jbt
Bank on a Smile®

BUILD
2017 ANNUAL REPORT

Since our founding in 1873,
Jonestown Bank & Trust Co. has
focused on building.

JBT builds attentive relationships
with customers, working to improve their
financial futures reliably.

BUILD

JONESTOWN BANK & TRUST CO.

We build flexible financial solutions
that help business owners pursue dreams
and enjoy greater success.

Today, as we build new full-service locations
throughout Lebanon and Lancaster Counties,
JBT plans to build something even stronger.
Our Communities.

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jbt® Bank on a Smile.®

BOARD OF DIRECTORS

Richard J. Newmaster, Jr. CPA
Chairman
Director since 2004
Chief Financial Officer, Lebanon Seaboard Corp.

Jeffrey L. Bohn
Vice Chairman
Director since 1987
Executive Director, Shining Light Ministries

Edward L. Anspach
Second Vice Chairman and Secretary
Director since 1987
President, Anspach Autos

Troy A. Peters
Director since 2016
President, Chief Executive Officer, Jonestown Bank & Trust Co.

Lloyd A. Deaven, Jr.
Director since 1998
Fisher Auto Parts (retired)

Edwin C. Hostetter II CPA CGMA
Director since 2013
Vice President of Finance & Chief Financial Officer, SSM Group, Inc.

Brian R. Miller
Director since 2015
Insurance Agency Principal, Richard S. Miller, Inc.

Larry P. Minnich
Director since 2013
Program Manager, Children's Heart Group, MS Hershey Medical Center (retired); COO, Central Medical Ambulance Svcs.; Mayor, Borough of Cleona

Sallie A. Neuin
Director since 2009
Lebanon County Treasurer, Lebanon County Tax Claim Director

Eric A. Trainer
Director since 2011
Co-owner/Operator, Trainer's Midway Diner, Comfort Inn at Midway, Microtel Inn & Suites–Hamburg, Pappy T's Pub & Lounge–Hamburg

Glenn T. Wenger
Director since 2008
President, Wengers of Myerstown, Chairman, Ag Industrial, Inc., President of JK&B Inc.

EXECUTIVE OFFICERS

Troy A. Peters
President
Chief Executive Officer

C. William Roth
Senior Vice President
Chief Financial Officer

Edward T. Martel, Jr.
Senior Vice President
Sales, Marketing and Branch Administration

Timothy D. Gingrich
Vice President
Operations and Information Technology

Terry L. Resanovich
Vice President
Senior Trust Officer

Richard M. Rollman
Vice President
Lending

LETTER TO SHAREHOLDERS

Richard J. Newmaster, Jr.
Chairman

Troy A. Peters
President
Chief Executive Officer

Dear Shareholders of Jonestown Bank & Trust Co.,

This past year has been one of growth, building, and solid financial performance for your Bank. Our expansion into Lancaster County was a planned front-end investment to provide for a future earnings increase and we are off to a good start. In May, we opened for business at our new Manheim location and in October we broke ground on a new site in Lititz. By the time you read this report, the Lititz location should be on-line and generating new business. In today's rate and competitive environment, decisions to increase a branch network require a sharp pencil and thought-out strategy. We are confident that we have a winning formula and excited about extending our market.

Despite our expansion investment, we produced earnings of $4,487,000 or $1.93 per share, slightly ahead of the previous years $4,471,000 or $1.93 per share. Return on average assets was .83% and return on average equity was 9.49% which positions us near the top of our peer group and in the top 11% of all banks headquartered within Pennsylvania. Assets grew by 14.2% to $575,610 million.

Our stock price climbed 40% during the year from the 1/1/17 opening price of $20.35 to the 12/31/17 closing price of $28.50, which represents 1.36 times book value. We traded a high of 90,524 known shares representing over $2.1 million in transactions. This is an increase over the prior year's volume of 86,598 shares.

We grew in the fundamental areas of our business, loans and deposits.

LENDING

Loan growth exceeded our expectations during the year and in fact, it needed to be tempered before stressing our funding and capital levels. Net loans grew by $74 million or 17.8% during the year—a record year for us! We continue to find consumer borrowers reluctant to take on new mortgage debt but that was more than offset by lending for automobiles and businesses borrowing for improvement and expansion.

Indirect auto financing was a big success story for us in 2017. This portfolio grew by 70% or $44 million during the course of the year and now accounts for 21.5% of our total loan portfolio. Recognition of this growth occurred when we were ranked by Bauer Financial, Inc. as the thirty-sixth leading bank in the United States for consumer loan growth from the period of 6/30/16 to 6/30/17 for banks whose consumer loans represent greater than 10% of gross loans. Indirect loans were the primary reason we ranked so high on this list. Aside from building the balance sheet, these loans offer a diversified geographic lending base with relatively short-term maturities and acceptable interest rates. We foresee continued growth in this lending discipline, albeit at a more measured rate.

Commercial loans grew by $23 million or 16.6% and represent 33.5% of our loan portfolio. Commercial lending has been our focus for several years and we have successfully built this line-of-business. We have assembled a top-notch local lending staff and through their efforts, have been able to attract and serve both a greater number of and more complex business customers.

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ASSET QUALITY

Asset quality improvement is important to us and our positive trends in this area continued throughout the year. Our 60 and 90-day delinquencies were reduced and overall delinquencies improved, as a percent of loans, to the lowest level in several years. Net charge-offs and recoveries also improved over the prior year. The loan portfolio growth resulted in a $1,450,000 loan loss provision, a 73% increase over the prior year. We believe that given our size and risk profile, we remain adequately reserved for potential future loan losses with an allowance for loan losses of $5,853,000.

DEPOSITS

Deposit growth also exceeded our expectations coming in at $31 million or a 7.3% increase over 2016. A large contributor to this increase was the opening of our new Manheim office that gathered nearly $10 million in deposits during the first seven months of operation. Even with this positive deposit growth, funding for loans required accessing other liquidity sources such as the Federal Home Loan Bank and national certificate of deposit markets. Low cost deposit generation will be a top priority in the coming year and should be aided by our new Lititz location.

CULTURE

When discussing our business results, we need to thank each and every JBT Director and employee for their dedication, guidance, and assistance in strengthening our corporate culture. During the past couple of years, we set out to better define our culture, values, and how we want to show up in the marketplace. We ultimately arrived at our SMILE Standards, which is a portrayal of our corporate values. Each letter in the acronym "SMILE" stands for a value that we hold ourselves accountable to: S - Sincere, M - Memorable, I - Integrity, L - Leadership, E - Expertise. These standards are present in nearly every facet of our corporate life and each employee is formally measured against them. We have also embarked on an initiative we call "Future Bank". Future Bank is a concept that involves the physical redesign of our branches, removing the traditional teller line, and replacing it with "pods", where employees and clients can better work together to advance their banking relationship. More importantly, Future Bank prepares our employees to better handle more complex sales and service issues that we encounter while working with clients and associates, whether they are internal, external, or bank vendors. The strategy cross-trains both client facing and operational staff and better defines a career path for improvement and growth. This year alone, seventy JBT employees earned a promotion to greater responsibilities and forty-two of these promotions were directly related to the Future Bank model.

MOVING FORWARD

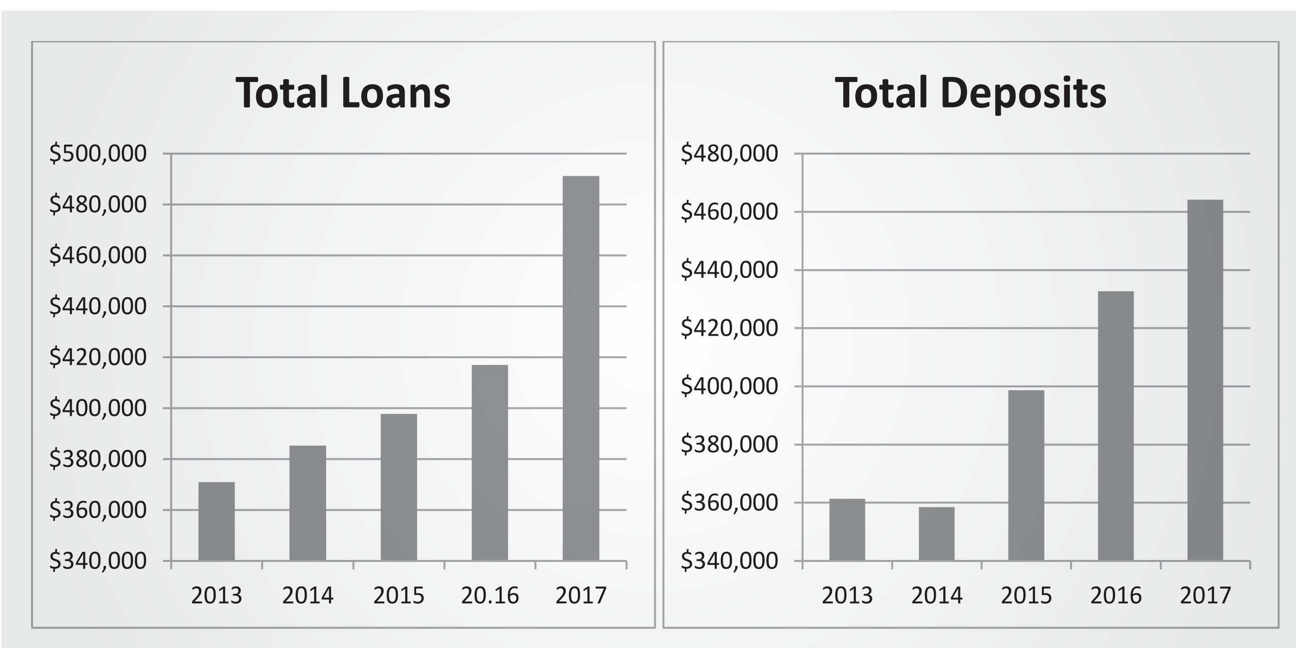
We believe that we have a well-crafted plan designed to continue building a successful franchise for the long-term. The Board of Directors, Management, and staff are excited about our future as an independent community bank and we continue to appreciate and value your investment and support. We will work hard every day to continue to earn it. Thank you!

Richard J. Newmaster, Jr.
Chairman

Troy A. Peters
President
Chief Executive Officer

FINANCIAL HIGHLIGHTS

(Dollars in thousands, except per share amounts)	**2017**	2016	Change
Results of Operations			
Net interest income	**17,954**	16,101	11.5%
Provision for loan losses	**1,450**	837	73.2%
Net income	**4,487**	4,471	0.4%
Per Share Data			
Basic earnings	**1.93**	1.93	0.0%
Book value	**20.93**	19.61	6.7%
Financial Condition at Year-end			
Assets	**575,610**	504,084	14.2%
Deposits	**464,166**	432,714	7.3%
Loans Receivable, net	**491,231**	417,028	17.8%
Allowance for loan loss	**5,853**	5,038	16.2%
Stockholders' equity	**48,831**	45,541	7.2%
Financial ratios			
Return on average assets	**0.83%**	0.91%	-8.8%
Return on average equity	**9.49%**	10.02%	-5.3%
Total capital to risk weighted assets	**11.88%**	12.91%	-8.0%



Smith Elliott Kearns & Company, LLC
CERTIFIED PUBLIC ACCOUNTANTS & CONSULTANTS

INDEPENDENT AUDITOR'S REPORT

Board of Directors and Shareholders
Jonestown Bank & Trust Co.

