24,275
Residential mortgage loans:						
First mortgages	1,947	566	471	2,984	134,827	137,811
Home equity loans	125	36	47	208	38,476	38,684
Consumer	42	-	2	44	4,292	4,336
Total	$ 2,114	$ 602	$ 1,063	$ 3,779	$ 282,869	$ 286,648

Impaired Loans

Management evaluates commercial loans and commercial real estate loans which are 90 days or more past due and considers them to be impaired. Loans rated substandard or doubtful are also evaluated for impairment. These loans are analyzed to determine whether it is probable that all amounts will not be collected according to the contractual terms of the loan agreement. If management determines that the value of the impaired loan is less than the recorded investment in the loan (net of previous charge-offs, deferred loan fees, or costs and unamortized premium or discount), impairment is recognized through an allowance estimate or a charge-off to the allowance.

(amounts in thousands except share data)

The following tables include the recorded investment and unpaid principal balances for impaired loans with the associated allowance amount, if applicable, as of and for the years ending December 31:

December 31, 2016	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Interest Income Recognized
With no related allowance recorded:					
Commercial:					
Other commercial loans	**$ 1,313**	**$ 1,313**	**$ -**	**$ 1,339**	**$ -**
Commercial real estate:					
Loans for investment properties	**-**	**-**	**-**	**-**	**-**
Residential real estate:					
First mortgages	**78**	**78**	**-**	**91**	**-**
With an allowance recorded:					
Commercial:					
Other commercial loans	**-**	**-**	**-**	**-**	**-**
Commercial real estate:					
Loans for investment properties	**-**	**-**	**-**	**-**	**-**
Residential mortgage loans:					
First mortgages	**-**	**-**	**-**	**-**	**-**
Total	**$ 1,391**	**$ 1,391**	**$ -**	**$ 1,430**	**$ -**

December 31, 2015	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Interest Income Recognized
With no related allowance recorded:					
Commercial:					
Other commercial loans	$ -	$ -	$ -	$ -	$ -
Commercial real estate:					
Loans for investment properties	-	-	-	-	-
Residential real estate:					
First mortgages	-	-	-	-	-
With an allowance recorded:					
Commercial:					
Other commercial loans	1,766	1,766	286	2,148	5
Commercial real estate:					
Loans for investment properties	-	-	-	-	-
Residential mortgage loans:					
First mortgages	-	-	-	-	-
Total	$ 1,766	$ 1,766	$ 286	$ 2,148	$ 5

Nonaccrual Loans

Loans are considered for nonaccrual status upon 90 days delinquency. When a loan is placed in nonaccrual status, previously accrued but unpaid interest is deducted from interest income.

(amounts in thousands except share data)

The following tables present loans that are on nonaccrual status and that are 90 days delinquent and still accruing interest by portfolio segment as of December 31:

December 31, 2016	Nonaccrual	Past Due 90 Days or More and Still Accruing
Commercial:		
Obligations of states and political subdivisions	**$ -**	**$ -**
Other commercial loans	**1,313**	**-**
Commercial real estate:		
Loans for investment properties	**40**	**-**
Other commercial real estate loans	**-**	**-**
Residential mortgage loans:		
First mortgages	**279**	**589**
Home equity loans	**27**	**22**
Consumer loans	**-**	**1**
	$ 1,659	**$ 612**

December 31, 2015	Nonaccrual	Past Due 90 Days or More and Still Accruing
Commercial:		
Obligations of states and political subdivisions	$ -	$ -
Other commercial loans	1,766	17
Commercial real estate:		
Loans for investment properties	-	-
Other commercial real estate loans	-	-
Residential mortgage loans:		
First mortgages	154	461
Home equity loans	-	27
Consumer loans	-	-
	$ 1,920	$ 505

Interest income on nonaccrual loans not recognized during 2016 and 2015 was $101,000 and $96,000, respectively.

The Bank identifies loans for potential restructure primarily through direct communication with the borrower and evaluation of the borrower's financial statements, revenue projections, tax returns, and credit reports. Even if the borrower is not presently in default, management will consider the likelihood that cash flow shortages, adverse economic conditions, and negative trends may result in a payment default in the near future.

