A Community Connection

2016 Annual Report

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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

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, Milton S. Hershey Medical Center, Operations Manager, COO, Central Medical Ambulance Services

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

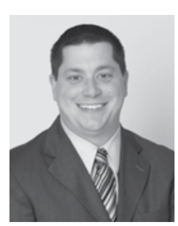
Troy A. Peters
President
Chief Executive Officer

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.,

The year of 2016 was another successful one for JBT. During the course of the year, your Bank produced a record setting net income of $4,471,000 – a 6.9% increase over the prior year. Return on average equity increased by 8.3% for shareholders and the Bank strengthened its capital position. Our stock price increased by 12% and finished the year trading above book value. The dividend yield was 3.19%, and share trading volume reached its peak as over 86,000 shares were bought and sold during the year. Loans and deposits both increased and we ended the year with total assets over the $500 million mark. We were able to take advantage of disruption in our marketplace caused by a number of bank mergers to gain both new commercial and consumer relationships. Interest income and non-interest income revenue streams improved and contributed to the growth of our bottom line. Asset quality continued to improve, and at the end of the year we broke ground in Manheim for a new branch location. In all, it was a busy, progressive year, and we are optimistic about our future.

LENDING

Loan growth is a key to our success, but growth was sluggish for most of the year. Loan balances grew 4.9% which was slightly under our expectations. We were led by strong commercial loan results and growth in our municipal lending portfolio. Even though the national economy is said to be through the recovery, and perhaps even in a modest expansion mode, many consumer households in our market are still resistant to adding new debt. However, we did see strong growth in our mortgage lending activities. This is an area that we emphasized in 2016, and it resulted in a 34% increase in mortgage income. It appears housing developments are in full swing throughout our market and with mortgage rates on the rise and appraisal values increasing; many homeowners are getting active and buying new homes.

Additionally, we entered the student lending market late in the year with an affiliation to *iHelp*, a student lending conduit. Booking loans through *iHelp* allows us to participate in this market without all of the servicing and credit risks associated with student lending. These loans are funded by JBT, but underwritten and guaranteed by an insurance company. By the end of the year, we already started to build a student loan portfolio.

For years, our indirect auto lending program had been a successful one, but coming out of the recession, the competitive landscape changed dramatically and we experienced a decline in outstanding balances. In 2016, we placed a renewed emphasis on this line of business by hiring a new department manager, Kody Sitch, investing in new technology for our lending platform, and revising the program and pricing for our dealership clients. Although the roll-out of this new program will not be complete until later in 2017, we have already seen a substantial increase in business. During the last quarter of 2016, we grew balances by 16%, we booked loans with higher credit-rated borrowers, and we began financing newer vehicles. Newly implemented technology has helped it become easier to do business with us, and we believe that we will continue to see positive results going forward.

ASSET QUALITY

Asset quality has been a major focus for us over the past several years as it is one area where we trail many banks in our peer group. Great strides were made in improving our asset quality in 2016. As mentioned earlier, our indirect program is now putting on higher quality credits which is aiding our

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progress. Our non-current loans (greater than 90 days) are at a seven year low. We remain adequately reserved for future loan losses and the provision expense increased by 42% during the year – largely due to our growth. We believe that we are positioning ourselves well for the next downturn in the credit cycle when it inevitably arrives.

DEPOSITS

The Bank had another year of strong deposit growth as we experienced increases in each deposit category, culminating in an 8.5% increase in total deposits. There are many reasons for this continued growth, including the aforementioned deleveraging of consumer households and the uncertainty related to the national elections. The latter is now a settled matter and we have seen both the equity markets and interest rates rise. Rates are widely expected to continue to increase in the near future and that is welcome news to both savers and the Bank. Rising rates will ultimately reduce the pressure on our net interest margin – a key metric in our profitability. Another important reason for our increase in deposits was the tremendous market disruption in our area, caused by the mergers of local competing banks with larger out-of-town financial institutions. At one time, there were more than a dozen banks headquartered in Lebanon County. Now, we are the last local bank left standing and we are benefiting from this “merger-mania.” Many of our new clients have come to us looking for the attention and flexibility that we provide through direct and personal ties to the communities we serve. This remains one of our strongest selling points.

TECHNOLOGY

As technology advances in all areas of our lives, we realize that those advances often require further investment to remain relevant. While most of our technology investments are related to increasing our security and protecting our data, they are largely invisible to our clients. One project that was certainly evident to our clients was our debit card conversion. With the payment systems shift in liability as a result of the nation’s change to EMV (Europay MasterCard® and Visa®) technology, commonly referred to as a *chip card*, we reissued all JBT debit cards under the Discover® brand in the third quarter of the year. We made the change after studying Discover’s security, acceptance, customer service, and pricing. This required the reissuance of 10,500 cards in a relatively short timeframe. This was a major undertaking and was not without its bumps, as retail merchants in the United States have been slow in their conversion to this new technology. We were very pleased with the professionalism and hard work our employees demonstrated while helping our clients navigate this change. Activity continues to increase and you might be surprised to learn that our clients used their JBT debit cards nearly 2 million times in 2016 alone!

MANHEIM EXPANSION

In the third quarter Shareholder Report, we were excited to announce the news of our thirteenth branch office, to be built in Manheim, PA. In December, we officially broke ground in the new Penn Towne Center development on Route 72, located directly across from the Manheim Auto Auction and next to the new Sheetz convenience store. This is a natural extension of our existing market, and we anticipate a June 2017 opening. Dee Ann Carpenter has been named as Branch Manager of this new office. Dee is a lifelong Manheim resident and helped manage the opening of our Ephrata office in 2011. She has also worked for a direct competitor in the Manheim market for 16 years before joining JBT. We look forward to additional growth to be able to serve more clients and more communities in Lancaster County.