We have audited the accompanying financial statements of Jonestown Bank & Trust Co., which comprise the balance sheets as of December 31, 2017 and 2016, and the related statements of income, comprehensive income, stockholders' equity, and cash flows for the years then ended, and the related notes to the financial statements.

MANAGEMENT'S RESPONSIBILITY FOR THE FINANCIAL STATEMENTS

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

AUDITOR'S RESPONSIBILITY

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

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

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

OPINION

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Jonestown Bank & Trust Co. as of December 31, 2017 and 2016, and the results of its operations and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

CHANGE IN ACCOUNTING PRINCIPLE

As discussed in Note 1, the Financial Accounting Standards Board issued ASU 2018-02, "Income Statement – Reporting Comprehensive Income (Topic 220): Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income" that gives entities the option to reclassify to retained earnings tax effects related to items in accumulated other comprehensive income (AOCI) that the FASB refers to as having been stranded in AOCI as a result of the enactment of the "Tax Cuts and Jobs Act of 2017". Jonestown Bank & Trust Co. elected to early adopt ASU 2018-02 in 2017 to properly reflect the effective tax rate within AOCI. Our opinion is not modified with respect to that matter.

Smith Elliott Kearns & Company, LLC

Chambersburg, Pennsylvania
February 27, 2018

Balance Sheets

(Dollars in thousands, except per share amounts)	December 31, 2017	December 31, 2016
ASSETS		
Cash and due from banks	$ 2,769	$ 3,152
Interest bearing deposits in other banks	10,528	14,081
Securities available for sale	41,747	46,386
Securities held to maturity, fair value of $853 and $865	851	863
Loans held for sale	-	385
Loans	497,084	422,066
Less allowance for loan losses	5,853	5,038
Net loans	491,231	417,028
Restricted investment in bank stock	2,965	1,510
Foreclosed assets	737	384
Premises and equipment	7,547	4,062
Investment in life insurance	12,450	11,281
Accrued interest receivable	1,641	1,286
Other assets	3,144	3,666
TOTAL ASSETS	$ 575,610	$ 504,084
LIABILITIES		
Deposits:		
Non-interest-bearing	48,267	48,051
Interest-bearing	415,899	384,663
Total deposits	464,166	432,714
Short-term debt	23,221	6,000
Long-term debt	33,704	14,274
Subordinated debt	3,000	3,000
Accrued interest payable and other liabilities	2,688	2,555
TOTAL LIABILITIES	$ 526,779	$ 458,543
STOCKHOLDERS' EQUITY		
Common stock, par value $2.00; 6,000,000 shares authorized; issued and outstanding 2,332,566 and 2,322,678 on December 31, 2017 and December 31, 2016	4,665	4,645
Surplus	5,074	4,877
Retained earnings	40,046	36,984
Accumulated other comprehensive (loss)	(954)	(965)
TOTAL STOCKHOLDERS' EQUITY	$ 48,831	$ 45,541
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	$ 575,610	$ 504,084

Statements of Income

(Dollars in thousands, except per share amounts)	Years Ended December 31, 2017	2016
INTEREST INCOME		
Loans receivables, including fees	$ 19,700	$ 17,229
Securities:		
Taxable	593	598
Tax-exempt	320	322
Other	226	194
Total interest income	$ 20,839	$ 18,343
INTEREST EXPENSE		
Deposits	1,926	1,706
Short-term borrowings	44	44
Interest on subordinated debt	165	165
Long-term debt	750	327
Total interest expense	$ 2,885	$ 2,242
NET INTEREST INCOME	17,954	16,101
Provision for loan losses	1,450	837
NET INTEREST INCOME AFTER PROVISION FOR LOAN LOSSES	$ 16,504	$ 15,264
OTHER INCOME		
Trust income	425	324
Service charges on deposit accounts	1,925	1,633
Automated teller machine and internet banking fees	209	235
Mortgage banking activities	434	502
Earnings on investment in life insurance	383	371
Gain on sales of investments	-	117
Other	462	195
Total other income	$ 3,838	$ 3,377
OTHER EXPENSE		
Salaries and employee benefits	7,732	6,834
Outsourcing services	1,559	1,237
Occupancy	942	816
Equipment and data processing	508	528
Marketing	437	296
ATM processing fees	417	433
Pennsylvania bank shares tax	433	349
Federal deposit insurance assessment	329	274
Net (gain) loss on foreclosed assets	15	(15)
Other	2,021	1,819
Total other expense	$ 14,393	$ 12,571
Income before income taxes	5,949	6,070
Federal income taxes	1,462	1,599
NET INCOME	$ 4,487	$ 4,471
EARNINGS PER SHARE	$ 1.93	$ 1.93
WEIGHTED-AVERAGE SHARES OUTSTANDING	2,328,038	2,316,599

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

Statements of Comprehensive Income

(Dollars in thousands, except per share amounts)	Years Ended December 31, 2017	2016
Net Income	$ 4,487	$ 4,471
Unrealized gains (losses) on securities:		
Unrealized holding gains (losses) arising during the year	301	(562)
Reclassification adjustment for (gains) realized in net income	-	(117)
Tax effect	(102)	232
Net unrealized gains (losses) on securities	199	(447)
Defined benefit pension plan:		
Change in benefit obligations and plan assets	(47)	77
Tax effect	16	(27)
Net change in defined benefit pension plan	(31)	50
Other comprehensive income (loss)	168	(397)
Total comprehensive income	$ 4,655	$ 4,074

Statements of Stockholders' Equity

(Dollars in thousands, except per share amoui **Years Ended December 31, 2017 and 2016**

	Common Stock	Surplus	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total
Balance, December 31, 2015	$ 4,620	$ 4,678	$ 33,995	$ (568)	$ 42,725
Issuance of common stock through dividend reinvestment plan (12,799 shares)	25	199	-	-	224
Comprehensive income:					
Net income	-	-	4,471	-	4,471
Other comprehensive loss, net of taxes	-	-	-	(397)	(397)
Cash dividends declared ($.64 per share)	-	-	(1,482)	-	(1,482)
Balance, December 31, 2016	$ 4,645	$ 4,877	$ 36,984	$ (965)	$ 45,541
Issuance of common stock through dividend reinvestment plan (9,887 shares)	20	197	-	-	217
Comprehensive income:					
Net income		-	4,487	-	4,487
Other comprehensive income, net of taxes	-	-	-	168	168
Adjustment due to tax rate change	-	-	157	(157)	-
Cash dividends declared ($.68 per share)	-	-	(1,582)	-	(1,582)
Balance, December 31, 2017	$ 4,665	$ 5,074	$ 40,046	$ (954)	$ 48,831

Statements of Cash Flows

(dollars in thousands)	Years Ended December 31, 2017	2016
OPERATING ACTIVITIES		
Net income	$ 4,487	$ 4,471
Adjustments to reconcile net income to net cash provided by operating activities		
Provision for loan losses	1,450	837
Provision for depreciation and amortization	514	538
Net amortization of securities premiums and discounts	397	426
Net amortization of deferred loan fees	(2,810)	(630)
Deferred income taxes	500	(34)
Loss on disposal of property and equipment	17	42
(Gain) on sale of investments	-	(117)
(Gain) loss on foreclosed assets	15	(15)
Writedown of other real estate owned	-	77
(Gain) on sale of loans, net	(315)	(237)
Proceeds from sales of loans	9,307	12,500
Loans originated for sale	(8,607)	(12,648)
Earnings on investment in Bank-owned life insurance, net	(283)	(283)
Increase in accrued interest receivable and other assets	(424)	(43)
Increase (decrease) in accrued interest payable and other liabilities	(14)	507
Net cash provided by operating activities	4,234	5,391
INVESTING ACTIVITIES		
Proceeds from maturities and principal repayments		
Securities held to maturity	12	12
Securities available for sale	4,543	3,396
Proceeds from sale of available for sale securities	-	4,720
Purchase of securities available for sale	-	(7,350)
Purchase of securities held to maturity	-	(400)
Net (increase) in loans	(74,110)	(20,361)
Redemption (purchase) of restricted bank stock	(1,455)	684
Purchase of premises and equipment	(3,911)	(657)
Proceeds from sale of foreclosed assets	899	1,354
Purchase of bank owned life insurance	(886)	-
Net cash used for investing activities	(74,908)	(18,602)
FINANCING ACTIVITIES		
Net increase in deposits	31,452	34,076
Net increase (decrease) in short-term borrowings	17,221	(11,947)
Proceeds from debt	25,000	-
Repayment of long term debt	(5,570)	(3,759)
Proceeds from the issuance of common stock	217	224
Dividends on common stock	(1,582)	(1,482)
Net cash provided by financing activities	66,738	17,112
Increase (decrease) in cash and cash equivalents	(3,936)	3,901
CASH AND CASH EQUIVALENTS AT BEGINNING OF YEAR	17,233	13,332
CASH AND CASH EQUIVALENTS AT END OF YEAR	$ 13,297	$ 17,233
Cash paid during the year for:		
Interest	$ 2,826	$ 2,240
Taxes	1,265	875
Noncash investing transactions:		
Loans Transferred to Foreclosed Assets	$ 1,267	$ 823

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

1. Summary of Significant Accounting Policies

Nature of Operations

The Jonestown Bank & Trust Co. (the "Bank") operates under a state bank charter and provides full banking services, including trust services. As a state bank, the Bank is subject to regulation of the Pennsylvania Department of Banking and Securities and the Federal Deposit Insurance Corporation. The area served by the Bank is principally Lebanon County and northern Lancaster County, Pennsylvania.

Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. Material estimates that are particularly susceptible to significant change in the near term relate to the determination of the allowance for loan losses, mortgage servicing rights, deferred tax valuation allowances, pension liability, and the determination of impairment of restricted investment in Bank stock and of other-than-temporary impairment of securities.

Presentation of Cash Flows

For purposes of reporting cash flows, cash and cash equivalents include cash and due from banks with original maturities of 90 days or less, if any.

Securities

Securities classified as available for sale are those securities that the Bank intends to hold for an indefinite period of time but not necessarily to maturity. Any decision to sell a security classified as available for sale would be based on various factors, including significant movement in interest rates, changes in maturity mix of the Bank's assets and liabilities, liquidity needs, regulatory capital considerations, and other similar factors. Securities available for sale are carried at fair value. Unrealized gains or losses are reported in other comprehensive income, net of the related deferred tax effect. Realized gains or losses, determined on the basis of the cost of the specific securities sold, are included in earnings. Premiums and discounts are recognized in interest income, using the interest method over the terms of the securities.

Bonds, notes, and debentures for which the Bank has the positive intent and ability to hold to maturity are reported at cost, adjusted for premiums and discounts that are recognized in interest income using the interest method over the terms of the securities.

Management determines the appropriate classification of debt securities at the time of purchase and reevaluates such designation as of each Balance Sheet date.

