Northumberland Bancorp

Consolidated Financial Statements

December 31, 2018 and 2017

Northumberland Bancorp

Contents

Northumberland Bancorp

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April 23, 2019

To our Stockholders:

I am happy to report two major of successes for Northumberland Bancorp (Company) in 2018 and The Northumberland National Bank (Bank). First, the Company experienced strong growth in assets and earnings during the year, as we continue to execute our growth strategy. The Office of the Comptroller of the Currency (OCC) terminated its Consent Order for the Bank. Both of these accomplishments are detailed below.

Total assets grew 5.2% to $534,261,000. Growth was driven by loans, which grew 8.8% to $349,723,000. This growth was funded primarily by growth in deposits of $24,131,000 which was an increase of 5.3% from the prior year.

Net income increased 48.8% to $2,931,000 in 2018 from $1,970,000 in 2017. The Company benefits from a lower tax rate due to recent tax legislation. Other factors affecting income were as follows: Net interest income grew $847,000. The Bank's tax equivalent net interest margin increased to 3.17% in 2018 from 3.11% in 2017. The provision for loan losses increased $229,000 to give effect to increases in the portfolio. Non-interest income increased by $60,000, which resulted from an increase in trust service income offset by a decline in the gain on sale of loans due to lower volume in 2018. Non-interest expense increased $461,000, primarily due to increased salaries and benefits, as well as, continued expenses associated with the Consent Order.

The Company and the Bank continue to be well capitalized. Tier One Capital of the Bank was 10.09%, compared to 10.32% in 2017. Common Equity Tier One Capital, Tier One Risk Based Capital and Total Risked based capital were 17.03%, 17.03% and 18.04%, compared to the same ratios in 2017 of 18.31%, 18.31% and 19.34%, respectively. The decline reflects the growth of the Bank coupled with the growth in the commercial and residential real estate loan portfolio. Past due loans increased to $4,254,000 or 1.21% in 2018, compared to $3,756,000 or 1.16% in 2017, and remains at a very low level.

The Bank had operated under the Consent Order since May 5, 2016. The OCC terminated the Consent Order on August 18, 2018. Also the Company received notice from the Federal Reserve Bank of Philadelphia (FRB) that they had no objection to the Company terminating the resolution that the Company was previously required to adopt. See Note 2 for a more in depth discussion of these matters.

The Company continues to enhance its electronic delivery channels. In 2018, we implemented DirectLink Merchant (a remote deposit product for business); a new debit card plastic look; additional images to our mobile banking product; the ability to add payees to bill payment on mobile banking; and enhanced statement rendering capabilities. In addition, we began the migrations of our individual servers to a virtual server configuration. In 2019, we plan the following initiatives: Zelle (a person to person payment system), business bill pay, and positive pay.

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

J. Donald Steele Jr.

J. Donald Steele, Jr.
Chairman and President

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Independent Auditor's Report

Board of Directors and Stockholders
Northumberland Bancorp
Northumberland, Pennsylvania

Report on the Financial Statements

We have audited the accompanying consolidated financial statements of Northumberland Bancorp and subsidiary, which comprise the consolidated balance sheets as of December 31, 2018 and 2017, and the related consolidated statements of income, comprehensive income, stockholders' equity, and cash flows for the years then ended, and the related notes to the consolidated financial statements.

Management's Responsibility for the Financial Statements

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

Auditor's Responsibility

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

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

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

Opinion

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

BDO USA, LLP

Harrisburg, Pennsylvania
April 23, 2019

Consolidated Financial Statements

Northumberland Bancorp

Consolidated Balance Sheets

(amounts in thousands except share and per share data)

December 31,	**2018**	2017
Assets		
Cash and due from banks	$ 6,171	$ 5,619
Interest-bearing deposits in other banks	5,733	7,928
Total cash and cash equivalents	11,904	13,547
Investment securities available-for-sale	142,921	144,923
Investment securities held-to-maturity (fair value of $1,851 in 2018 2018 and $648 in 2017)	1,849	650
Equity securities	183	202
Total investment securities	144,953	145,775
Restricted stock, at cost	3,599	3,806
Loans held for sale	2,414	1,353
Loans	349,723	321,516
Less allowance for loan losses	3,163	2,910
Net loans	346,560	318,606
Premises and equipment	9,123	9,361
Bank-owned life insurance	11,523	11,237
Accrued interest and other assets	4,185	4,204
Total Assets	$ 534,261	$ 507,889
Liabilities and Stockholders' Equity		
Liabilities		
Deposits:		
Noninterest-bearing demand	$ 89,761	$ 78,221
Interest-bearing demand	157,866	164,393
Savings	83,192	82,661
Time deposits	146,688	128,101
Total deposits	477,507	453,376
Short-term borrowings	3,175	3,000
Accrued interest and other liabilities	1,876	2,645
Total Liabilities	482,558	459,021
Stockholders' Equity		
Common stock, par value $0.10; 5,000,000 shares authorized, 1,502,500 shares issued and 1,327,858 shares outstanding in 2018, and 1,502,500 shares issued and 1,328,358 outstanding in 2017	150	150
Capital surplus	3,832	3,832
Retained earnings	52,304	50,304
Accumulated other comprehensive loss	(2,269)	(3,118)
Treasury stock, at cost (174,642 shares in 2018 and 174,142 in 2017)	(2,265)	(2,248)
Total Northumberland Bancorp stockholders' equity	51,752	48,920
Non-controlling interest	(49)	(52)
Total Stockholders' Equity	51,703	48,868
Total Liabilities and Stockholders' Equity	$ 534,261	$ 507,889

Northumberland Bancorp

Consolidated Statements of Income

(amounts in thousands except share and per share data)

Years Ended December 31,		**2018**		2017
Interest and Dividend Income				
Interest and fees on loans:				
Taxable	$	15,059	$	13,601
Tax-exempt		268		264
Interest on interest-bearing deposits in other banks		176		103
Interest and dividends on investment securities:				
Taxable		2,121		1,736
Tax-exempt		879		991
Dividends		242		176
Total Interest and Dividend Income		18,745		16,871
Interest Expense				
Deposits		3,855		2,832
Short-term borrowings		11		7
Total Interest Expense		3,866		2,839
Net interest income		14,879		14,032
Provision for Loan Losses		456		227
Net Interest Income After Provision for Loan Losses		14,423		13,805
Noninterest Income				
Service charges on deposit accounts		1,165		1,125
Trust services income		770		674
Investment securities losses, net		(14)		(31)
Gains on sales of loans		464		633
Earnings on bank-owned life insurance		286		268
Change in fair value of equity securities		(19)		-
Other income		887		810
Total Noninterest Income		3,539		3,479
Noninterest Expense				
Salaries and employee benefits		8,055		7,331
Occupancy expense, net		778		790
Equipment expense		982		937
Professional fees		961		1,058
Data processing		960		913
Shares tax		372		435
Federal deposit insurance expense		225		289
Reimbursements to customers		18		227
Other expense		2,255		2,165
Total Noninterest Expense		14,606		14,145
Income before income taxes		3,356		3,139
Income Taxes		422		1,163
Net Income		2,934		1,976
Net income attributable to non-controlling interest		3		6
Net Income Attributable to Northumberland Bancorp	$	2,931	$	1,970
Earnings Per Share	$	2.21	$	1.48
Weighted-Average Shares Outstanding		1,328,203		1,328,358

