CoastalSouth Bancshares, Inc.
and Subsidiary

Report on Consolidated Financial Statements

For the years ended December 31, 2017 and 2016

Contents

Independent Auditor's Report

The Board of Directors
CoastalSouth Bancshares, Inc. and CoastalStates Bank
Hilton Head Island, South Carolina

Report on the Financial Statements

We have audited the accompanying consolidated financial statements of CoastalSouth Bancshares, Inc. which are comprised of the consolidated balance sheets as of December 31, 2017 and 2016, and the related consolidated statements of operations, comprehensive income, changes in 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 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 from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal controls 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 CoastalSouth Bancshares, Inc. and its Subsidiary as of December 31, 2017 and 2016, 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.

Elliott Davis, LLC

Columbia, South Carolina
March 23, 2018

CoastalSouth Bancshares, Inc. and Subsidiary

Consolidated Balance Sheets

As of December 31, 2017 and 2016

(in thousands of dollars, except share data)	2017	2016
Assets		
Cash and cash equivalents:		
Cash and due from banks	$ 6,917	$ 5,969
Interest bearing accounts with other banks	89,924	13,246
Federal funds sold	48,959	15,392
Total cash and cash equivalents	145,800	34,607
Investments		
Securities available for sale (amortized cost of $54,577 and $42,380, respectively)	54,786	41,593
Non-marketable equity securities	3,686	2,035
Total investments	58,472	43,628
Loans held for sale	36,333	62,885
Loans held for investment	265,821	240,352
Allowance for loan losses	(3,915)	(2,608)
Loans held for investment, net	261,906	237,744
Premises, furniture and equipment, net	1,174	1,657
Bank-owned life insurance	11,227	6,055
Deferred tax asset	10,020	11,471
Other real estate owned	4,172	8,058
Other assets	2,864	5,522
Other assets held for sale	-	1,890
Total assets	$ 531,968	$ 413,517
Liabilities		
Deposits		
Non-interest bearing transaction accounts	$ 90,374	$ 75,529
Interest-bearing transaction accounts	87,829	81,681
Savings and money market	111,980	124,706
Time deposits	77,016	57,974
Total deposits	367,199	339,890
Other borrowings	105,682	37,850
Other liabilities	1,948	1,585
Total liabilities	$ 474,829	$ 379,325
Stockholders' Equity		
Preferred stock 10,000,000 shares authorized		
Series A, 0 and 16,015 shares issued and outstanding at December 31, 2017 and 2016, respectively	$ -	$ 16,015
Series B, 0 and 480 shares issued and outstanding at December 31, 2017 and 2016, respectively	-	480
Voting common stock, $1.00 and $10.00 par value at December 31, 2017 and 2016, respectively, 50,000,000 shares authorized at December 31, 2017 and 2016, respectively; 4,254,714 and 9,758,033 shares issued and outstanding at December 31, 2017 and 2016, respectively	4,255	36,627
Nonvoting common stock, $1.00 par value at December 31, 2017; 10,000,000 and 0 shares authorized at December 31, 2017 and 2016, respectively; 1,449,482 and 0 shares issued and outstanding at December 31, 2017 and 2016, respectively	1,449	-
Capital surplus	90,743	1,138
Accumulated deficit	(39,478)	(19,560)
Accumulated other comprehensive income (loss)	170	(508)
Total stockholders' equity	$ 57,139	$ 34,192
Total liabilities and stockholders' equity	$ 531,968	$ 413,517

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

CoastalSouth Bancshares, Inc. and Subsidiary

Consolidated Statements of Operations

For the years ended December 31, 2017 and 2016

(in thousands of dollars, except share data)	2017	2016
Interest income		
Loans, including fees	$ 15,885	$ 16,255
Investments		
Taxable	945	594
Non-taxable	28	21
Non-marketable equity securities	76	129
Federal funds sold	266	50
Other earning assets from banks	309	38
Total	17,509	17,087
Interest expense		
Interest bearing deposits	886	742
Other borrowings	830	1,498
Total	1,716	2,240
Net interest income	15,793	14,847
Provision for credit losses	4,452	775
Net interest income after provision for credit losses	11,341	14,072
Noninterest income		
Income from mortgage originations	3,170	4,273
Service charges on deposit accounts	650	582
Interchange income and card fees	599	552
Bank-owned life insurance	172	454
Securities (gains) losses, net	-	153
Other noninterest income	405	64
Total noninterest income	4,996	6,078
Noninterest expenses		
Salaries and employee benefits	11,277	8,210
FDIC assessment	464	584
Occupancy and equipment	1,377	1,307
Data processing	723	663
Marketing and advertising	186	47
Net cost of operation of other real estate owned	698	322
Loss on other real estate owned, net	1,445	503
Other professional fees	1,007	1,040
Impairment on investment securities	344	-
Other noninterest expense	4,438	2,791
Total noninterest expense	21,959	15,467
Income (loss) before taxes	(5,622)	4,683
Income tax provision	3,510	1,651
Net income (loss) from continuing operations	(9,132)	3,032
Loss from discontinued operations, net of tax	(2,681)	(1,594)
Net income (loss)	(11,813)	1,438
Net accretion of preferred shares to redemption value	-	-
Preferred shares dividends	-	1,482
Net loss available to common shareholders	$ (11,813)	$ (44)
Net loss per common share		
Basic	$ (3.59)	$ (0.05)
Diluted	$ (3.59)	$ (0.05)

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

CoastalSouth Bancshares, Inc. and Subsidiary

Consolidated Statements of Comprehensive Income

For the years ended December 31, 2017 and 2016

(In thousands of dollars, except share data)

	2017	2016
Net income (loss)	$ (11,813)	$ 1,438
Other comprehensive income (loss)		
Unrealized gains (losses) on investment securities available for sale:		
Holding gains (losses) arising during the period, net of taxes of $235 and ($8)	459	(15)
Reclassification adjustment for realized net gains (losses) included in net income (loss), net of taxes of ($98) and $52	192	(101)
Reclassification of income tax effects associated with the Tax Cuts and Jobs Act	27	-
Other comprehensive income (loss), net of tax	678	(116)
Comprehensive income (loss)	$ (11,135)	$ 1,322

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

CoastalSouth Bancshares, Inc. and Subsidiary

Consolidated Statements of Changes in Stockholders' Equity

For the years ended December 31, 2017 and 2016

(In thousands of dollars, except share data)

	Preferred Stock			Common Stock							Accumulated Other	
	Series A	Series B	Series D	Voting		Nonvoting		Treasury	Capital	Accumulated	Comprehensive	
	Amount	Amount	Amount	Shares	Amount	Shares	Amount	Stock	Surplus	Deficit	Income/ (Loss)	Total
Balance as of December 31, 2015	$ 16,015	$ 480	$ -	9,744,943	$ 36,627	-	$ -	$ -	$ 1,115	$ (20,998)	$ (392)	$ 32,847
Issuance of common stock	-	-	-	13,090	-	-	-	-	23	-	-	23
Net income	-	-	-	-	-	-	-	-	-	1,438	-	1,438
Other comprehensive loss, net of tax	-	-	-	-	-	-	-	-	-	-	(116)	(116)
Balance as of December 31, 2016	$ 16,015	$ 480	$ -	9,758,033	$ 36,627	-	$ -	$ -	$ 1,138	$ (19,560)	$ (508)	$ 34,192
Repurchase of shares	-	-	-	-	-	-	-	500	-	-	-	500
Issuance of common and preferred stock	-	-	14	32,788,750	32,789	-	-	(500)	24,395	(67)	-	56,631
Issuance of stock warrants	-	-	-	-	-	-	-	-	1,335	-	-	1,335
Repayment of preferred sock and dividends	(16,015)	(480)	-	-	-	-	-	-	-	(8,011)	-	(24,506)
10-for-1 reverse stock split	-	-	-	(38,292,069)	(65,161)	-	-	-	65,161	-	-	-
Conversion of shares from preferred to common	-	-	(14)	-	-	1,449,482	1,449	-	(1,435)	-	-	-
Stock based compensation expense	-	-	-	-	-	-	-	-	149	-	-	149
Net loss	-	-	-	-	-	-	-	-	-	(11,813)	-	(11,813)
Reclassication of income tax effects associated with the Tax Cuts and Jobs Act	-	-	-	-	-	-	-	-	-	(27)	27	-
Other comprehensive income, net of tax	-	-	-	-	-	-	-	-	-	-	651	651
Balance as of December 31, 2017	$ -	$ -	$ -	4,254,714	$ 4,255	1,449,482	$ 1,449	$ -	$ 90,743	$ (39,478)	$ 170	$ 57,139

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

CoastalSouth Bancshares, Inc. and Subsidiary

Consolidated Statements of Cash Flows

For the years ended December 31, 2017 and 2016

(In thousands of dollars, except share data)

	2017	2016
Operating activities		
Net Income (loss)	$ (11,813)	$ 1,438
Adjustments to reconcile net income to net cash used by operating activities:		
Provision for loan losses	4,452	775
Depreciation expense	505	565
Increase in cash value of bank-owned life insurance	(172)	(161)
Stock-based compensation	149	-
Net gain on sale of securities available for sale	-	(153)
Impairment of securities available for sale	290	-
Write down on nonmarketable securities	54	-
Write down on other real estate owned	889	82
Write down on repossessed assets	25	
Net gain on sale of premises, furniture and equipment	(51)	-
Net loss on sale of other real estate owned	531	331
Net loss on sale of portfolio loans	916	3
Discount accretion and premium amortization	886	825
Deferred income tax (benefit) expense	(2,023)	384
Decrease (increase) in loans held for sale	26,552	(11,819)
Decrease (increase) decrease in other assets	5,759	(167)
Decrease (increase) in other liabilities	362	(28)
Net cash provided (used) by operating activities	27,311	(7,925)
Investing activities		
Purchase of securities available for sale	(19,254)	(19,155)
Proceeds from sales of securities available for sale	-	19,366
Proceeds from paydowns on mortgage backed securities	5,883	4,520
Net sale of non-marketable equity securities	(1,703)	616
Net decrease (increase) in loans	(30,185)	18,777
Net disposals (purchase) of premises, furniture and equipment	1,919	(2,539)
Proceeds from sales of other real estate owned	3,121	3,097
(Purchases) redemption of bank owned life insurance	(5,000)	517
Gain on redemption of bank owned life insurance	-	(293)
Net cash provided (used) by investing activities	(45,219)	24,906
Financing activities		
Net increase in deposits	27,309	16,915
Net proceeds (repayments) of Federal Home Loan Bank advances	40,000	(15,000)
Net increase in federal funds purchased	30,182	-
Net decrease in notes payable and subordinated debt	(2,350)	-
Issuance of preferred stock, net	17,153	-
Issuance of stock warrants	1,335	-
Issuance of common stock, net	39,978	23
Repayment of preferred stock and dividends	(24,506)	-
Net cash provided by financing activities	129,101	1,938
Net increase in cash and cash equivalents	111,193	18,919
Cash and cash equivalents, beginning of year	34,607	15,688
Cash and cash equivalents, end of year	$ 145,800	$ 34,607
Cash paid during the year for:		
Interest	$ 1,708	$ 2,241
Income taxes	(57)	775
Noncash investing and financing activities:		
Unrealized gains (losses) on securities available for sale, net	$ 651	$ (115)
Reclassification of income tax effects associated with the Tax Cuts and Jobs Act	27	-
Transfers of loans to other real estate owned	655	1,860
Issuance of common stock in relation to debt	-	23

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

(In thousands of dollars, except share data)

Note 1. Summary of Significant Accounting Policies

Organization
CoastalSouth Bancshares, Inc. (the "Company"), headquartered in Hilton Head Island, South Carolina, is a registered bank holding company with one banking subsidiary, CoastalStates Bank ("CSB"). CSB operates retail banking branches in Beaufort County, South Carolina and has commercial lending businesses with a local and national footprint. The deposits of CSB are insured by the Federal Deposit Insurance Corporation ("FDIC"). CSB has one wholly owned subsidiary, CoastalStates Mortgage, Inc. ("CSM"), formerly known as Homeowners Mortgage Enterprises, Inc. ("HME"), a mortgage company focused on originating and selling residential mortgages to investors. The Company was organized on September 28, 2003 as a Virginia corporation, with no activity until August 9, 2004. CSB was organized as a South Carolina state-chartered bank on July 30, 2004 and opened on August 9, 2004. HME was acquired on June 29, 2007.

Nature of Business
The Company offers full-service banking services designed to meet the needs of retail and commercial customers in the markets in which it operates. The services offered include transaction and savings deposit accounts, commercial and consumer lending, mortgage banking and other activities related to commercial banking. The Company and CSB are subject to the regulations of certain federal and state agencies and are periodically examined by those regulatory agencies. CSM is an approved mortgage lender with the Federal Housing Administration, Department of Veterans Affairs, Federal National Mortgage Association and Federal Home Loan Mortgage Corporation.

Use of Estimates in the Preparation of Financial Statements
The accounting and reporting policies of the Company and its subsidiaries are in accordance with accounting principles generally accepted in the United States of America ("US GAAP" or "GAAP") and also conform to general industry practices. All intercompany accounts and transactions have been eliminated in consolidation. Assets and liabilities of purchased companies are stated at estimated fair values at the date of acquisition. Results of operations of companies purchased are included from the date of acquisition. Certain reclassifications have been made to prior period amounts to conform to the current period presentation.