(amounts in thousands except share data)

Troubled debt restructurings (TDR) may be designated as performing or non-performing. A TDR may be designated as performing if the loan has demonstrated sustained performance under the modified terms. The period of sustained performance may include the periods prior to modification if prior performance met or exceeded the modified terms. For non-performing restructured loans, the loan will remain on non-accrual status until the borrower demonstrates a sustained period of performance, generally six consecutive months of payments. The Bank had $268,000 in total performing restructured loans as of December 31, 2016. During the year ended December 31, 2016, the Bank did not have any loans classified as troubled debt restructurings that subsequently defaulted. During the year ended December 31, 2015, the Bank did not have any modifications classified as troubled debt restructurings.

The following table reflects information regarding the Bank's troubled debt restructurings for the year ended December 31, 2016:

	2016	
	Modification of Payment and Other Terms	
	Number of Contracts	Recorded Investment
Commercial	1	$ 190
Residential real estate	4	78
Total	5	$ 268

6. Premises and Equipment

Major classifications of premises and equipment are summarized as follows:

December 31,	**2016**	2015
Land and improvements	**$ 1,458**	$ 1,458
Buildings and improvements	**9,973**	9,986
Furniture, fixtures and equipment	**4,281**	4,090
	15,712	15,534
Less accumulated depreciation	**5,932**	5,362
Total	**$ 9,780**	$ 10,172

Depreciation expense for the years ended December 31, 2016 and 2015 was $652,000 and $602,000, respectively.

(amounts in thousands except share data)

7. Deposits

Time deposits and their remaining maturities at December 31, 2016 are as follows:

Year Ending December 31,		
2017	$	35,779
2018		16,261
2019		24,087
2020		23,375
2021		18,268
Thereafter		366
	$	118,136

Time deposits $250,000 and greater were $22,961,000 and time deposits less than $250,000 were $95,175,000 as of December 31, 2016.

8. Income Taxes

The provision (benefit) for income taxes consists of:

		2016		2015
Current	**$**	**374**	$	446
Deferred		**217**		(458)
Total	**$**	**591**	$	(12)

(amounts in thousands except share data)

The tax effects of deductible and taxable temporary differences that give rise to significant portions of the deferred tax assets and deferred tax liabilities, respectively, at December 31 are as follows:

	2016	2015
Deferred tax assets:		
Allowance for loan losses	**$ 870**	$ 809
Accrued pension obligation	**856**	806
Accrued cross trade liability	**-**	413
Unrealized loss on investment securities	**500**	-
Alternative minimum tax credit	**201**	100
Other	**268**	161
Total gross deferred tax assets	**2,695**	2,289
Deferred tax liabilities:		
Premises and equipment	**477**	525
Investment accretion	**4**	3
Unrealized gain on investment securities	**-**	141
Prepaid pension costs	**622**	554
Loan origination fees and costs	**114**	95
Other	**60**	24
Total gross deferred tax liabilities	**1,277**	1,342
Net Deferred Tax Asset	**$ 1,418**	$ 947

No valuation allowance was established at December 31, 2016 and 2015, in view of the Company's ability to carryback to taxes paid in previous years and certain tax strategies, coupled with the anticipated future taxable income as evidenced by the Company's earnings potential.

The following is a reconciliation of the federal statutory rate and the Company's effective income tax rate for the years ended December 31:

	2016		2015	
	Amount	% of Pretax Income	Amount	% of Pretax Income
Provision at statutory rate	**$ 1,171**	**34.0 %**	$ 748	34.0 %
Effect of tax-exempt income	**(603)**	**(17.5)**	(762)	(34.7)
Nondeductible interest expense	**21**	**0.5**	27	1.2
Other	**2**	**-**	(25)	(1.0)
Actual Tax Expense (Benefit) and Effective Rate	**$ 591**	**17.0 %**	$ (12)	(0.5) %

The Company prescribes a recognition threshold and a measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. Benefits from tax positions should be recognized in the financial statements only when it is more likely than not that the tax position will be sustained upon examination by the appropriate taxing authority that would have full knowledge of all relevant information. A tax position that meets the more-likely-than-not recognition threshold is measured at the largest amount of benefit that is greater than 50 percent likely of being realized upon ultimate settlement. Tax positions that previously failed to meet the more-likely-than-not recognition threshold should be recognized in the first subsequent financial reporting period in which that threshold is met. Previously recognized tax positions that no longer meet the more-likely-than-not recognition threshold should be derecognized in the first subsequent financial reporting period in which that threshold is no longer met.