Northumberland Bancorp

Consolidated Statements of Comprehensive Income

(amounts in thousands)

Years Ended December 31,		**2018**		2017
Net Income	**$**	2,934	$	1,976
Other Comprehensive Income / (Loss)				
Change in unrealized holding gains/(losses) on investment securities available-for-sale		(703)		176
Tax effect		147		(60)
Reclassification adjustment for investment securities losses recognized in net income		14		31
Tax effect		(3)		(10)
Change in unrecognized pension costs		(110)		(211)
Tax effect		23		72
Reclassification adjustment for pension costs		1,925		-
Tax effect		(405)		-
Other Comprehensive Income/(Loss), Net of Tax		888		(2)
Comprehensive income before non-controlling interest		3,822		1,974
Less: net income attributable to non-controlling interest		3		6
Comprehensive Income	**$**	3,819	$	1,968

Northumberland Bancorp

Consolidated Statements of Stockholders' Equity

(amounts in thousands excepts share and per share data)

	Common Stock	Capital Surplus	Retained Earnings	Accumulated Other Comprehensive Loss	Treasury Stock	Non-controlling Interest	Total
Balance, December 31, 2016	$ 150	$ 3,832	$ 48,778	$ (2,603)	$ (2,248)	$ (58)	$ 47,851
Net income	-	-	1,970	-	-	6	1,976
Other comprehensive loss	-	-	-	(2)	-	-	(2)
Reclassification of Certain Tax Effects	-	-	513	(513)	-	-	-
Dividends declared ($0.68 per share)	-	-	(957)	-	-	-	(957)
Balance, December 31, 2017	150	3,832	50,304	(3,118)	(2,248)	(52)	48,868
Net income	-	-	2,931	-	-	3	2,934
Other comprehensive income	-	-	-	888	-	-	888
Cumulative adjustment for fair value of equity securities	-	-	39	(39)	-	-	-
Dividends declared ($0.73 per share)	-	-	(970)	-	-	-	(970)
Purchase of treasury stock shares (500 shares)	-	-	-	-	(17)	-	(17)
Balance, December 31, 2018	$ 150	$ 3,832	$ 52,304	$ (2,269)	$ (2,265)	$ (49)	$ 51,703

See accompanying notes to consolidated financial statements.

Northumberland Bancorp

Consolidated Statements of Cash Flows
(amounts in thousands)

Years Ended December 31,	**2018**	2017
Cash Flows from Operating Activities		
Net income	$ 2,934	$ 1,976
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for loan losses	456	227
Depreciation, amortization, and accretion, net	1,678	1,714
Proceeds from sales of loans held for sale	17,485	22,194
Gains on sales of loans	(464)	(633)
Originations of residential loans held for sale	(18,081)	(21,422)
Investment securities losses, net	14	31
Deferred income tax (benefit)/expense	(48)	276
Earnings on bank-owned life insurance	(286)	(268)
Write-down of other real estate owned	71	-
Increase in accrued interest receivable	(107)	(185)
Decrease in accrued interest payable	30	13
Other, net	1,340	1,308
Net Cash Provided by Operating Activities	5,022	5,231
Cash Flows from Investing Activities		
Investment securities available-for-sale:		
Proceeds from sales	3,192	14,483
Proceeds from maturities or redemptions	24,986	20,807
Purchases	(27,875)	(31,617)
Investment securities held-to-maturity:		
Proceeds from maturities or redemptions	402	1,015
Purchases	(1,612)	-
Increase in loans, net	(28,938)	(21,460)
Purchases of premises and equipment, net	(346)	(204)
Purchases of restricted stock	(515)	(528)
Redemptions of restricted stock	722	227
Purchase of bank-owned life insurance	-	(1,444)
Net Cash Used in Investing Activities	(29,984)	(18,721)
Cash Flows from Financing Activities		
Net increase in deposits	24,131	10,746
Net increase in short-term borrowed funds	175	3,000
Cash dividends paid	(970)	(957)
Purchase of treasury stock	(17)	-
Net Cash Provided by Financing Activities	23,319	12,789
Decrease in cash and cash equivalents	(1,643)	(701)
Cash and Cash Equivalents, Beginning Of Year	13,547	14,248
Cash and Cash Equivalents, End Of Year	$ 11,904	$ 13,547

1. Summary of Significant Accounting Policies

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

Nature of Operations and Basis of Presentation

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

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

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

Investment Securities

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

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

In January 2016, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2016-01, Recognition and measurement of Financial Assets and Liabilities. This standard requires several changes including that equity investments are to be measured at fair value, with changes in fair value measured in net income. This standard also requires public business entities to use the exit price notion when measuring the fair value of financial instruments for disclosure purposes. The Company adopted ASU 2016-01 on January 1, 2018, and it had no material impact on the Consolidated Financial Statements. The Company reclassified the fair value of equity securities by increasing Retained Earnings by $39,000 and decreasing Accumulated Other Comprehensive Income by the same amount.

Federal Home Loan Bank Stock

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

Loans Held for Sale and Loans Serviced

Loans held for sale are carried at the lower of cost or fair value, as determined on an aggregate basis. Gains and losses on sales of loans held for sale are recognized on settlement dates and are determined by the difference between the sale proceeds and the carrying value of loans. All sales are made with limited recourse. Loans held for sale were $2,414,000 and $1,353,000 at December 31, 2018 and 2017, respectively. At December 31, 2018 and 2017, the amounts of loans serviced by the Company for the benefit of others were $126,403,000 and $128,121,000, respectively. These loans are not included in the Company’s consolidated balance sheet.

Mortgage Servicing Rights ("MSRs")

The Company has agreements for the express purpose of selling loans in the secondary market. The Company maintains servicing rights for certain loans. Originated MSRs are recorded by allocating total costs incurred between the loan and servicing rights based on their relative fair values. MSRs are amortized in proportion to the estimated servicing income over the estimated life of the servicing portfolio. Annually, the Company performs an impairment review of the MSRs and recognizes impairment through a valuation account. No impairment was recognized in 2018 or 2017. MSRs are a component of other assets on the consolidated balance sheets. The balance of loan servicing assets was $688,000 and $831,000 at December 31, 2018 and 2017, respectively.

Loans

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

Allowance for Loan Losses

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

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

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

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

Premises and Equipment

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

Real Estate Owned

Real estate owned acquired in settlement of foreclosed loans is carried as a component of other assets at fair value minus estimated cost to sell. Prior to foreclosure, the estimated collectible value of the collateral is evaluated to determine whether a partial charge-off of the loan balance is necessary. After transfer to real estate owned, any subsequent write-downs are charged against other operating expenses. Direct costs incurred in the foreclosure process and subsequent holding costs incurred on such properties are recorded as expenses of current operations. The balance of real estate owned included in accrued interest and other assets was $389,000 and $0 at December 31, 2018 and 2017, respectively.