Management's Estimates
The preparation of consolidated financial statements requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent liabilities at the date of the consolidated 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 changes include:

- Determination of the allowance for loan losses ("ALL") and provision for credit losses
- Valuation of real estate acquired in conjunction with foreclosures or in satisfaction of loans
- Income taxes, including tax provisions and realization of deferred tax assets

Investment Securities

The Company classifies debt and equity investment securities into three categories: trading, held-to-maturity and available-for-sale. Management determines the appropriate classification of investment securities at the time of

(In thousands of dollars, except share data)

Note 1. Summary of Significant Accounting Policies, Continued

purchase. Debt investment securities are classified as held-to-maturity when the Company has the positive intent and ability to hold the investment securities to maturity. Held-to-maturity investment securities are carried at amortized cost. At December 31, 2017 and 2016, the Company had no investment securities classified as held-to-maturity.

Investment securities classified as trading are held principally for resale in the near term and are recorded at fair value. Gains or losses, either unrealized or realized, are reported in noninterest income. At December 31, 2017 and 2016, the Company had no investment securities classified as trading.

Investment securities not classified as either held-to-maturity or trading are classified as available-for-sale. Investment securities available-for-sale are stated at fair value, with the unrealized gains and losses, net of tax, reported as a separate component of accumulated other comprehensive income in the Consolidated Statements of Comprehensive Income.

The amortized cost of debt investment securities classified as either held-to-maturity or available-for-sale is adjusted for amortization of premiums and accretion of discounts to maturity or call, or in the case of mortgage-backed securities, over the estimated life of the security. Such amortization is considered an adjustment to yield on the security and included in interest income from investments. Interest and dividends are included in interest and dividends on investment securities in the Consolidated Statements of Income.

Gains and losses realized from the sales of investment securities are determined by specific identification and are included in noninterest income. Available-for-sale and held-to-maturity investment securities are reviewed quarterly for potential impairment. The Company determines whether it has the intent to sell a debt security or whether it is more likely than not it will be required to sell the debt security before the recovery of its amortized cost basis. If either condition is met, the Company will recognize, in earnings, an impairment loss necessary to reduce the carrying value of the debt security to fair value. For all other debt investment securities for which the Company does not expect to recover the entire amortized cost basis of the security and do not meet either condition, an other-than-temporary loss is considered to have occurred and the Company records the credit loss portion of impairment in earnings and the impairment related to all other factors in other comprehensive income.

Non-Marketable Equity Securities
Non-marketable equity securities include the cost of the Company's investment in the stock of the Federal Home Loan Bank of Atlanta and various other non-marketable equity investments. These stocks have no quoted market value and no ready market for them exists. Investment in the Federal Home Loan Bank of Atlanta is a condition of borrowing from the Federal Home Loan Bank of Atlanta, and the stock is pledged to collateralize such borrowings. At December 31, 2017 and 2016, the Company's investment in Federal Home Loan Bank stock was \$3,559 and \$1,856, respectively. At December 31, 2017 and 2016, the Company had investments in other non-marketable equity securities totaling \$127 and \$179, respectively. Dividends received on non-marketable equity securities are included as a separate component in interest income.

Loans Held for Sale
Loans held for sale ("LHFS") represent mortgage loans originated by CSM with the intent to sell. Generally, loans

(In thousands of dollars, except share data)

Note 1. Summary of Significant Accounting Policies, Continued

originated by CSM with the intent to sell are accounted for at fair value. Electing to use the fair value option of accounting allows a better offset of the changes in the fair values of the loans and the derivative instruments used to economically hedge them without the burden of complying with the requirements for hedge accounting. These loans are initially recorded and carried at fair value, with changes in fair value recognized in income from mortgage operations.

LHFS also includes loans acquired through the Company's mortgage banker finance line of business that are acquired with the intent to sell. These LHFS are accounted for at the lower of cost or fair value; as of December 31, 2017 and 2016, respectively, there have been no fair value adjustments recorded on this type of LHFS.

Additionally, the Company may periodically decide to sell other commercial and consumer loans and may reclassify loans from held for investment to held for sale when appropriate. At the time of transfer, the amount by which the amortized cost basis of the LHFS exceeds fair value may be accounted for as a valuation allowance or direct write-down.

Loans Held for Investment
Loans held for investment ("LHFI" or "Loans") are stated at their unpaid principal balance, net of any charge-offs. Interest income on loans is computed based upon the unpaid principal balance. Interest income on loans is recognized in the period earned and is computed using the effective interest method. Bank loan origination and commitment fees and certain direct loan origination costs, as well as purchase premiums and discounts, are deferred and amortized to income over the contractual life of the related loans or commitments, adjusted for prepayments, using a method that approximates a level yield.

Loans are considered past due or delinquent when the contractual principal or interest due in accordance with the terms of the loan agreement or any portion thereof remains unpaid after the due date of the scheduled payment. Loans are placed on non-accrual status when it becomes probable that interest is not fully collectible, generally when the loan becomes 90 days past due. Once loans are placed on non-accrual status, previously accrued but unpaid interest is reversed from interest income, and the accrual of interest income is suspended. Future payments received are applied to the principal balance of the loan. If and when borrowers demonstrate the sustained ability to repay such loans in accordance with the loan's contractual terms, the loan may be returned to accrual status. Loans which become 90 days past due are reviewed for collectability of principal. Principal amounts deemed uncollectible are charged off against the ALL, unless such loans are in the process of modification, collection through repossession, or foreclosure.

Impaired Loans
The Company considers a loan to be impaired when, based upon current information and events, it believes it is probable that the Company will be unable to collect all amounts due according to the contractual terms of the loan agreement. Management reviews all impaired loans over $100,000, and certain loans judgmentally identified under this threshold, individually to determine if a specific allowance based upon the borrower's overall financial condition, resources and payment record, support from guarantors and the realizable value of any collateral is necessary. Specific allowances are based upon discounted cash flows using a loan's initial effective interest rate or the net realizable value of the collateral for collateral-dependent loans. If the recorded investment in the

(In thousands of dollars, except share data)

Note 1. Summary of Significant Accounting Policies, Continued

impaired loan exceeds its fair value, a valuation allowance is required as a component of the ALL. Interest income on impaired loans is recorded on a cash basis once the loan's principal has been fully recovered.

Troubled Debt Restructurings
A loan is also considered impaired if its terms are modified in a troubled debt restructuring ("TDR"). A restructuring of debt constitutes a TDR if the Company, for economic or legal reasons related to a borrower's financial difficulties, grants a concession to a borrower that it would not otherwise consider. Concessions granted generally involve forgiving or forbearing a portion of interest or principal on any loans or making loans at a rate that is less than prevailing market rates. Prior to modifying a borrower's loan terms, the Company performs an evaluation of the borrower's financial condition and ability to service the debt under the potential modified loan terms. If a loan is accruing at the time of modification, the loan remains on accrual status and is subject to the Company's charge-off and non-accrual policies. If a loan is on non-accrual before it is determined to be a TDR, then the loan remains on non-accrual. TDRs may be returned to accrual status if there has been a sustained period of repayment performance by the borrower.

Allowance for Loan Losses
The ALL represents management's estimate of probable and reasonably estimable credit losses incurred in loans held for investment as of the balance sheet date. The estimate of the ALL is based upon management's evaluation of the loan portfolio including such factors as past loan loss experience, known and inherent risks in the portfolio, adverse situations that may affect the borrower's ability to repay (including the timing of future payments), the estimated value of any underlying collateral, composition of the loan portfolio, current market and economic conditions, borrower's payment status, internal credit risk ratings and other relevant factors. This evaluation is inherently subjective as it requires material estimates including the amounts and timing of future cash flows expected to be received on impaired loans that may be susceptible to significant changes. Loans are charged off when management believes that the ultimate collectability of the loan is unlikely. Allocation of the ALL may be made for specific loans, but the entire allowance is available for any loan that, in management's judgment, is deemed to be uncollectible. The ALL is increased by provisions charged to expense and decreased by actual charge-offs, net of recoveries.

The ALL adequacy assessment begins with a process of estimating probable and reasonably estimable credit losses incurred within the loan portfolio. These estimates are established by category and based upon the Company's internal system of credit risk ratings and historical loss data. The estimate of probable and reasonably estimable credit losses incurred within the loan portfolio may then be adjusted for management's estimate of additional probable and reasonably estimable credit losses as a result of specific credit exposures, trends in delinquent and nonaccrual loans, as well as other factors such as prevailing economic conditions, lending strategies, and other influencing factors.

Bank-Owned Life Insurance
Bank Owned Life Insurance ("BOLI") is long-term life insurance on the lives of certain employees where the insurance policy benefits and ownership are retained by the employer. To date, the Company has purchased life insurance policies on certain senior officers. BOLI is recorded at the cash surrender value, which can be adjusted for charges due at settlement at the balance sheet date. The cash value accumulation on BOLI is permanently tax deferred if

(In thousands of dollars, except share data)

Note 1. Summary of Significant Accounting Policies, Continued

the policy is held until the insured person's death.

Derivative Instruments
The Company issues rate lock commitments to borrowers on prices quoted by secondary market investors. Derivatives related to these commitments are recorded as either assets or liabilities on the balance sheet and are measured at fair value. The Company does not currently engage in any activities that qualify for hedge accounting. Accordingly, changes in fair value of these derivative instruments are included in noninterest income in the Consolidated Statements of Operations.

Liabilities for Representations and Warranties
The Company is exposed to certain liabilities under representations and warranties made to purchasers of mortgage loans and servicing rights that require indemnification or repurchase of loans. At the time it issues a guarantee, the Company is required to recognize an initial liability for the fair value of obligations assumed under the guarantee.

The Company establishes a contingency reserve for its liabilities under representations and warranties provided to purchasers of its mortgage loans and servicing rights. This reserve is maintained at a level considered appropriate by management to provide adequately for known and inherent losses. The reserve is based upon a continuing review of past loss experience, estimates and assumptions of risk elements and future economic conditions. Additions to the reserve are recorded in other expenses.

Management's judgment about the adequacy of the reserve is based upon a number of assumptions about future events which it believes to be reasonable but which may or may not be accurate. There is no assurance that additional increases in the reserve will not be required. The Company may from time-to-time be required to repurchase loans previously sold to investors due to loan nonperformance. In 2013 and 2014, a number of regulatory changes were enacted to limit loan repurchase risk. At December 31, 2017 and 2016, CSM had a contingency reserve of $200 and $202, respectively, for potential indemnifications to other third-party purchasers.

Premises and Equipment
Premises and equipment are stated at cost, less accumulated depreciation. The provision for depreciation is computed by the straight-line method, based on the estimated useful lives for buildings of 30 to 40 years and software, furniture and equipment of 3 to 10 years. Leasehold improvements are amortized over the life of the respective leases or over the useful life of the asset. The cost of assets sold or otherwise disposed of and the related allowance for depreciation are eliminated from the accounts and the resulting gains or losses are reflected in the income statement when incurred. Routine maintenance and repairs are charged to current expense. The costs of major repairs and improvements are capitalized. Premises and equipment are evaluated for impairment whenever events or changes in circumstances indicate that the carrying value of the asset may not be recoverable.

Other Real Estate Owned
Other real estate owned ("OREO") includes assets that have been acquired in satisfaction of debt through foreclosure. OREO is recorded at the lower of cost or fair value, minus estimated costs to sell. Subsequent to

(In thousands of dollars, except share data)

Note 1. Summary of Significant Accounting Policies, Continued

foreclosure, losses resulting from the periodic revaluation of the property are charged to net income and a new carrying value is established. Any gains or losses realized at the time of disposal or subsequent write-downs are reflected in the Consolidated Statements of Income. Expenses to maintain such assets are included in net cost of operation of other real estate owned.

Income Taxes
Income tax expense is based upon income before income taxes and generally differs from income taxes paid due to deferred income taxes and benefits arising from income and expenses being recognized in different periods for financial and income tax reporting purposes, as well as permanent differences. The Company uses the asset and liability method to account for deferred income taxes. The objective of the asset and liability method is to establish deferred tax assets and liabilities for the temporary differences between the financial reporting basis and the income tax basis of the Company's assets and liabilities at the effective rates expected to be in effect when such amounts are realized or settled. The Company evaluates the realization of deferred tax assets based upon all positive and negative evidence available at the balance sheet date. Realization of deferred tax assets is based upon the Company's judgments, including taxable income within any applicable carryback periods, future projected taxable income, reversal of taxable temporary differences and other tax-planning strategies to maximize realization of the deferred tax assets. A valuation allowance is recognized for a deferred tax asset if, based upon the weight of available evidence, it is more likely than not that some portion or all of the deferred tax asset will not be realized. In computing the income tax provision or benefit, the Company evaluates the technical merits of its income tax positions based upon current legislative, judicial and regulatory guidance.