There is currently no liability for uncertain tax positions and no known unrecognized tax benefits. The Company recognizes, when applicable, interest and penalties related to unrecognized tax benefits in the provision for income taxes in the consolidated statements of income. With few exceptions, the Company is no longer subject to U.S. federal or state income tax examinations by tax authorities for years before 2013.

9. Commitments and Contingencies

In the normal course of business, the Company makes various commitments that are not reflected in the accompanying consolidated financial statements. These instruments involve, to varying degrees, elements of credit and interest rate risk in excess of the amount recognized in the consolidated balance sheets. The Company's exposure to credit loss in the event of nonperformance by the other parties to the financial instruments is represented by the contractual amounts as disclosed. Losses, if any, are charged to the allowance for loan losses. The Company minimizes its exposure to credit loss under these commitments by subjecting them to credit approval, review procedures, and collateral requirements as deemed necessary.

The off-balance sheet commitments consisted of the following:

	2016	2015
Commitments to extend credit	$ 66,419	$ 54,686
Standby letters of credit	6,367	5,990

Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the loan agreement. These commitments are composed primarily of available commercial lines of credit and mortgage loan commitments. The Company uses the same credit policies in making loan commitments and conditional obligations as it does for on-balance sheet instruments. The Company evaluates each customer's creditworthiness on a case-by-case basis. The amount of collateral obtained, as deemed necessary, is based upon management's credit evaluation in compliance with the Company's lending policy guidelines. Customers use credit commitments to ensure funds will be available for working capital purposes, for capital expenditures, and to ensure access to funds at specified terms and conditions.

(amounts in thousands except share data)

Standby letters of credit are conditional commitments issued by the Company to guarantee the performance of a customer to a third party. Performance letters of credit represent conditional commitments issued by the Company to guarantee the performance of a customer to a third party. These instruments are issued primarily to support bid- or performance-related contracts. The coverage period for these instruments is typically a one-year period with an annual renewal option subject to prior approval by management. Fees earned from the issuance of these letters are recognized over the coverage period. For secured letters of credit, the collateral is typically company deposit instruments or customer business assets.

As discussed in Note 2, the Bank entered into a Consent Order with the OCC and the Company adopted a resolution at the request of the FRB and incurred costs in connection therewith, including professional fees and reimbursements to customers.

10. Pension Plan

The Bank sponsors a defined benefit pension plan covering substantially all employees and officers. The Plan calls for benefits to be paid to eligible employees at retirement, based primarily upon years of service with the Bank and compensation rates during employment. The Bank's funding policy is to make annual contributions, if needed, based upon the funding formula developed by the plan's actuary.

The following table sets forth the obligation and funded status as of December 31:

	2016	2015
Change in benefit obligation:		
Benefit obligation at beginning of year	**$ 9,613**	$ 10,178
Service cost	**786**	800
Interest cost	**420**	370
Change in assumptions	**293**	(884)
Actuarial loss (gains)	**109**	(480)
Benefits paid	**(368)**	(371)
Benefit obligation at end of year	**10,853**	9,613
Change in plan assets:		
Fair value of plan assets at beginning of year	**8,899**	8,492
Actual return on plan assets	**860**	(22)
Employer contribution	**800**	800
Benefits paid	**(368)**	(371)
Fair value of plan assets at end of year	**10,191**	8,899
Funded Status, included in Other Liabilities	**$ (662)**	$ (714)

(amounts in thousands except share data)

	2016	2015
Amounts recognized in accumulated other comprehensive loss consist of:		
Net loss	**$ 2,518**	$ 2,371
Total	**$ 2,518**	$ 2,371

The accumulated benefit obligation for the defined benefit pension plan was $9,059,000 and $8,087,000 at December 31, 2016 and 2015, respectively.