Bank Owned Life Insurance

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

Advertising Costs

Advertising costs are expensed as the costs are incurred. Advertising expenses amounted to $118,000 and $122,000 for 2018 and 2017, respectively.

Income Taxes

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

On December 22, 2017, the Tax Cuts and Jobs Act (the "Act") was signed into law resulting in a reduction in the Company's federal income tax rate to 21% from 34% effective January 1, 2018.

In February 2018, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2018-02, Income Statement—Reporting Comprehensive Income (Topic 220): Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income, which would require entities to reclassify from accumulated other comprehensive income (AOCI) to retained earnings the effects of the change in the federal tax rate under the Act on deferred amounts that were originally recorded in other comprehensive income. The amount of the reclassification would exclude the effects of any valuation allowance previously charged to income from continuing operations. The Company early adopted this ASU in 2017 which resulted in a reclassification of $513,000 from AOCI to retained earnings in the consolidated financial statements.

Employee Benefit Plans

The Bank has a noncontributory defined benefit pension plan that covers all eligible employees. Benefits are based upon years of service, the employee's compensation, and age at retirement. The Bank's contribution is actuarially determined and is intended to meet the current and projected obligations of the plan. Effective December 31, 2018, the defined benefit pension plan was frozen. See Note 12 for more details on this plan.

The Bank has a defined contribution plan in the form of a 401(k) plan, that covers all eligible employees. During 2018, the Bank amended the 401(k) plan to include Roth elective deferral contributions by employees. The amendment also included employer Safe Harbor Matching Contributions by the Bank for both traditional 401(k) employee contributions and Roth contributions. The Bank matches 100% of employee contributions up to 3%, and 50% of employee contributions that exceed 3% up to a maximum of 5%.

Trust Assets

Assets held by the Bank in a fiduciary or agency capacity for its customers are not included in the accompanying financial statements, since such items are not assets of the Bank. The fair value of trust assets under administration were $121,495,000 and $117,963,000 as of December 31, 2018 and 2017, respectively. In accordance with banking industry practice, trust services income is recognized on the cash basis and is not materially different than if it was reported on the accrual basis.

Comprehensive Income

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

Earnings Per Share

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

Cash Flow Information

The Company has defined cash and cash equivalents as those amounts included in the consolidated balance sheet captions "cash and due from banks," and "interest-bearing deposits in other banks," with original maturities of 90 days or less. The following are supplemental disclosures for the consolidated statements of cash flows (in thousands):

	2018	2017
Cash paid during the year for:		
Interest	$ 3,836	$ 2,826
Income taxes	475	250
Noncash investing transactions:		
Transfer of loans to real estate owned	460	57

Reclassification of Comparative Amounts

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

2. OCC Consent Order and Federal Reserve Bank Resolution

On May 5, 2016, The Northumberland National Bank ("Bank"), the wholly owned subsidiary of Northumberland Bancorp ("Company"), entered into a Stipulation and Consent to the Issuance of a Consent Order ("Consent Order") with the Comptroller of the Currency of the United States of America, through its national bank examiners and other staff of the Office of the Comptroller of the Currency ("OCC"), which has supervisory authority over the Bank. The full text of the Consent Order was published by the OCC on its website (www.occ.gov). The actions to be taken by the Bank's Board of Directors, as a result of the Consent Order, were required to be taken within time periods specified in the Consent Order.

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

On August 21, 2018, the OCC issued an order terminating its Consent Order. On December 19, 2018, the FRB sent a letter to the Company's Board of Directors, indicating that the FRB would not object to the Board terminating the resolution which it had adopted at the FRB's request. Pursuant to that notice, the Board of Directors for the Company did terminate the resolution on January 8, 2019.

In connection with the matters, which were the subject of the Consent Order and the resolution adopted at the request of the FRB, including the related investigation, the Company incurred professional fees of $197,000 and $277,000 for 2018 and 2017, respectively, and made or accrued reimbursements to customers of $18,000 and $227,000 for 2018 and 2017, respectfully.

3. Investment Securities

The amortized cost and fair values of investment securities are as follows (in thousands):

December 31, 2018	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Available-for-sale:				
Obligations of states and political subdivisions	$ 55,113	$ 62	$ (729)	$ 54,446
Mortgage-backed securities in government sponsored entities	89,766	116	(1,407)	88,475
Total	$ 144,879	$ 178	$ (2,136)	$ 142,921

December 31, 2017	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Available-for-sale:				
Obligations of states and political subdivisions	$ 56,758	$ 269	$ (518)	$ 56,509
Mortgage-backed securities in government sponsored entities	89,444	99	(1,129)	88,414
	146,202	368	(1,647)	144,923
Equity securities in financial institutions	143	59	-	202
Total	$ 146,345	$ 427	$ (1,647)	$ 145,125

December 31, 2018	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Held-to-maturity:				
Obligations of states and political subdivisions	$ 1,849	$ 9	$ (7)	$ 1,851
Total	$ 1,849	$ 9	$ (7)	$ 1,851

December 31, 2017	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Held-to-maturity:				
Obligations of states and political subdivisions	$ 650	$ -	$ (2)	$ 648
Total	$ 650	$ -	$ (2)	$ 648

The following tables show the Company's gross unrealized losses and fair value, aggregated by investment category and length of time that the individual securities have been in a continuous unrealized loss position, at December 31, 2018 and 2017 (in thousands).

December 31, 2018	Less than 12 Months		12 Months or Longer		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Available-for-sale:						
Obligations of states and political subdivisions	**$ 7,877**	**$ (20)**	**$ 27,537**	**$ (709)**	**$ 35,414**	**$ (729)**
Mortgage-backed securities in government sponsored entities	24,003	(175)	48,933	(1,232)	72,936	(1,407)
Total	**$ 31,880**	**$ (195)**	**$ 76,470**	**$ (1,941)**	**$ 108,350**	**$ (2,136)**
Held-to-maturity:						
Obligations of states and political subdivisions	**$ 1,173**	**$ (6)**	**$ 252**	**$ (1)**	**$ 1,425**	**$ (7)**
Total	**$ 1,173**	**$ (6)**	**$ 252**	**$ (1)**	**$ 1,425**	**$ (7)**

December 31, 2017	Less than 12 Months		12 Months or Longer		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Available-for-sale:						
Obligations of states and political subdivisions	$ 16,652	$ (183)	$ 8,842	$ (335)	$ 25,494	$ (518)
Mortgage-backed securities in government sponsored entities	27,686	(296)	47,007	(833)	74,693	(1,129)
Total	$ 44,338	$ (479)	$ 55,849	$ (1,168)	$ 100,187	$ (1,647)
Held-to-maturity:						
Obligations of states and political subdivisions	$ 641	$ (2)	$ -	$ -	$ 641	$ (2)
Total	$ 641	$ (2)	$ -	$ -	$ 641	$ (2)

The Company reviews its unrealized loss positions quarterly and has asserted that at December 31, 2018 and 2017, the declines outlined in the above tables represent temporary declines and the Company does not intend to sell and does not believe it will be required to sell these securities before recovery of their cost basis, which may be at maturity. There were 220 and 184 positions that were temporarily impaired at December 31, 2018 and 2017, respectively. The Company has concluded that the unrealized losses disclosed above are not other than temporary but are the result of interest rate changes, sector credit ratings changes, or issuer-specific ratings changes that are not expected to result in the non-collection of principal and interest during the period.