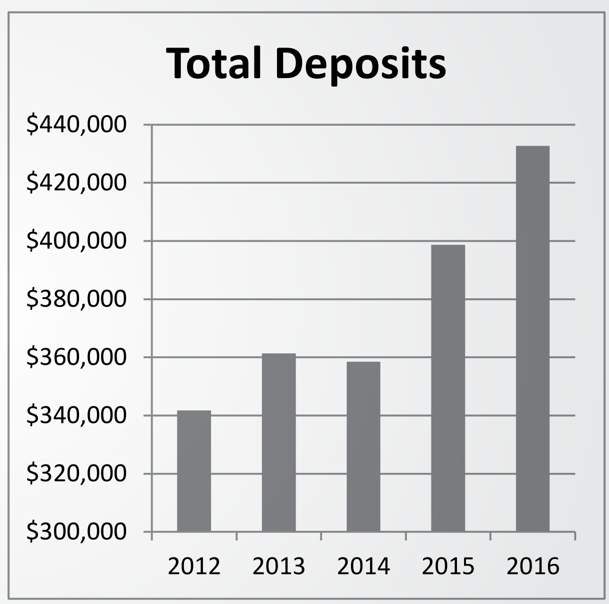
As always, we thank you for your continued business, investment, and support. Bank on a Smile®.

Richard J. Newmaster, Jr.
Chairman

Troy A. Peters
President
Chief Executive Officer

FINANCIAL HIGHLIGHTS

(Dollars in thousands, except per share amounts)	2016	2015	Change
Results of Operations			
Net interest income	16,101	15,406	4.5%
Provision for loan losses	837	588	42.3%
Net income	4,471	4,181	6.9%
Per Share Data			
Basic earnings	1.93	1.80	7.2%
Book value	19.61	18.50	6.0%
Financial Condition at Year-end			
Assets	504,084	482,906	4.4%
Deposits	432,714	398,638	8.5%
Loans Receivable, net	417,028	397,697	4.9%
Allowance for loan loss	5,038	5,034	0.1%
Stockholders' equity	45,541	42,725	6.6%
Financial ratios			
Return on average assets	0.91%	0.92%	-1.1%
Return on average equity	10.02%	9.25%	8.3%
Total capital to risk weighted assets	12.91%	12.73%	1.4%



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, 2016 and 2015, 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, 2016 and 2015, 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.

Smith Elliott Kearns & Company, LLC

Chambersburg, Pennsylvania
February 22, 2017

Balance Sheets

(Dollars in thousands, except per share amounts)	December 31, 2016	December 31, 2015
ASSETS		
Cash and due from banks	$ 3,152	$ 4,354
Interest bearing deposits in other banks	14,081	8,978
Securities available for sale	46,386	48,140
Securities held to maturity, fair value of $865 and $478	863	475
Loans held for sale	385	-
Loans	422,066	402,731
Less allowance for loan losses	5,038	5,034
Net loans	417,028	397,697
Restricted investment in bank stock	1,510	2,194
Foreclosed assets	384	977
Premises and equipment	4,062	3,859
Investment in life insurance	11,281	10,998
Accrued interest receivable	1,286	1,167
Other assets	3,666	4,067
TOTAL ASSETS	$ 504,084	$ 482,906
LIABILITIES		
Deposits:		
Non-interest-bearing	48,051	43,560
Interest-bearing	384,663	355,078
Total deposits	432,714	398,638
Short-term debt	6,000	17,947
Long-term debt	14,274	18,033
Subordinated debt	3,000	3,000
Accrued interest payable and other liabilities	2,555	2,563
TOTAL LIABILITIES	$ 458,543	$ 440,181
STOCKHOLDERS' EQUITY		
Common stock, par value $2.00; 6,000,000 shares authorized; issued and outstanding 2,322,678 and 2,309,878 on December 31, 2016 and December 31, 2015	4,645	4,620
Surplus	4,877	4,678
Retained earnings	36,984	33,995
Accumulated other comprehensive (loss)	(965)	(568)
TOTAL STOCKHOLDERS' EQUITY	$ 45,541	$ 42,725
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	$ 504,084	$ 482,906

Statements of Income

(Dollars in thousands, except per share amounts)	Years Ended December 31, 2016	2015
INTEREST INCOME		
Loans receivables, including fees	$ 17,229	$ 16,443
Securities:		
Taxable	598	500
Tax-exempt	322	253
Other	194	210
Total interest income	$ 18,343	$ 17,406
INTEREST EXPENSE		
Deposits	1,706	1,590
Short-term borrowings	44	-
Interest on subordinated debt	165	24
Long-term debt	327	386
Total interest expense	$ 2,242	$ 2,000
NET INTEREST INCOME	16,101	15,406
Provision for loan losses	837	588
NET INTEREST INCOME AFTER PROVISION FOR LOAN LOSSES	$ 15,264	$ 14,818
OTHER INCOME		
Trust income	324	278
Service charges on deposit accounts	1,633	1,426
Automated teller machine and internet banking fees	235	268
Mortgage banking activities	502	374
Earnings on investment in life insurance	371	332
Gain on sales of investments	117	163
Other	195	156
Total other income	$ 3,377	$ 2,997
OTHER EXPENSE		
Salaries and employee benefits	6,834	6,542
Outsourcing services	1,237	1,028
Occupancy	816	819
Equipment and data processing	528	565
Marketing	296	254
ATM processing fees	433	327
Pennsylvania bank shares tax	349	376
Federal deposit insurance assessment	274	333
Net (gain) loss on foreclosed assets	(15)	46
Other	1,819	1,850
Total other expense	$ 12,571	$ 12,140
Income before income taxes	6,070	5,675
Federal income taxes	1,599	1,494
NET INCOME	$ 4,471	$ 4,181
PREFERRED DIVIDENDS	-	34
NET INCOME AVAILABLE TO COMMON SHAREHOLDERS	4,471	4,147
EARNINGS PER SHARE	$ 1.93	$ 1.80
WEIGHTED-AVERAGE SHARES OUTSTANDING	2,316,599	2,303,861