Securities are evaluated on a periodic basis to determine whether a decline in their value is other than temporary. For debt securities, management considers whether the present value of cash flow expected to be collected is less than the security's amortized cost basis (the difference defined as the credit loss), the magnitude and duration of the decline, the reasons underlying the decline, and the Bank's intent to sell the security or whether it is more likely than not that the Bank would be required to sell the security before its anticipated recovery in market value, to determine whether the loss in value is other than temporary. Once a decline in value is determined to be other than temporary, if the investor does not intend to sell the security, and it is more likely than not that it will not be required to sell the security before recovery of the security's amortized cost basis, the charge to earnings is limited to the amount of credit loss. Any remaining difference between fair value and amortized cost (the difference defined as the non-credit portion) is recognized in other comprehensive income, net of applicable taxes. Otherwise, the entire difference between fair value and amortized cost is charged to earnings.

1. Summary of Significant Accounting Policies (Continued)

Restricted Investments in Bank Stock

Restricted investments in bank stock, which represent required investments in the common stock of correspondent banks, are carried at cost and as of December 31, 2017 and 2016 consist of the common stock of the Federal Home Loan Bank ("FHLB") of Pittsburgh and Atlantic Community Bankers Bank ("ACBB"). Federal law requires a member institution of the FHLB to hold stock of its district FHLB according to a predetermined formula. As of December 31, 2017 and 2016, the recorded investment in restricted bank stock is $2,965,000 and $1,510,000, respectively.

Management evaluates the restricted stock for impairment at least annually, or more frequently, if necessary. Management's determination of whether these investments are impaired is based on their assessment of the ultimate recoverability of their cost rather than by recognizing temporary declines in value.

Loans Held for Sale

Loans originated and intended for sale in the secondary market are carried at the lower of cost or fair value in the aggregate. Net unrealized losses, if any, are recognized through a valuation allowance by charges to income. There were no loans held for sale at December 31, 2017 and $385,000 loans held for sale at December 31, 2016.

Mortgage loans held for sale are generally sold with the mortgage-servicing rights retained by the Bank; however, the Bank does sell some mortgage loans with servicing released. The carrying value of mortgage loans sold is reduced by the cost allocated to the associated mortgage-servicing rights. Gains or losses on sales of mortgage loans are recognized based on the difference between the selling price and the carrying value of the related mortgage loans sold.

Loans Receivable

The Bank grants mortgage, commercial, and consumer loans to customers. A substantial portion of the loan portfolio is represented by mortgage loans throughout Lebanon County, Pennsylvania. The ability of the Bank's debtors to honor their contracts is dependent upon the real estate and general economic conditions in this area.

Loans that management has the intent and ability to hold for the foreseeable future or until maturity or payoff generally are stated at their outstanding unpaid principal balances, net of any deferred fees or costs on originated loans. Interest income is accrued on the unpaid principal balance. Loan origination fees, net of certain direct origination costs, are deferred and recognized as an adjustment of the yield (interest income) of the related loans. The Bank is generally amortizing these amounts over the contractual life of the loan.

The accrual of interest for all loan segments, except for consumer loans, is discontinued when the contractual payment of principal or interest has become 90 days past due, unless the credit is well-secured and in the process of collection or management has serious doubts about further collectability of principal or interest, even though the loan is currently performing. Consumer loans are charged-off on or before 90 days past due. When a loan is placed on nonaccrual status, unpaid interest credited to income in the current year is reversed and unpaid interest accrued in prior years is charged against the allowance for loan losses. Interest received on nonaccrual loans generally is either applied against principal or reported as interest income, according to management's judgment as to the collectability of principal. Generally, loans are restored to accrual status when the obligation is brought current, has performed in accordance with the contractual terms for a reasonable period of time, and the ultimate collectability of the total contractual principal and interest is no longer in doubt. Loan delinquencies for all loan segments are determined based on contractual terms of the loans.

1. Summary of Significant Accounting Policies (Continued)

Loans Receivable (Continued)

The Bank segregates its loan portfolio into segments with varying risk characteristics. Commercial loans include loans to businesses for general commercial purposes and include permanent and short-term working capital, machinery and equipment financing, and may be either in the form of lines of credit, demand, or term loans. Some commercial and industrial loans may be unsecured to higher rated customers, but the majority of these loans are secured by the borrower's accounts receivable, inventory and machinery and equipment and in many loans, the collateral also includes the business real estate or the business owner's personal real estate or assets. Commercial loans have credit exposure since they are more susceptible to risk of loss during a downturn in the economy as borrowers may have greater difficulty in meeting their debt service requirements and the value of the collateral may decline.

Commercial real estate loans consist of owner occupied and non-owner occupied commercial real estate loans. Owner occupied commercial real estate loans are generally dependent upon the successful operation of the borrower's business, with the cash flows generated from the business being the primary source of repayment of the loan. If the business suffers a downturn in sales or profitability, the borrower's ability to repay the loan could be in jeopardy, which could increase the risk of loss. Non-owner occupied and multi-family commercial real estate loans and non-owner occupied residential loans are dependent on the borrower's ability to generate a sufficient level of occupancy to produce rental income that exceeds debt service requirements and operating expenses. Lower occupancy or lease rates may result in a reduction in cash flows, which may affect the ability of the borrower to meet debt service requirements, and may result in lower collateral values, which represents a higher inherent risk than owner-occupied commercial loans.

Commercial real estate construction loans consist of 1-4 family residential construction and commercial and land development loans. The risk of loss on these loans is contingent on the assessment of the property's value at the completion of the project, which should exceed the property's construction costs. A number of factors can negatively affect the project during the construction phase such as cost overruns, delays in completing the project, competition, and real estate market conditions which may change based on the supply of similar properties in the area. If the collateral value at the completion of the project is not sufficient to cover the outstanding loan balance, repayment of the loan would potentially need to rely on other repayment sources, including the guarantors of the project or other collateral securing the loan.

Residential real estate loans include fixed-rate and adjustable first lien mortgage loans with the underlying 1-4 family owner-occupied residential property securing the loan. Risk exposure is mitigated somewhat through the evaluation of the credit worthiness of the borrower, including credit scores and debt-to-income ratios, and limits on the loan-to-value ratios based on collateral values.

Home equity lines of credit represent a slightly higher risk than residential real estate first liens, as these loans can be first or second liens on residential family owner occupied residential property, but there are loan-to-value limits on the value of the real estate taken as collateral. The credit worthiness of the borrower is considered, including credit scores and debt-to-income ratios.

Consumer indirect automobile and other consumer loans' credit risk are mitigated through evaluation of the credit worthiness of the borrower through credit scores and debt-to-income ratios, and if secured, the collateral value of the assets. However, these loans can be unsecured or secured by assets that may depreciate quickly or may fluctuate and represent a greater risk than 1-4 family residential loans. Indirect automobile loans represent some risk as the initiation of the credit process begins with a consumer and dealer at the point of purchase with the Bank then approving or denying the credit based on the consumer's credit worthiness.

1. Summary of Significant Accounting Policies (Continued)

Allowance for Loan Losses

Management establishes the allowance for loan losses based upon its evaluation of the pertinent factors underlying the types and quality of loans in the portfolio. All commercial loans and commercial real estate loans are reviewed on a regular basis with a focus on larger loans along with loans which have experienced past payment or financial deficiencies. All commercial loans and commercial real estate loans which are 90 days or more past due are selected for impairment testing. These loans are analyzed to determine if they are "impaired," which means that it is probable that all amounts will not be collected according to the contractual terms of the loan agreement. All commercial loans that are delinquent 90 days and residential mortgage loans that are 120 days delinquent and are placed on nonaccrual status are evaluated for impairment on an individual basis. The remaining loans are evaluated for impairment as groups of loans with similar risk characteristics. The Bank allocates allowances based on the factors described below, which conform to the Bank's asset classification policy. In reviewing risk within the Bank's loan portfolio, management has determined there to be several different risk categories within the loan portfolio. The allowance for loan losses consists of amounts applicable to: (i) the commercial loan portfolio; (ii) the commercial real estate portfolio; (iii) the consumer loan portfolio (indirect and other); (iv) the loans secured by residential real estate portfolio; and (v) home equity lines of credit. Factors considered in this process include general loan terms, collateral, and availability of historical data to support the analysis. Historical loss percentages for each risk category are calculated and used as the basis for calculating allowance allocations based on the last eight or twelve quarters of historical losses. Certain qualitative factors are then added to the historical allocation percentage to get the total factor to be applied to non-classified loans. The following qualitative factors are analyzed:

- Trends in delinquency
- Underlying loan collateral value factors
- Trends in risk ratings
- Economic trends
- Concentrations of credit risk
- Lending policies and procedures
- Quality of loan review methodology
- External factors (competition, legal, regulatory)
- Experience, depth and ability of lending management/staff
- Nature and volume of the portfolio and terms of loans
- Special mention and substandard trends

The Bank analyzes its loan portfolio each quarter to determine the appropriateness of its allowance for loan losses. While management uses available information to recognize losses on loans, future additions to the allowance may be necessary based on changes in local economic conditions. In addition, regulatory agencies, as an integral part of their examination process, periodically review the Bank's allowance for losses on loans. Such agencies 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. Because of these factors, management's estimate of credit losses inherent in the loan portfolio and the related allowance may change in the near term. However, the amount of the change that is reasonably possible cannot be estimated.

Loan Charge-off Policies

Consumer and residential real estate loans are generally fully or partially charged down to the fair value of collateral securing the asset when the loan is 120 days past due unless the loan is well secured and in the process of collection. On all other loans, the primary factors considered by management in determining charge-offs include payment status and collateral value but could also include debt service coverage, financial health of the borrower, and other external factors that could impact the ability of the borrower to repay the loan.

1. Summary of Significant Accounting Policies (Continued)

Servicing

Servicing assets are recognized as separate assets when rights are acquired through the sale of loans. Capitalized servicing rights are reported in other assets and are amortized as a reduction of noninterest income in proportion to, and over the period of, the estimated future net servicing income of the underlying loans. Servicing assets are evaluated for impairment based upon the fair value of the rights as compared with amortized cost. Impairment is determined by stratifying rights by predominant characteristics, such as interest rates and terms. Fair value is determined using prices for similar assets with similar characteristics, when available, or based upon discounted cash flows using market-based assumptions. Impairment is recognized through a valuation allowance for an individual stratum, to the extent that fair value is less than the capitalized amount for the stratum.

Foreclosed Assets

Assets acquired through, or in lieu of, loan foreclosure are held for sale and are initially recorded at fair value less cost to sell at the date of foreclosure, establishing a new cost basis. Subsequent to foreclosure, valuations are periodically performed by management and the assets are carried at the lower of carrying amount or fair value less cost to sell. Revenue and expenses from operations and changes in the valuation allowance are included in net expenses from foreclosed assets. Residential real estate in the process of foreclosure was $752,000 and $593,000 at December 31, 2017 and 2016, respectively. Residential real estate held as other real estate owned and included in foreclosed assets on the balance sheets was $358,000 and $225,000 at December 31, 2017 and 2016, respectively. Commercial real estate and other foreclosed assets were $379,000 and $159,000 at December 31, 2017 and 2016, respectively.

Bank Premises and Equipment

Land is carried at cost. Bank premises and equipment are stated at cost less accumulated depreciation. Depreciation is computed principally on the straight-line method over the estimated useful lives of the related assets, ranging from 3 to 40 years.