The Company continually monitors and evaluates the potential impact of current events on the estimates used to establish income tax expense and income tax liabilities. The Company and its Subsidiary file a consolidated federal income tax return and separate state income tax returns based upon current tax law, positions taken by various tax auditors within the jurisdictions that the Company is required to file income tax returns, as well as potential or pending audits or assessments by such tax auditors. If the Company incurs interest and/or penalties related to income tax matters it will report them as a part of income tax expense.

The Company believes that its income tax filing positions taken or expected to be taken in its tax returns will more likely than not be sustained upon audit by the taxing authorities and does not anticipate any adjustments that will result in a material adverse impact on the Company's financial condition, results of operations, or cash flow. Therefore no reserves for uncertain income tax positions have been recorded.

Retirement Plan
The Company has a 401(k) profit sharing plan (the "Plan"), which provides retirement benefits to officers and employees who meet certain age and service requirements. The Plan includes a salary reduction feature pursuant to Section 401(k) of the Internal Revenue Code of 1986, as amended (the "Code"). At its discretion, the Bank makes matching contributions to the Plan. Expenses charged to earnings for the 401(k) profit sharing plan were $189 and $110 in 2017 and 2016, respectively, from continuing operations.

Net Loss Per Common Share
Basic net loss per common share represents loss available to stockholders divided by the weighted-average number of common shares outstanding during the period. Dilutive loss per share reflects additional common shares that would have been outstanding if dilutive potential common shares had been issued. Potential common

(In thousands of dollars, except share data)

Note 1. Summary of Significant Accounting Policies, Continued

shares that may be issued by the Company relate solely to outstanding options, warrants and restricted stock units are determined using the treasury stock method. Potential common shares are not included in the denominator of the diluted per share computation when inclusion would be anti-dilutive.

Comprehensive Income
Other comprehensive income is defined as the change in stockholders' equity during the period from transactions and other events and circumstances from nonowner sources. Accumulated other comprehensive income includes the reclassification for realized gains and losses from investment securities sales during the period and the unrealized holding gains and losses from investment securities available-for-sale.

Statement of Cash Flows
For purposes of reporting cash flows in the financial statements, the Company considers certain highly liquid debt instruments purchased with a maturity of three months or less to be cash equivalents. Cash equivalents include amounts due from banks, interest bearing accounts with other banks and federal funds sold. Generally, federal funds are sold for one-day periods.

Off-Balance-Sheet Financial Instruments
In the ordinary course of business, the Company enters into off-balance-sheet financial instruments consisting of commitments to extend credit and letters of credit. These financial instruments are recorded in the financial statements when they become payable by the customer.

Stock-Based Compensation
The Company grants stock options, restricted stock units, and other equity awards to purchase its common stock to certain key officers/employees and directors. Stock options are for a fixed number of shares with an exercise price equal to the fair value of the shares at the grant date. Fair value is determined using the Black-Scholes model. Stock-based compensation expense is recognized in the Consolidated Statements of Income on a straight-line basis over the vesting period. In addition, the Company estimates the number of awards for which vesting is probable and adjusts compensation cost accordingly. For nonqualified stock options, as compensation expense is recognized, a deferred tax asset is recorded that represents an estimate of the future tax deduction from exercise. At the time that stock-based awards are exercised, cancelled, or expire, the Company may be required to recognize an adjustment to income tax expense. For incentive stock options, the Company does not recognize an income tax benefit related to compensation expense in the period incurred or when exercised, unless there is a disqualifying disposition.

Fair Value
US GAAP requires the use of fair values in determining the carrying values of certain assets and liabilities, as well as for specific disclosures. Fair value is defined as the price that would be received to sell an asset or transfer a liability in an orderly transaction between willing market participants at the measurement date. When determining the fair value measurements for assets and liabilities, the Company considers the principal or most advantageous market in which those assets or liabilities are sold and considers assumptions that market participants would use when pricing those assets or liabilities.

(In thousands of dollars, except share data)

Note 1. Summary of Significant Accounting Policies, Continued

Individual fair value estimates are classified on a three-tiered scale based upon the relative reliability of the inputs used in the valuation. Fair values determined using Level 1 inputs rely on active and observable markets to price identical assets or liabilities. In situations where identical assets and liabilities are not traded in active markets, fair values may be determined based upon Level 2 inputs, which are used when observable data exists for similar assets and liabilities. Fair values for assets and liabilities that are not actively traded in observable markets are based upon Level 3 inputs, which are considered to be unobservable.

Operating Segments
Accounting standards require that information be reported about a company's operating segments using a "management approach." Reportable segments are identified in these standards as those revenue producing components for which separate financial information is produced internally and which are subject to evaluation by the chief operating decision maker. While the chief operating decision maker monitors the revenue streams of the various products and services, operations are managed and financial performance is evaluated on a Company-wide basis. Accordingly, all of the financial service operations are considered by management to be aggregated in one reportable segment.

Reclassifications
Certain captions and amounts in the 2016 consolidated financial statements were reclassified to conform with the 2017 presentation. These reclassifications had no effect on the net results of operations or stockholders' equity.

Recently Issued Accounting Pronouncements
In 2017, the Company registered with OTC-QX, which classifies the bank as a public business entity for the purposes of adopting new accounting pronouncements. The following table summarizes Accounting Standard Updates ("ASUs") which update various topics of the Accounting Standards Codification ("ASC") recently issued by the Financial Accounting Standards Board ("FASB") that could have a material effect on the Company's financial statements:

Standards Adopted in 2017			
Standard	**Description**	**Date of Adoption**	**Effect on the Financial Statements or Other Significant Matters**
ASU 2016-09, *Improvements to Employee Share-Based Payment Accounting*	This ASU updates ASC Topic 718, *Compensation-Stock Compensation,* guidance to simplify several aspects of the accounting for share-based payment award transactions including the income tax consequences, the classification of awards as either equity or liabilities, and the classification on the statement of cash flows.	January 1, 2017	There were no outstanding other stock options, warrants, or other instruments at the date of adoption. There was no impact upon adoption. The Company issued stock-based compensation in 2017 and elected to estimate compensation expense based on the expected amount of forfeitures.
ASU 2018-02, *Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income*	This ASU updates ASC Topic 220, Income Statement – Reporting Comprehensive Income, to allow a reclassification from accumulated other comprehensive income ("AOCI") for stranded tax effects resulting from the Tax Cuts and Jobs Act.	December 31, 2017	Upon adoption, there was an adjustment of $27 to increase AOCI and decrease retained earnings. This adjustment reflected the change in effective tax rates related to the net unrealized gain in AOCI associated with investment securities.

(In thousands of dollars, except share data)

Standards Not Yet Adopted			
Standard	**Description**	**Required Date of Adoption**	**Effect on the Financial Statements or Other Significant Matters**
ASU 2014-09, *Revenue from Contracts with Customers* ASU 2015-14, *Deferral of the Effective Date* ASU 2016-08, *Principal versus Agent Considerations* ASU 2016-10, *Identifying Performance Obligations and Licensing* ASU 2016-12, *Narrow-Scope Improvements and Practical Expedients* ASU 2016-20, *Technical Corrections and Improvements* ASU 2017-05*, Clarifying the Scope of Asset Derecognition Guidance and Accounting for Partial Sales of Nonfinancial Assets*	These ASUs supersede the revenue recognition requirements in ASC Topic 605, *Revenue Recognition*, and most of the industry-specific guidance throughout Industry Topics of the Codification. The core principle of the new guidance is that an entity should recognize revenue to reflect the transfer of goods and services to customers in an amount equal to the consideration the entity receives or expects to receive. Additionally, guidance was added to align the derecognition of non-financial assets with the new revenue recognition guidance. There are several new qualitative and quantitative disclosures required. The ASUs may be adopted either retrospectively or on a modified retrospective basis to new contracts and existing contracts, with remaining performance obligations as of the adoption date.	January 1, 2018	The Company plans to adopt the standards beginning January 1, 2018 and expects to use the modified retrospective method of adoption. The Company's revenue is comprised of net interest income and noninterest income. The scope of the guidance explicitly excludes net interest income as well as many other revenue streams for financial institutions, including loans, securities, and derivatives. The Company is assessing revenue streams that are within the scope of the ASUs. The Company's accounting policies will not change materially since the principles of revenue recognition from the ASUs are largely consistent with existing guidance and current practices applied by our businesses. We have not identified material changes to the timing or amount of revenue recognition for in-scope revenue streams. Based on the updated guidance, we do anticipate some changes in the disclosures associated with revenue.
ASU 2016-01, *Recognition and Measurement of Financial Assets and Financial Liabilities*	The ASU amends ASC Topic 825, *Financial Instruments-Overall*, and addresses certain aspects of recognition, measurement, presentation, and disclosure of financial instruments. The main provisions require investments in equity securities to be measured at fair value through net income, unless they qualify for a practicability exception, and require fair value changes arising from changes in instrument-specific credit risk for financial liabilities that are measured under the fair value option to be recognized in other comprehensive income. With the exception of disclosure requirements that will be adopted prospectively, the ASU must be adopted on a modified retrospective basis.	January 1, 2018	The Company plans to adopt the standards beginning January 1, 2018 and will record a cumulative-effect adjustment to the balance sheet as of the beginning of the fiscal year of adoption. The Company does not expect this ASU to have a material effect on the Consolidated Financial Statements.

(In thousands of dollars, except share data)

Standards Not Yet Adopted			
Standard	**Description**	**Required Date of Adoption**	**Effect on the Financial Statements or Other Significant Matters**
ASU 2016-02, *Leases*	The ASU creates ASC Topic 842, *Leases*, which supersedes ASC Topic 840, *Leases*. ASC Topic 842 requires lessees to recognize right-of-use assets and associated liabilities that arise from leases, with the exception of short-term leases. The ASU does not make significant changes to lessor accounting; however, there were certain improvements made to align lessor accounting with the lessee accounting model and ASC Topic 606, *Revenue from Contracts with Customer*s. There are several new qualitative and quantitative disclosures required. Upon transition, lessees and lessors are required to recognize and measure leases at the beginning of the earliest period presented using a modified retrospective approach.	January 1, 2019 Early adoption is permitted.	The amount of the right-of-use assets and associated lease liabilities recorded upon adoption will be based primarily on the present value of unpaid future minimum lease payments, the amount of which will depend on the population of leases in effect at the date of adoption. The Company does not expect this ASU to have a material effect on the Consolidated Financial Statements.
ASU 2016-13, *Measurement of Credit Losses on Financial Instruments*	The ASU amends ASC Topic 326, Financial Instruments- Credit Losses, to replace the incurred loss impairment methodology with a current expected credit loss ("CECL") methodology for financial instruments measured at amortized cost and other commitments to extend credit. For this purpose, expected credit losses reflect losses over the remaining contractual life of an asset, considering the effect of voluntary prepayments and considering available information about the collectability of cash flows, including information about past events, current conditions, and reasonable and supportable forecasts. The resulting allowance for credit losses reflects the portion of the amortized cost basis that the entity does not expect to collect. Additional quantitative and qualitative disclosures are required upon adoption. The CECL model does not apply to AFS debt securities; however, the ASU requires entities to record an allowance when recognizing credit losses for AFS securities, rather than recording a direct write-down of the carrying amount.	January 1, 2021 Early adoption is permitted.	The Company is evaluating the impact that this ASU will have on its Consolidated Financial Statements and related disclosures, and the Company currently anticipates that an increase to the allowance for credit losses will be recognized upon adoption to provide for the expected credit losses over the estimated life of the financial assets. In addition to our allowance for loan losses, we may also be required to record an allowance for credit losses on debt securities instead of applying the impairment model currently utilized. However, since the magnitude of the anticipated increase in the allowance for credit losses will be impacted by economic conditions and trends in the Company's portfolio at the time of adoption, the quantitative impact cannot yet be reasonably estimated.

(In thousands of dollars, except share data)

Standards Not Yet Adopted			
Standard	**Description**	**Required Date of Adoption**	**Effect on the Financial Statements or Other Significant Matters**
ASU 2016-15, *Statement of Cash Flows (Topic 230): Classification of Certain Cash Receipts and Cash Payments*	The ASU amends ASC Topic 230, Statement of Cash Flows, to clarify the classification of certain cash receipts and payments within the Company's Consolidated Statements of Cash Flow. These items include: cash payments for debt prepayment or debt extinguishment costs; cash outflows for the settlement of zero-coupon debt instruments or other debt instruments with coupon interest rates that are insignificant; contingent consideration payments made after a business combination; proceeds from the settlement of insurance claims; proceeds from the settlement of corporate-owned life insurance policies, including bank-owned life insurance policies; distributions received from equity method investees; and beneficial interests acquired in securitization transactions. The ASU also clarifies that when no specific U.S. GAAP guidance exists and the source of the cash flows are not separately identifiable, then the predominant source of cash flow should be used to determine the classification for the item. The ASU must be adopted on a retrospective basis.	January 1, 2018 Early adoption is permitted.	The Company does not expect this ASU to have a material effect on the Consolidated Financial Statements.
ASU 2017-09, *Scope of Modification Accounting*	This ASU updates ASC Topic 718, *Compensation – Stock Compensation*, to provide guidance about which changes to the terms and conditions of a share-based payment award require an entity to apply modification accounting. An entity should account for the effects of a modification unless all of the following conditions are met: the fair value of the modified award is the same as the fair value of the original award at the time of modification, the vesting conditions of the modified award are unchanged, and the classification of the award as an equity instrument or liability instrument is unchanged.	January 1, 2018	The Company does not expect this ASU to have a material effect on the Consolidated Financial Statements.