The amortized cost and fair value of debt securities at December 31, 2018, by contractual maturity, are shown below. Expected maturities will differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties (in thousands).

	Available-for-Sale		Held-to-Maturity	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
Due in one year or less	$ **7,925**	$ **7,903**	$ **-**	$ **-**
Due after one year through five years	80,008	79,105	1,840	1,842
Due after five years through ten years	43,845	42,887	-	-
Due after ten years	13,101	13,026	9	9
Total	$ **144,879**	$ **142,921**	$ **1,849**	$ **1,851**

Proceeds from the sales of available-for-sale securities during 2018 amounted to $3,192,000 resulting in gross gains and gross losses of $18,000 and $(32,000), respectively. Proceeds from the sales of available-for-sale securities during 2017 amounted to $14,483,000 resulting in gross gains and gross losses of $65,000 and $(96,000), respectively.

Investment securities with fair values of $77,314,000 and $74,196,000 at December 31, 2018 and 2017, respectively, were pledged to secure public deposits and other purposes as required by law.

4. Loans

Major classifications of loans are summarized as follows (in thousands):

	2018	2017
Commercial	$ 75,335	$ 63,179
Commercial real estate	76,636	70,614
Residential real estate	192,960	183,536
Consumer	4,792	4,187
	349,723	321,516
Less allowance for loan losses	3,163	2,910
Net Loans	$ 346,560	$ 318,606

The Company grants residential, commercial, and consumer loans to customers throughout its trade area, which is concentrated in North Central Pennsylvania. Although the Company has a diversified loan portfolio at December 31, 2018 and 2017, a substantial portion of its debtors' ability to honor their loan agreements is dependent upon the economic stability of its immediate trade area.

5. Allowance for Loan Losses

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

December 31, 2018	Commercial	Commercial Real Estate	Residential Real Estate	Consumer	Unallocated	Total
Beginning Balance	$ 574	$ 499	$ 1,465	$ 45	$ 327	$ 2,910
Charge-offs	-	-	(170)	(46)	-	(216)
Recoveries	-	-	2	11	-	13
Provision	132	45	240	53	(14)	456
Ending Balance	$ 706	$ 544	$ 1,537	$ 63	$ 313	$ 3,163

December 31, 2017	Commercial	Commercial Real Estate	Residential Real Estate	Consumer	Unallocated	Total
Beginning Balance	$ 671	$ 284	$ 1,483	$ 40	$ 300	$ 2,778
Charge-offs	(5)	-	(71)	(32)	-	(108)
Recoveries	11	-	1	1	-	13
Provision	(103)	215	52	36	27	227
Ending Balance	$ 574	$ 499	$ 1,465	$ 45	$ 327	$ 2,910

Management has an established methodology to determine the adequacy of the allowance for loan losses that assesses the risks and losses inherent in the loan portfolio. For purposes of determining the allowance for loan losses, the Company has segmented certain loans in the portfolio by product type. Loans are segmented into the following pools: commercial, commercial real estate loans, residential real estate loans, and consumer loans. Historical loss percentages for each risk category are calculated and used as the basis for calculating allowance allocations. These historical loss percentages are calculated over a two-year period during 2018 and a two-year period during 2017 for all portfolio segments. Certain qualitative factors are then added to the historical allocation percentage to apply the adjusted factor to non-classified loans. The following qualitative factors are analyzed for each portfolio segment and are adjusted based upon relevant changes within the portfolio:

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

In addition, regulatory agencies, as an integral part of their examination process, periodically review the Bank's allowance for loan losses and may require the Bank to recognize additions to the allowance based on their judgments about information available to them at the time of their examination, which may not be currently available to management. Based on management's comprehensive analysis of the loan portfolio, management believes the current level of the allowance for loan losses is adequate.

The total allowance reflects management's estimate of loan losses inherent in the loan portfolio at the consolidated balance sheet date. The Company considers the allowance for loan losses of $3,163,000 and $2,910,000 adequate to cover loan losses inherent in the loan portfolio at December 31, 2018 and 2017, respectively. The following tables present the balance in the allowance for loan losses and the recorded investment in loans by portfolio segment and based on impairment evaluation method as of December 31, 2018 and 2017 (in thousands):

December 31, 2018	Commercial	Commercial Real Estate	Residential Real Estate	Consumer	Unallocated	Total
Allowance for loan losses:						
Individually evaluated for impairment	$ -	$ -	$ -	$ -	$ -	$ -
Collectively evaluated for impairment	706	544	1,537	63	313	3,163
Total	$ 706	$ 544	$ 1,537	$ 63	$ 313	$ 3,163
Loans:						
Individually evaluated for impairment	$ 926	$ -	$ 335	$ -	$ -	$ 1,261
Collectively evaluated for impairment	74,409	76,636	192,625	4,792	-	348,462
Total	$ 75,335	$ 76,636	$ 192,960	$ 4,792	$ -	$ 349,723

December 31, 2017	Commercial	Commercial Real Estate	Residential Real Estate	Consumer	Unallocated	Total
Allowance for loan losses:						
Individually evaluated for impairment	$ -	$ -	$ -	$ -	$ -	$ -
Collectively evaluated for impairment	574	499	1,465	45	327	2,910
Total	$ 574	$ 499	$ 1,465	$ 45	$ 327	$ 2,910
Loans:						
Individually evaluated for impairment	$ 1,005	$ -	$ 141	$ -	$ -	$ 1,146
Collectively evaluated for impairment	62,174	70,614	183,395	4,187	-	320,370
Total	$ 63,179	$ 70,614	$ 183,536	$ 4,187	$ -	$ 321,516

Credit Quality Information

The Company's internally assigned loan grades are as follows:

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

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

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

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

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

The following tables represent credit exposures for commercial real estate and commercial and industrial loans by internally assigned grades for the years ended December 31, 2018 and 2017. The grading analysis estimates the capability of the borrower to repay the contractual obligations of the loan agreements as scheduled or at all. The Company's internal credit risk grading system is based on experiences with similarly graded loans (in thousands).

December 31, 2018	Loans to States and Political Subdivisions	Other Commercial Loans	Loans for Investment Properties	Other Commercial Real Estate Loans	Total
Pass	$ 15,685	$ 55,181	$ 29,998	$ 44,399	$ 145,263
Special Mention	-	636	-	2,186	2,822
Substandard	-	3,833	29	24	3,886
Doubtful	-	-	-	-	-
Loss	-	-	-	-	-
Ending Balance	$ 15,685	$ 59,650	$ 30,027	$ 46,609	$ 151,971

December 31, 2017	Loans to States and Political Subdivisions	Other Commercial Loans	Loans for Investment Properties	Other Commercial Real Estate Loans	Total
Pass	$ 15,553	$ 43,531	$ 27,970	$ 42,188	$ 129,242
Special Mention	-	-	-	-	-
Substandard	-	4,095	243	213	4,551
Doubtful	-	-	-	-	-
Loss	-	-	-	-	-
Ending Balance	$ 15,553	$ 47,626	$ 28,213	$ 42,401	$ 133,793

The following tables present performing and nonperforming residential real estate and consumer loans based on payment activity for the years ended December 31, 2018 and 2017. Payment activity is reviewed by management on a monthly basis to determine how loans are performing. Loans are considered to be nonperforming when they become 90 days past due or are placed on nonaccrual (in thousands).