Transfers of Financial Assets

Transfers of financial assets are accounted for as sales when control over the assets has been surrendered. Control over transferred assets is deemed to be surrendered when: (1) the assets have been isolated from the Bank; (2) the transferee obtains the right (free of conditions that constrain it from taking advantage of that right) to pledge or exchange the transferred assets; and (3) the Bank does not maintain effective control over the transferred assets through an agreement to repurchase them before their maturity.

Investment in Life Insurance

The Bank invests in split-dollar 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 chosen group of employees. The Bank 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 is included in other income on the income statement. The expense related to the liability for future benefits of the Bank's split-dollar bank-owned life insurance was approximately $61,000 and $33,000 for the years ended December 31, 2017 and 2016, respectively.

Trust Assets

Assets held by the Bank in a fiduciary capacity for customers are not included in the financial statements, since such items are not assets of the Bank. Trust income is reported on the accrual method.

1. Summary of Significant Accounting Policies (Continued)

Income Taxes

Deferred taxes are provided on the liability method, whereby deferred tax assets are recognized for deductible temporary differences and deferred tax liabilities are recognized for taxable temporary differences. Temporary differences are the differences between the reported amounts of assets and liabilities and their tax basis. 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. Deferred tax assets and liabilities are adjusted for the effects of changes in tax laws and rates on the date of enactment.

The Bank follows generally accepted accounting principles, which provides guidance on accounting for uncertainty in income taxes recognized in a Bank's financial statements. The Bank's policy is to charge penalties and interest to income tax expense as incurred. The Bank's federal and state tax returns are subject to examination by the Internal Revenue Service and state tax authorities, generally for a period of three years after the returns are filed.

Advertising

Advertising costs are expensed as incurred. The Bank's expenditures on advertising were $437,000 and $296,000 for the years ended December 31, 2017 and 2016, respectively.

Off-Balance Sheet Financial Instruments

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

Earnings per Share

Basic earnings per share represent net income available to common shareholders divided by the weighted-average number of shares outstanding during the period. Dividends on preferred stock are deducted from net income in calculating earnings per common share.

Comprehensive Income

Accounting principles generally accepted in the United States of America require that recognized revenue, expenses, gains, and losses be included in net income. Although certain changes in assets and liabilities, such as unrealized gains and losses on available-for-sale securities and unrecognized gains and losses, prior service costs, and transition assets or obligations for defined benefit pension plans are reported as a separate component of the equity section of the Balance Sheets, such items, along with net income, are components of comprehensive income.

Change in Accounting Principles

On December 22, 2017, the U.S. federal government enacted the "Tax Cuts and Jobs Act of 2017" (TCJA). As a result of the newly enacted tax laws and rates, in accordance with generally accepted accounting principles, the bank remeasured their future tax benefits and liabilities using the newly enacted tax rates. Generally accepted accounting principles requires that the effect of tax law and rate changes be recognized in income tax from continuing operations, even if the deferred tax asset or liability originally related to items recognized in Accumulated Other Comprehensive Income (AOCI). Because of this, the tax effects of items within AOCI do not reflect the appropriate tax rate. For additional information regarding the additional income tax expense recognized as a result of the remeasurement of the bank's net deferred tax asset, refer to Note13.

On February 14, 2018, FASB finalized ASU 2018-02, "Income Statement – Reporting Comprehensive Income (Topic 220): Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income" to allow reclassifying the effect of remeasuring deferred tax assets and liabilities related to items within accumulated other comprehensive income (AOCI) to retained earnings, effectively correcting the stranded tax effects created by the newly enacted tax rates. The Corporation elected to early adopt ASU 2018-02 in 2017 in order to properly reflect the effective tax rate within AOCI. This change in accounting principle caused the bank to reclassify $157,246 from AOCI to retained earnings during the year-ended December 31, 2017.

1. Summary of Significant Accounting Policies (Continued)

Accumulated other Comprehensive Income (Loss)

The components of accumulated other comprehensive income (loss) and related tax effects are presented in the following table:

(Dollars in 000s)

		Unrealized Gains\ (losses) on Securities		Defined Benefit Pension Plan		Total
Balance, December 31, 2015	$	197	$	(765)	$	(568)
Change in urealized losses on securities available for sale		(562)		-		(562)
Reclassification adjustment for (gains) realized in net income from sale of available for sale securities (1)		(117)		-		(117)
Change in benefit obligation and plan assets		-		77		77
Tax effect of current period changes (2)		232		(27)		205
Balance, December 31, 2016	$	(250)	$	(715)	$	(965)
Change in urealized losses on securities available for sale		301		-		301
Change in benefit obligation and plan assets		-		(47)		(47)
Tax effect of current period changes		(102)		16		(86)
Adjustment due to tax rate change		(10)		(147)		(157)
Balance, December 31, 2017	$	(61)	$	(893)	$	(954)

(1) Gain on sale of investments is included gross on the statements of income.
(2) $40,000 is included in federal income taxes on the statements of income, and the remainder is included in accumulated other comprehensive loss.

2. Restrictions on Cash and Due from Bank Balances

The Bank is required to maintain cash reserve balances with the Federal Reserve Bank. The required reserve balances were $ 423,000 at December 31, 2017 and $373,000 at December 31, 2016. The Bank maintains balances with its correspondent banks that may exceed federal insured limits, which management considers a normal business risk.

3. Securities

The amortized cost and fair value of securities are presented in the following tables:

December 31, 2017 (Dollars in 000s)	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Available-for-sale securities:				
U. S. government agencies	$ 1,000	$ -	$ -	$ 1,000
Certificates of deposit	2,629	5	-	2,634
Obligations of states and political subdivisions	11,816	117	(35)	11,898
Mortgage-backed securities in government-sponsored entities	26,380	90	(255)	26,215
Total	$ 41,825	$ 212	$ (290)	$ 41,747
Held-to-maturity securities:				
Mortgage-backed securities in government-sponsored entities	$ 51	$ 2	$ -	$ 53
Investment note receivable	800	-	-	800
Total	$ 851	$ 2	$ -	$ 853

December 31, 2016 (Dollars in 000s)	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Available-for-sale securities:				
U.S. government agencies	$ 1,000	$ -	$ -	$ 1,000
Certificates of deposit	2,629	8	(5)	2,632
Obligations of states and political subdivisions	13,023	142	(284)	12,881
Mortgage-backed securities in government-sponsored entities	30,113	126	(366)	29,873
Total	$ 46,765	$ 276	$ (655)	$ 46,386
Held-to-maturity securities:				
Mortgage-backed securities in government-sponsored entities	$ 63	$ 2	$ -	$ 65
Investment note receivable	800	-	-	800
Total	$ 863	$ 2	$ -	$ 865

3. Securities (Continued)

Securities with a fair value of $10,345,000 and $23,055,000 at December 31, 2017 and 2016, respectively, were pledged to secure public deposits and for other purposes as required or permitted by law. No securities were sold in 2017. Seven securities were sold in 2016 for a gross gain of $117,000.

The amortized cost and fair value of securities by contractual maturity are shown in the following table. Expected maturities may differ from contractual maturities because borrowers may have the right to prepay obligations with or without call or prepayment penalties.

December 31, 2017	**Available for Sale**		**Held to Maturity**	
(Dollars in 000s)	**Amortized Cost**	**Fair Value**	**Amortized Cost**	**Fair Value**
Due in one year or less	$ 1,000	$ 1,000	$ -	$ -
Due after one year through five years	5,072	5,133	400	400
Due after five years through ten years	3,522	3,569	400	400
Due after ten years	5,851	5,830	-	-
Mortgage-backed securities in government-sponsored entities	26,380	26,215	51	53
Total	$ 41,825	$ 41,747	$ 851	$ 853

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

December 31, 2017	Less Than Twelve Months		Twelve Months or Greater		Total	
(Dollars in 000s)	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Available-for-sale securities:						
Obligations of states and political subdivisions	2,342	(6)	2,210	(29)	4,552	(35)
Mortgage-backed securities in government-sponsored entites	12,919	(109)	5,562	(146)	18,481	(255)
Total	$ 15,261	$ (115)	$ 7,772	$ (175)	$ 23,033	$ (290)

December 31, 2016	Less Than Twelve Months		Twelve Months or Greater		Total	
(Dollars in 000s)	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Available-for-sale securities:						
Certificates of deposit	$ 244	$ (5)	$ -	$ -	$ 244	$ (5)
Obligations of states and political subdivisions	8,292	(284)	-	-	8,292	(284)
Mortgage-backed securities in government-sponsored entites	20,830	(365)	190	(1)	21,020	(366)
Total	$ 29,366	$ (654)	$ 190	$ (1)	$ 29,556	$ (655)

3. Securities (Continued)

In management's opinion, the unrealized losses reflect changes in interest rates subsequent to the acquisition of specific securities. At December 31, 2017, the Bank had 31 securities in a loss position and no securities had a loss of more than 5% of book value. Management believes that the unrealized losses are temporary and the Bank: (a) does not have the intent to sell any of the debt securities prior to recovery; and (b) it is more likely than not that it will not have to sell any of the debt securities prior to recovery. In addition, management feels that these losses are the result of interest rate changes that are not expected to result in the non-collection of principal and interest during the period.

At December 31, 2016, the Bank had 38 securities in a loss position and 4 securities had a loss of more than 5% of book value with the largest loss on one security being 7.14%.

The Bank's investments are exposed to various risks, such as interest rate, market, currency and credit risks. Due to the level of risk associated with certain investments and the level of uncertainty related to the changes in the value of the investments, it is at least reasonably possible that charges in risks in the near term would materially affect investment assets reported in the financial statements.

4. Loans Receivable

Loans receivable consist of the following:

(Dollars in 000s)	December 31, 2017	2016
Commercial	$ 57,542	$ 52,334
Commercial real estate	96,644	82,433
Commercial real estate contruction	10,145	6,202
Secured by residential real estate	143,079	142,337
Home equity lines of credit	63,507	62,235
Consumer - indirect automobile financing	106,882	62,845
Consumer - other	19,285	13,680
Gross loans	497,084	422,066
Less allowance for loan losses	(5,853)	(5,038)
Net loans	$ 491,231	$ 417,028

Net deferred costs included in the table above total $4,429,000 and $1,614,000 as of December 31, 2017 and 2016, respectively.

5. Allowance for Loan Losses

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 Bank has segmented certain loans in the portfolio by product type. Loans are segmented into the following pools: commercial loans, commercial real estate loans, residential real estate loans, home equity lines of credit, 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 three-year period for all loan segments except for home equity lines of credit which are evaluated over a two-year period. The following qualitative factors are analyzed for the loan portfolio:

- Trends in delinquency
- Underlying loan collateral value factors
- Trends in risk ratings
- Economic trends
- Concentrations of credit risk
- Lending policies and procedures
- Quality of loan review methodology

5. Allowance for Loan Losses (Continued)

- External factors (competition, legal, regulatory)
- Experience, depth and ability of lending management/staff
- Nature and volume of the portfolio and terms of loans
- Special mention and substandard trends

These qualitative factors are reviewed each quarter and adjusted based upon relevant changes within the portfolio. Historical loss percentages are calculated over a three-year period for all loan segments except home equity lines of credit where average annual losses are calculated for the most recent year. Improving charge-offs indicate a need for a longer period for historical loss and worsening charge-offs indicate the need for a shorter period for historical losses. Historical losses for one year are used as a more accurate predictor of future losses on home equity lines of credit.