 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,	
	2016	2015
Net Income	$ 4,471	$ 4,181
Unrealized (losses) on securities:		
Unrealized holding (losses) arising during the year	(562)	(232)
Reclassification adjustment for (gains) realized in net income	(117)	(163)
Tax effect	232	134
Net unrealized (losses) on securities	(447)	(261)
Defined benefit pension plan:		
Change in benefit obligations and plan assets	77	117
Tax effect	(27)	(39)
Net change in defined benefit pension plan	50	78
Other comprehensive (loss)	(397)	(183)
Total comprehensive income	$ 4,074	$ 3,998

Statements of Stockholders' Equity

(Dollars in thousands, except per share amounts) **Years Ended December 31, 2016 and 2015**

	Preferred Stock	Common Stock	Surplus	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total
Balance, December 31, 2014	$ 4,000	$ 3,066	$ 3,678	$ 33,631	$ (385)	$ 43,990
Issuance of common stock through dividend reinvestment plan (8,846 shares)	-	17	171	-	-	188
Repayment of preferred stock	(4,000)	-	-	-	-	(4,000)
Adjustment for stock split	-	1,537	829	(2,366)	-	-
Comprehensive income:						
Net income	-	-	-	4,181	-	4,181
Other comprehensive loss, net of taxes	-	-	-	-	(183)	(183)
Dividends on preferred shares	-	-	-	(34)	-	(34)
Cash dividends declared ($0.61 per share)	-	-	-	(1,417)	-	(1,417)
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)
Dividends on preferred shares	-	-	-	-	-	-
Cash dividends declared ($.64 per share)	-	-	-	(1,482)	-	(1,482)
Balance, December 31, 2016	$ -	$ 4,645	$ 4,877	$ 36,984	$ (965)	$ 45,541

Statements of Cash Flows

(dollars in thousands)	Years Ended December 31, 2016	2015
OPERATING ACTIVITIES		
Net income	$ 4,471	$ 4,181
Adjustments to reconcile net income (loss) to net cash provided by operating activities		
Provision for loan losses	837	588
Provision for depreciation and amortization	538	534
Net amortization of securities premiums and discounts	426	175
Net amortization of deferred loan fees	(630)	8
(Increase) decrease in deferred income taxes	(34)	746
Loss (gain) on disposal of property and equipment	42	(1)
(Gain) on sale of investments	(117)	(163)
(Gain) loss on foreclosed assets	(15)	46
Writedown of other real estate owned	77	36
Charitable donation of other real estate owned	-	24
(Gain) on sale of loans, net	(237)	(177)
Proceeds from sales of loans	12,500	8,933
Loans originated for sale	(12,648)	(8,756)
Earnings on investment in Bank-owned life insurance, net	(283)	(254)
(Decrease) in accrued interest receivable and other assets	(43)	(638)
Decrease in accrued interest payable and other liabilities	507	206
Net cash provided by operating activities	5,391	5,488
INVESTING ACTIVITIES		
Proceeds from maturities and principal repayments		
Securities held to maturity	12	166
Securities available for sale	3,396	6,592
Proceeds from sale of available for sale securities	4,720	5,759
Proceeds from sale of held to maturity securities	-	291
Purchase of securities available for sale	(7,350)	(31,819)
Purchase of securities held to maturity	(400)	-
Net (increase) in loans	(20,361)	(14,238)
Redemption of restricted bank stock	684	256
Purchase of premises and equipment	(657)	(388)
Proceeds from sale of foreclosed assets	1,354	829
Purchase of bank owned life insurance	-	(2,000)
Net cash used for investing activities	(18,602)	(34,552)
FINANCING ACTIVITIES		
Net increase in deposits	34,076	40,135
Net (decrease) in short-term borrowings	(11,947)	(3,514)
Proceeds from subordinated debt	-	3,000
Repayment of long term debt	(3,759)	(1,247)
Proceeds from the issuance of common stock	224	188
Redemption of preferred stock	-	(4,000)
Dividends on preferred stock	-	(34)
Dividends on common stock	(1,482)	(1,417)
Net cash provided by financing activities	17,112	33,111
Increase in cash and cash equivalents	3,901	4,047
CASH AND CASH EQUIVALENTS AT BEGINNING OF YEAR	13,332	9,285
CASH AND CASH EQUIVALENTS AT END OF YEAR	$ 17,233	$ 13,332
Cash paid during the year for:		
Interest	$ 2,240	$ 1,995
Taxes	875	1,150
Noncash investing transactions:		
Loans Transferred to Foreclosed Assets	$ 823	$ 1,240

 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, 2016 and 2015 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, 2016 and 2015, the recorded investment in restricted bank stock is $1,510,000 and $2,194,000, 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 $385,000 loans held for sale at December 31, 2016 and no loans were held for sale in 2015.

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 (including impaired 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. 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. The risk to the Bank is somewhat limited by loan officers using the same underwriting credit criteria as direct financing loans and risk can also be limited if the loan is written with recourse that requires the dealer to purchase the contract back in the event of default, but this is also dependent on the financial condition of the dealership.

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)

<u>Servicing</u>

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.