Components of Net Periodic Benefit Cost

	2016	2015
Net periodic pension cost:		
Service cost	**$ 786**	$ 800
Interest cost	**420**	371
Expected return on plan assets	**(707)**	(654)
Amortization of net loss	**101**	109
Net Periodic Benefit Cost	**$ 600**	$ 626

The estimated net loss for the defined benefit pension plan that will be amortized from accumulated other comprehensive loss into net periodic benefit cost over the next fiscal year is $102,000.

Assumptions

The weighted-average assumptions used to determine benefit obligations at December 31:

	2016	2015
Discount rate	**4.14 %**	4.35 %
Rate of compensation increase	**4.00**	4.00

The weighted-average assumptions used to determine net periodic benefit cost for the years ended December 31:

	2016	2015
Discount rate	**4.35 %**	3.96 %
Expected long-term return on plan assets	**8.00**	8.00
Rate of compensation increase	**4.00**	4.00

The long-term rate of return on plan assets gives consideration to returns currently being earned on plan assets, as well as future rates expected to be returned.

(amounts in thousands except share data)

Plan Assets

The Bank's defined benefit pension plan weighted-average asset allocations at December 31 by asset category are as follows:

	2016		2015	
Asset category:				
Mutual funds	**70.14**	**%**	65.39	%
Corporate bonds	**26.39**		15.23	
U.S. government agency securities	**2.29**		14.49	
Cash and cash equivalents	**1.18**		4.89	
Total	**100.00**	**%**	100.00	%

The Bank believes that the Plan's risk and liquidity position are, in large part, a function of the asset class mix. The Bank desires to utilize a portfolio mix that results in a balanced investment strategy. The investment objective for the defined benefit pension plan is to maximize total return with tolerance for average to slightly above average risk. Asset allocation strongly favors mutual funds.

The following table sets forth by level, within the fair value hierarchy, the plan's assets at fair value as of December 31, 2016 and 2015:

December 31, 2016	Level I	Level II	Level III	Total
Assets:				
Cash and cash equivalents	**$ 120**	**$ -**	**$ -**	**$ 120**
U.S. government agency securities	**-**	**233**	**-**	**233**
Corporate bonds	**-**	**2,690**	**-**	**2,690**
Mutual funds	**7,148**	**-**	**-**	**7,148**
Total Assets at Fair Value	**$ 7,268**	**$ 2,923**	**$ -**	**$ 10,191**

December 31, 2015	Level I	Level II	Level III	Total
Assets:				
Cash and cash equivalents	$ 435	$ -	$ -	$ 435
U.S. government agency securities	-	1,289	-	1,289
Corporate bonds	-	1,356	-	1,356
Mutual funds	5,819	-	-	5,819
Total Assets at Fair Value	$ 6,254	$ 2,645	$ -	$ 8,899

(amounts in thousands except share data)

Cash Flows

The Bank expects to contribute $800,000 to its defined benefit pension plan in 2017.

The following benefit payments that reflect expected future service, as appropriate, are expected to be paid:

		Pension Benefits
2017	$	190
2018		272
2019		295
2020		352
2021 through 2024		3,032

11. Accumulated Other Comprehensive Loss

The following tables present the changes in accumulated other comprehensive loss by component net of tax for the years ended December 31, 2016 and 2015:

		Unrealized Gains (Losses) on Available-for-Sale Securities		Unrecognized Pension Costs		Total
Balance as of December 31, 2014	$	479	$	(2,091)	$	(1,612)
Other comprehensive (loss) income before reclassification		(108)		599		491
Amount reclassified from accumulated other comprehensive loss		(100)		(72)		(172)
Total other comprehensive (loss) income		(208)		527		319
Balance as of December 31, 2015		271		(1,564)		(1,293)
Other comprehensive loss before reclassification		**(1,105)**		**(31)**		**(1,136)**
Amount reclassified from accumulated other comprehensive loss		**(108)**		**(66)**		**(174)**
Total other comprehensive loss		**(1,213)**		**(97)**		**(1,310)**
Balance as of December 31, 2016	**$**	**(942)**	**$**	**(1,661)**	**$**	**(2,603)**