Two qualitative factors comprise more than 62% of the qualitative reserves, the economic risk based on unemployment statistics and trends in delinquencies in our loan portfolio. The qualitative factor for unemployment was lowered to reflect improvement in unemployment statistics in our market area during 2017.

Loans by Segment

The total allowance reflects management's estimate of loan losses inherent in the loan portfolio at the Balance Sheet date. The Bank considers the allowance for loan losses of $5,853,000 adequate to cover loan losses inherent in the loan portfolio at December 31, 2017. The following table presents, by portfolio segment, the allowance for loan losses for the years ended December 31:

As of December 31, 2017								
(Dollars in 000s)	Commercial	Commercial Real Estate	Secured by Residential Real Estate	Home Equity Lines of Credit	Consumer - Indirect Automobiles	Consumer Other	Not allocated	Total
Allowance for credit losses:								
Beginning Balance	$ 571	$ 858	$ 1,460	$ 723	$ 1,123	$ 271	$ 32	$ 5,038
Charge-offs	(32)	(14)	(104)	(62)	(583)	(213)	-	$ (1,008)
Recoveries	2	10	97	1	211	52	-	$ 373
Provision	17	255	(163)	106	1,054	182	(1)	$ 1,450
Ending Balance	$ 558	$ 1,109	$ 1,290	$ 768	$ 1,805	$ 292	$ 31	$ 5,853
Ending balance: individually evaluated for impairment	$ 5	$ 6	$ 55	$ 24	$ 55	$ 4	$ -	$ 149
Ending balance: collectively evaluated for impairment	$ 553	$ 1,103	$ 1,235	$ 744	$ 1,750	$ 288	$ 31	$ 5,704
Financing receivables:								
Ending balance, net of fees	$ 57,542	$ 106,789	$ 143,079	$ 63,507	$ 106,882	$ 19,285		$ 497,084
Ending balance: individually evaluated for impairment	$ 159	$ 5,094	$ 2,664	$ 285	$ 164	$ 30		$ 8,396
Ending balance: collectively evaluated for impairment	$ 57,383	$ 101,695	$ 140,415	$ 63,222	$ 106,718	$ 19,255		$ 488,688

5. Allowance for Loan Losses (Continued)

As of December 31, 2016								
(Dollars in 000s)	Commercial	Commercial Real Estate	Secured by Residential Real Estate	Home Equity Lines of Credit	Consumer - Indirect Automobiles	Consumer-Other	Unallocated	Total
Allowance for credit losses:								
Beginning Balance	$ 548	$ 984	$ 1,382	$ 645	$ 1,100	$ 314	$ 61	$ 5,034
Charge-offs	(17)	(29)	(142)	(37)	(645)	(229)	-	$ (1,099)
Recoveries	1	-	8	1	189	67	-	$ 266
Provision	39	(97)	212	114	479	119	(29)	$ 837
Ending Balance	$ 571	$ 858	$ 1,460	$ 723	$ 1,123	$ 271	$ 32	$ 5,038
Ending balance: individually evaluated for impairment	$ 5	$ 1	$ 76	$ -	$ 61	$ 7	$ -	$ 150
Ending balance: collectively evaluated for impairment	$ 566	$ 857	$ 1,384	$ 723	$ 1,062	$ 264	$ 32	$ 4,888
Financing receivables:								
Ending balance, net of fees	$ 52,334	$ 88,635	$ 142,337	$ 62,235	$ 62,845	$ 13,680		$ 422,066
Ending balance: individually evaluated for impairment	$ 234	$ 6,046	$ 2,901	$ 292	$ 227	$ 56		$ 9,756
Ending balance: collectively evaluated for impairment	$ 52,100	$ 82,589	$ 139,436	$ 61,943	$ 62,618	$ 13,624		$ 412,310

Credit Quality Information

The following tables represent credit exposures by internally assigned grades for the years ended December 31, 2017 and 2016. The grading analysis estimates the capability of the borrower to repay the contractual obligations of the loan agreements as scheduled or at all. The Bank's internal credit risk grading system is based on definitions determined by the Bank.

The Bank's internally assigned grades are as follows:

Pass – loans which 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 where a potential weakness or risk exists, which could cause a more serious problem if not corrected.

Substandard – loans that 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 classified as doubtful 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 classified as a loss are considered uncollectible, or of such value that continuance as an asset is not warranted.

5. Allowance for Loan Losses (Continued)

Credit Quality Information (Continued)

As of December 31, 2017						
(Dollars in 000s)		**Commercial**		**Commercial Real Estate**		**Commercial Real Estate Construction**
Pass	$	53,746	$	89,995	$	7,519
Special Mention		979		2,615		-
Substandard		2,817		4,034		2,626
Doubtful		-		-		-
Loss		-		-		-
Ending Balance	$	57,542	$	96,644	$	10,145

As of December 31, 2016						
(Dollars in 000s)		**Commercial**		**Commercial Real Estate**		**Commercial Real Estate Construction**
Pass	$	49,397	$	77,421	$	3,115
Special Mention		3		990		-
Substandard		2,934		4,022		3,087
Doubtful		-		-		-
Loss		-		-		-
Ending Balance	$	52,334	$	82,433	$	6,202

The following tables present performing and nonperforming consumer loans based on payment activity for the year ended December 31, 2017 and 2016. 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, but do not include non-accrual loans less than 90 days past due. For more information on non-accrual loans see the section on non-accrual loans later in this footnote.

As of December 31, 2017								
(Dollars in 000s)		**Secured by Residential Real Estate**		**Home Equity Lines of Credit**		**Indirect Automobile Financing**		**Other Consumer Loans**
Performing	$	141,234	$	62,979	$	106,833	$	19,282
Nonperforming		1,845		528		49		3
Total	$	143,079	$	63,507	$	106,882	$	19,285

As of December 31, 2016								
(Dollars in 000s)		**Secured by Residential Real Estate**		**Home Equity Lines of Credit**		**Indirect Automobile Financing**		**Other Consumer Loans**
Performing	$	140,424	$	61,975	$	62,833	$	13,636
Nonperforming		1,913		260		12		44
Total	$	142,337	$	62,235	$	62,845	$	13,680

5. Allowance for Loan Losses (Continued)

Credit Quality Information (Continued)

Following is a table which includes an aging analysis of the recorded investment of past due financing receivables:

As of December 31, 2017 (Dollars in 000s)	30-59 Days Past Due	60-89 Days Past Due	90 Days Or Greater	Total Past Due	Current	Total Financing Receivables	> 90 Days and Accruing
Commercial	$ 39	$ 113	$ -	$ 152	$ 57,390	$ 57,542	$ -
Commercial real estate	450	-	597	1,047	95,597	96,644	-
Commercial real estate construction	-	-	-	-	10,145	10,145	-
Secured by residential real estate	2,754	55	1,845	4,654	138,425	143,079	
Home equity lines of credit	282	135	528	945	62,562	63,507	-
Consumer - indirect automobile financing	1,289	149	49	1,487	105,395	106,882	49
Consumer - other	134	35	3	172	19,113	19,285	3
Total	$ 4,948	$ 487	$ 3,022	$ 8,457	$ 488,627	$ 497,084	$ 52

As of December 31, 2016 (Dollars in 000s)	30-59 Days Past Due	60-89 Days Past Due	90 Days Or Greater	Total Past Due	Current	Total Financing Receivables	> 90 Days and Accruing
Commercial	$ -	$ -	$ 139	$ 139	$ 52,195	$ 52,334	$ -
Commercial real estate	237	890	702	1,829	80,604	82,433	-
Commercial real estate construction	-	-	-	-	6,202	6,202	-
Secured by residential real estate	1,167	1,055	1,913	4,135	138,202	142,337	
Home equity lines of credit	565	64	260	889	61,346	62,235	-
Consumer - indirect automobile financing	1,008	195	12	1,215	61,630	62,845	12
Consumer - other	90	45	44	179	13,501	13,680	-
Total	$ 3,067	$ 2,249	$ 3,070	$ 8,386	$ 413,680	$ 422,066	$ 12

Impaired Loans

Management considers commercial loans and commercial real estate loans which are 90 days or more past due to be impaired along with loans that are not expected to be collected as per the original loan contract. Larger commercial loans and commercial real estate loans which are 90 days or more past due are selected for impairment testing in accordance with GAAP. All substandard and doubtful loans are reviewed to determine if the loan is impaired. These loans are analyzed to determine if 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.

5. Allowance for Loan Losses (Continued)

Impaired Loans (Continued)

The following table includes the recorded investment and unpaid principal balances for impaired financing receivables with the associated allowance amount, if applicable:

As of and for the year ended December 31, 2017 (Dollars in 000s)	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Interest Income Recognized
With no related allowance recorded:					
Commercial	$ 154	$ 158	$ -	$ 154	$ 5
Commercial real estate	3,867	4,773	-	4,012	38
Commercial real estate construction	1,106	1,106	-	1,645	64
Secured by residential real estate	2,255	2,395	-	2,338	37
Home equity lines of credit	256	256	-	259	11
Consumer - indirect auto	14	14	-	19	2
Consumer - other	17	17	-	18	1
Subtotal	$ 7,669	$ 8,719	$ -	$ 8,445	$ 158
With an allowance recorded:					
Commercial	5	5	5	5	-
Commercial real estate	121	121	6	133	8
Secured by residential real estate	409	417	55	421	15
Home equity lines of credit	29	30	24	31	-
Consumer - indirect auto	150	150	55	168	11
Consumer - other	13	13	4	16	1
Subtotal	$ 727	$ 736	$ 149	$ 774	$ 35
Commercial	159	163	5	159	5
Commercial real estate	3,988	4,894	6	4,145	46
Commercial real estate construction	1,106	1,106	-	1,645	64
Secured by residential real estate	2,664	2,812	55	2,759	52
Home equity lines of credit	285	286	24	290	11
Consumer - indirect auto	164	164	55	187	13
Consumer - other	30	30	4	34	2
Total	$ 8,396	$ 9,455	$ 149	$ 9,219	$ 193

5. Allowance for Loan Losses (Continued)

Impaired Loans (Continued)

As of and for the year ended December 31, 2016					
(Dollars in 000s)	**Recorded Investment**	**Unpaid Principal Balance**	**Related Allowance**	**Average Recorded Investment**	**Interest Income Recognized**
With no related allowance recorded:					
Commercial	$ 229	$ 229	$ -	$ 227	$ 9
Commercial real estate	3,962	4,608	-	4,108	55
Commercial real estate construction	2,037	2,196	-	2,063	77
Secured by residential real estate	2,376	2,415	-	2,755	81
Home equity lines of credit	292	292	-	293	11
Consumer - indirect auto	30	30	-	34	2
Consumer - other	19	19	-	19	-
Subtotal	$ 8,945	$ 9,789	$ -	$ 9,499	$ 235
With an allowance recorded:					
Commercial	5	5	5	5	-
Commercial real estate	47	52	1	57	1
Secured by residential real estate	525	614	76	543	14
Consumer - indirect auto	197	197	61	249	20
Consumer - other	37	37	7	44	2
Subtotal	$ 811	$ 905	$ 150	$ 898	$ 37
Commercial	234	234	5	232	9
Commercial real estate	4,009	4,660	1	4,165	56
Commercial real estate construction	2,037	2,196	-	2,063	77
Secured by residential real estate	2,901	3,029	76	3,298	95
Home equity lines of credit	292	292	-	293	11
Consumer - indirect auto	227	227	61	283	22
Consumer - other	56	56	7	63	2
Total	$ 9,756	$ 10,694	$ 150	$ 10,397	$ 272

5. Allowance for Loan Losses (Continued)

Nonaccrual Loans

All loans except for consumer loans are place on non-accrual once the loan becomes 90 days past due. Consumer loans are charged-off on or before 90 days past due. A nonaccrual loan will generally only be placed back on accrual status after the borrower has become current and has demonstrated six consecutive months of non-delinquency. When a loan is placed in nonaccrual status, previously accrued but unpaid interest is deducted from interest income.