<u>Foreclosed Assets</u>

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 $593,000 and $712,000 at December 31, 2016 and 2015, respectively. Residential real estate held as other real estate owned and included in foreclosed assets on the balance sheets was $225,000 and $551,000 at December 31, 2016 and 2015, respectively. Commercial real estate and other foreclosed assets were $159,000 and $426,000 at December 31, 2016 and 2015, respectively.

<u>Bank Premises and Equipment</u>

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.

<u>Transfers of Financial Assets</u>

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.

<u>Investment in Life Insurance</u>

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 $33,000 and $37,000 for the years ended December 31, 2016 and 2015, respectively.

<u>Trust Assets</u>

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 $296,000 and $254,000 for the years ended December 31, 2016 and 2015, 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. The bank declared a 3 for 2 stock split in August 2015 payable in September 2015. The outstanding shares before the split were 1,537,004 and after the split were 2,305,506. All per share data was restated to account for this.

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.

1. Summary of Significant Accounting Policies (Continued)

Comprehensive Income (Continued)

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, 2014	$ 458	$ (843)	$ (385)
Change in urealized gains on securities available for sale	(232)	-	(232)
Reclassification adjustment for (gains) realized in net income from sale of available for sale securities (1)	(163)	-	(163)
Change in benefit obligation and plan assets	-	117	117
Tax effect of current period changes (2)	134	(39)	95
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 (3)	232	(27)	205
Balance, December 31, 2016	$ (250)	$ (715)	$ (965)

(1) Gain on sale of investments is included gross on the statements of income.
(2) $55,000 is included in federal income taxes on the statements of income, and the remainder is included in accumulated other comprehensive loss.
(3) $40,000 in included in federal income taxes on the statements of income, and the remainder is included in accumulated other comprehensive loss.

Reclassifications

Certain amounts in the prior year financial statements have been reclassified for comparative purposes to conform to the presentation in the current year financial statements.

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 $ 373,000 at December 31, 2016 and $215,000 at December 31, 2015. 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, 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

December 31, 2015 *(Dollars in 000s)*		Amortized Cost		Gross Unrealized Gains		Gross Unrealized Losses		Fair Value
Available-for-sale securities:								
U.S. government agencies	$	1,988	$	3	$	(1)	$	1,990
Certificates of deposit		2,629		-		-		2,629
Obligations of states and political subdivisions		12,832		338		(11)		13,159
Mortgage-backed securities in government-sponsored entities		30,392		153		(183)		30,362
Total	$	47,841	$	494	$	(195)	$	48,140
Held-to-maturity securities:								
Mortgage-backed securities in government-sponsored entities	$	75	$	3	$	-	$	78
Investment Note Receivable		400		-		-		400
Total	$	475	$	3	$	-	$	478

3. Securities (Continued)

Securities with a fair value of $23,055,000 and $22,856,000 at December 31, 2016 and 2015, respectively, were pledged to secure public deposits and for other purposes as required or permitted by law. Seven securities were sold in 2016 for a gross gain of $117,000. Eighteen securities were sold in 2015 for a gross gain of $163,000.

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, 2016	Available for Sale		Held to Maturity	
(Dollars in 000s)	Amortized Cost	Fair Value	Amortized Cost	Fair Value
Due in one year or less	$ 1,043	$ 1,055	$ -	$ -
Due after one year through five years	5,012	5,104	400	400
Due after five years through ten years	3,477	3,473	400	400
Due after ten years	7,120	6,881	-	-
Mortgage-backed securities in government-sponsored entities	30,113	29,873	63	65
Total	$ 46,765	$ 46,386	$ 863	$ 865

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, 2016 and 2015:

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)

December 31, 2015	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:						
U.S. government agencies	$ 1,172	$ (1)	$ -	$ -	$ 1,172	$ (1)
Obligations of states and political subdivisions	2,160	(11)	-	-	2,160	(11)
Mortgage-backed securities in government-sponsored entites	19,755	(182)	30	(1)	19,785	(183)
Total	$ 23,087	$ (194)	$ 30	$ (1)	$ 23,117	$ (195)

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, 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%. 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, 2015, the Bank had 25 securities in a loss position and only one security that was at a loss of more than 1% of amortized cost. The loss on this security was 2.63%.

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:

	December 31,	
(Dollars in 000s)	2016	2015
Commercial	$ 52,334	$ 48,576
Commercial real estate	82,433	75,700
Commercial real estate contruction	6,202	10,696
Secured by residential real estate	142,337	134,981
Home equity lines of credit	62,235	58,590
Consumer - indirect automobile financing	62,845	60,153
Consumer - other	13,680	14,035
Gross loans	422,066	402,731
Less allowance for loan losses	(5,038)	(5,034)
Net loans	$ 417,028	$ 397,697

Net deferred costs included in the table above total $1,614,000 and $984,000 as of December 31, 2016 and 2015, 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. Two qualitative factors comprise 65% of the 2016 qualitative reserves and they are the unemployment rate and trends in delinquencies. Both factors increased slightly during 2016 and accounted for most of the $254,000 increase in the qualitative reserve from 2015. This increase was mostly offset by decreases in the specific reserves for impaired loans and the general reserve which is based on historical losses.