Other accounting standards that have been issued or proposed by the FASB or other standards-setting bodies are not expected to have a material impact on the Company's financial position, results of operations or cash flows.

Note 2. Cash and Due From Banks

The Company is required to maintain cash balances with its correspondent banks to cover all cash letter transactions. At December 31, 2017 and 2016, the requirement was met by the cash balance in the vault and balances on deposit with other banks.

(In thousands of dollars, except share data)

Note 3. Investment Securities

The amortized cost and estimated fair values of securities available for sale at December 31, 2017 and 2016 are shown in the tables below:

	2017			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Mortgage backed securities	$ 40,950	$ 142	$ 281	$ 40,811
Government-sponsored agencies	4,360	24	34	4,350
Obligations of corporations	500	-	-	500
Municipal obligations	8,767	415	57	9,125
Total securities available for sale	$ 54,577	$ 581	$ 372	$ 54,786

	2016			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Mortgage backed securities	$ 34,283	$ 30	$ 571	$ 33,742
Government-sponsored agencies	5,347	18	56	5,309
Obligations of corporations	500	-	-	500
Municipal obligations	2,250	-	208	2,042
Total securities available for sale	$ 42,380	$ 48	$ 835	$ 41,593

Proceeds from sales of securities available for sale during 2017 and 2016 were $0 and $19,366, respectively, resulting in gross realized gains of $0 and $161, respectively, and gross realized losses of $0 and $8, respectively.

The following is a summary of maturities available for sale as of December 31, 2017. The amortized cost and estimated fair values are based on the contractual maturity dates. Actual maturities may differ from contractual maturities because borrowers may have the right to call or repay obligations with or without penalty. Mortgaged-backed securities are not presented by maturity date because pay-downs are expected before contractual maturity dates.

(In thousands of dollars, except share data)

Note 3. Investment Securities, Continued

	Amortized Cost	Estimated Fair Value
Due after one year but within five years	$ 4,360	$ 4,350
Due after five years but within ten years	4,121	4,205
Due after ten years	5,146	5,420
Mortgage backed securities	40,950	40,811
Total	$ 54,577	$ 54,786

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

	Less than Twelve months		Twelve months or more		Total	
	Fair Value	Unrealized losses	Fair Value	Unrealized losses	Fair Value	Unrealized losses
Mortgage backed securities	$ 17,167	$ 30	$ 11,407	$ 251	$ 28,574	$ 281
Government-sponsored agencie	2,444	26	562	8	3,006	34
Municipal obligations	-	-	1,752	57	1,752	57
	$ 19,611	$ 56	$ 13,721	$ 316	$ 33,332	$ 372

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

	Less than Twelve months		Twelve months or more		Total	
	Fair Value	Unrealized losses	Fair Value	Unrealized losses	Fair Value	Unrealized losses
Mortgage backed securities	$ 20,813	$ 501	$ 7,759	$ 70	$ 28,572	$ 571
Government-sponsored agencie	3,475	56	-	-	3,475	56
Municipal obligations	2,042	208	-	-	2,042	208
	$ 26,330	$ 765	$ 7,759	$ 70	$ 34,089	$ 835

Securities classified as available for sale are recorded at fair market value. Of the securities in an unrealized loss position at December 31, 2017 and 2016, eighteen and thirty-one securities were in a continuous loss position for twelve months or more, respectively. The Company believes, based on industry analyst reports and credit ratings, that the deterioration in value is attributable to changes in market interest rates and is not in the credit quality of the issuer and therefore, these losses are not considered other-than-temporary.

The Company evaluates securities for other-than-temporary impairment on a quarterly basis and more frequently

(In thousands of dollars, except share data)

Note 3. Investment Securities, Continued

when economic conditions warrant. In performing this evaluation, the length of time and the extent to which the fair value has been less than cost, the fact that the Company's securities are primarily issued by U.S. Treasury and U.S. Government agencies and the cause of the decline in value are considered. In addition, the Company does not intend to sell and it is not more likely than not that we will be required to sell these securities before maturity. While some available for sale securities have been sold for liquidity purposes or for gains, the Company has traditionally held its securities, including those classified as available for sale, until maturity. As a result of this evaluation, the Company has determined that the declines summarized in the tables above are not deemed to be other-than-temporary.

As part of its routine evaluation of securities for other-than-temporary impairment, the Company identified potential credit losses on certain individual bonds issued by the Small Business Administration ("SBA") with a carrying value of $14,209 during 2017. On October 16, 2017, the SBA posted in the Federal Register (Vol. 82 No. 198) to provide notice of a procedural change in SBA's Secondary Market Pooling Program. The change involved the way principal payments were passed through on prepayments in SBA pools which caused a push-through of "retained principal" when a loan prepays. The change increased prepayment speeds on investment securities in 2017. Due to the changes to the SBA program, the Company had the intent to sell such securities prior to December 31, 2017 and would not likely recover the amortized cost basis. Therefore, the Company recorded a loss of $290 from the credit impairment of these bonds.

During 2017, the Company recognized a write down of $54 on a cost basis investment included in non-marketable equity securities to reduce the balance to its fair value. No write down on other non-marketable equity securities was recognized during 2016.

At December 31, 2017 and 2016, investment securities with a book value of $46,135 and $11,579, respectively, and a market value of $45,724 and $11,485, respectively, were pledged to secure federal funds lines of credit and Federal Home Loan Bank borrowings.

Note 4. Loans and Allowance for Loan Losses

Composition of Loan Portfolio

The Company engages in a full complement of lending activities, including real estate-related loans, construction loans, commercial and industrial loans, and consumer purpose loans. While risk of loss in the Company's portfolio is primarily tied to the credit quality of the various borrowers, risk of loss may increase due to factors beyond the Company's control, such as local, regional and/or national economic downturns. General conditions in the real estate market may also impact the relative risk in the real estate portfolio.

Construction and land loans include loans for the development of residential neighborhoods, construction of one-to-four family residential construction loans to builders, commercial real estate construction loans, primarily for owner-occupied properties, and other loans for land investment. Construction loans generally carry a higher degree of risk than long-term financing of existing properties because repayment depends upon the ultimate completion of the project and usually on the subsequent lease-up and/or sale of the property. The Company limits its construction lending risk through adherence to established underwriting procedures.

(In thousands of dollars, except share data)

Note 4. Loans and Allowance for Loan Losses, Continued

Commercial real estate loans include loans secured by owner-occupied commercial buildings for office, storage, retail, farmland, and warehouse space. They also include non-owner occupied commercial buildings such as leased retail and office space, multi-family properties, and senior housing developments. The primary risk associated with loans secured with income-producing property is the inability of that property to produce adequate cash flow to service the debt. High unemployment, generally weak economic conditions and/or an oversupply in the market may result in our customers having difficulty achieving adequate occupancy rates. Payments on such loans are often dependent on successful operation or management of the properties.

Commercial and industrial loans include both secured and unsecured loans for working capital, expansion, and other business purposes. Short-term working capital loans may be secured by non-real estate collateral such as accounts receivable, inventory, and/or equipment. The Company evaluates the financial strength, cash flow, management, credit history of the borrower and the quality of the collateral securing the loan. Repayment is primarily dependent on the ability of the borrower to achieve business results consistent with those projected at loan origination resulting in cash flow sufficient to service the debt. To the extent that a borrower's business results are significantly unfavorable versus the original projections, the ability for the loan to be serviced on a basis consistent with the contractual terms may be at risk. The Company often requires personal guarantees and secondary sources of repayment on commercial and industrial loans.

Residential real estate loans include permanent mortgage financing, construction loans to individual consumers, and home equity lines of credit. These loans are secured by residential properties. Significant and rapid declines in real estate values can result in residential mortgage loan borrowers having debt levels in excess of the current market value of the collateral.

Consumer purpose loans primarily includes purchased student loans and purchased consumer unsecured loans. Consumer loans may carry greater risks than other loans, as these loans are generally unsecured.

Loans held for sale are comprised of loans acquired through mortgage warehouse lending activities and mortgage banking activities. The Company serves as a warehouse lender by purchasing loans originated by third-party mortgage originators and selling these loans to other third-party investors. The Company also originates mortgage loans with customers through CSM and sells these loans to third-party investors.

(In thousands of dollars, except share data)

Note 4. Loans and Allowance for Loan Losses, Continued

Following is a summary of the composition of the loan portfolio at December 31, 2017 and 2016:

	2017	2016
Commercial loans:		
Construction and land	$ 16,136	$ 10,047
Commercial real estate	79,342	72,136
Commercial and industrial	49,763	49,044
Consumer loans:		
Residential real estate	73,675	70,692
Other consumer (2)	46,905	38,433
Total gross LHFI	265,821	240,352
Less allowance for loan losses	(3,915)	(2,608)
LHFI, net	$ 261,906	$ 237,744
LHFS (1)	$ 36,333	$ 62,885

(1) Includes $34,128 and $23,529 in loans acquired through mortgage banker finance as of December 31, 2017 and 2016, respectively.
(2) Includes $28,022 and $32,898 in loans acquired through the Lending Club program, an online marketplace lender, and $14,942 and $0 of student loans acquired from Laurel Road, a division of Darien Rowayton Bank, as of December 31, 2017 and 2016, respectively.

Credit Quality Indicators

The Company monitors the credit quality of its commercial loan portfolio using internal credit risk ratings. These credit risk ratings are based upon established regulatory guidance and are assigned upon initial approval of credit to borrowers. Credit risk ratings are updated periodically after the initial assignment or whenever management becomes aware of information affecting the borrowers' ability to fulfill their obligations. The Company utilizes the following categories of credit grades to evaluate its commercial loan portfolio:

Pass - Loans classified as pass are higher quality loans that do not fit any of the other categories below.

Special Mention - Loans classified as special mention have a potential weakness that deserves management's close attention. If left uncorrected, these potential weaknesses may result in deterioration of the repayment prospects for the loan or of the Company's credit position at some future date.

Substandard - Loans classified as substandard are inadequately protected by the current net worth and paying capacity of the obligor or of the collateral pledged, if any. Loans so classified have a well-defined weakness or weaknesses that jeopardize the liquidation of the debt. They are characterized by the distinct possibility that the Company will sustain some loss if the deficiencies are not corrected.

Doubtful - Loans classified as doubtful have all the weaknesses inherent in those classified as substandard, with the added characteristic that the weaknesses make collection or liquidation in full, on the basis of currently existing facts, conditions, and values, highly questionable and improbable. The possibility of loss is high, but because of certain important and reasonably specific pending factors that may work to the advantage and strengthening of the credit quality of the loan, its classification as an estimated loss is deferred until its more exact status may be determined. Pending factors include proposed merger, acquisition, or liquidation procedures, capital injection, perfecting liens on additional collateral and refinancing plans.

(In thousands of dollars, except share data)

Note 4. Loans and Allowance for Loan Losses, Continued

The following table shows the credit quality indicators associated with the Company's commercial loan portfolio as of December 31, 2017:

	Construction and Land	Commercial Real Estate	Commercial and Industrial	Total
Pass	$ 15,550	$ 71,903	$ 48,479	$ 135,932
Special mention	483	5,216	997	6,696
Substandard	103	2,223	287	2,613
Doubtful	-	-	-	-
Total	$ 16,136	$ 79,342	$ 49,763	$ 145,241

The following table shows the credit quality indicators associated with the Company's commercial loan portfolio as of December 31, 2016:

	Construction and Land	Commercial Real Estate	Commercial and Industrial	Total
Pass	$ 8,398	$ 68,185	$ 47,545	$ 124,128
Special mention	1,073	3,650	295	5,018
Substandard	576	301	1,204	2,081
Doubtful	-	-	-	-
Total	$ 10,047	$ 72,136	$ 49,044	$ 131,227

The Company monitors the credit quality of its consumer portfolio based primarily on payment activity and credit scores. Payment activity is the primary factor considered in determining whether a consumer loan should be classified as nonperforming.