December 31, 2018	First Mortgages	Home Equity Loans	Consumer	Total
Performing	$ 164,852	$ 27,481	$ 4,792	$ 197,125
Nonperforming	537	90	-	627
Total	$ 165,389	$ 27,571	$ 4,792	$ 197,752

December 31, 2017	First Mortgages	Home Equity Loans	Consumer	Total
Performing	$ 155,874	$ 27,067	$ 4,187	$ 187,128
Nonperforming	574	21	-	595
Total	$ 156,448	$ 27,088	$ 4,187	$ 187,723

Following are tables which include an aging analysis of the recorded investment of past-due loans as of December 31, 2018 and 2017 (in thousands):

December 31, 2018	30-59 Days Past Due	60-89 Days Past Due	90 Days or Greater	Total Past Due	Current	Total
Commercial:						
Obligations of states and political subdivisions	$ -	$ -	$ -	$ -	$ 15,685	$ 15,685
Other commercial loans	31	-	78	109	59,541	59,650
Commercial real estate:						
Loans for investment property	232	156	-	388	29,639	30,027
Other commercial real estate loans	-	-	-	-	46,609	46,609
Residential mortgage loans:						
First mortgages	2,026	729	732	3,487	161,902	165,389
Home equity loans	134	12	83	229	27,342	27,571
Consumer	19	17	5	41	4,751	4,792
Total	$ 2,442	$ 914	$ 898	$ 4,254	$ 345,469	$ 349,723

December 31, 2017	30-59 Days Past Due	60-89 Days Past Due	90 Days or Greater	Total Past Due	Current	Total
Commercial:						
Obligations of states and political subdivisions	$ -	$ -	$ -	$ -	$ 15,553	$ 15,553
Other commercial loans	17	-	-	17	47,609	47,626
Commercial real estate:						
Loans for investment property	-	-	163	163	28,050	28,213
Other commercial real estate loans	34	-	-	34	42,367	42,401
Residential mortgage loans:						
First mortgages	2,268	219	761	3,248	153,200	156,448
Home equity loans	154	33	40	227	26,861	27,088
Consumer	65	1	1	67	4,120	4,187
Total	$ 2,538	$ 253	$ 965	$ 3,756	$ 317,760	$ 321,516

Impaired Loans

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

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

December 31, 2018	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Interest Income Recognized
With no related allowance recorded:					
Commercial:					
Other commercial loans	$ 926	$ 1,295	$ -	$ 965	$ -
Commercial real estate:					
Loans for investment properties	-	-	-	-	-
Residential real estate:					
First mortgages	335	368	-	218	11
With an allowance recorded:					
Commercial:					
Other commercial loans	-	-	-	-	-
Commercial real estate:					
Loans for investment properties	-	-	-	-	-
Residential mortgage loans:					
First mortgages	-	-	-	-	-
Total	$ 1,261	$ 1,663	$ -	$ 1,183	$ 11

December 31, 2017	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Interest Income Recognized
With no related allowance recorded:					
Commercial:					
Other commercial loans	$ 1,005	$ 1,309	$ -	$ 1,081	$ -
Commercial real estate:					
Loans for investment properties	-	-	-	-	-
Residential real estate:					
First mortgages	141	173	-	117	-
With an allowance recorded:					
Commercial:					
Other commercial loans	-	-	-	-	-
Commercial real estate:					
Loans for investment properties	-	-	-	-	-
Residential mortgage loans:					
First mortgages	-	-	-	-	-
Total	$ 1,146	$ 1,482	$ -	$ 1,198	$ -

Nonaccrual Loans

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

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

December 31, 2018	Nonaccrual	Past Due 90 Days or More and Still Accruing
Commercial:		
Obligations of states and political subdivisions	$ -	$ -
Other commercial loans	926	78
Commercial real estate:		
Loans for investment properties	-	-
Other commercial real estate loans		
Residential mortgage loans:		
First mortgages	537	290
Home equity loans	90	76
Consumer loans	-	-
	$ 1,553	$ 444

December 31, 2017	Nonaccrual	Past Due 90 Days or More and Still Accruing
Commercial:		
Obligations of states and political subdivisions	$ -	$ -
Other commercial loans	1,005	-
Commercial real estate:		
Loans for investment properties	-	-
Other commercial real estate loans		
Residential mortgage loans:		
First mortgages	574	590
Home equity loans	21	40
Consumer loans	-	1
	$ 1,600	$ 631

Interest income on nonaccrual loans not recognized during 2018 and 2017 was $129,000 and $96,000, respectively.

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

Troubled debt restructurings (TDR) may be designated as performing or non-performing. A TDR may be designated as performing if the loan has demonstrated sustained performance under the modified terms. The period of sustained performance may include the periods prior to modification if prior performance met or exceeded the modified terms. For non-performing restructured loans, the loan will remain on non-accrual status until the borrower demonstrates a sustained period of performance, generally six consecutive months of payments. The Bank had $335,000 and $141,000 in total performing restructured loans as of December 31, 2018 and 2017, respectively. During the year ended December 31, 2018 and 2017, the Bank did not have any loans classified as troubled debt restructurings that subsequently defaulted.

The following table reflects the Bank's troubled debt restructuring activity during 2018 and 2017 (in thousands):

	2018		2017	
	Modification of Payment and Other Terms		Modification of Payment and Other Terms	
	Number of Contracts	Recorded Investment	Number of Contracts	Recorded Investment
Residential real estate	1	**200**	5	141
Total	**1**	**$ 200**	5	$ 141

6. Premises and Equipment

Major classifications of premises and equipment are summarized as follows (in thousands):

December 31,	**2018**	2017
Land and improvements	$ 1,458	$ 1,458
Buildings and improvements	10,043	9,984
Furniture, fixtures and equipment	4,531	4,411
	16,032	15,853
Less accumulated depreciation	6,909	6,492
Total	$ 9,123	$ 9,361

Depreciation expense for the years ended December 31, 2018 and 2017 was $584,000 and $623,000, respectively.

7. Deposits

The components of deposits at December 31, 2018 and 2017 are as follows (in thousands):

	2018	2017
Demand, noninterest-bearing	$ 89,761	$ 78,221
Demand, interest-bearing	71,417	68,535
Savings	83,192	82,661
Money Market Accounts	86,449	95,858
Time, $250 and over	30,097	25,145
Time, other	116,591	102,956
Total	$ 477,507	$ 453,376

Time deposits and their remaining maturities at December 31, 2018 are as follows (in thousands):

Year Ending December 31,	
2019	$ 53,156
2020	58,735
2021	22,961
2022	6,240
2023	5,490
Thereafter	106
	$ 146,688

8. Short-Term Borrowings

Borrowings at December 31, 2018 and 2017 consisted of the following short-term notes with the Federal Home Loan Bank (dollars in thousands):

Maturity Date	Interest Rate	2018	2017
January 2, 2018	1.54%	$ -	$ 3,000
January 2, 2019	2.62%	$ 3,175	-
Total		**$ 3,175**	$ 3,000

9. Revenue Recognition

On January 1, 2018, the Company adopted ASC 606 "Revenue from Contracts with Customers" (ASC 606) using the modified retrospective approach. The accounting standard was applied to all contracts initiated on or after the effective date, and also for contracts which have remaining obligations after the effective date.