(amounts in thousands except share data)

The following table presents significant amounts reclassified out of each component of accumulated other comprehensive loss for the years ended December 31, 2016 and 2015:

	Amount Reclassified from Accumulated Other Comprehensive Loss		Affected Line Item in the Statement Where Net Income is Presented
	2016	2015	
Unrealized gains on available-for-sale securities:			
	$ (163)	$ (152)	Investment securities gains, net
	55	52	Income taxes
	$ 108	$ (100)	Net of tax
Unrecognized pension costs:			
	$ 100	$ 109	Salaries and employee benefits
	(34)	(37)	Income tax
	$ 66	$ 72	Net of tax

12. Regulatory Matters

Cash and Due from Banks

The Bank is required to maintain average cash reserve balances in vault cash or with the Federal Reserve Bank. The amount of these restricted cash reserve balances at December 31, 2016 and 2015 was $-0-.

Loans

Federal law prevents the Company from borrowing from the Bank unless the loans are secured by specific collateral. Further, such secured loans are limited in amount to 10 percent of the Bank's common stock and capital surplus.

Dividends

The Bank is subject to a dividend restriction that generally limits the amount of dividends that can be paid by a national bank. Prior approval of the Office of the Comptroller of the Currency ("OCC") is required if the total of all dividends declared by a national bank in any calendar year exceeds net profits, as defined for the year, combined with its retained net profits for the two preceding calendar years less any required transfers to surplus. Using this formula, the amount available for payment of dividends by the Bank in 2017, without approval of the OCC, is approximately $8,738,000 plus 2017 net profits retained up to the date of the dividend declaration.

Capital Requirements

The Bank is subject to various regulatory capital requirements administered by the federal banking agencies. Failure to meet the minimum capital requirements can initiate certain mandatory and possibly additional discretionary-actions by regulators that, if undertaken, could have a direct material effect on the Bank's financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, the Bank must meet specific capital guidelines that involve quantitative measures of the Bank's assets, liabilities and certain off-balance sheet items as calculated under regulatory accounting practices. The Bank's capital amounts and classification are also subject to qualitative judgments by the regulators about components, risk-weightings and other factors.

Information presented for December 31, 2016 and 2015, reflects the Basel III capital requirements that became effective January 1, 2015 for the Bank. Prior to January 1, 2015, the Bank was subject to capital requirements under Basel I. Under these capital requirements and the regulatory framework for prompt corrective action, the Bank must meet specific capital guidelines that involve quantitative measures of the Bank's assets, liabilities and certain off-balance-sheet items as calculated under regulatory accounting practices. The Bank's capital amounts and classifications are also subject to qualitative judgments by regulators about components, risk-weightings and other factors.

The risk-based capital rules adopted effective January 1, 2015 require that banks and holding companies maintain a "capital conservation buffer" of 250 basis points in excess of the "minimum capital ratio." The minimum capital ratio is equal to the prompt corrective action adequately capitalized threshold ratio. The capital conservation buffer is being phased in over a four year period that began January 1, 2016, with a required buffer of 0.625% of risk weighted assets for 2016, 1.25% for 2017, 1.875% for 2018, and 2.5% for 2019 and thereafter. Failure to maintain the required capital conservation buffer will result in limitations on capital distributions and on discretionary bonuses to executive officers.

Effective January 1, 2016, the capital levels required for the Bank to avoid these limitations were as follows:

1) a common equity Tier 1 capital ratio of 5.125%
2) a Tier 1 risk based capital ratio of 6.625%; and
3) a Total risk based capital ratio of 8.625%

As of December 31, 2016, the Bank had a conservation buffer greater than 2.5%.

In addition to the capital requirements, the Federal Deposit Insurance Corporation Improvement Act ("FDICIA") established five capital categories ranging from "well capitalized" to "critically undercapitalized." Should any institution fail to meet the requirements to be considered "adequately capitalized," it would become subject to a series of increasingly restrictive regulatory actions.