(In thousands of dollars, except share data)

Note 4. Loans and Allowance for Loan Losses, Continued

The following table shows the credit quality indicators associated with the Company's consumer loan portfolio as of December 31, 2017:

	Residential Real Estate	Other Consumer	Total
Performing	$ 71,030	$ 46,895	$ 117,925
Nonperforming	2,645	10	2,655
Total	$ 73,675	$ 46,905	$ 120,580

The following table shows the credit quality indicators associated with the Company's consumer loan portfolio as of December 31, 2016:

	Residential Real Estate	Other Consumer	Total
Performing	$ 68,053	$ 38,433	$ 106,486
Nonperforming	2,639	-	2,639
Total	$ 70,692	$ 38,433	$ 109,125

(In thousands of dollars, except share data)

Note 4. Loans and Allowance for Loan Losses, Continued

The following is a summary of information pertaining to our allowance for loan losses at December 31, 2017:

	Construction and Land	Commercial Real Estate	Commercial and Industrial	Residential Real Estate	Other Consumer	Total
Allowance for loan losses:						
Beginning balance:	$ 88	$ 294	$ 747	$ 418	$ 1,061	$ 2,608
Charge-offs	(35)	(34)	(990)	(493)	(1,913)	(3,465)
Recoveries	11	49	10	151	99	320
Provision	138	508	644	1,015	2,147	4,452
Ending balance	$ 202	$ 817	$ 411	$ 1,091	$ 1,394	$ 3,915
Ending balances:						
Individually evaluated for impairment	$ 73	$ 386	$ 12	$ 454	$ -	$ 925
Collectively evaluated for impairment	$ 129	$ 431	$ 399	$ 637	$ 1,394	$ 2,990
Loans receivable:						
Ending balance - total	$ 16,136	$ 79,342	$ 49,763	$ 73,675	$ 46,905	$ 265,821
Ending balances:						
Individually evaluated for impairment	$ 408	$ 3,130	$ 287	$ 4,065	$ 10	$ 7,900
Collectively evaluated for impairment	$ 15,728	$ 76,212	$ 49,476	$ 69,610	$ 46,895	$ 257,921

(In thousands of dollars, except share data)

Note 4. Loans and Allowance for Loan Losses, Continued

The following is a summary of information pertaining to our allowance for loan losses at December 31, 2016:

	Construction and Land	Commercial Real Estate	Commercial and Industrial	Residential Real Estate	Other Consumer	Total
Allowance for loan losses:						
Beginning balance:	$ 176	$ 578	$ 525	$ 648	$ 912	$ 2,839
Charge-offs	(1)	(207)	(502)	(208)	(524)	(1,442)
Recoveries	10	201	-	207	18	436
Provision (Release)	(97)	(278)	724	(229)	655	775
Ending balance	$ 88	$ 294	$ 747	$ 418	$ 1,061	$ 2,608
Ending balances:						
Individually evaluated for impairment	$ 70	$ 143	$ 420	$ 179	$ -	$ 812
Collectively evaluated for impairment	$ 18	$ 151	$ 327	$ 239	$ 1,061	$ 1,796
Loans receivable:						
Ending balance - total	$ 10,047	$ 72,136	$ 49,044	$ 70,692	$ 38,433	$ 240,352
Ending balances:						
Individually evaluated for impairment	$ 1,518	$ 5,406	$ 1,409	$ 2,109	$ 14	$ 10,456
Collectively evaluated for impairment	$ 8,529	$ 66,730	$ 47,635	$ 68,583	$ 38,419	$ 229,896

(In thousands of dollars, except share data)

Note 4. Loans and Allowance for Loan Losses, Continued

The following summarizes the Company's impaired loans at December 31, 2017:

	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Interest Income Recognized
With no related allowance needed:					
Construction and land	$ 268	$ 382	$ -	$ 280	$ 1
Commercial real estate	797	797	-	804	-
Commercial and industrial	-	-	-	-	-
Residential real estate	2,025	2,115	-	2,110	87
Other consumer	10	10	-	20	8
Ending balance	$ 3,100	$ 3,304	$ -	$ 3,214	$ 96
With an allowance recorded:					
Construction and land	$ 140	$ 140	$ 73	$ 143	$ -
Commercial real estate	2,333	2,333	386	2,351	1
Commercial and industrial	287	287	12	293	-
Residential real estate	2,040	2,040	454	2,058	48
Other consumer	-	-	-	-	-
Ending balance	$ 4,800	$ 4,800	$ 925	$ 4,845	$ 49
Total:					
Construction and land	$ 408	$ 522	$ 73	$ 423	$ 1
Commercial real estate	3,130	3,130	386	3,155	1
Commercial and industrial	287	287	12	293	-
Residential real estate	4,065	4,155	454	4,168	135
Other consumer	10	10	-	20	8
Ending balance	$ 7,900	$ 8,104	$ 925	$ 8,059	$ 145

(In thousands of dollars, except share data)

Note 4. Loans and Allowance for Loan Losses, Continued

The following summarizes the Company's impaired loans at December 31, 2016:

	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Interest Income Recognized
With no related allowance needed:					
Construction and land	$ 816	$ 932	$ -	$ 790	$ -
Commercial real estate	2,920	2,920	-	2,941	4
Commercial and industrial	186	186	-	232	1
Residential real estate	1,052	1,207	-	1,055	30
Other consumer	14	14	-	14	-
Ending balance	$ 4,988	$ 5,259	$ -	$ 5,032	$ 35
With an allowance recorded:					
Construction and land	$ 702	$ 702	$ 70	$ 705	$ -
Commercial real estate	2,486	2,907	143	2,492	111
Commercial and industrial	1,223	1,292	420	1,275	34
Residential real estate	1,057	1,057	179	1,045	7
Other consumer	-	-	-	-	-
Ending balance	$ 5,468	$ 5,958	$ 812	$ 5,517	$ 152
Total:					
Construction and land	$ 1,518	$ 1,634	$ 70	$ 1,495	$ -
Commercial real estate	5,406	5,827	143	5,433	115
Commercial and industrial	1,409	1,478	420	1,507	35
Residential real estate	2,109	2,264	179	2,100	37
Other consumer	14	14	-	14	-
Ending balance	$ 10,456	$ 11,217	$ 812	$ 10,549	$ 187

The following is a summary of past due and nonaccrual loans as of December 31, 2017:

	30-59 Days Past Due	60-89 Days Past Due	Over 90 Days and Accruing	Nonaccrual	Total Past Due and Nonaccrual	Current	Total Loans Receivable
Construction and land	$ -	$ -	$ -	$ -	$ -	$ 16,136	$ 16,136
Commercial real estate	255	-	-	1,618	1,873	77,469	79,342
Commercial and industrial	164	-	-	287	451	49,312	49,763
Residential real estate	320	-	-	2,644	2,964	70,711	73,675
Other consumer	215	188	-	10	413	46,492	46,905
	$ 954	$ 188	$ -	$ 4,559	$ 5,701	$ 260,120	$ 265,821

(In thousands of dollars, except share data)

Note 4. Loans and Allowance for Loan Losses, Continued

The following is a summary of past due and nonaccrual loans as of December 31, 2016:

	30-59 Days Past Due	60-89 Days Past Due	Over 90 Days and Accruing	Nonaccrual	Total Past Due and Nonaccrual	Current	Total Loans Receivable
Construction and land	$ -	$ -	$ -	$ 576	$ 576	$ 9,471	$ 10,047
Commercial real estate	-	-	-	301	301	71,835	72,136
Commercial and industrial	-	-	-	1,204	1,204	47,840	49,044
Residential real estate	1,769	-	-	2,639	4,408	66,284	70,692
Other consumer	171	11	-	-	182	38,251	38,433
	$ 1,940	$ 11	$ -	$ 4,720	$ 6,671	$ 233,681	$ 240,352

Troubled Debt Restructurings

The following table summarizes the carrying balance of troubled debt restructurings ("TDRs") as of December 31, 2017 and 2016:

	2017	2016
Performing TDRs	$ 1,618	$ 4,801
Nonperforming TDRs	3,340	221
Total TDRs	$ 4,958	$ 5,022

Loans classified as TDRs may be removed from this status for disclosure purposes after a specified period of time if a subsequent restructured agreement specifies an interest rate equal to or greater than the rate that the lender was willing to accept at the time of the restructuring for a new loan with comparable risk, and the loan is performing in accordance with the terms specified by the restructured agreement.

The following is an analysis of TDRs identified during the year ended December 31, 2017:

	Number of Contracts	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment
Troubled Debt Restructurings			
Construction and land	-	$ -	$ -
Commercial real estate	1	728	728
Commercial and industrial	-	-	-
Residential real estate	1	638	638
Other consumer	-	-	-
	2	$ 1,366	$ 1,366

(In thousands of dollars, except share data)

Note 4. Loans and Allowance for Loan Losses, Continued

The following is an analysis of TDRs identified during the year ended December 31, 2016:

	Number of Contracts	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment
Troubled Debt Restructurings			
Construction and land	1	$ 557	$ 557
Commercial real estate	-	-	-
Commercial and industrial	1	221	221
Residential real estate	-	-	-
Other consumer	-	-	-
	2	$ 778	$ 778

The Bank provided interest rate and/or amortization term concessions for loans identified as TDRs during the years ended December 31, 2017 and 2016, respectively. No TDRs that were restructured in the previous twelve months re-defaulted during the years ended December 31, 2017 and 2016.

Note 5. Premises, Furniture and Equipment

Premises, furniture and equipment is summarized as follows as of December 31:

	2017	2016
Furniture and equipment	$ 3,370	$ 3,263
Leasehold and land improvements	2,550	2,572
Software	1,374	1,413
Buildings and improvements	501	496
Vehicles	208	209
Land	-	250
Total	8,003	8,203
Less: accumulated depreciation and amortization	(6,829)	(6,546)
Premises, furniture and equipment, net	$ 1,174	$ 1,657

Depreciation expense for the years ended December 31, 2017 and 2016 was $505 and $565, respectively.

(In thousands of dollars, except share data)

Note 6. Other Assets

Other assets consisted of the following as of December 31:

	2017	2016
Accrued interest receivable	$ 1,394	$ 1,207
Prepaid expense	703	888
Accounts receivable	615	1,728
Secondary market gains receivable	71	850
Mortgage loan interest rate lock commitments	-	584
Other	81	265
Total	$ 2,864	$ 5,522

Note 7. Other Real Estate Owned

The following summarizes the activity in the other real estate owned for the years ended December 31:

	2017	2016
Balance, beginning of year	$ 8,058	$ 9,708
Additions - foreclosures	656	1,860
Sales	(3,653)	(3,337)
Writedowns	(889)	(173)
Balance, end of year	$ 4,172	$ 8,058

Net losses of $531 and $331 were recognized on the sale of other real estate owned for the years ended December 31, 2017 and 2016, respectively and are included in the net cost of operation of other real estate owned in the statement of operations. Other real estate expenses for the years ended December 31, 2017 and 2016 were $698 and $322, respectively, which includes gains and losses on sales as well as write-downs.

There were $0 and $63 of repossessed assets at December 31, 2017 and 2016, respectively. Repossessed asset write-downs for the years ended December 31, 2017 and 2016 were $25 and $0, respectively.

There were $765 and $1,063 of residential real estate loans in the process of foreclosure at December 31, 2017 and 2016, respectively.

(In thousands of dollars, except share data)

Note 8. Derivatives

There were no outstanding derivative positions as of December 31, 2017.

The derivative positions of the Company as of December 31, 2016 are reported as other assets and other liabilities and are as follows:

	2016	
	Fair value	**Notional value**
Derivative assets:		
Mortgage loan interest rate lock commitments	$ 584	$ 47,420
Derivative liabilities:		
Mortgage loan forward sales commitments	$ 17	$ 39,000

The Company uses derivatives intended to reduce interest rate risk incurred as a result of market movements. These derivatives primarily consist of mortgage loan interest rate lock commitments. A derivative is a financial instrument that derives its cash flows, and therefore its value, by reference to an underlying instrument, index or reference interest rate. The Company uses derivatives primarily to minimize interest rate risk related to its pipeline of loan interest rate lock commitments issued on residential mortgage loans in the process of origination for sale or loans held for sale. The Company's derivative positions are classified as trading assets and liabilities, and as such, the changes in the fair market value of the derivative positions are recognized in the consolidated statements of operations within income from mortgage operations.

Note 9. Deposits

At December 31, 2017, the scheduled maturities of certificates of deposit were as follows:

Maturing In	**Amount**
2018	$ 67,951
2019	4,842
2020	1,319
2021	1,867
2022 and thereafter	1,037
Total	$ 77,016

The Company had $25,251 and $11,811 in brokered deposits at December 31, 2017 and 2016, respectively.

Time deposits that meet or exceed the FDIC Insurance limit of $250 at December 31, 2017 and 2016 were $12,196 and $8,268, respectively.

(In thousands of dollars, except share data)

Note 10. Other Borrowings

The Company has the following other borrowings at December 31, 2017 and 2016:

	2017	2016
Federal Home Loan Bank advance	$ 75,000	$ 35,000
Federal funds purchased	30,182	-
Note payable	-	2,850
Subordinated debt	500	-
Total	$ 105,682	$ 37,850

A detailed description of Federal Home Loan Bank ("FHLB") advances at December 31, 2017 and 2016 is listed below.

	Interest Rate	2017	2016
FHLB adjustable rate advances maturing:			
September 20, 2017	3.71%	$ -	$ 5,000
September 20, 2017	3.61%	-	5,000
September 26, 2017	3.07%	-	5,000
November 7, 2017	2.78%	-	5,000
November 30, 2017	3.17%	-	5,000
December 20, 2017	2.85%	-	10,000
FHLB fixed rate advances maturing:			
September 28, 2018 (1)	1.59%	75,000	-
Total FHLB advances		$ 75,000	$ 35,000

(1) This FHLB advance is a daily rate line of credit that can be repaid at any time with no penalty.

At December 31, 2017, all $75,000 repayments of FHLB advances are scheduled for 2018.