Results for the year ended December 31, 2018 are presented under ASC 606, while prior periods are presented under legacy Generally Accepted Accounting Principles. The accounting standard adoption did not have a material impact on any of the reported periods. The Company did not record a cumulative effect adjustment to the beginning retained earnings balance as of January 1, 2018 as it was determined that the transition adjustment, from the adoption of ASC 606, was immaterial to the Company's consolidated financial statements.

All of the revenue from contracts with customers, within the scope of ASC 606 is recognized in the non-interest income as presented in the Company's consolidated financial statements.

Sources of revenue for the Company which fall within the scope of ASC 606 are described as follows:

- Deposit Service Charges – The Bank earns fees from its deposit customers for various services transaction based services and periodic account maintenance. Transaction based services include but are not limited to stop payment fees, overdraft fees, check cashing fees, wire transfer fees, and early withdrawal penalties. Maintenance fees include account maintenance fees, minimum balance fees, and monthly service charge. Transaction based fees are only recognized when the transaction is complete, and maintenance fees are recognized when the period of the obligation is complete. Deposit service charges and fees amounted to $394,000 in 2018, which are included in Service Charges on Deposit Accounts on the Consolidated Statements of Income.

- Trust Services Income
    - Asset Management - The Trust department receives fees for providing trust related services including Investment Management, Security Custody, and Other Trust Services. These fees are based upon the value of assets under management and are assessed using a tiered rate schedule. Fees are recognized on a monthly basis when the service obligation is complete. Trust asset management fees amounted to $751,000 in 2018. These fees are included in Trust Services Income on the Consolidated Statements of Income.

    - Estate Settlement – The trust department provides estate settlement services. These fees are based on the estimated fair value of the estate according to a tiered rate schedule. Each estate is unique in the nature, size, and complexity, and may include many tasks or milestones to complete. Fees are recognized in proportion to the number of milestones completed which is a judgement made by the trust management team. Estate settlement fees amounted to $19,000 in 2018. These fees are included in Trust Services Income on the Consolidated Statements of Income.

- Debit Card Income – The Bank provides electronic funds transfer processing services for the debit cards it offers to its customers. The Bank earns interchange fees from each cardholder transaction conducted through various networks. The fees are transaction based and are earned when the transaction is complete. Debit card income amounted to $668,000 in 2018. These fees are included in Service Charges on Deposit Accounts on the Consolidated Statements of Income.

- Merchant Services Income - The Bank arranges for its business customers to contract with our credit card vendor for merchant (credit card) processing services. Customers are provided with a POS credit card terminal so they can take payment from retail sales customers. The fees are transaction based and are earned when the transaction is complete. Merchant Services Income amounted to $68,000 in 2018. These fees are included in Other Income on the Consolidated Statements of Income.

- Insurance and Investment Service Fees – The Company sells investments and insurance through its Trust and Wealth Management division. Commissions from the sale of these products are recognized upon the completion of the transaction. These fees amounted to $ 64,000 in 2018. These fees are included in Other Income on the Consolidated Statements of Income.

- ATM Service Charges – ATM service charges are earned when non customers use Bank ATM machines. These fees are recognized when the transaction is complete. These fees amounted to $47,000 in 2018. These fees are included in Service Charges on Deposit Accounts on the Consolidated Statements of Income.

- Gains/ Losses on the Sale of Other Real Estate – these assets are de-recognized when control of the property transfers to the buyer. These gains/losses are included in Other Income on the Consolidated Statements of Income.

The Company expenses all contract acquisition costs as costs are incurred.

10. Income Taxes

The provision for Federal income taxes consists of (in thousands):

	2018	2017
Current	$ 472	$ 887
Deferred	(48)	276
Total	$ 422	$ 1,163

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

	2018	2017
Deferred tax assets:		
Allowance for loan losses	$ 618	$ 565
Accrued pension obligation	192	573
Unrealized loss on investment securities	411	256
Alternative minimum tax credit	-	201
Other	224	178
Total gross deferred tax assets	1,445	1,773
Deferred tax liabilities:		
Premises and equipment	260	267
Investment accretion	3	2
Prepaid pension costs	104	262
Loan origination fees and costs	94	80
Other	37	37
Total gross deferred tax liabilities	498	648
Net Deferred Tax Asset	$ 947	$ 1,125

No valuation allowance was established at December 31, 2018 and 2017, in view of the Company's ability to carryback to taxes paid in previous years and certain tax strategies, coupled with the anticipated future taxable income as evidenced by the Company's earnings potential. Net deferred tax assets are included in Accrued Interest and Other Assets on the balance sheet.

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

	2018		2017	
	Amount	% of Pretax Income	Amount	% of Pretax Income
Provision at statutory rate	$ **705**	21.0 %	$ 1,067	34.0 %
Effect of tax-exempt income	(241)	(7.2)	(426)	(13.6)
Nondeductible interest Expense	26	0.8	22	0.7
Revaluation of certain deferred tax assets and liabilities	-	**-**	569	18.1
Other	(68)	**(2.0)**	(69)	(2.2)
Actual Tax Expense and Effective Rate	**$ 422**	**12.6 %**	$ 1,163	37.0 %

On December 22, 2017, H.R.1, commonly known as the Tax Cuts and Jobs Act (the "Act"), was signed into law. The Act included several provisions that affected the Company's federal income tax expense, including reducing the federal income tax rate to 21% from 34% effective January 1, 2018. As a result of the rate reduction, the Company was required to perform a one-time re-measurement, through income tax expense, of the deferred tax assets and liabilities using the enacted rate at which these items are expected to be recovered or settled. Accordingly, in 2017, the Company re-measured net deferred tax assets which resulted in additional 2017 deferred income tax expense of $569,000.

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

There is currently no liability for uncertain tax positions and no known unrecognized tax benefits. The Company recognizes, when applicable, interest and penalties related to unrecognized tax benefits in the provision for income taxes in the consolidated statements of income. With few exceptions, the Company is no longer subject to U.S. federal or state income tax examinations by tax authorities for years before 2014.

11. Commitments and Contingencies

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

The off-balance sheet commitments consisted of the following (in thousands):

	2018	2017
Commitments to extend credit	$ 76,570	$ 64,264
Standby letters of credit	3,579	5,563

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

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

12. Pension Plan

The Bank sponsors a defined benefit pension plan covering substantially all employees and officers hired before December 31, 2018. The Plan calls for benefits to be paid to eligible employees at retirement, based primarily upon years of service with the Bank and compensation rates during employment.