On the following table are the financing receivables on nonaccrual status as of December 31, 2017 and 2016. The balances are presented by class of financing receivable.

(Dollars in 000s)	As of December 31, 2017	As of December 31, 2016
Commercial	$ 36	$ 139
Commercial real estate	2,733	2,791
Secured by residential real estate	2,283	2,386
Home equity lines of credit	689	299
Consumer - other	-	44
Total	$ 5,741	$ 5,659

5. Allowance for Loan Losses (Continued)

Troubled Debt Restructurings

In situations where, for economic or legal reasons related to a borrower's financial difficulties, management may grant a concession for other than an insignificant period of time to the borrower that would not otherwise be considered, the related loan is classified as a Troubled Debt Restructuring ("TDR"). Management strives to identify borrowers in financial difficulty early and work with them to modify more affordable terms before their loan reaches nonaccrual status. These modified terms may include rate reductions, principal forgiveness, payment forbearance and other actions intended to minimize the economic loss and to avoid foreclosure or repossession of the collateral. In cases where borrowers are granted new terms that provide for a reduction of either interest or principal, management measures any impairment on the restructuring by calculating the present value of the revised loan terms and comparing this balance to the Company's investment in the loan prior to the restructuring. As these loans are individually evaluated for impairment, they are excluded from pooled portfolios when calculating the allowance for loan and lease losses and a separate allocation within the allowance for loan and lease losses is provided. Management continually evaluates loans that are considered TDRs, including payment history under the modified loan terms, the borrower's ability to continue to repay the loan based on continued evaluation of their operating results, and cash flows from operations.

Loan modifications that are considered TDRs completed during the years ended December 31, 2017 and 2016, were as follows:

(Dollars in 000s)	Number of Contracts	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment
2017			
Troubled debt restructurings:			
Commercial real estate	$ 1	$ 1,252	$ 1,252
Consumer - indirect automobile financing	1	26	26
Total	2	1,278	1,278

(Dollars in 000s)	Number of Contracts	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment
2016			
Troubled debt restructurings:			
Commercial real estate	$ 1	$ 1,234	$ 1,234
Secured by residential real estate	1	81	81
Total	2	1,315	1,315

All of the TDRs are performing and are in compliance with their modified terms and there were no commitments to lend more funds to these borrowers. The restructuring of the majority of loans for both 2017 and 2016 was either an extension of the maturity date or temporary reduction or moratorium on the payment terms or amounts. No modifications involved any changes in principal balances for 2017 or 2016.

6. Mortgage Servicing

The Bank entered into agreements to sell residential mortgages to the FHLB of Pittsburgh. The agreements include a maximum credit enhancement of $520,000 which the Bank may be required to pay if realized losses on any of the sold mortgages exceed the amount held in the FHLB's Spread Account. The FHLB is funding the Spread Account at 0.04 percent of the outstanding balance of loans sold annually. The Bank's historical losses on residential mortgages have been lower than the amount that will be funded to the Spread Account. Therefore, the Bank has not recorded a liability for the credit enhancement. As compensation for the credit enhancement, the FHLB is paying the Bank 0.10 percent of the outstanding loan balance in the portfolio on a monthly basis.

Loans serviced for others are not included in the accompanying balance sheets. The unpaid principal balances of mortgage loans serviced for others were $78,501,000 and $80,717,000 at December 31, 2017 and 2016, respectively.

The Bank retains the servicing on certain loans sold to the FHLB and receives a fee based upon the principal balance outstanding. The balance of mortgage servicing rights included in other assets on the balance sheets was $234,000 and $261,000 at December 31, 2017 and 2016. Mortgage servicing fee income for the years ended December 31, 2017 and 2016 was $119,000 and $103,000, respectively, which is included in mortgage banking activities in the statements of income.

The following summarizes mortgage servicing rights capitalized and amortized:

	Years Ended December 31,	
(Dollars in 000s)	**2017**	**2016**
Mortgage servicing rights capitalized	$ 72	$ 95
Mortgage servicing rights amortized	(98)	(113)
Net change	$ (26)	$ (18)

7. Bank Premises and Equipment

Components of Bank premises and equipment are as follows:

	December 31,	
(Dollars in 000s)	**2017**	**2016**
Land and improvements	$ 1,978	$ 456
Buildings	6,588	5,357
Furniture and equipment	2,775	2,714
Contruction in progress	1,141	358
Total premises and equipment	$ 12,482	$ 8,885
Less accumulated depreciation	(4,935)	(4,823)
Net premises and equipment	$ 7,547	$ 4,062

Depreciation expense for the years ended December 31, 2017 and 2016 was approximately $409,000 and $425,000, respectively.

7. Bank Premises and Equipment (Continued)

The Bank leases land and office space under operating leases. Rental expense, including real estate taxes, for these leases was $325,000 and $249,000 for years ended December 31, 2017 and 2016 respectively. Future minimum rental commitments under these leases are as follows:

(Dollars in 000s)		**Years Ending December 31,**
2018	$	278
2019		235
2020		238
2021		242
2022		247
Thereafter		1,700
Total	$	2,940

The bank entered in an agreement on April 4, 2017 with a contractor to build a new bank branch for $1,527,000 in Lititz, Pennsylvania, of which $1,045,000 had been paid at December 31, 2017. It is expected to be completed by April of 2018.

8. Deposits

The composition of deposits is as follows:

	December 31,			
(Dollars in 000s)		**2017**		**2016**
Demand, non-interest-bearing	$	48,267	$	48,051
Checking with interest and money market		208,461		198,755
Savings		47,130		41,159
Time deposits greater than $250,000		22,532		16,971
Other time deposits		137,776		127,778
Total	$	464,166	$	432,714

At December 31, 2017, the scheduled maturities of time deposits are as follows:

(Dollars in 000s)		**Years Ended December 31,**
2018	$	77,882
2019		31,246
2020		31,796
2021		11,826
2022		7,558
Total	$	160,308

9. Employee Benefits

The Bank has a defined contribution 401(k) plan for employees who meet the eligibility requirements set forth in the plan. All of the Bank's employees that are 21 years and older are eligible for the plan. The Bank increased its match in 2013 to 100% of elective contributions of employees not to exceed 4% of the employee's salary, plus 50% of the employees elective contribution that exceed 4% of their salary but not to exceed 6% of their salary. The Bank's contributions to this plan were $223,000 in 2017 and $202,000 in 2016.

The Bank has a noncontributory defined benefit pension plan (the "Plan") covering substantially all employees hired prior to February 1, 2006. The Plan's benefit formulas generally base payments to retired employees upon their length of service and the employees' average monthly compensation. This plan was frozen as of December 31, 2012 and no employees are accruing any more benefits.

The following table sets forth the Plan's funded status and the amounts recognized in the Bank's financial statements. The measurement date for purposes of these valuations was December 31, 2017 and 2016.

(Dollars in 000s)	December 31, 2017	December 31, 2016
Change in benefit obligation		
Benefit obligation at beginning of year	$ 3,823	$ 3,859
Interest cost	156	165
Actuarial (gain) loss	407	(15)
Benefits paid	(83)	(79)
Settlements	(103)	(107)
Benefit obligation at end of year	4,200	3,823
Change in plan assets		
Fair value of plan assets at beginning of year	3,635	3,156
Employer contribution	-	450
Actual return on plan assets	551	215
Benefits paid	(83)	(79)
Settlements	(103)	(107)
Fair value of plan assets at end of year	4,000	3,635
Funded status (Included in other liabilities)	$ (200)	$ (188)
Amounts recognized in accumulated other comprehensive income (loss) consist of:		
Net acturial loss	$ (1,131)	$ (1,085)
Deferred tax benefit	238	370
Total	$ (893)	$ (715)

9. Employee Benefits (Continued)

Net periodic pension expense included the following components:

(Dollars in 000s)	Years Ended December 31, 2017	2016
Interest cost	$ 156	$ 165
Expected return on plan assets	(251)	(217)
Net amortization and deferral	60	64
Net periodic pension expense	$ (35)	$ 12

The accumulated benefit obligation was $4,200,000 and $3,823,000 at December 31, 2017 and 2016 respectively.

The following is a summary of actuarial assumptions used for the Bank's pension plan:

	December 31, 2017	2016
Discount rate	3.60%	4.14%
Expected long-term return on Plan assets	6.50%	7.00%
Rate of compensation increase	N/A	N/A

The estimated net actuarial loss that will be amortized into net periodic pension cost over the next year is $62,000.

The selected long-term rate of return on Plan assets (6.5 percent) was primarily based on the asset allocation of the Plan's assets. Analysis of the historic returns on these asset classes and projections of expected future returns were considered in setting the long-term rate of return.

The Bank's pension plan target asset allocations, by asset category, are as follows:

	December 31, 2017	2016
Equities	65%	65%
Fixed income	35%	35%
Other	0%	0%
Total	100%	100%

9. Employee Benefits (Continued)

The following table sets forth by level, within the fair value hierarchy, the Plan's assets at fair value:

	As of December 31, 2017			
(Dollars in 000s)	**Level I**	**Level II**	**Level III**	**Total**
Assets:				
Mutual funds:				
Equities				
Large-Cap Value	$ 249	$ -	$ -	$ 249
Large-Cap Core	336	-	-	336
Mid-Cap Core	291	-	-	291
Small-Cap Core	138	-	-	138
International Core	658	-	-	658
Large Cap Growth	529	-	-	529
Small/ midcap Growth	154	-	-	154
Fixed income				
Fixed Income- US Core	1,012	-	-	1,012
Intermediate Duration	342	-	-	342
Other	-	254	-	254
Cash Equivalent	37	-	-	37
Total assets at fair value	$ 3,746	$ 254	$ -	$ 4,000

	As of December 31, 2016			
(Dollars in 000s)	**Level I**	**Level II**	**Level III**	**Total**
Assets:				
Mutual funds:				
Equities				
Large-Cap Value	$ 222	$ -	$ -	$ 222
Large-Cap Core	291	-	-	291
Mid-Cap Core	258	-	-	258
Small-Cap Core	134	-	-	134
International Core	535	-	-	535
Large Cap Growth	405	-	-	405
Small-Cap Growth	140	-	-	140
Fixed income				
Fixed Income- US Core	1,024	-	-	1,024
Intermediate Duration	345	-	-	345
Other	-	230	-	230
Cash Equivalent	51	-	-	51
Total assets at fair value	$ 3,405	$ 230	$ -	$ 3,635

9. Employee Benefits (Continued)

The Bank does not expect to contribute to its pension plan in 2018.