The Company had pledged investment securities at December 31, 2017 and 2016, totaling $35,459 and $1,585, respectively, as collateral for the FHLB advances. The Company's Federal Home Loan Bank stock is also pledged to secure the borrowings. In addition, the Company has pledged blanket liens on its first mortgage 1-4 family loans, its multifamily residential property loans, and its revolving, open-end loans secured by 1-4 family residential properties and extended under lines of credit. The aggregate balance of these loans totaled $40,355 and $61,961 at December 31, 2017 and 2016, respectively. Certain advances are subject to prepayment penalties.

The Company had pledged investment securities at December 31, 2017 and 2016, totaling $9,045 and $7,595, respectively, as collateral for federal funds purchased.

The Company executed a promissory note on December 23, 2015 for $3,548 with CSouth Financial Group, LLC ("CSFG"). The outstanding principal was immediately reduced to $2,850 on the date of execution due to a common stock for debt swap transaction also with CSFG. The individual owners of CSFG were issued 415,540 shares of common stock (pre-split). Interest payments were calculated based on the Prime Rate as published by the Wall

(In thousands of dollars, except share data)

Note 10. Other Borrowings, Continued

Street Journal, and due quarterly beginning March 23, 2016, with principal installments of $285 beginning December 23, 2018 and to be repaid in its entirety by December 23, 2027. The Company incurred $108 in interest expense for the year ended December 31, 2017. The Company issued 13,090 shares of common stock during 2016 in relation

to payment of interest, with total interest expense on the note payment totaling $110for the year ending December 31, 2016. The full balance of the note payable in the amount of $2,850 was paid off on November 30, 2017.

On July 27, 2017, the Company issued a 9% fixed rate subordinated note payable for $500 to KR Four, LLC. The subordinated note will mature on July 27, 2027 and bear a fixed rate of interest of 9% per annum, payable on May 1 and November 1 of each year. Beginning July 27, 2022 and thereafter, the Company may, at its option redeem the subordinated note due in whole or in part at a redemption price equal to 100% of the principal amount plus accrued and unpaid interest, subject to prior approval by the Board of Governors of the Federal Reserve System. The subordinated note is unsecured and is an obligation of the Company only and is not guaranteed by its subsidiary, CSB. The Company incurred $19 and $0 of interest expense for the year ended December 31, 2017 and 2016, respectively. The Company's subordinated note payable was $500 and $0 at December 31, 2017 and 2016, respectively.

Note 11. Discontinued Operations

On November 3, 2017, the Company sold the third-party origination and non-core retail mortgage origination lines of business to Towne Mortgage ("Towne"), an unrelated third party, for $200 of consideration plus an earn-out related to its future production from the portion of the business that was sold. Towne also purchased an immaterial amount of furniture and equipment associated with the business. The Company also sold the building where CSM was headquartered. This sale reflected a strategic shift that will have a major effect on the Company's operations and financial results as the Company no longer intends to continue with these lines of business after the sale. As of the date of the transaction, CSM began operating as a correspondent bank of Towne where the majority of loans originated after the transaction were fulfilled by Towne. As a result of the sale, approximately 75% of the employees of CSM and the business name Homeowners Mortgage Enterprises were transferred to Towne. A transition services agreement was put in place for a limited time to help facilitate the transition of operations to Towne.

Detail of the assets of the disposal group at December 31, 2017 and 2016 is below:

	2017	2016
Other assets held for sale		
Premises, furniture and equipment, net	$ -	$ 1,890
Total other assets held for sale	$ -	$ 1,890

(In thousands of dollars, except share data)

Note 11. Discontinued Operations, Continued

The following table indicates the results of operations associated with the disposal group for the years ending December 31, 2017 and 2016, respectively:

	2017	2016
Net interest income	$ 446	$ 898
Noninterest income		
Income from mortgage originations	3,392	6,924
Other non-interest income (including gain on disposal of $272 in 2017)	325	5
Total noninterest income	3,717	6,929
Noninterest expenses		
Salaries and employee benefits	5,051	6,235
Net occupancy	303	333
Furniture and equipment	156	263
Marketing and advertising	105	175
Other professional fees	403	431
Service charges on deposit accounts	11	16
Other operating	2,409	2,917
Total noninterest expense	8,438	10,370
Loss before taxes	(4,275)	(2,543)
Income tax benefit	(1,594)	(949)
Net loss from discontinued operations	$ (2,681)	$ (1,594)

Note 12. Income Taxes

On December 22, 2017, H.R.1, commonly known as the Tax Cuts and Jobs Act (the “Act”) was signed into law. The Act reduces our corporate federal tax rate from 34% to 21% effective January 1, 2018. As a result, we are required to remeasure, through income tax expense, our deferred tax assets and liabilities using the enacted rate at which we expect them to be recovered or settled. The remeasurement of our net deferred tax asset resulted in additional income tax expense of $5,532.

(In thousands of dollars, except share data)

Note 12. Income Taxes, Continued

Income tax expense (benefit) for the years ended December 31, 2017 and 2016 is summarized as follows:

	2017	2016
Current portion:		
Federal	$ 1	$ 102
State	-	216
	1	318
Deferred income tax (benefit) expense	(2,023)	1,333
Effect of federal tax law change	5,532	-
	3,509	1,333
Total tax expense from continuing operations	$ 3,510	$ 1,651
Tax benefit related to discontinued operations	$ (1,594)	$ (949)

A reconciliation between the income tax expense and the amount computed by applying the Federal statutory rate of 34% for the years ended December 31, 2017 and 2016 to income before income taxes follows:

	2017	2016
Tax at U.S. Statutory Rate	$ (1,912)	$ 1,592
Increase (decrease) resulting from:		
State income tax, net of federal income tax effect	(113)	135
Life insurance	(58)	(55)
Tax exempt income	(88)	(6)
Equity based compensation	31	-
Effect of federal tax law change	5,532	-
Other items, net	118	(15)
Total tax expense from continuing operations	$ 3,510	$ 1,651

(In thousands of dollars, except share data)

Note 12. Income Taxes, Continued

The gross amounts of deferred tax assets and deferred tax liabilities at December 31, are as follows:

	2017	2016
Deferred tax assets		
Origination costs and fees	$ 122	$ 143
Allowance for loan losses	880	-
Net operating loss carryforward	8,059	10,660
Reserve for investment securities	73	340
Depreciation	270	457
Nonaccrual loan interest	18	165
Tax credits	157	140
Unrealized losses on securities available for sale	-	263
Other real estate owned	357	365
Other	154	79
Total deferred tax asset	10,090	12,612
Deferred tax liabilities		
Allowance for loan losses	-	(1,101)
Prepaid expenses	(26)	(40)
Unrealized gain on securities available for sale	(44)	-
Total deferred tax liabilities	(70)	(1,141)
Net deferred tax asset	$ 10,020	$ 11,471

Deferred tax assets represent the future benefit of deductible differences and, if it is more likely than not that a tax asset will not be realized, a valuation allowance is required to reduce the recorded deferred tax assets to net realizable value. After review of all positive and negative factors and potential tax planning strategies, as of December 31, 2017 and 2016, management has determined that a valuation allowance is not necessary. Management has determined that it is more likely than not that the remaining deferred tax asset at December 31, 2017 will be realized, and accordingly, has not established a valuation allowance.

The Company has federal net operating losses of $34,817 and $29,869 at December 31, 2017 and 2016, respectively. These net operating losses expire at various times from 2030 through 2037. The Company has $84 of federal alternative minimum tax credit carryforwards which do not expire and are carried as a deferred tax asset at December 31, 2017. The Company has state net operating losses of $21,010 and $15,780 at December 31, 2017 and 2016, respectively. These net operating losses expire at various times from 2033 through 2037.

The Company has analyzed the tax positions taken or expected to be taken in its tax returns and concluded it has no liability related to uncertain tax positions in accordance with applicable regulations.

Tax returns for 2014 and subsequent years are subject to examination by taxing authorities.

(In thousands of dollars, except share data)

Note 13. Leases

The Company has entered into a number of operating leases for properties relating to its branch banking and mortgage operations. The leases have various initial terms and expire on various dates. The lease agreements generally provide that the Bank is responsible for ongoing repairs and maintenance, insurance and real estate taxes. The leases also provide for renewal options and certain scheduled increases in monthly lease payments. Rental expenses recorded under leases for the years ended December 31, 2017 and 2016 were $965 and $1,016, respectively.

Minimum future lease payments under noncancelable operating leases having remaining terms in excess of one year are:

	Amount
2018	$ 224
2019	99
2020	84
2021 and thereafter	-
Total future minimum lease payments	$ 407

Note 14. Other Noninterest Expense

A summary of the components of other noninterest expense is as follows for the years ended December 31:

	2017	2016
Net loss on portfolio loan sales	$ 916	$ 3
Other loan fees	549	236
Software amortization and maintenance	535	480
Travel related expenses	284	423
Correspondent bank charges	223	44
Board of director compensation	217	220
Mortgage loan expenses	196	302
Mortgage loans sold indemnification and repurchase expense	23	39
Other	1,495	1,044
	$ 4,438	$ 2,791

Note 15. Related Party Transactions

Certain parties (principally certain directors and executive officers of the Company, their immediate families and business interests) were loan customers of and had other transactions in the normal course of business with the Company. Related party loans are made on substantially the same terms, including interest rates and collateral, as those prevailing at the time for comparable transactions with unrelated persons and do not involve more than the normal risk of collectability. Related party loans totaled $4,581 and $5,584 as of December 31, 2017 and 2016, respectively. At December 31, 2017 and 2016, total deposits held by related parties were $7,062 and $583, respectively.

(In thousands of dollars, except share data)

Note 15. Related Party Transactions, Continued

During 2017, the Company had five leases with a limited liability company that is owned by certain directors of the Company. The expenses associated with the leases totaled $570 and $543 for the years ended December 31, 2017 and 2016, respectively.

The Company executed a promissory note on December 23, 2015 for $3,548 with CSouth Financial Group, LLC ("CSFG"), which is owned by certain directors of the Company. The outstanding principal was immediately reduced to $2,850 on the date of execution due to a common stock for debt swap transaction also with CSFG. The individual owners of CSFG were issued 415,540 shares of common stock. The balance of the note payable in the amount $2,850 was paid off on November 30, 2017. See Note 10 for further details.

Note 16. Commitments and Contingencies

The Company is subject to claims and lawsuits which arise primarily in the ordinary course of business. Management is not aware of any legal proceedings which could have a material adverse effect on the financial position or operating results of the Company.

Note 17. Stock-Based Compensation

In 2004, the stockholders approved an Incentive Stock Option Plan ("2004 Plan"). The 2004 Plan provided for the granting of stock options to purchase up to 49,950 shares of the Company's common stock, to officers, employees, and directors, of the Company. The Company could grant awards for a term of up to ten years from the effective date of grant. The expiration date of any option could not be greater than ten years from the date of grant, or five years if the grantee owned more than 10% of the outstanding common stock of the Company or its affiliates. The per-share exercise price would be determined by the board of directors, except that the exercise price of an incentive stock option could not be less than fair market value of the common stock on the grant date, or less than 110% of the fair value if the grantee owned more than 10% of the outstanding common stock of the Company or its affiliates. In 2016, all remaining shares granted under the 2004 Plan were forfeited.

In 2017, the stockholders of the Company approved the CoastalSouth Bancshares, Inc. 2017 Incentive Plan ("2017 Plan") to motivate, attract and retain the services of employees, officers, and directors. The 2017 Plan provides 627,450 shares to be available for stock-based awards, including options, stock appreciation rights, restricted stock, restricted stock units, deferred stock units, or any other right or interest related to stock or cash granted to a participant. The terms of each stock-based award is indicated in an award certificate. At December 31, 2017, there were 176,950 remaining shares available to be awarded under the 2017 Plan.

(In thousands of dollars, except share data)

Note 17. Stock-Based Compensation, Continued

The Company granted stock options in 2017 which vest 25% each year on the anniversary date of the grant date over four years of continuous service. The term of the options are for ten years expiring on the tenth anniversary of the grant date. A summary of stock option activity for the years ended December 31, 2017 and 2016 is below:

	Number of Shares	Weighted Average Exercise Price	Weighted Average Grant Date Fair Value	Weighted Average Remaining Contractual Life
Outstanding at December 31, 2015 (1)	2,400	$ 100.00	$ -	0.93
Granted	-	-	-	-
Exercised	-	-	-	-
Forfeited (1)	2,400	100.00	-	-
Outstanding at December 31, 2016	-	$ -	$ -	-
Granted	382,500	13.00	4.91	10.00
Exercised	-	-	-	-
Forfeited	-	-	-	-
Outstanding at December 31, 2017	382,500	$ 13.00	$ 4.91	9.73

(1) Note that the number of shares and values have been adjusted to reflect the 10-for-1 reverse stock split that occurred in 2017.

No options were exercisable at December 31, 2017 or 2016, respectively.