As of December 31, 2016 and 2015, the OCC categorized the Bank as well-capitalized under the regulatory framework for prompt corrective action. To be classified as a well-capitalized financial institution, Common equity Tier 1, Total risk-based, Tier I risk-based, and Tier I leverage capital ratios must be at least 6.5 percent, 10 percent, 6 percent, and 5 percent, respectively.

(amounts in thousands except share data)

The Company's actual capital ratios are presented in the following table that shows the Company met all regulatory capital requirements. The capital position of the Bank does not differ significantly from the Company's capital position.

December 31, 2016	Actual		For Capital Adequacy Purposes		To be Well Capitalized under Prompt Corrective Action Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
Common equity Tier 1 (total risk-weighted assets)	**$ 50,332**	**18.57%**	**$ ≥12,200**	**≥4.5%**	**$ ≥17,622**	**≥ 6.5%**
Total capital (to risk-weighted assets)	**53,110**	**19.59%**	**≥21,688**	**≥8.0%**	**≥27,110**	**≥10.0%**
Tier I capital (to risk-weighted assets)	**50,332**	**18.57%**	**≥10,844**	**≥4.0%**	**≥16,266**	**≥ 6.0%**
Tier I capital (to average assets)	**50,332**	**10.33%**	**≥19,497**	**≥4.0%**	**≥24,372**	**≥ 5.0%**

December 31, 2015	Actual		For Capital Adequacy Purposes		To be Well Capitalized under Prompt Corrective Action Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
Common equity Tier 1 (total risk-weighted assets)	$ 48,303	19.09%	$ ≥11,390	≥4.5%	$ ≥16,451	≥ 6.5%
Total capital (to risk-weighted assets)	50,977	20.15%	≥20,244	≥8.0%	≥25,305	≥10.0%
Tier I capital (to risk-weighted assets)	48,303	19.09%	≥10,122	≥4.0%	≥15,183	≥ 6.0%
Tier I capital (to average assets)	48,303	10.10%	≥19,130	≥4.0%	≥23,912	≥ 5.0%

13. Fair Value Measurements

The following disclosures show the hierarchal disclosure framework associated with the level of pricing observations utilized in measuring assets and liabilities at fair value. The three broad levels of pricing observations are as follows:

Level I: Quoted prices are available in active markets for identical assets or liabilities as of the reported date.

Level II: Pricing inputs are other than the quoted prices in active markets, which are either directly or indirectly observable as of the reported date. The nature of these assets and liabilities includes items for which quoted prices are available but traded less frequently and items that are fair-valued using other financial instruments, the parameters of which can be directly observed.

Level III: Valuations derived from valuation techniques in which one or more significant inputs or significant value drivers are unobservable.

This hierarchy requires the use of observable market data when available.

(amounts in thousands except share data)

The following tables present the assets measured on a recurring basis on the consolidated balance sheets at their fair value as of December 31, 2016 and 2015, by level within the fair value hierarchy. Financial assets and liabilities are classified in their entirety based on the lowest level of input that is significant to the fair value measurement.

December 31, 2016	Level I	Level II	Level III	Total
Assets measured on a recurring basis:				
Investment securities available-for-sale:				
Obligations of states and political subdivisions	**$ -**	**$ 58,126**	**$ -**	**$ 58,126**
Mortgage-backed securities in government-sponsored entities	**-**	**91,335**	**-**	**91,335**
Equity securities in financial institutions	**205**	**-**	**-**	**205**
Total	**$ 205**	**$ 149,461**	**$ -**	**$ 149,666**

December 31, 2015	Level I	Level II	Level III	Total
Assets measured on a recurring basis:				
Investment securities available-for-sale:				
Obligations of states and political subdivisions	$ -	$ 65,495	$ -	$ 65,495
Mortgage-backed securities in government-sponsored entities	-	82,843	-	82,843
Corporate debt securities	-	498	-	498
Equity securities in financial institutions	178	-	-	178
Total	$ 178	$ 148,836	$ -	$ 149,014

(amounts in thousands except share data)

The following tables present the assets measured on a nonrecurring basis on the consolidated balance sheets at their fair value as of December 31, 2016 and 2015, by level within the fair value hierarchy. Impaired loans that are collateral dependent are written down to fair value through the establishment of specific reserves. Techniques used to value the collateral that secure the impaired loans include quoted market prices for identical assets classified as Level I inputs; and observable inputs, employed by certified appraisers, for similar assets classified as Level II inputs. In cases where valuation techniques included inputs that are unobservable and are based on estimates and assumptions developed by management based on the best information available under each circumstance, the asset valuation is classified as Level III inputs. The fair values consist of the loan balances of $-0- and $1,766,000 less their valuation allowances of $-0- and $286,000 at December 31, 2016 and 2015, respectively.