Effective December 31, 2018 the Plan was frozen. As a result, no new employees will be admitted to the Plan, and service costs for active employees participating in the plan will no longer accrue benefits. The Bank's actuaries re-measured the Projected Benefit Obligation as of December 31, 2018. The re-measurement resulted in the recognition of a curtailment gain of $2,049,000 recognized as a credit to pension expense and a reduction of pension liability. The curtailment gain triggered recognition of $2,049,000 of unrecognized pension costs previously recorded in accumulated other comprehensive income. These costs were recognized as a charge to pension expense for $2,049,000. As a result of the freeze, and the current funding status of the Plan, the Bank does not intend to make any contributions during 2019.

The following table sets forth the obligation and funded status as of December 31 (in thousands):

	2018	2017
Change in benefit obligation:		
Benefit obligation at beginning of year	$ 12,782	$ 10,853
Service cost	1,005	814
Interest cost	469	441
Change in assumptions	(1,566)	1,181
Actuarial loss (gains)	453	(85)
Benefits paid	(627)	(422)
Effect of curtailment	(2,049)	-
Benefit obligation at end of year	10,467	12,782
Change in plan assets:		
Fair value of plan assets at beginning of year	11,329	10,191
Actual return on plan assets	(627)	1,560
Employer contribution	-	-
Benefits paid	(627)	(422)
Fair value of plan assets at end of year	10,075	11,329
Funded Status, included in Other Liabilities	$ (392)	$ (1,453)

	2018	2017
Amounts recognized in accumulated other comprehensive loss consist of:		
Net loss	$ 914	$ 2,729
Total	$ 914	$ 2,729

The accumulated benefit obligation for the defined benefit pension plan was $10,467,000 and $10,713,000 at December 31, 2018 and 2017, respectively.

Components of Net Periodic Benefit Cost

	2018	2017
Net periodic pension cost:		
Service cost	$ 1,005	$ 814
Interest cost	469	441
Expected return on plan assets	(844)	(771)
Amortization of net loss	124	97
Net Periodic Benefit Cost	$ 754	$ 581

As a result of the freeze of the plan, there will be no amortization of accumulated other comprehensive loss into net periodic pension expense in 2019 and net periodic pension expense will no longer include service cost in 2019.

Assumptions

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

	2018	2017
Discount rate	4.21 %	3.59 %
Rate of compensation increase	4.00	4.00

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

	2018	2017
Discount rate	3.59 %	4.14 %
Expected long-term return on plan assets	8.00	8.00
Rate of compensation increase	4.00	4.00

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

Plan Assets

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

	2018	2017
Asset category:		
Mutual funds	71.9 %	73.8 %
Corporate bonds	24.4	22.9
U.S. government agency securities	2.3	2.0
Cash and cash equivalents	1.4	1.3
Total	**100.00 %**	100.00 %

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

The following table sets forth by level, within the fair value hierarchy, the plan's assets at fair value as of December 31, 2018 and 2017 (in thousands):

December 31, 2018	Level I	Level II	Level III	Total
Cash and cash equivalents	**$ 143**	**$ -**	**$ -**	**$ 143**
U.S. government agency securities	**-**	**234**	**-**	**234**
Corporate bonds	**-**	**2,451**	**-**	**2,451**
Mutual funds	**7,247**	**-**	**-**	**7,247**
Total Assets at Fair Value	**$ 7,390**	**$ 2,685**	**$ -**	**$ 10,075**

December 31, 2017	Level I	Level II	Level III	Total
Assets:				
Cash and cash equivalents	$ 146	$ -	$ -	$ 146
U.S. government agency securities	-	235	-	235
Corporate bonds	-	2,600	-	2,600
Mutual funds	8,348	-	-	8,348
Total Assets at Fair Value	$ 8,494	$ 2,835	$ -	$ 11,329

Cash Flows

Due to the funding position of the Plan, and the current interest rate environment, the Bank does not expect to make a contribution to its defined benefit pension plan in 2019.

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

	Pension Benefits
2019	$ 303
2020	340
2021	378
2022	379
2023 through 2028	3,645

13. Accumulated Other Comprehensive Loss

The following tables present the changes in accumulated other comprehensive loss by component net of tax for the years ended December 31, 2018 and 2017 (in thousands):

	Unrealized Gains (Losses) on Available-for-Sale Securities	Unrecognized Pension Costs	Total
Balance as of December 31, 2016	$ (942)	$ (1,661)	$ (2,603)
Other comprehensive loss before reclassification	116	(74)	42
Amount reclassified from accumulated other comprehensive loss	20	(64)	(44)
Total other comprehensive loss	136	(138)	(2)
Reclassification of stranded tax effects	(158)	(355)	(513)
Balance as of December 31, 2017	(964)	(2,154)	(3,118)
Other comprehensive loss before reclassification	(555)	(88)	(643)
Amount reclassified from accumulated other comprehensive loss	11	1,520	1,531
Total other comprehensive loss	(544)	1,432	888
Cumulative adjustment for fair value of equity securities	(39)	-	(39)
Balance as of December 31, 2018	$ (1,547)	$ (722)	$ (2,269)

The following table presents significant amounts reclassified out of each component of accumulated other comprehensive loss for the years ended December 31, 2018 and 2017 (in thousands):

	Amount Reclassified from Accumulated Other Comprehensive Loss		Affected Line Item in the Statement Where Net Income is Presented
	2018	2017	
Unrealized gains on available-for-sale securities:			
	$ 14	$ 31	Investment securities gains, net
	(3)	(11)	Income taxes
	$ 11	$ 20	Net of tax
Unrecognized pension costs:			
	$ **1,925**	$ 97	Salaries and employee benefits
	(405)	(33)	Income tax
	$ **1,520**	$ 64	Net of tax

14. Regulatory Matters

Cash and Due from Banks

The Bank is required to maintain average cash reserve balances in vault cash or with the Federal Reserve Bank. The amount of these restricted cash reserve balances at December 31, 2018 and 2017 was $-0-.

Loans

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

Dividends

The Bank is subject to a dividend restriction that generally limits the amount of dividends that can be paid by a national bank. Prior approval of the Office of the Comptroller of the Currency ("OCC") is required if the total of all dividends declared by a national bank in any calendar year exceeds net profits, as defined for the year, combined with its retained net profits for the two preceding calendar years less any required transfers to surplus. Using this formula, the amount available for payment of dividends by the Bank in 2018, without approval of the OCC, is approximately $2,915,000 plus 2018 net profits retained up to the date of the dividend declaration.

Capital Requirements

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

Information presented for December 31, 2018 and 2017, reflects the Basel III capital requirements that became effective January 1, 2015 for the Bank. Prior to January 1, 2015, the Bank was subject to capital requirements under Basel I. Under these capital requirements and the regulatory framework for prompt corrective action, the Bank must meet specific capital guidelines that involve quantitative measures of the Bank's assets, liabilities and certain off-balance-sheet items as calculated under regulatory accounting practices. The Bank's capital amounts and classifications are also subject to qualitative judgments by regulators about components, risk-weightings and other factors.