The grant date fair value of stock options is determined using the Black-Scholes model. A summary of assumptions used in the valuation for stock options granted during the year ended December 31, 2017 is below:

	2017 Black-Scholes Inputs
Expected dividend yield	0.00%
Expected volatility	34.50%
Risk-free interest rate	2.10%
Expected life (in years)	6.25

(In thousands of dollars, except share data)

Note 17. Stock-Based Compensation, Continued

The Company also awarded restricted stock units in 2017 which vest over four years of continuous service, with 50% vesting on the third anniversary of the grant date and the remaining 50% vesting on the fourth anniversary of the grant date. A summary of restricted stock unit activity for the years ended December 31, 2017 and 2016 is below:

	Number of Shares	Weighted Average Grant Date Fair Value
Outstanding at December 31, 2015	-	$ -
Granted	-	-
Delivered	-	-
Forfeited	-	-
Outstanding at December 31, 2016	-	$ -
Granted	68,000	13.00
Delivered	-	-
Forfeited	-	-
Outstanding at December 31, 2017	68,000	$ 13.00

Stock-based awards are recognized over the vesting period and reflected as salaries and employee benefits within the Consolidated Statements of Income, which was $149 and $0 for the years ending December 31, 2017 and 2016, respectively.

Note 18. Stock Warrants

In conjunction with the July 28, 2017 capital raise, the Company issued stock warrants in conjunction with the issuance of voting common stock and preferred stock. At the time of the capital raise, insufficient shares of stock were authorized to permit classification of the warrants as equity, and $1,335 was recorded as a liability to reflect the fair value of warrants on July 28, 2017. Following the authorization of the nonvoting common stock class at the shareholder meeting on September 22, 2017, the fair value of the warrants was reclassified to equity. The warrants vested immediately upon issuance and are outstanding for five years. Under the warrants, there are 385,202 shares of nonvoting common stock permitted for purchase with an exercise price of $13 per share. At December 31, 2017, none of the warrants had been exercised and no warrants were considered in-the-money.

Note 19. Net Loss Per Common Share

Basic net loss per common share is computed by dividing net loss by the weighted-average number of common shares outstanding. Diluted loss per share is computed by dividing net loss by the weighted-average number of common shares outstanding and dilutive common share equivalents using the treasury stock method. Dilutive common share equivalents include common shares issuable upon exercise of outstanding in-the-money stock warrants, options and restricted stock units. Potential common shares are not included in the denominator of the

(In thousands of dollars, except share data)

Note 19. Net Loss Per Common Share, Continued

diluted per share computation when inclusion would be anti-dilutive.

	2017	2016
Net loss per share - basic computation:		
Net loss available to common stockholders	$ (11,813)	$ (44)
Average common shares outstanding - basic	3,290,473	975,622
Basic net loss per share	$ (3.59)	$ (0.05)
Diluted net loss per share computation:		
Net loss available to common stockholders	$ (11,813)	$ (44)
Average common shares outstanding - basic	3,290,473	975,622
Incremental shares from assumed conversions		
Restricted stock units	366	-
Average common shares outstanding - diluted	3,290,839	975,622
Diluted net loss per share	$ (3.59)	$ (0.05)

Note that the number of shares and values have been adjusted to reflect the 10-for-1 reverse stock split that occurred in 2017.

Note 20. Regulatory Matters

CSB 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 adverse material effect on the Company's financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, CSB must meet specific capital guidelines that involve quantitative measures of the CSB's assets, liabilities, and certain off-balance-sheet items as calculated under regulatory accounting practices. The CSB's capital amounts and classifications 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 ratios (set forth in the table below) of Tier 1, Common Equity Tier 1 (CET1), and total capital as a percentage of assets and off-balance-sheet exposures, adjusted for risk-weights ranging from 0% to 150%. Tier 1 capital of the CSB consists of common stockholders' equity, excluding the unrealized gain or loss on securities available-for-sale, minus certain intangible assets, while CET1 is comprised of Tier 1 capital, adjusted for certain regulatory deductions and limitations. Tier 2 capital consists of the allowance for loan losses subject to certain limitations. Total capital for purposes of computing the capital ratios consists of the sum of Tier 1 and Tier 2 capital.

CSB is also required to maintain capital at a minimum level based on total assets, which is known as the leverage ratio. Only the strongest banks are allowed to maintain capital at the minimum requirement of 3%. All others are subject to maintaining ratios 1% to 2% above the minimum.

Effective March 31, 2015, quantitative measures established by applicable regulatory standards, including the

(In thousands of dollars, except share data)

Note 20. Regulatory Matters, Continued

newly implemented Basel III revised capital adequacy standards and relevant provisions of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd Frank Act"), require CSB to maintain (i) a minimum ratio of Tier 1 capital to average total assets, after certain adjustments, of 4.00%, (ii) a minimum ratio of Tier 1 capital to risk-weighted assets of 6.00%, (iii) a minimum ratio of total-capital to risk-weighted assets of 8.00% and (iv) a minimum ratio of CET1 to risk-weighted assets of 4.50%. A "well-capitalized" institution must generally maintain capital ratios 2% higher than the minimum guidelines.

In order to avoid restrictions on capital distributions or discretionary bonus payments to executives, CSB will also be required to maintain a "capital conservation buffer" in addition to its minimum risk-based capital requirements. This buffer will be required to consist solely of CET1, but the buffer will apply to all three risk-based measurements (CET1, Tier 1 and total capital). The capital conservation buffer will be phased in incrementally over time, beginning January 1, 2016 at 0.625% and becoming fully effective on January 1, 2019, and will ultimately consist of an additional amount of Tier 1 capital equal to 2.5% of risk-weighted assets. The capital conservation buffer in effect for the year ended December 31, 2017 was 0.625%.

The following table summarizes the capital amounts and ratios of the CSB and the regulatory minimum requirements at December 31, 2017 and 2016.

	Actual		For Capital Adequacy Purposes		To Be Well-Capitalized Under Promp Corrective Action Provisions	
December 31, 2017	**Amount**	**Ratio**	**Amount**	**Ratio**	**Amount**	**Ratio**
CoastalStates Bank						
Total capital (to risk-weighted assets)	$ 47,487	14.58%	$ 26,060	8.00%	$ 32,576	10.00%
Tier 1 capital (to risk-weighted assets)	43,572	13.38%	19,545	6.00%	26,060	8.00%
Tier 1 capital (to average assets)	43,572	10.38%	16,796	4.00%	20,995	5.00%
Common Equity Tier 1 Capital (to risk weighted-assets)	43,572	13.38%	14,659	4.50%	21,174	6.50%
December 31, 2016						
CoastalStates Bank						
Total capital (to risk-weighted assets)	$ 30,321	10.61%	$ 22,817	8.00%	$ 28,521	10.00%
Tier 1 capital (to risk-weighted assets)	27,713	9.72%	17,113	6.00%	22,817	8.00%
Tier 1 capital (to average assets)	27,713	6.73%	16,464	4.00%	20,850	5.00%
Common Equity Tier 1 Capital (to risk weighted-assets)	27,713	9.72%	12,834	4.50%	18,539	6.50%

Note 21. Lines of Credit

As of December 31, 2017 and 2016, the Company had unused lines of credit to purchase federal funds from unrelated banks totaling $6,000 and $32,500, respectively, a portion of which is secured by investment securities. These lines of credit are available on a one-day basis for general corporate purposes. As of December 31, 2017 and 2016, the Company had $30,182 and $0 outstanding, respectively.

At December 31, 2017, CSB had the ability to borrow an additional $6,653 from the Federal Home Loan Bank

(In thousands of dollars, except share data)

Note 21. Lines of Credit, Continued

(“FHLB”) secured by a blanket lien on one-to-four family first mortgage loans, multifamily residential loans, and revolving, open-end loans, marketable securities or cash. FHLB has approved borrowings up to 20% of CSB's total assets less advances outstanding. The borrowings are available by pledging collateral and purchasing additional stock in the FHLB. All of the lines discussed above can be revoked at the lender’s discretion.

Note 22. Stockholders’ Equity

Preferred Stock – Series A & Series B - In December 2009, the Company issued to the United States Department of the Treasury (“Treasury”) 16,015 shares of its newly designated Series A Preferred shares, liquidation preference $1,000 per share, and a warrant to purchase approximately 480 shares of the Company’s newly designated Series B Preferred shares, liquidation preference $1,000 per share, for $16,015 pursuant to the Capital Purchase Program (“Capital Purchase Program”), implemented as part of the Emergency Economic Stabilization Act’s (“EESA”) Troubled Asset Relief Program (“TARP”). Treasury immediately exercised the warrant for nominal consideration, resulting in the Company issuing to the Treasury the 480 shares of the Series B Preferred shares underlying the warrant.

On February 28, 2013, the Treasury auctioned 16,015 Series A and 480 Series B Preferred shares, with the sale of the Series A and Series B Preferred Stock having settled on March 11, 2013 to the private investors.

On July 28, 2017, the Company redeemed 16,015 shares of Series A and 480 shares of Series B preferred stock for $16,015 and $480, respectively, and paid $8,011 in accrued dividends to preferred shareholders. Under the terms of the Series A Preferred shares, the Company was obligated to pay a 5% per annum cumulative dividend on the liquidation preference of the preferred shares until December 29, 2014 and thereafter at a rate of 9% per annum. The terms of the Series B Preferred shares were identical to those for the Series A Preferred shares except that (i) the dividend rate on the Series B is fixed at 9% per annum and does not adjust in the future and (ii) the Series B Preferred shares may not be redeemed unless all of the Series A Preferred shares have been redeemed.

Preferred Stock – Series D – On July 28, 2017, the Company issued 14,494.82 shares of $1.00 par value Series D Preferred shares at $1,300 per share, resulting in gross proceeds of $18,843. The Series D Preferred shares were mandatorily convertible to nonvoting common stock. On September 22, 2017, the Series D Preferred shares were converted to 1,449,482 shares of $1.00 par value nonvoting common stock.

Voting Common Stock – On July 28, 2017, the Company issued 32,455,416 shares of voting common stock and sold 333,334 shares of treasury stock at $1.30 per share, resulting in gross proceeds of $43,125. On September 22, 2017, the Company performed a 10-for-1 reverse stock split for $1.00 par voting common stock. Following the reverse stock split, and at December 31, 2017, there are 4,254,714 shares outstanding.

Nonvoting Common Stock – On August 28, 2017, the stockholders of the Company authorized 10,000,000 shares of nonvoting common stock. On September 22, 2017, the Series D Preferred shares were converted to 1,449,482 shares of $1.00 par value nonvoting common stock.

(In thousands of dollars, except share data)

Note 22. Stockholders' Equity, Continued

Treasury Stock – On July 27, 2017, the Company repurchased 333,334 shares of common stock for $1.50 per share. On July 28, 2017, these shares were reissued as common stock for $1.30 per share. The resulting difference in share price was recorded as an adjustment to retained earnings of $67.

Dividends – The ability of the Company to pay cash dividends to stockholders is dependent upon receiving cash in the form of dividends from its banking subsidiary. However, certain restrictions exist regarding the ability of the subsidiary to transfer funds in the form of cash dividends to the Company. South Carolina banking regulators restrict the amount of dividends that can be paid to stockholders. All of CSB's dividends to the Company are payable only from the undivided profits of CSB. At December 31, 2017, CSB had an accumulated deficit of $25,822.

As a State chartered bank under South Carolina law, the Bank is authorized to pay cash dividends up to 100% of net income in any calendar year without obtaining the prior approval of the South Carolina State Board of Financial Institutions ("State Board") or the Commissioner of Banking provided that the Bank received a composite rating of one or two at the last examination conducted by the State or Federal regulatory authority. Otherwise, the Bank must file an income and expense report and obtain the specific approval of the State Board. Under Federal Reserve Board regulations, the amount of loans or advances from the banking subsidiary to the parent company are also restricted.

Note 23. Financial Instruments with Off-Balance-Sheet Risk

The Company 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 consist of commitments to extend credit and standby letters of credit. 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. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. A commitment involves, to varying degrees, elements of credit and interest rate risk in excess of the amount recognized in the balance sheet. The Company's exposure to credit loss in the event of nonperformance by the other party to the instrument is represented by the contractual notional amount of the instrument. Since certain commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. The Company uses the same credit policies in making commitments to extend credit as it does for on-balance-sheet instruments. Letters of credit are conditional commitments issued to guarantee a customer's performance to a third party and have essentially the same credit risk as other lending facilities. Collateral held for commitments to extend credit and letters of credit varies but may include accounts receivable, inventory, property, plant, equipment and income-producing commercial properties.

The Company uses derivatives primarily to neutralize interest rate risk related to its pipeline of interest rate lock commitments issued on residential mortgage loans in the process of origination for sale. At December 31, 2017 and 2016, the Company's outstanding mortgage interest rate lock commitments totaled $0 and $47,420, respectively. The Company uses mortgage loan forward sales commitments that generally correspond with the composition of the locked pipeline to hedge a percentage of the Company's pipeline of mortgage loan interest rate lock commitments and loans held for sale. At December 31, 2017 and 2016, the Company's outstanding mortgage loan forward sales commitments totaled $0 and $39,000, respectively. The Company's derivative positions are marked

(In thousands of dollars, except share data)

Note 23. Financial Instruments with Off-Balance-Sheet Risk, Continued

to market as shown in Note 8.

The following table summarizes the Bank's off-balance-sheet financial instruments at December 31, 2017 and 2016 whose contract amounts represent credit risk:

	2017	2016
Commitments to extend credit	$ 46,488	$ 34,018
Letters of credit	646	771
Total	$ 47,134	$ 34,789

Note 24. Fair Value of Financial Instruments

US GAAP provides a framework for measuring and disclosing fair value which requires disclosures about the fair value of assets and liabilities recognized in the balance sheet, whether the measurements are made on a recurring basis (for example, available for sale investment securities) or on a nonrecurring basis (for example, impaired loans).