Other real estate owned ("OREO") is measured at fair value, less cost to sell at the date of foreclosure, establishing a new cost basis. Subsequent to foreclosure, valuations are periodically performed by management and the assets are carried at the lower of carrying amount or fair value, less cost to sell.

December 31, 2016	Level I	Level II	Level III	Total
Fair value measurements on nonrecurring basis:				
Impaired loans	$ -	$ -	$ -	$ -
Other real estate owned	-	-	-	-
Total	$ -	$ -	$ -	$ -

December 31, 2015	Level I	Level II	Level III	Total
Fair value measurements on nonrecurring basis:				
Impaired loans	$ -	$ -	$ 1,480	$ 1,480
Other real estate owned	-	-	299	299
Total	$ -	$ -	$ 1,779	$ 1,779

(amounts in thousands except share data)

The following table provides information describing the valuation processes used to determine nonrecurring fair value measurements categorized within Level III of the fair value hierarchy:

December 31, 2015	Quantitative Information About Level III Fair Value Measurements			
	Fair Value	Valuation Techniques	Unobservable Input	Range (Weighted Average)
Impaired loans	$ 1,478	Appraisal of collateral (1)	Appraisal adjustments (2)	0% - 46% (36%)
Other real estate owned	299	Appraisal of collateral (1) (3)	Appraisal adjustments (2)	6% - 7% (7%)

(1) Fair value is generally determined through independent appraisals of the underlying collateral, which include various level III inputs which are not identifiable.
(2) Appraisals may be adjusted by management for qualitative factors such as economic conditions, aging, and/or estimated liquidation expenses incurred when selling the collateral. The range and weighted average of appraisal adjustments and liquidation expenses are presented as a percentage of the appraisal.
(3) Includes qualitative adjustments by management and estimate liquidation expenses.

14. Fair Value of Financial Instruments

The fair values at December 31 of the Company's financial instruments are as follows:

December 31, 2016	Carrying Value	Fair Value	Level I	Level II	Level III
Financial assets:					
Cash and cash equivalents	**$ 14,248**	**$ 14,248**	**$ 14,248**	**$ -**	**$ -**
Investment securities:					
Available-for-sale	**149,666**	**149,666**	**205**	**149,461**	**-**
Held-to-maturity	**1,692**	**1,686**	**-**	**1,686**	**-**
Loans held for sale	**1,493**	**1,493**	**1,493**	**-**	**-**
Net loans	**297,423**	**300,218**	**-**	**-**	**300,218**
Restricted stock	**3,505**	**3,505**	**-**	**3,505**	**-**
Mortgage servicing rights	**893**	**893**	**-**	**893**	**-**
Accrued interest receivable	**1,408**	**1,408**	**1,408**	**-**	**-**
Financial liabilities:					
Deposits	**$ 442,630**	**$ 427,148**	**$ -**	**$ 427,148**	**$ -**
Accrued interest payable	**98**	**98**	**98**	**-**	**-**

(amounts in thousands except share data)

December 31, 2015	Carrying Value	Fair Value	Level I	Level II	Level III
Financial assets:					
Cash and cash equivalents	$ 11,699	$ 11,699	$ 11,699	$ -	$ -
Investment securities:					
Available-for-sale	149,014	149,014	178	148,836	-
Held-to-maturity	3,191	3,183	-	3,183	-
Loans held for sale	1,293	1,293	1,293	-	-
Net loans	283,974	285,368	-	-	285,368
Restricted stock	3,300	3,300	-	3,300	-
Mortgage servicing rights	959	959	-	959	-
Accrued interest receivable	1,386	1,386	1,386	-	-
Financial liabilities:					
Deposits	$ 426,337	$ 413,764	$ -	$ 413,764	$ -
Accrued interest payable	100	100	100	-	-

Financial instruments are defined as cash, evidence of ownership interest in an entity, or a contract that creates an obligation or right to receive or deliver cash or another financial instrument from/to a second entity on potentially favorable or unfavorable terms.