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 $5,038,000 adequate to cover loan losses inherent in the loan portfolio at December 31, 2016. The following table presents, by portfolio segment, the allowance for loan losses for the years ended December 31:

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	Not allocated	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

5. Allowance for Loan Losses (Continued)

As of December 31, 2015								
(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	$ 483	$ 1,086	$ 1,458	$ 610	$ 1,100	$ 275	$ 28	$ 5,040
Charge-offs	-	-	(181)	(22)	(728)	(235)	-	$ (1,166)
Recoveries	1	272	5	-	213	81	-	$ 572
Provision	64	(374)	100	57	515	193	33	$ 588
Ending Balance	$ 548	$ 984	$ 1,382	$ 645	$ 1,100	$ 314	$ 61	$ 5,034
Ending balance: individually evaluated for impairment	$ 9	$ 3	$ 94	$ -	$ 118	$ 39	$ -	$ 263
Ending balance: collectively evaluated for impairment	$ 539	$ 981	$ 1,288	$ 645	$ 982	$ 275	$ 61	$ 4,771
Financing receivables:								
Ending balance, net of fees	$ 48,576	$ 86,396	$ 134,981	$ 58,590	$ 60,153	$ 14,035		$ 402,731
Ending balance: individually evaluated for impairment	$ 378	$ 6,022	$ 3,869	$ 294	$ 466	$ 163		$ 11,192
Ending balance: collectively evaluated for impairment	$ 48,198	$ 80,374	$ 131,112	$ 58,296	$ 59,687	$ 13,872		$ 391,539

Credit Quality Information

The following tables represent credit exposures by internally assigned grades for the years ended December 31, 2016 and 2015. The grading analysis estimates the capability of the borrower to repay the contractual obligations of the loan agreements as scheduled or at all. The 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, 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

As of December 31, 2015

(Dollars in 000s)	Commercial	Commercial Real Estate	Commercial Real Estate Construction
Pass	$ 45,261	$ 68,928	$ 6,320
Special Mention	510	2,376	693
Substandard	2,805	4,396	3,683
Doubtful	-	-	-
Loss	-	-	-
Ending Balance	$ 48,576	$ 75,700	$ 10,696

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

As of December 31, 2015

(Dollars in 000s)	Secured by Residential Real Estate	Home Equity Lines of Credit	Indirect Automobile Financing	Other Consumer Loans
Performing	$ 132,683	$ 58,405	$ 60,097	$ 13,991
Nonperforming	2,298	185	56	44
Total	$ 134,981	$ 58,590	$ 60,153	$ 14,035

5. Allowance for Loan Losses (Continued)

Credit Quality Information (Continued)

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

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

As of December 31, 2015							
(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	$ 40	$ 1	$ -	$ 41	$ 48,535	$ 48,576	$ -
Commercial real estate	320	-	807	1,127	74,573	75,700	-
Commercial real estate construction	-	-	-	-	10,696	10,696	-
Secured by residential real estate	1,276	591	2,298	4,165	130,816	134,981	70
Home equity lines of credit	281	40	185	506	58,084	58,590	-
Consumer - indirect automobile financing	684	142	56	882	59,271	60,153	56
Consumer - other	88	23	44	155	13,880	14,035	26
Total	$ 2,689	$ 797	$ 3,390	$ 6,876	$ 395,855	$ 402,731	$ 152

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)

<u>Impaired Loans</u> (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, 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)

Impaired Loans (Continued)

As of and for the year ended December 31, 2015					
(Dollars in 000s)	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Interest Income Recognized
With no related allowance recorded:					
Commercial	$ 263	$ 263	$ -	$ 270	$ 6
Commercial real estate	3,759	4,263	-	3,874	28
Commercial real estate construction	2,198	2,352	-	2,332	59
Secured by residential real estate	2,634	2,655	-	2,689	70
Home equity lines of credit	294	294	-	284	10
Consumer - other	29	29	-	32	1
Subtotal	$ 9,177	$ 9,856	$ -	$ 9,481	$ 174
With an allowance recorded:					
Commercial	115	115	9	108	1
Commercial real estate	65	68	3	72	2
Secured by residential real estate	1,235	1,335	94	1,270	31
Consumer - other	600	588	157	657	42
Subtotal	$ 2,015	$ 2,106	$ 263	$ 2,107	$ 76
Commercial	378	378	9	378	7
Commercial real estate	3,824	4,331	3	3,946	30
Commercial real estate construction	2,198	2,352	-	2,332	59
Secured by residential real estate	3,869	3,990	94	3,959	101
Home equity lines of credit	294	294	-	284	10
Consumer - other	629	617	157	689	43
Total	$ 11,192	$ 11,962	$ 263	$ 11,588	$ 250

Nonaccrual Loans

Commercial Loans are placed on nonaccrual upon 90 days delinquency and residential loans are placed on nonaccrual after 120 days. 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, 2016 and 2015. The balances are presented by class of financing receivable.

(Dollars in 000s)	As of December 31, 2016	As of December 31, 2015
Commercial	$ 139	$ -
Commercial real estate	2,791	1,410
Secured by residential real estate	2,386	2,696
Home equity lines of credit	299	226
Consumer - other	44	18
Total	$ 5,659	$ 4,350

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, 2016 and 2015, were as follows:

(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

(Dollars in 000s)	Number of Contracts	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment
2015			
Troubled debt restructurings:			
Commercial	3	$ 73	$ 73
Secured by residential real estate	6	635	668
Consumer	25	451	448
Total	34	$ 1,159	$ 1,189

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 2016 and 2015 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 2016 or 2015.

6. Mortgage Servicing

The Bank entered into agreements to sell residential mortgages to the FHLB of Pittsburgh. The total amount of loans sold under these agreements was $200,733,000 and $188,665,000 as of December 31, 2016 and 2015, respectively. 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 $80,717,000 and $79,628,000 at December 31, 2016 and 2015, 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 $261,000 and $279,000 at December 31, 2016 and 2015. Mortgage servicing fee income for the years ended December 31, 2016 and 2015 was $103,000 and $106,000, respectively, which is included in mortgage banking activities in the statements of income.