Fair value is defined as the exchange in price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. US GAAP also establishes a fair value hierarchy, which requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value.

The Company utilizes fair value measurements to record fair value adjustments to certain assets and to determine fair value disclosures. Securities available for sale are recorded at fair value on a recurring basis. Additionally, from time to time, the Company may be required to record at fair value other assets on a nonrecurring basis, such as loans held for sale, loans held for investment and certain other assets. These nonrecurring fair value adjustments typically involve application of lower of cost or market accounting or write-downs of individual assets.

Fair Value Hierarchy

The Company groups assets and liabilities at fair value in three levels, based on the markets in which the assets and liabilities are traded and the reliability of the assumptions used to determine the fair value. These levels are:

Level 1 Valuation is based upon quoted prices for identical instruments traded in active markets.

Level 2 Valuation is based upon quoted prices for similar instruments in active markets, quoted prices for identical or similar instruments in markets that are not active, and model-based valuation techniques for which all significant assumptions are observable in the market.

Level 3 Valuation is generated from model-based techniques that use at least one significant assumption not observable in the market. These unobservable assumptions reflect estimates of assumptions that market participants would use in pricing the asset or liability. Valuation techniques include the use of option pricing models, discounted cash flow models and similar techniques.

(In thousands of dollars, except share data)

Note 24. Fair Value of Financial Instruments, Continued

Following is a description of valuation methodologies used for assets and liabilities recorded at fair value.

Investment Securities Available for Sale - Investment securities available for sale are recorded at fair value on a recurring basis. Fair value measurement is based upon quoted prices, if available. If quoted prices are not available, fair values are measured using independent pricing models or other model-based valuation techniques such as the present value of future cash flows, adjusted for the security's credit rating, prepayment assumptions and other factors such as credit loss assumptions. Level 1 securities include those traded on an active exchange such as the New York Stock Exchange, Treasury securities that are traded by dealers or brokers in active over-the counter markets and money market funds. Level 2 securities include mortgage backed securities issued by government sponsored entities, municipal bonds and corporate debt securities. Securities classified as Level 3 include asset-backed securities in less liquid markets.

Loans Held for Sale - Loans held for sale are comprised of loans originated for sale in the ordinary course of business. The fair value of loans originated for sale in the secondary market is based on purchase commitments or quoted prices for the same or similar loans and are classified as recurring Level 2.

Impaired Loans - The Company does not record loans at fair value on a recurring basis, however, from time to time, a loan is considered impaired and an allowance for loan loss is established. Loans for which it is probable that payment of interest and principal will not be made in accordance with the contractual terms of the loan are considered impaired. Once a loan is identified as individually impaired, management measures impairment. The fair value of impaired loans is estimated using one of several methods, including the collateral value, market value of similar debt, enterprise value, liquidation value and discounted cash flows. Those impaired loans not requiring a specific allowance represents loans for which the fair value of expected repayments or collateral exceed the recorded investment in such loans. At December 31, 2017 and 2016, substantially all of the impaired loans were evaluated based upon the fair value of the collateral. Impaired loans where an allowance is established based on the fair value of collateral require classification in the fair value hierarchy. When the fair value of the collateral is based on an observable market price or a current appraised value, the Company records the loan as nonrecurring Level 2. When an appraised value is not available or management determines the fair value of the collateral is further impaired below the appraised value and there is no observable market price, the Company records the loan as nonrecurring Level 3.

Other Real Estate Owned - Foreclosed assets are adjusted to fair value upon transfer of the loans to other real estate owned. Real estate acquired in settlement of loans is recorded initially at estimated fair value of the property less estimated selling costs at the date of foreclosure. The initial recorded value may be subsequently reduced by additional allowances, which are charges to earnings if the estimated fair value of the property less estimated selling costs declines below the initial recorded value. Fair value is based upon independent market prices, appraised values of the collateral or management's estimation of the value of the collateral. When the fair value of the collateral is based on an observable market price or a current appraised value, the Company recorded the foreclosed asset as nonrecurring Level 2. When an appraised value is not available, or management determines the fair value of the collateral is further impaired below the appraised value and there is no observable market price, the Company records the foreclosed asset as nonrecurring Level 3.

Derivatives - The Company’s valuation techniques and inputs to internally-developed models depend on the type of derivative and nature of the underlying rate, price or index upon which the derivative's value is based. Key

(In thousands of dollars, except share data)

Note 24. Fair Value of Financial Instruments, Continued

inputs can include yield curves, credit curves, foreign-exchange rates, prepayment rates, volatility measurements and correlation of such inputs. Where model inputs can be observed in a liquid market and the model does not require significant judgment, such derivatives are typically classified as Level 2 of the fair value hierarchy. Examples of derivatives classified as Level 2 include interest rate lock commitments written for our residential mortgage loans that we intend to sell. When instruments are traded in less liquid markets and significant inputs are unobservable, such derivatives are classified as Level 3. Additionally, significant judgments are required when classifying financial instruments within the fair value hierarchy, particularly between Level 2 and 3, as is the case for certain derivatives.

The table below presents the balances of assets and liabilities measured at fair value on a recurring basis by level within the hierarchy at December 31, 2017 and 2016.

	December 31, 2017			
	Total	Level 1	Level 2	Level 3
Mortgage backed securities	$ 40,811	$ -	$ 40,811	$ -
Government-sponsored agencies	4,350	-	4,350	-
Obligations of corporations	500	-	-	500
Municipal obligations	9,125	-	9,125	-
Residential mortgage LHFS	2,205	-	2,205	-
Total	$ 56,991	$ -	$ 56,491	$ 500

	December 31, 2016			
	Total	Level 1	Level 2	Level 3
Mortgage backed securities	$ 33,743	$ -	$ 33,743	$ -
Government-sponsored agencies	5,308	-	5,308	-
Obligations of corporations	500	-	-	500
Municipal obligations	2,042	-	2,042	-
Residential mortgage LHFS	39,357	-	39,357	-
Derivative asset:				
Mortgage loan interest rate lock commitments	584	-	584	-
Derivative liability:				
Mortgage loan forward sales commitments	17	-	17	-
Total	$ 81,517	$ -	$ 81,017	$ 500

(In thousands of dollars, except share data)

Note 24. Fair Value of Financial Instruments, Continued

The changes in Level 3 assets and liabilities measured at fair value on a recurring basis are summarized as follows:

	Obligations of Corporations
Balance at December 31, 2015	$ 500
Total net gains (losses) included in:	
Net income (loss)	-
Other comprehensive income	-
Purchases, sales, issuances and settlements, net	-
Transfers into/out of Level 3	-
Balance at December 31, 2016	500
Total net gains (losses) included in:	
Net income (loss)	-
Other comprehensive income	-
Purchases, sales, issuances and settlements, net	-
Transfers into/out of Level 3	-
Balance at December 31, 2017	$ 500

Certain assets and liabilities are measured at fair value on a nonrecurring basis; that is, the instruments are not measured at fair value on an ongoing basis but are subject to fair value adjustments in certain circumstances (for example, when there is evidence of impairment). The following table presents the assets and liabilities carried on the balance sheet by caption and by level within the valuation hierarchy (as described above) for which a nonrecurring change in fair value has been recorded during the years ended December 31, 2017 and 2016.

	December 31, 2017			
	Total	**Level 1**	**Level 2**	**Level 3**
Other real estate owned	$ 3,377	$ -	$ -	$ 3,377
Impaired loans, net	6,975			7,900
Total	$ 10,352	$ -	$ -	$ 11,277

	December 31, 2016			
	Total	**Level 1**	**Level 2**	**Level 3**
Other real estate owned	$ 1,324	$ -	$ -	$ 1,324
Impaired loans, net	9,644			10,456
Total	$ 10,968	$ -	$ -	$ 11,780

There were no liabilities measured at fair value on a nonrecurring basis at December 31, 2017 and 2016.

(In thousands of dollars, except share data)

Note 24. Fair Value of Financial Instruments, Continued

The following tables provide information describing the unobservable inputs used in Level 3 fair value measurements at December 31, 2017 and 2016:

December 31, 2017				
Financial Instrument	**Net Carrying Value**	**Valuation Technique**	**Unobservable Input**	**Range of Inputs**
Other real estate owned	$ 3,377	Third party appraisal or broker's price opinion	Management discount for costs to sell	0% -10%
Impaired loans, net	$ 6,975	Non-collateral dependent - Discounted cash flow analysis	Discount rate	3.32% - 3.75%
		Collateral dependent - Third party appraisal or broker's price opinion	Management discount for costs to sell	0% -10%

December 31, 2016				
Financial Instrument	**Net Carrying Value**	**Valuation Technique**	**Unobservable Input**	**Range of Inputs**
Other real estate owned	$ 1,324	Third party appraisal or broker's price opinion	Management discount for costs to sell	0% -10%
Impaired loans, net	$ 9,644	Non-collateral dependent - Discounted cash flow analysis	Discount rate	3.25% - 10.00%
		Collateral dependent - Third party appraisal or broker's price opinion	Management discount for costs to sell	0% -10%

Fair Value of Financial Instruments

The following table includes the estimated fair value of the Company's financial assets and financial liabilities. The methodologies for estimating the fair value of financial assets and financial liabilities measured on a recurring and nonrecurring basis are discussed above. The methodologies for estimating the fair value for other financial assets and financial liabilities are discussed below. The estimated fair value amounts have been determined by the Company using available market information and appropriate valuation methodologies. However, considerable judgement is required to interpret market data in order to develop the estimates of fair value. Accordingly, the estimates presented below are not necessarily indicative of the amounts the Company could realize in a current market exchange. The use of different market assumptions and/or estimation techniques may have a material effect on the estimated fair value amounts at December 31, 2017.

(In thousands of dollars, except share data)

Note 24. Fair Value of Financial Instruments, Continued

	2017		2016	
	Carrying Value	Fair Value	Carrying Value	Fair Value
Cash and cash equivalents	$ 145,800	$ 145,800	$ 34,607	$ 34,607
Securities available-for-sale	54,786	54,786	41,593	41,593
Loans held for sale	36,333	36,333	62,885	62,885
Loans held for investment, net	261,906	260,365	237,744	235,512
Non-marketable equity securities	3,686	3,686	2,035	2,035
Deposits	367,199	339,631	339,890	320,771
Other borrowings	105,682	105,682	37,850	35,557

Cash and cash equivalents
The carrying amount approximates fair value for these instruments.

Securities available-for-sale
The fair value of investment securities are generally determined using widely accepted valuation techniques including matrix pricing and broker-quote-based applications.

Loans held for sale
Loans held for sale are carried at the lower of cost or fair value. These loans currently consist of on-to-four family residential real estate loans originated for sale to qualified third parties. Fair value is based upon the contractual price to be received from these third parties, which may be different than cost.

Loans held for investment
Fair values are estimated for portfolios of loans with similar financial characteristics if collateral-dependent. Loans are segregated by type. The fair value of performing loans is calculated by discounting scheduled cash flows through the estimated maturity using estimated market discount rates that reflect observable market information incorporating the credit, liquidity, yield and other risks inherent in the loan. The estimate of maturity is based upon the Company's historical experience with repayments for each loan classification, modified, as required, by an estimate of the effect of the current economic and lending conditions. Fair value for significant non-performing loans is generally based upon recent external appraisals. If appraisals are not available, estimated cash flows are discounted using a rate commensurate with the risk associated with the estimated cash flows. Assumptions regarding credit risk, cash flows and discounted rates are judgmentally determined using available market information and specific borrower information.

Non-marketable equity securities
Non-marketable equity securities are carried at original cost basis, as cost approximates fair value and there is no ready market for such investments.

(In thousands of dollars, except share data)

Note 24. Fair Value of Financial Instruments, Continued

Deposits
The fair value of deposits with no stated maturity date, such as noninterest-bearing demand deposits, savings and money market and checking accounts, is based on the discounted value of estimated cash flows. The fair value of time deposits is based upon the discounted value of contractual cash flows. The discount rate is estimated using the rates currently offered for deposits of similar remaining maturities.

Other borrowings
The fair value of the Company's FHLB advances is estimated based upon the discounted value of contractual cash flows. The fair value of investment securities sold under agreements to repurchase approximates the carrying amount because of the short maturity of these borrowings. The discount rate is estimated using rates quoted for the same or similar issues or the current rates offered to the Company for debt of the same remaining maturities.

Note 25. Subsequent Events

Subsequent events are events or transactions that occur after the balance sheet date but before financial statements are issued. Recognized subsequent events are events or transactions that provide additional evidence about conditions that existed at the date of the balance sheet, including the estimates inherent in the process of preparing financial statements. Nonrecognized subsequent events are events that provide evidence about conditions that did not exist at the date of the balance sheet but arose after that date.

On January 22, 2018, the Company purchased land and three bank buildings from Cassons, LLC, a limited liability company that is owned by certain members of the board of directors of the Company. The purchase price paid of the land and buildings was $1,245 and $4,024, respectively. These facilities were previously leased by the Company.

No other subsequent events were noted through March 23, 2018.