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

(Dollars in 000s)	**Years Ended December 31,**	
2018	$	103
2019		102
2020		107
2021		117
2022		166
2023 through 2027		963
	$	1,558

10. Borrowed Funds

The Bank has available a $25 million line with the FHLB of Pittsburgh. This line expires in February 2018. The interest rate on this line was 1.54 percent at December 31, 2017, and 0.74 percent at December 31, 2016. The outstanding balance under this line as of December 31, 2017 and 2016 was $23,221,000 and $6,000,000 respectively. The bank also has an unsecured $3 million line with the Atlantic Community Bankers Bank (ACBB), which was not used in 2017 or 2016. The Bank also entered into unsecured subordinated debt with ACBB in 2015, maturing in November 2025, at a fixed rate of 5.5% for five years and then a variable rate based on prime rate plus 0.50% for the last five years. The debt can be redeemed after November 2020.

Long-term debt is composed of the following FHLB fixed-rate advances and subordinated debt:

(Dollars in 000s)			December 31,			
Maturity Date		**Rate**		**2017**		**2016**
July 2017	(Non-amortizing)	1.39		-		5,300
July 2018	(Non-amortizing)	1.81		7,000		7,000
June 2019	(Non-amortizing)	1.68		2,000		-
Dec 2019	(Non-amortizing)	1.77		10,000		-
June 2020	(Non-amortizing)	1.84		10,000		-
June 2021	(Non-amortizing)	1.97		3,000		-
May 2023	(Amortizing	4.57		1,105		1,280
May 2023	(Amortizing)	4.68		599		694
November 2025 subordinated debt		5.50		3,000		3,000
(requires $150,000 quarterly payments beginning in November 2020)						
			$	36,704	$	17,274

10. Borrowed Funds (Continued)

The following table represents maturities/repayments of the remaining FHLB advances at December 31, 2017 and subordinated debt:

(Dollars in 000s)		Amount
2018		7,283
2019		12,297
2020		10,461
2021		3,926
2022		940
Thereafter		1,797
Total	$	36,704

Borrowings from the FHLB are collateralized by certain qualifying assets of the Bank with an approximate value of $185,408,000 at December 31, 2017. The Bank has a maximum borrowing capacity with the FHLB of approximately $143,092,000 of which $74,625,000 is outstanding and includes $17,700,000 in total letters of credits issued to municipalities to secure deposits.

The following table represents the activity related to the Bank's short-term borrowings under the $25 million line of credit with the FHLB of Pittsburgh:

(Dollars in 000s)	As of and for the Years Ended December 31, 2017	2016
Balance at year-end	$ 23,221	$ 6,000
Average balance outstanding during the year	24,896	6,434
Maximum amount outstanding at any month-end	40,590	27,968
Weighted-average interest rate:		
As of year-end	1.54 %	0.74 %
Paid during the year	1.19 %	0.56 %

11. Related-Party Transactions

The Bank has had banking transactions in the ordinary course of business with its executive officers, directors, principal stockholders, and their affiliated companies (related parties) on the same terms, including interest rates and collateral, as those prevailing at the time for comparable transactions with others. A summary of loan activity during the year ended December 31, 2017 is as follows:

Balance at December 31, 2016	Additions	Amount Collected	Balance at December 31, 2017
$2,762,000	$169,000	$829,000	$2,102,000

Deposits from related parties totaled $5,367,000 and $6,328,000 as of December 31, 2017 and 2016 respectively.

12. Off-Balance Sheet Commitments

The Bank is a 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 letters of credit. Those instruments involve, to varying degrees, elements of credit risk in excess of the amount recognized in the balance sheet.

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 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.

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. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. 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. Collateral held varies but may include personal or commercial real estate, accounts receivable, inventory, and equipment.

Outstanding letters of credit written are conditional commitments issued by the Bank to guarantee the performance of a customer to a third party. The majority of these standby letters of credit expire within the next 12 months. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending other loan commitments. The Bank requires collateral supporting these letters of credit, as deemed necessary. Management believes that the proceeds obtained through a liquidation of such collateral would be sufficient to cover the maximum potential amount of future payments required under the corresponding guarantees. The amount of the liability for guarantees under standby letters of credit issued is not material as of December 31, 2017 and 2016.

A summary of the Bank's financial instrument commitments is as follows:

	December 31,	
(Dollars in 000s)	**2017**	**2016**
Commitments to extend credit	$ 6,803	$ 8,538
Unfunded commitments	78,027	80,421
Standby letters of credit	7,669	6,712
Total	$ 92,499	$ 95,671

13. Income Taxes

The provision for federal income taxes consisted of the following:

(Dollars in 000s)	Years Ended December 31, 2017	2016
Current	$ 962	$ 1,428
Deferred	500	171
Total	$ 1,462	$ 1,599

Included within the applicable income tax for the year ended December 31, 2017 is $81,907 in reduction of income tax expense as a result of the remeasurement of the net deferred tax asset necessary because of the newly enacted corporate tax rates included in the "Tax Cuts and Jobs Act of 2017". The Act reduces the corporate tax rate from a graduated 34% tax rate to a flat 21% tax rate. As a result, in accordance with generally accepted accounting principles, the Bank was required to remeasure the net deferred tax asset as of December 22, 2017 to recognize future tax benefits and liabilities at the newly enacted 21% tax rate.

Reconciliation of the statutory income tax expense computed at 34 percent to the income tax expense included in the statements of income is as follows:

(Dollars in 000s)	Years Ended December 31, 2017		2016	
	Amount	% of Pretax Income	Amount	% of Pretax Income
Provision at statutory rate	$ 2,023	34.0 %	$ 2,064	34.0 %
Tax exempt interest, net	(387)	(6.5)	(373)	(6.2)
Life insurance	(75)	(1.3)	(85)	(1.4)
Effect of tax rate change	(82)	(1.4)	-	-
Other, net	(17)	(0.3)	(7)	(0.1)
Actual tax expense and effective rate	$ 1,462	24.5 %	$ 1,599	26.3 %

Net deferred tax assets consisted of the following components:

13. Income Taxes (Continued)

(Dollars in 000s)	As of December 31, 2017	2016
Deferred tax assets:		
Allowance for loan losses	$ 1,049	$ 1,389
Other pension adjustments	238	369
Nonaccrual loan interest	97	167
Net unrealized loss on securities	16	129
Deferred loan fees	110	88
Deferred gains from sale of assets	72	83
Other	42	49
Total deferred tax assets	1,624	2,274
Deferred tax liabilities:		
Accrued pension	(195)	(305)
Premises and equipment	(360)	(571)
Deferred loan fees costs	(1,079)	(754)
Mortgage servicing rights	(49)	(89)
Prepaid expenses	(73)	(100)
Total deferred tax liabilities	(1,756)	(1,819)
Net deferred tax assets (liability)	$ (132)	$ 455

14. Concentration of Credit Risk

The Bank grants commercial, residential, and consumer loans to customers primarily located in Lebanon County, Pennsylvania. The concentrations of credit by type of loan are set forth in Note 4. Although the Bank has a diversified loan portfolio, its debtors' ability to honor their contracts is influenced by the region's economy.

15. Regulatory Matters

The Bank is subject to various regulatory capital requirements administered by the federal banking agencies. Failure to meet minimum capital requirements can initiate certain mandatory and possibly additional discretionary actions by regulators that, if undertaken, could have a direct material effect on the 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 and 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.

Quantitative measures established by regulation to ensure capital adequacy require the Bank to maintain minimum amounts and ratios (set forth in the following table) of Total, Tier I capital and Common Equity Tier I capital (as defined in the regulations) to risk-weighted assets (as defined) and of Tier I capital (as defined) to average assets (as defined). Management believes, as of December 31, 2017, that the Bank meets all capital adequacy requirements to which it is subject.

As of December 31, 2017, the most recent notification from the Federal Deposit Insurance Corporation categorized the Bank as well capitalized under the regulatory framework for prompt corrective action. There are no conditions or events since that notification that management believes have changed the Bank's category.

The Bank's actual capital amounts and ratios as of December 31 are also presented below:

15. Regulatory Matters (Continued)

	Actual		For Capital Adequacy Purposes		To Be Well Capitalized Under Prompt Corrective Action Provisions	
(Dollars in 000s)	Amount	Ratio	≥ Amount	≥ Ratio	≥ Amount	≥ Ratio
Total capital (to risk-weighted assets)						
2017	$ 58,690	11.88 %	$ 39,518	8.00 %	$ 49,398	10.00 %
2016	$ 54,584	12.91 %	$ 33,828	8.00 %	$ 42,285	10.00 %
Tier I capital (to risk-weighted assets)						
2017	$ 49,785	10.08 %	$ 29,639	6.00 %	$ 39,518	8.00 %
2016	$ 46,506	11.00 %	$ 25,371	6.00 %	$ 33,828	8.00 %
Tier I capital (to average assets)						
2017	$ 49,785	8.74 %	$ 22,841	4.00 %	$ 28,552	5.00 %
2016	$ 46,506	9.41 %	$ 19,769	4.00 %	$ 24,711	5.00 %
Common equity tier one capital (to risk-weighted assets)						
2017	$ 49,785	10.08 %	$ 22,229	4.50 %	$ 32,109	6.50 %
2016	$ 46,506	11.00 %	$ 19,028	4.50 %	$ 27,485	6.50 %

The Bank is subject to certain restrictions on the amount of dividends that it may declare without prior regulatory approval. At December 31, 2017, $40,046,000 of retained earnings was available for dividend declaration without prior regulatory approval, subject to the above regulatory capital requirements.

16. Fair Value

The framework for measuring fair value provides a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (level 1) and the lowest priority to unobservable inputs (level 3). Valuation techniques maximize the use of relevant observable inputs and minimize the use of unobservable inputs. The three levels of the fair value hierarchy under Table 820 are described as follows:

Level I: Inputs to the valuation methodology are quoted prices (unadjusted) in active markets for identical assets or liabilities that the organization can access at the measurement date.

Level II: Inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly or indirectly, such as:

- Quoted prices for similar assets or liabilities in active markets;
- Quoted prices for identical or similar assets or liabilities in inactive markets;
- Inputs other than quoted prices that are observable for the asset or liability;
- Inputs that are derived principally from or corroborated by observable market data by correlation or other means.

Level III: Inputs that are unobservable inputs for the asset or liability.

16. Fair Value (Continued)

An asset's or liability's level within the fair value hierarchy is based on the lowest level of input that is significant to the fair value measurement.

All securities available for sale are priced using pricing models, quoted prices of securities with similar characteristics or using discounted cash flows and therefore are classified in the level 2 hierarchy.