The following summarizes mortgage servicing rights capitalized and amortized:

(Dollars in 000s)	Years Ended December 31, 2016	2015
Mortgage servicing rights capitalized	$ 95	$ 53
Mortgage servicing rights amortized	(113)	(122)
Net change	$ (18)	$ (69)

7. Bank Premises and Equipment

Components of Bank premises and equipment are as follows:

(Dollars in 000s)	December 31, 2016	2015
Land and improvements	$ 456	$ 456
Buildings	5,357	5,372
Furniture and equipment	2,714	2,706
Contruction in progress	358	-
Total premises and equipment	$ 8,885	$ 8,534
Less accumulated depreciation	(4,823)	(4,675)
Net premises and equipment	$ 4,062	$ 3,859

Depreciation expense for the years ended December 31, 2016 and 2015 was approximately $425,000 and $412,000, 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 $249,000 and $218,000 for years ended December 31, 2016 and 2015 respectively. Future minimum rental commitments under these leases are as follows:

(Dollars in 000s)		Years Ending December 31,
2017	$	197
2018		193
2019		150
2020		153
2021		157
Thereafter		1,075
Total	$	1,925

The bank entered in an agreement on October 7, 2016 with a contractor to build a new bank branch for $1,260,000 in Manheim, Pennsylvania, of which $252,000 had been paid at December 31, 2016. It is expected to be completed by June of 2017.

8. Deposits

The composition of deposits is as follows:

(Dollars in 000s)		December 31, 2016		2015
Demand, non-interest-bearing	$	48,051	$	43,560
Checking with interest and money market		198,755		173,071
Savings		41,159		38,778
Time deposits greater then $250,000		16,971		10,020
Other time deposits		127,778		133,209
Total	$	432,714	$	398,638

At December 31, 2016, the scheduled maturities of time deposits are as follows:

(Dollars in 000s)		Years Ended December 31,
2017	$	76,716
2018		25,316
2019		17,168
2020		14,691
2021		10,858
Total	$	144,749

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 $202,000 in 2016 and $191,000 in 2015.

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, 2016 and 2015.

(Dollars in 000s)	December 31, 2016	2015
Change in benefit obligation		
Benefit obligation at beginning of year	$ 3,859	$ 4,106
Interest cost	165	160
Actuarial (gain)	(15)	(347)
Benefits paid	(79)	(60)
Settlements	(107)	-
Benefit obligation at end of year	3,823	3,859
Change in plan assets		
Fair value of plan assets at beginning of year	3,156	2,965
Employer contribution	450	350
Actual return on plan assets	215	(98)
Benefits paid	(79)	(61)
Settlements	(107)	-
Fair value of plan assets at end of year	3,635	3,156
Funded status (Included in other liabilities)	$ (188)	$ (703)
Amounts recognized in accumulated other comprehensive income (loss) consist of:		
Net acturial loss	$ (1,085)	$ (1,162)
Deferred tax benefit	370	397
Total	$ (715)	$ (765)

9. Employee Benefits (Continued)

Net periodic pension expense included the following components:

(Dollars in 000s)	Years Ended December 31, 2016	2015
Interest cost	$ 165	$ 160
Expected return on plan assets	(217)	(204)
Net amortization and deferral	64	72
Net periodic pension expense	$ 12	$ 28

The accumulated benefit obligation was $3,823,000 and $3,859,000 at December 31, 2016 and 2015 respectively.

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

	December 31, 2016	2015
Discount rate	4.14%	4.34%
Expected long-term return on Plan assets	7.00%	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 $60,000.

The selected long-term rate of return on Plan assets (7.0 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, 2016	2015
Equities	65%	60%
Fixed income	35%	39%
Other	0%	1%
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:

(Dollars in 000s)	As of December 31, 2016 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

(Dollars in 000s)	As of December 31, 2015 Level I	Level II	Level III	Total
Assets:				
Mutual funds:				
Equities				
Large-Cap Value	$ 173	$ -	$ -	$ 173
Large-Cap Core	243	-	-	243
Mid-Cap Core	216	-	-	216
Small-Cap Core	104	-	-	104
International Core	496	-	-	496
Large Cap Growth	375	-	-	375
Small-Cap Growth	110	-	-	110
Fixed income				
Fixed Income- US Core	915	-	-	915
Intermediate Duration	304	-	-	304
Other	-	166	-	166
Cash Equivalent	54	-	-	54
Total assets at fair value	$ 2,990	$ 166	$ -	$ 3,156

9. Employee Benefits (Continued)

The Bank expects to contribute $100,000 to its pension plan in 2017.

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

(Dollars in 000s)	Years Ended December 31,
2017	$ 110
2018	114
2019	113
2020	117
2021	127
2022 - 2026	970
	$ 1,551

10. Borrowed Funds

The Bank has available a $25 million line with the FHLB of Pittsburgh. This line expires in February 2017. The interest rate on this line was 0.74 percent at December 31, 2016, and 0.43 percent at December 31, 2015. The outstanding balance under this line as of December 31, 2016 and 2015 was $6,000,000 and $17,947,000 respectively. The bank also has an unsecured $3 million line with the Atlantic Community Bankers Bank (ACBB), which was not used in 2016 or 2015. 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**	**2016**	**2015**
October 2016	(Non-amortizing)	0.94	-	3,500
July 2017	(Non-amortizing)	1.39	5,300	5,300
July 2018	(Non-amortizing)	1.81	7,000	7,000
May 2023	(Amortizing	4.57	1,280	1,448
May 2023	(Amortizing)	4.68	694	785
November 2025 subordinated debt		5.50	3,000	3,000
(requires $150,000 quarterly payments beginning in November 2020)				
			$ 17,274	$ 21,033

10. Borrowed Funds (Continued)

The following table represents maturities/repayments of the remaining FHLB advances at December 31, 2016 and subordinated debt:

(Dollars in 000s)		Amount
2017		5,571
2018		7,283
2019		297
2020		461
2021		926
Thereafter		2,736
Total	$	17,274

Borrowings from the FHLB are collateralized by certain qualifying assets of the Bank with an approximate value of $169,680,000 at December 31, 2016. The Bank has a maximum borrowing capacity with the FHLB of approximately $169,680,000 of which $26,774,000 is outstanding which includes a $6,500,000 letter of credit issued to a municipality to secure deposits.