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

Effective January 1, 2018, the capital levels required for the Bank to avoid these limitations were as follows:

- Common Equity Tier 1 capital ratio of 6.375%
- Tier 1 risk based capital ratio of 7.875%
- Total risk based capital ratio of 9.875%

As of December 31, 2018, the Bank had a conservation buffer greater than 2.5%.

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

As of December 31, 2018 and 2017, the OCC categorized the Bank as well-capitalized under the regulatory framework for prompt corrective action. To be classified as a well-capitalized financial institution, Common equity Tier 1, Total risk-based, Tier I risk-based, and Tier I leverage capital ratios must be at least 6.5 percent, 10 percent, 6 percent, and 5 percent, respectively.

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

December 31, 2018	Actual		For Capital Adequacy Purposes		To be Well Capitalized under Prompt Corrective Action Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
Common equity Tier 1 (total risk-weighted assets)	$ 53,762	17.03%	$ ≥14,202	≥4.5%	$ ≥20,514	≥ 6.5%
Total capital (to risk-weighted assets)	56,925	18.04%	≥25,248	≥8.0%	≥31,560	≥10.0%
Tier I capital (to risk-weighted assets)	53,762	17.03%	≥18,936	≥6.0%	≥25,248	≥8.0%
Tier I capital (to average assets)	53,762	10.09%	≥21,316	≥4.0%	≥26,645	≥5.0%

December 31, 2017	Actual		For Capital Adequacy Purposes		To be Well Capitalized under Prompt Corrective Action Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
Common equity Tier 1 (total risk-weighted assets)	$ 51,867	18.31%	$ ≥12,745	≥4.5%	$ ≥18,410	≥ 6.5%
Total capital (to risk-weighted assets)	54,777	19.34%	≥22,658	≥8.0%	≥28,323	≥10.0%
Tier I capital (to risk-weighted assets)	51,867	18.31%	≥11,329	≥4.0%	≥16,994	≥ 6.0%
Tier I capital (to average assets)	51,867	10.32%	≥20,124	≥4.0%	≥25,155	≥ 5.0%

15. Fair Value Measurements

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

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

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

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

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

The following tables present the assets measured on a recurring basis on the consolidated balance sheets at their fair value as of December 31, 2018 and 2017, by level within the fair value hierarchy. Financial assets and liabilities are classified in their entirety based on the lowest level of input that is significant to the fair value measurement (in thousands).

December 31, 2018	Level I	Level II	Level III	Total
Assets measured on a recurring basis:				
Investment securities available-for-sale:				
Obligations of states and political subdivisions	$ -	$ 54,446	$ -	$ 54,446
Mortgage-backed securities in government-sponsored entities	-	88,475	-	88,475
Equity securities in financial institutions	183	-	-	183
Total	$ 183	$ 142,921	$ -	$ 143,104

December 31, 2017	Level I	Level II	Level III	Total
Assets measured on a recurring basis:				
Investment securities available-for-sale:				
Obligations of states and political subdivisions	$ -	$ 56,509	$ -	$ 56,509
Mortgage-backed securities in government-sponsored entities	-	88,414	-	88,414
Equity securities in financial institutions	202	-	-	202
Total	$ 202	$ 144,923	$ -	$ 145,125

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

December 31, 2018	Level I	Level II	Level III	Total
Fair value measurements on nonrecurring basis:				
Other real estate owned	$ -	$ -	$ 389	$ 389
Total	$ -	$ -	$ 389	$ 389

December 31, 2017	Level I	Level II	Level III	Total
Fair value measurements on nonrecurring basis:				
Other real estate owned	$ -	$ -	$ -	$ -
Total	$ -	$ -	$ -	$ -

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

December 31, 2018	Quantitative Information About Level III Fair Value Measurements			
	Fair Value	Valuation Techniques	Unobservable Input	Range (Weighted Average)
Other real estate owned	$ 389	Appraisal of collateral (1) (3)	Appraisal adjustments (2)	10% - 59% (29%)

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

16. Fair Value of Financial Instruments

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

December 31, 2018	Carrying Value	Fair Value	Level I	Level II	Level III
Financial assets:					
Cash and cash equivalents	$ 11,904	$ 11,904	$ 11,904	$ -	$ -
Investment securities:					
Available-for-sale	142,921	142,921	-	142,921	-
Held-to-maturity	1,849	1,851	-	1,851	-
Equity Securities	183	183	183	-	-
Loans held for sale	2,414	2,414	2,414	-	-
Net loans	346,560	341,519	-	341,519	-
Restricted stock	3,599	3,599	-	3,599	-
Mortgage servicing rights	688	1,225	-	1,225	-
Accrued interest receivable	1,700	1,700	1,700	-	-
Financial liabilities:					
Deposits	$ 477,507	$ 457,444	$ -	$ 457,444	$ -
Borrowings	3,175	3,175	-	3,175	-
Accrued interest payable	141	141	141	-	-

December 31, 2017	Carrying Value	Fair Value	Level I	Level II	Level III
Financial assets:					
Cash and cash equivalents	$ 13,547	$ 13,547	$ 13,547	$ -	$ -
Investment securities:					
Available-for-sale	145,125	145,125	202	144,923	-
Held-to-maturity	650	641	-	641	-
Loans held for sale	1,353	1,353	1,353	-	-
Net loans	318,606	317,506	-	317,506	-
Restricted stock	3,806	3,806	-	3,806	-
Mortgage servicing rights	831	1,105	-	1,105	-
Accrued interest receivable	1,593	1,593	1,593	-	-
Financial liabilities:					
Deposits	$ 453,376	$ 436,292	$ -	$ 436,292	$ -
Borrowings	3,000	2,999	-	2,999	-
Accrued interest payable	111	111	111	-	-

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

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

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

In accordance with Accounting Standards Update (ASU) 2016-01, *Recognition and Measurement of Financial Assets and Liabilities*, the Company has considered the exit price notion when measuring the fair value of financial instruments.

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

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

Investment Securities

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

Mortgage Servicing Rights

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

Commitments to Extend Credit and Commercial Letters of Credit

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

The carrying value, represented by the net deferred fee arising from the unrecognized commitment or letter of credit, and the fair value, determined by discounting the remaining contractual fee over the term of the commitment using fees currently charged to enter into similar agreements with similar credit risk, are not considered material for disclosure. The contractual amounts of unfunded commitments and letters of credit are presented in Note 11.

17. Related Party Transactions

Certain officers, directors and other related parties have loans and conduct other transactions with the Bank. Deposits of related parties totaled $1,914,000 and $1,815,000 at December 31, 2018 and 2017, respectively. The aggregate dollar amount of loans to related parties, along with an analysis of the activity for December 31, 2018 and 2017 are as follows (in thousands):

	2018	2017
Balance, beginning	$ 1,585	$ 987
Additions	960	698
Repayments	605	100
Balance, ending	$ 1,940	$ 1,585

18. Employment Agreements

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

19. Subsequent Events

Management has reviewed events occurring through April 23, 2019, the date the financial statements were available to be issued for items that should potentially be recognized or disclosed in these consolidated financial statements. On March 19, 2019, the Board of Directors of the Bank agreed to terminate the defined benefit pension plan effective July 1, 2019. The financial impact of the termination is indeterminable at this time.