For financial assets measured at fair value on a recurring basis, the fair value measurements by level within the fair value hierarchy used at December 31, 2017 and 2016 are as follows:

	As of December 31, 2017			
(Dollars in 000s)	**Level I**	**Level II**	**Level III**	**Total**
Assets measured on a recurring basis:				
Available-for-sale securities:				
U.S. government agencies	$ -	$ 1,000	$ -	$ 1,000
Certificates of deposit	-	2,634	-	2,634
Obligations of states and political subdivisions	-	11,898	-	11,898
Mortgage-backed securities in government-sponsored entities	-	26,215	-	26,215
Total	$ -	$ 41,747	$ -	$ 41,747

	As of December 31, 2016			
(Dollars in 000s)	Level I	Level II	Level III	Total
Assets measured on a recurring basis:				
Available-for-sale securities:				
U.S. government agencies	$	1,000	$	$ 1,000
Certificates of deposit	-	2,632	-	2,632
Obligations of states and political subdivisions	-	12,881	-	12,881
Mortgage-backed securities in government-sponsored entities		29,873	-	29,873
Total	$ -	$ 46,386	$ -	$ 46,386

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

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

<u>Other Real Estate Owned</u>

Certain assets such as other real estate owned (OREO) acquired through foreclosure are initially recorded at fair value of the property at the transfer date less estimated selling costs. At or near the time of foreclosure, real estate appraisals are obtained on the properties acquired through foreclosure. The real estate is then valued and subsequently carried at the lesser of the appraised value less estimated selling costs or the loan balance, including interest receivable at the time of foreclosure. Appraised values are typically determined utilizing an income or market valuation approach based on an appraisal conducted by an independent, licensed appraiser outside of the

16. Fair Value (Continued)

Bank using observable market data or on a recent sale offer (Level 2). However, if the appraisal for the acquired property is over two years old, then the fair value is considered Level 3. The estimate of costs to sell the property is based on historical transactions of similar holdings. There were two OREO properties with write-downs during the year ended December 31, 2017 and three with write-downs during the year ended December 31, 2016.

Impaired Loans

Loans of a commercial nature are designated as impaired when, in the judgment of management based on current information and events, it is probable that all amounts due will not be collected according to the contractual terms of the loan agreement. The measurement of loss associated with impaired loans can be based on either the observable market price of the loan, the fair value of the collateral (if collateral dependent), or the present value of expected future cash flows. Fair value is measured based on the value of the collateral securing the loan less estimated costs to sell or the expected present value of future cash flows. Collateral may be in the form of real estate or business assets including equipment, inventory, and accounts receivable. The value of the collateral is typically determined utilizing an income or market valuation approach based on an appraisal conducted by an independent, licensed appraiser outside of the Bank using observable market data (Level 2). However, if the collateral is a house or building in the process of construction or if an appraisal of the real estate property is stale, then the fair value is considered Level 3. The value of business equipment is based upon an outside appraisal if deemed significant, or the net book value of the applicable business' financial statements if not considered significant using observable market data. Likewise, values for inventory and accounts receivable collateral are based on financial statement balances or aging reports (Level 3). Impaired loans with an allocation to the allowance for loan losses are measured at fair value on a nonrecurring basis. Any fair value adjustments are recorded in the period incurred as provision for loan losses on the statements of income.

The fair value of impaired loans reported below is based on the total impaired loans with a specific allowance for loan loss allocation less the total allocations for such loans, while the fair value measurement level is based on the age of the underlying appraisal of the collateral securing the loans. Specific allocations to the allowance for loan losses for impaired loans were $149,000 and $150,000 at December 31, 2017 and 2016, respectively.

There were no loans held for sale as of December 31, 2017. There was $385,000 of loans held for sale with a fair value of $386,000 as of December 31, 2016. The fair value is determined by pricing of similar loans in the secondary market (Level 2).

16. Fair Value (Continued)

For financial assets measured at fair value on a nonrecurring basis, the fair value measurements by level within the fair value hierarchy used at December 31, 2017 and 2016 are as follows:

	As of December 31, 2017				
(Dollars in 000s)	**Level I**	**Level II**	**Level III**	**Total**	**Gain\ (Losses)**
Impaired loans	$ -	$ -	$ 578	$ 578	$ -
Other real estate owned	-	-	554	554	-
Total	$ -	$ -	$ 1,132	$ 1,132	$ -

	As of December 31, 2016				
(Dollars in 000s)	Level I	Level II	Level III	Total	**Gain\ (Losses)**
Impaired loans	$ -	$ -	$ 661	$ 661	$ -
Loans held for sale	-	386	-	386	-
Other real estate owned	-	-	249	249	(49)
Total	$ -	$ 386	$ 910	$ 1,296	$ (49)

The following table provides a listing of the significant unobservable inputs used in the fair value measurement process for items valued utilizing Level III techniques:

	As of December 31, 2017			
(Dollars in 000s)	**Fair Value**	**Valuation Techniques**	**Unobservable Input**	**Range**
Impaired Loans	578	Appraised collateral values and discounted cash flows	Discount for time since appraisal	0-30%
			Selling costs	0-6%
			Holding period	0-60 months
Other real estate owned	554	Appraised collateral values	Selling costs	0-6%
			Holding period	0-78 months

	As of December 31, 2016			
(Dollars in 000s)	**Fair Value**	**Valuation Techniques**	**Unobservable Input**	**Range**
Impaired Loans	661	Appraised collateral values and discounted cash flows	Discount for time since appraisal	0-30%
			Selling costs	0-6%
			Holding period	0-60 months
Other real estate owned	249	Appraised collateral values	Selling costs	0-6%
			Holding period	0-48 months

17. Fair Values of Financial Instruments

The following information should not be interpreted as an estimate of the fair value of the entire Bank, since a fair value calculation is only provided for a limited portion of the Bank's assets and liabilities. Due to a wide range of valuation techniques and the degree of subjectivity used in making the estimates, comparisons between the Bank's disclosures and those of other companies may not be meaningful. The following methods and assumptions were used to estimate the fair values of the Bank's financial instruments at December 31, 2017 and 2016.

Cash and due from banks and interest bearing balances with other banks
The carrying amounts reported in the balance sheet for cash and short-term instruments approximate those assets' fair values.

Securities available for sale and held to maturity
The Bank utilizes a third-party source to determine the fair value of its securities available for sale (carried at fair value) and held to maturity (carried at amortized cost). The methodology consists of pricing models based on asset class and includes available trade, bid, other market information, broker quotes, proprietary models, various databases and trading desk quotes, some of which are heavily influenced by unobservable inputs. The carrying amount of time certificates of deposit approximates its fair value.

Loans held for sale
The carrying amount of loans held for sale approximates its fair value.

Loans receivable
For variable rate loans that reprice frequently and with no significant change in credit risk, fair values are based on carrying values. The fair values for other loans (e.g., residential real estate and consumer loans) are estimated using discounted cash flow analyses, using interest rates currently being offered for loans with similar terms to borrowers of similar credit quality.

Restricted investment in Bank stock
The carrying amount of restricted investment in Bank stock approximates fair value.

Accrued interest receivable and payable
The carrying amount of accrued interest receivable and accrued interest payable approximates its fair value.

Mortgage servicing rights
The fair value of mortgage servicing rights is based on observable market prices, when available, or the present value of expected future cash flows.

Deposits
The fair values disclosed for demand deposits (e.g., interest and noninterest checking, passbook savings, and money market accounts) are, by definition, equal to the amount payable on demand at the reporting date (i.e., their carrying amounts). Fair values for fixed-rate certificates of deposit are estimated using a discounted cash flow calculation that applies interest rates currently being offered on certificates to a schedule of aggregated expected monthly maturities on time deposits.

Short-term debt
The amounts of short-term debt approximate their fair value.

Long-term debt
Fair values of long-term debt are estimated using discounted cash flow analysis, based on rates currently available to the Bank for advances from the FHLB with similar terms and remaining maturities.

Off-balance sheet financial instruments
Fair values for the Bank's off-balance sheet financial instruments (lending commitments and letters of credit) are based on fees currently charged to enter into similar agreements, taking into account the remaining terms of the agreements and the counterparties' credit standing.

17. Fair Values of Financial Instruments (Continued)

The estimated fair values of the Bank's financial instruments were as follows at December 31, 2017 and 2016:

			As of December 31, 2017		
(Dollars in 000s)	Carrying Amount	Fair Value	Level I	Level II	Level III
Financial assets:					
Cash and due from banks	$ 2,769	2,769	2,769		
Interest Bearing Balances with other Banks	10,528	10,528	10,528		
Available-for-sale securities	41,747	41,747		41,747	
Held-to-maturity securities	851	853		853	
Net loans	491,231	491,824		491,246	578
Accrued interest receivable and dealer reserve	2,131	2,131	2,131		
Restricted investment in Bank stock	2,965	2,965		2,965	
Mortgage servicing rights	234	604		604	
Financial liabilities:					
Deposits	$ 464,166	463,273		463,273	
Short-term debt	23,221	23,221		23,221	
Long-term debt	36,704	36,637		36,637	
Accrued interest payable	184	184	184		

			As of December 31, 2016		
(Dollars in 000s)	Carrying Amount	Fair Value	Level I	Level II	Level III
Financial assets:					
Cash and due from banks	$ 3,152	3,152	3,152		
Interest Bearing Balances with other Banks	14,081	14,081	14,081		
Available-for-sale securities	46,386	46,386		46,386	
Held-to-maturity securities	863	865		865	
Loans held for sale	385	386		386	
Net loans	417,028	423,803		423,142	661
Accrued interest receivable and dealer reserve	2,358	2,358	2,358		
Restricted investment in Bank stock	1,510	1,510		1,510	
Mortgage servicing rights	261	581		581	
Financial liabilities:					
Deposits	$ 432,714	432,109		432,109	
Short-term debt	6,000	6,000		6,000	
Long-term debt	17,274	17,826		17,826	
Accrued interest payable	125	125	125		

18. Contingencies

The Bank is subject to claims and lawsuits which arise primarily in the ordinary course of business. Based on information presently available and advice received from legal counsel representing the Bank in connection with any such claims and lawsuits, it is the opinion of management that the disposition or ultimate determination of any such claims and lawsuits will not have a material adverse effect on the financial position, results of operations or liquidity of the Bank.

19. Subsequent Events

Management has reviewed events occurring through February 27, 2018, the date the financial statements were available to be issued and no subsequent events occurred requiring disclosure.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Lebanon
717-273-0405

NEW! Lititz
717-568-8488

Manheim
717-664-0190

Newmanstown
610-589-1234

Northside Commons
717-838-2265

Palmyra
717-641-0032

Quentin Road
717-279-7720

Cornwall Manor
717-769-2818

Londonderry Village
717-838-7000

The Build in Lititz, Pennsylvania

From left: Glenn Grau, PWCampbell Vice President; Edward Anspach, JBT Second Vice Chairman and Secretary of the Board; Troy A. Peters, JBT President and CEO; Eric Trainer, JBT Director; Richard J. Newmaster Jr., JBT Chairman of the Board; Edward T. Martel, Jr., JBT Senior Vice President, Sales, Marketing and Branch Administration; Richard Rollman, JBT Vice President of Lending; Sallie Neuin, JBT Director; Brian Miller, JBT Director; Terry Resanovich, Vice President and Senior Trust Officer of JBT Financial Services; Jarrett Dickson, PWCampbell Project Manager.

Lititz Office Prior to Opening in March 2018

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This statement has not been reviewed, or confirmed for accuracy or relevance, by the Federal Deposit Insurance Corporation.

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