11. Short-Term Borrowings

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:

	As of and for the Years Ended December 31,			
(Dollars in 000s)		2016		2015
Balance at year-end	$	6,000	$	17,947
Average balance outstanding during the year		6,434		9,551
Maximum amount outstanding at any month-end		27,968		17,947
Weighted-average interest rate:				
As of year-end		0.74 %		0.43 %
Paid during the year		0.56 %		0.35 %

12. Preferred Stock

Small Business Lending Fund

On August 16, 2011, the Company received $4 million from the Small Business Lending Fund ("SBLF"). The SBLF is a voluntary program sponsored by the U.S. Treasury that encourages small business lending by providing capital to qualified community banks at favorable rates. The initial interest rate on the SBLF funds was 5 percent and have been decreased to as low as 1 percent because growth thresholds were met for outstanding small business loans. The Bank paid a 1 percent dividend for 2015. On November 6, 2015 all of this preferred stock was paid back to the U.S. Treasury.

13. 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, 2016 is as follows:

Balance at December 31, 2015	Additions	Amount Collected	Balance at December 31, 2016
$2,457,000	$1,042,000	$737,000	$2,762,000

Deposits to related parties totaled $6,328,000 and $5,273,000 as of December 31, 2016 and 2015 respectively.

14. 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, 2016 and 2015.

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

(Dollars in 000s)	December 31, 2016	December 31, 2015
Commitments to extend credit	$ 8,538	$ 14,698
Unfunded commitments	80,421	73,848
Standby letters of credit	6,712	6,708
Total	$ 95,671	$ 95,254

15. Income Taxes

The provision for federal income taxes consisted of the following:

(Dollars in 000s)	Years Ended December 31, 2016	2015
Current	$ 1,428	$ 652
Deferred	171	842
Total	$ 1,599	$ 1,494

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)	2016 Amount	2016 % of Pretax Income	2015 Amount	2015 % of Pretax Income
Provision at statutory rate	$ 2,064	34.0 %	$ 1,929	34.0 %
Tax exempt interest, net	(373)	(6.2)	(321)	(5.6)
Life insurance	(85)	(1.4)	(74)	(1.3)
Other, net	(7)	(0.1)	(40)	(0.7)
Actual tax expense and effective rate	$ 1,599	26.3 %	$ 1,494	26.4 %

Net deferred tax assets consisted of the following components:

(Dollars in 000s)	As of December 31, 2016	2015
Deferred tax assets:		
Allowance for loan losses	$ 1,389	$ 1,324
Other pension adjustments	369	395
Nonaccrual loan interest	167	172
Net unrealized loss on securities	129	-
Deferred loan fees	88	53
Deferred gains from sale of assets	83	83
Other	49	24
Total deferred tax assets	2,274	2,051
Deferred tax liabilities:		
Net unrealized gain on securities	-	(102)
Accrued pension	(305)	(156)
Premises and equipment	(571)	(605)
Deferred loan fees costs	(754)	(559)
Mortgage servicing rights	(89)	(95)
Prepaid expenses	(100)	(113)
Total deferred tax liabilities	(1,819)	(1,630)
Net deferred tax assets	$ 455	$ 421

16. 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.

17. 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, 2016, that the Bank meets all capital adequacy requirements to which it is subject.

As of December 31, 2016, 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:

	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)						
2016	$ 54,584	12.91 %	$ 33,828	8.00 %	$ 42,285	10.00 %
2015	$ 51,334	12.73 %	$ 32,262	8.00 %	$ 40,328	10.00 %
Tier I capital (to risk-weighted assets)						
2016	$ 46,506	11.00 %	$ 25,371	6.00 %	$ 33,828	8.00 %
2015	$ 43,293	10.74 %	$ 24,197	6.00 %	$ 32,262	8.00 %
Tier I capital (to average assets)						
2016	$ 46,506	9.41 %	$ 19,769	4.00 %	$ 24,711	5.00 %
2015	$ 43,293	9.24 %	$ 18,741	4.00 %	$ 23,426	5.00 %
Common equity tier one capital (to risk-weighted assets)						
2016	$ 46,506	11.00 %	$ 19,028	4.50 %	$ 27,485	6.50 %
2015	$ 43,293	10.74 %	$ 18,148	4.50 %	$ 26,213	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, 2016, $36,984,000 of retained earnings was available for dividend declaration without prior regulatory approval, subject to the above regulatory capital requirements.

18. Fair Value

Management has established a fair value hierarchy that prioritizes the inputs to valuation methods used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level I measurements) and the lowest priority to unobservable inputs (Level III measurements). The three levels of the fair value hierarchy are as follows:

Level I: Unadjusted quoted prices in active markets that are accessible at the measurement date for identical, unrestricted assets, or liabilities.

Level II: Quoted prices in markets that are not active, or inputs that are observable either directly or indirectly, for substantially the full term of the asset or liability.

Level III: Prices or valuation techniques that require inputs that are both significant to the fair value measurement and unobservable (i.e., supported with little or no market activity).