Fair value is defined as the amount at which a financial instrument could be exchanged in a current transaction between willing parties other than in a forced or liquidation sale. If a quoted market price is available for a financial instrument, the estimated fair value would be calculated based upon the market price per trading unit of the instrument.

If no readily available market exists, the fair value estimates for financial instruments should be based upon management's judgment regarding current economic conditions, interest rate risk, expected cash flows, future estimated losses, and other factors as determined through various option pricing formulas. As many of these assumptions result from judgments made by management based upon estimates that are inherently uncertain, the resulting estimated fair values may not be indicative of the amount realizable in the sale of a particular financial instrument. In addition, changes in assumptions on which the estimated fair values are based may have a significant impact on the resulting estimated fair values.

As certain assets, such as deferred tax assets and premises and equipment, are not considered financial instruments, the estimated fair value of financial instruments would not represent the full value of the Company.

The Company employed simulation modeling in determining the estimated fair value of financial instruments for which quoted market prices were not available based upon the following assumptions:

Cash and Cash Equivalents, Loans Held for Sale, Regulatory Stock, Accrued Interest Receivable, and Accrued Interest Payable

The fair value is equal to the current carrying value.

Investment Securities

The fair market value of investment securities is equal to the available quoted market price. If no quoted market price is available, fair value is estimated using the quoted market price for similar securities. Fair values for certain corporate bonds were determined utilizing discounted cash flow models, due to the absence of a current market to provide reliable market quotes for the instruments.

Loans

Fair value is estimated by discounting future cash flows using current market inputs at which loans with similar terms and qualities would be made to borrowers of similar credit quality. Where quoted market prices were available, primarily for certain residential mortgage loans, such market rates were utilized as estimates for fair value.

Mortgage Servicing Rights

The fair value for mortgage servicing rights is estimated by discounting contractual cash flows and adjusting for prepayment estimates. Discount rates are based upon rates generally charged for such loans with similar characteristics.

The fair values of certificates of deposit are based on the discounted value of contractual cash flows. The discount rates are estimated using rates currently offered for similar instruments with similar remaining maturities. Demand, savings, and money market deposit accounts are valued at the amount payable on demand as of year-end.

Commitments to Extend Credit and Commercial Letters of Credit

These financial instruments are generally not subject to sale, and estimated fair values are not readily available.

The carrying value, represented by the net deferred fee arising from the unrecognized commitment or letter of credit, and the fair value, determined by discounting the remaining contractual fee over the term of the commitment using fees currently charged to enter into similar agreements with similar credit risk, are not considered material for disclosure. The contractual amounts of unfunded commitments and letters of credit are presented in Note 8.

(amounts in thousands except share data)

15. Related Party Transactions

Certain officers, directors and other related parties have loans and conduct other transactions with the Bank. Deposits of related parties totaled $1,771,000 and $2,009,000 at December 31, 2016 and 2015, respectively. The aggregate dollar amount of loans to related parties, along with an analysis of the activity for December 31, 2016 and 2015 are as follows:

		2016		2015
Balance, beginning	**$**	**698**	$	1,695
Additions		**631**		133
Repayments		**391**		341
Reclassification		**49**		789
Balance, ending	**$**	**987**	$	698

16. Employment Agreements

The Company entered into three-year employment agreements with certain members of management, which includes minimum annual salary commitments and change of control provisions. Upon resignation after a change in the control of the Company, as defined in the agreement, the individual will receive monetary compensation in the amount set forth therein. The agreements include covenant not-to-compete provisions and are subject to limitations as discussed in Note 2.

17. Subsequent Events

Management has reviewed events occurring through April 24, 2017, the date the financial statements were available to be issued and no subsequent events occurred requiring accrual or disclosure.