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, 2016 and 2015 are as follows:

	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:				
Certificates of deposit	$ -	$ 2,632	$ -	$ 2,632
U.S. government agencies	-	1,000	-	1,000
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

	As of December 31, 2015			
(Dollars in 000s)	Level I	Level II	Level III	Total
Assets measured on a recurring basis:				
Available-for-sale securities:				
Certificates of deposit	$	2,629	$	$ 2,629
U.S. government agencies	-	1,990	-	1,990
Obligations of states and political subdivisions	-	13,159	-	13,159
Mortgage-backed securities in government-sponsored entities		30,362	-	30,362
Total	$ -	$ 48,140	$ -	$ 48,140

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.

18. Fair Value (Continued)

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.

Other Real Estate Owned

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 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 three OREO properties with write-downs during the year ended December 31, 2016 and one with a write-down during the year ended December 31, 2015.

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 $150,000 and $263,000 at December 31, 2016 and 2015, respectively.

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). There were no loans held for sale as of December 31, 2015.

18. 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, 2016 and 2015 are as follows:

	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)

	As of December 31, 2015				
(Dollars in 000s)	Level I	Level II	Level III	Total	**Gain\(Losses)**
Impaired loans	$ -	$ -	$ 1,752	$ 1,752	$ -
Other real estate owned	-	-	916	916	(35)
Total	$ -	$ -	$ 2,668	$ 2,668	$ (35)

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, 2016			
(Dollars in 000s)	**Fair Value**	**Valuation Techniques**	**Unobservable Input**	**Range**
Impaired Loans	661	Appraised collateral values	Discount for time since appraisal	0-30%
		and discounted cash flows	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

	As of December 31, 2015			
(Dollars in 000s)	**Fair Value**	**Valuation Techniques**	**Unobservable Input**	**Range**
Impaired Loans	1,752	Appraised collateral values	Discount for time since appraisal	0-30%
		and discounted cash flows	Selling costs	0-6%
			Holding period	0-60 months
Other real estate owned	916	Appraised collateral values	Selling costs	0-6%
			Holding period	0-48 months

19. 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, 2016 and 2015.

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 debit
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.

19. Fair Values of Financial Instruments (Continued)

The estimated fair values of the Bank's financial instruments were as follows at December 31, 2016 and 2015:

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

		2015	
(Dollars in 000s)		Carrying Amount	Fair Value
Financial assets:			
Cash and due from banks	$	4,354	4,354
Interest Bearing Balnces with other Banks		8,978	8,978
Available-for-sale securities		48,140	48,140
Held-to-maturity securities		475	478
Net loans		397,697	407,641
Accrued interest receivable and dealer reserve		2,666	2,666
Restricted investment in Bank stock		2,194	2,194
Mortgage servicing rights		279	613
Financial liabilities:			
Deposits	$	398,638	398,836
Short-term debt		17,947	17,949
Long-term debt		21,033	22,152
Accrued interest payable		124	124

20. 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.

21. Subsequent Events

Management has reviewed events occurring through February 22, 2017, the date the financial statements were available to be issued and one subsequent event occurred requiring disclosure. The Bank purchased land in Manheim, Pennsylvania for a new branch location for $1,500,000 on January 20, 2017. No other subsequent events occurred requiring recognition in the financial statements.

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Breaking Ground at the Manheim Location

From left: Eric A. Trainer, Director; Jeffrey L. Bohn, Vice Chairman of the Board; Edward L. Anspach, Second Vice Chairman and Secretary of the Board; Glenn T. Wenger, Director; Troy A. Peters, President and CEO; Brian R. Miller, Director; Timothy D. Gingrich, Vice President of Operations; Richard J. Newmaster Jr., Chairman of the Board; Richard M. Rollman, Vice President of Lending; DeeAnn D. Carpenter, Commercial Lender and Manheim Branch Manager; C. William Roth, CFO; Sallie A. Neuin, Director; and Terry L. Resanovich, Vice President and Senior Trust Officer of JBT Financial Services.

Architect's Rendering of the Manheim Office

The new office will be completed in late spring of 2017 at Penn Towne Center on Route 72, located next to the new Sheetz store already in business. This milestone was marked by an official Groundbreaking Ceremony held Monday, December 12, 2016, at the site of the new branch. This is JBT's thirteenth community office, and its second full-service banking location in Lancaster County.

Jonestown
2 West Market Street
P.O. Box 717
Jonestown, PA 17038
717-865-2112

Investor Relations
717-865-4246

Grantville
10103 Jonestown Road
P.O. Box 180
Grantville, PA 17028
717-469-0623

Ebenezer
1725 Route 72 North
Lebanon, PA 17046
717-274-5421

Lebanon
122 Bowman Street
Lebanon, PA 17046
717-273-0405

Newmanstown
25 East Main Street
Newmanstown, PA 17073
610-589-1234

Cleona
421 East Penn Avenue
Cleona, PA 17042
717-279-7655

Quentin Road
1765 Quentin Road
Lebanon, PA 17042
717-279-7720

Palmyra
2 East Main Street
Palmyra, PA 17078
717-641-0032

Northside Commons
101 Northside Commons
Palmyra, PA 17078
717-838-2265

Ephrata
1001 Sharp Avenue
Ephrata, PA 17522
717-733-5281

Cornwall Manor
1 Boyd Street
P.O. Box 125
Cornwall, PA 17016
717-769-2818

Lebanon Valley
Brethren Home
1200 Grubb Rd.
Palmyra, PA 17078
717-838-7000

Manheim *(Coming Soon)*
1211 Lancaster Rd.
Manheim, PA 17545

bankjbt.com